

SECTION 3 (80 marks)
Answer **ONE** question

8. Marginal and Absorption Costing

- (a) Murphy Ltd, produces a single product. The company's profit and loss account for the year ended 31/12/2013, during which 16,000 units were produced and sold, was as follows:

| | € | € |
|-------------------------|----------------|----------------|
| Sales (16,000 units) | | 480,000 |
| Materials | 120,000 | |
| Direct labour | 110,000 | |
| Factory overheads | 60,000 | |
| Administration expenses | <u>105,000</u> | <u>395,000</u> |
| Net profit | | <u>85,000</u> |

The materials, direct labour and $\frac{1}{3}$ of the factory overheads are variable costs. €65,000 of the administration expenses are fixed.

You are required to calculate:

- (i) The company's break-even point and margin of safety.
 - (ii) Roughly sketch a graph, showing **your** break-even point.
 - (iii) The profit the company would make in 2014 if it reduced its selling price by 5%, increased advertising by €5,000 and thereby increased sales to 19,000 units, with all other cost levels and percentages remaining unchanged.
 - (iv) The number of units that must be sold at €26 per unit to provide a profit of 20% of the sales revenue received from these same units.
 - (v) The profit the company would make in 2014 if a commission of 5% of sales is given to sales personnel and €1 extra per unit spent on new packaging, thereby increasing the sales to 17,000 units at €34 per unit.
- (b) Barry Ltd, produced 10,000 units of product A during the year ended 31/12/2013. 9,000 of these units were sold at €4 per unit. The production costs were as follows:

| | |
|----------------------------------|----------------|
| Direct Materials | €0.60 per unit |
| Direct Labour | €0.50 per unit |
| Variable Overhead | €0.40 per unit |
| Fixed Overhead Cost for the year | €4,000 |

You are required to:

- (i) Prepare Profit and Loss statements under Marginal Costing and Absorption Costing principles for Barry Ltd.
- (ii) Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.

(80 marks)