<u>LEAVING CERTIFICATE ACCOUNTING</u>

MARKING SCHEME FOR THE 2006 EXAMINATION

INTRODUCTION

The solutions and marking schemes for Accounting, Higher and Ordinary levels, are attached.

The solutions are printed and the marks allocated to each line/figure are highlighted and shown in a circle like this **(6)** alongside.

These marks are then totalled for each section/page and shown in a square like this 40

Accounting solutions are mainly computational and most figures are made up of more than one component. If a figure is wrong per the solution, the examiners analyse the make-up of the candidate's figure and allocate some marks for each correct element included. To facilitate this, where relevant, the make-up of the figures is shown in workings attached to the solution.

In some Accounting questions there can be a number of alternative approaches and formats that can be validly used by candidates (eg A Bank Reconciliation Statement can start with either the bank statement figure or the adjusted bank account balance). The solutions provided here are based on the approaches adopted by the vast majority of teachers/candidates and alternatives are not included. In cases where a valid alternative solution is required, it is provided for the examiners, so that full marks can be gained for correct accounting treatment.

Sometimes the solution to a part of a question may depend on the answer computed in another part of that question. Where their calculation in Section (a) is incorrect, but this inaccurate information is used in the answer to Section (b), examiners give credit for analysis/decisions correctly made by the candidate on the basis of the incorrect data in this section. In this way, candidates are not penalised twice for the same error.

Leaving Certificate Accounting - Higher Level 2006

Question 1

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Trading and Profit and loss Account for the year ended 31/12/2005

		€		€		€	
Sales						980,000	(3)
Less Cost of sales							
Stock 1/1/2005				65,700	(3)		
Add Purchases	**W1**			629,600	(6)		
				695,300			
Less Stock 31/12/2005	**W2**			(78,100)	(6)	(617,200)	
Gross Profit						362,800	
Less Expenses							
Administration							
Patent written off	**W3**	12,600	(5)				
Salaries and General expenses	**W4**	193,700	(7)				
Insurance		7,800	(3)				
Depreciation – Buildings	**W5**	17,500	(4)	231,600			
Selling and Distribution							
Commission		20,000	(3)				
Loss on sale of van	**W6**	6,875	(6)				
Depreciation –Delivery Vans	**W7**	20,100	(4)	46,975		(278,575)	
						84,225	
Add Operating income							
Discount	**W8**					4,300	(5)
Rent						12,000	(3)
Reduction in Provision for bad debts	**W9**					1,605	(4)
Operating Profit						102,130	
Investment Income	**W10**					5,600	(5)
						107,730	
Mortgage Interest	**W11**					(13,750)	(6)
Net Profit for year						93,980	(2)

Question 1 continued

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Balance sheet as at 31/12/2005

		Cost		Accumulated Depreciation		Net		Total	
Intangible Fixed assets		€		€		€		€	
Patents (63,000 – 12,600)								50,400	(4)
Tangible Fixed Assets									
Buildings	**W12**	1,200,000	(2)			1,200,000			
Delivery Vans	**W13, W 14**	136,000	(3)	76,475	(3)	59,525			
		1,336,000		76,475		1,259,525		1,259,525	
Financial Assets									
6% Investments								160,000	(1)
								1,469,925	
Current Assets									
Stock						78,100	(2)		
Debtors				76,500	(2)				
Less provision				(2,295)	(1)	74,205			
VAT	**W15**					20,700	(5)		
Investment Income due						3,200	(3)		
						176,205			
Creditors: amounts falling due within one year									
Creditors	**W16**			91,100	(3)				
Bank				60,800	(2)				
PRSI				2,500	(2)				
Mortgage interest due				11,250	(3)	(165,650)		10,555	
								1,480,480	
Financed by									
Creditors: amounts falling due after more than one year									
5% Fixed mortgage								300,000	(2)
Capital and reserves									
Capital 1/1/2005						735,000	(1)		
Add Net Profit						93,980	(1)		
						828,980			
Less Drawings						36,000	(2)		
						792,980			
Revaluation Reserve	**W17**					387,500	(3)		
								1,180,480	
Capital employed								1,480,480	

Question 1 – *Workings*

1.	Purchases	650,000	
	Add Goods in transit	5,600	
	Less Payment for van	(26,000)	629,600
2.	Closing stock	72,500	
	Add Goods in transit	5,600	78,100
3.	Patent (60,600+2,400) x 20%		12,600
4.	Salaries and General expenses	192,500	
	Add Mortgage interest	500	
	Add Discount	700	193,700
5.	Depreciation on Buildings		
	(875,000 x 2%)		17,500
6.	Loss on sale of van		
	(35,000 – 15,000 – 13,125)		6,875
7.	Depreciation – Delivery Vans		
	(14,250 + 1,750 +4,100)		20,100
	(19,500 + 600)		
	(6,500 + 13,600)		
8.	Discount	3,600	
	Add Unrecorded discount	700	4,300
9.	Provision for bad debts		
	(3,900 – 2,295)		1,605 cr
10.	Investment income		
	(2,400 + 3,200)		5,600
11.	Mortgage interest		
	(3,000 – 500 + 11,250)		13,750
12.	Buildings	900,000	
	Less VAT	(25,000)	
	Add Revaluation	325,000	1,200,000
13.	Provision for depreciation - Vans		
	(69,500 + 20,100 – 13,125)		76,475
14.	Delivery Vans		
	(130,000 - 35,000 + 41,000		136,000
15.	VAT Account	4,300	
	Less VAT on buildings	(25,000)	20,700
16.	Creditors	85,500	
	Add Goods in transit	5,600	91,100
17.	Revaluation Reserve		
	Land and Buildings	325,000	
	Add Provision for depreciation (45,000 + 17,500)	62,500	387,500

Question 2

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(a) **Statement of Capital 1/1/2005**

		€		€	
Assets					
Land & buildings		290,000	(2)		
Machinery		60,000	(2)		
Investments		30,000	(3)		
Milk cheque due		2,400	(1)		
Cattle		60,000	(1)		
Sheep		18,000	(1)		
Fuel		800	(1)		
Bank		2,800	(2)	464,000	
Liabilities					
Electricity due		400	(1)		
Bank Loan		15,000	(2)		
Loan interest due	**W1**	1,050	(3)	16,450	
Capital				447,550	(1)

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(b)

Enterprise Analysis Account – Cattle and Milk

Income					
Sales – Milk	**W2**	27,400	(2)		
- Cattle & Calves (13,000 + 5,900)		18,900	(1)		
EU subsidy - cattle		2,500	(1)		
Increase in stock		2,000	(1)		
Drawings by family		700	(1)	51,500	
Expenditure					
Purchases – Cattle		14,000	(1)		
Dairy wages		1,500	(1)		
General farm expenses		9,000	(1)		
Fertiliser		2.040	(1)		
Vet fees		660	(1)	27,200	
Gross Profit				24,300	

Enterprise Analysis Account –Sheep

Income				
Sales – Sheep & Lambs (22,000 + 12,600)		34,600	(1)	
EU subsidy - sheep		3,400	(1)	
Wool		1,800	(1)	
Increase in stock		7,000	(1)	
Drawings family		300	(1)	47,100
Expenditure				
Purchases – sheep		19,000	(1)	
General farm expenses		6,000	(1)	
Fertiliser	**W3**	1,360	(1)	
Vet fees	**W4**	440	(1)	26,800
Gross profit				20,300

Question 2 – (continued)

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(b) General Profit and loss Account for the year ended 31/12/2005

		€		€	
Income					
Gross profit – Cattle and Milk		24,300			
Sheep		20,300			
Interest	**W5**	1,200	(1)		
Forestry premium		2,100	(1)	47,900	
Less Expenditure					
Light, heat and fuel (80%)	**W6**	2,320	(4)		
Repairs (80%)		5,040	(1)		
Machinery Depreciation		5,320	(1)		
Loan Interest	**W1**	240	(2)	12,920	
Net Profit				34,980	(2)

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d)

To find out the profit of the farm
To find out the net worth of the farm
To find out the profit of each section of the farm
To back up applications for grants and bank loans
To facilitate planning/ budgeting

Workings

1. Interest - 18 months interest	=	6% x 1.5 = 9%		
109%	=		16,350	
9%	=		1,350	
Interest for year 2005	=		300	
Less Drawings			60	240
2. Milk sales			28,000	
Add due 31/12			1,800	
Less due 1/1			(2,400)	27,400
3. Fertiliser			3,000	
Add due 31/12			400	3,400
4. Veterinary fees			1,750	
Less VHI			(650)	1,100
5. Investment Interest			600	
Interest due			600	1,200
6. Light Heat and Fuel			3,400	
Add stock 1/1			800	
Less due 1/1			(400)	
Less stock 31/12			(900)	
Less drawings (20% of 2,900)			(580)	2,320

Question 3

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(a) Reconciliation of operating profit to net cash flow from operating activities

	€	
Operating profit	140,000	(2)
Depreciation charges for the year	75,000	(4)
Profit on sale of machinery	(3,000)	(6)
Increase in stock	(15,000)	(2)
Increase in debtors	(10,000)	(2)
Increase in creditors	22,000	(2)
Net cash inflow from operating activities	209,000	(2)

Cash Flow Statement of Butler Plc for the year ended 31/12/2005

				€	
Operating Activities					
Net cash inflow from operating activities				209,000	(1)
Returns on investments and servicing of finance					
Interest paid				(6,800)	(3)
Taxation					
Corporation tax paid				(38,000)	(3)
Capital expenditure and financial investment					
Investments	(30,000)	(3)			
Payments to acquire tangible fixed assets	(75,000)	(2)			
Receipts from sale of fixed assets	35,000	(2)		(70,000)	
Equity dividends paid					
Dividends paid during the year				(55,000)	(3)
Net cash **inflow** before liquid resources and financing				39,200	
Management of Liquid Resources					
Purchase of Government securities				(12,000)	(2)
Financing					
Repayment of debentures	(105,000)	(1)			
Receipts from issue of shares	40,000	(1)			
Receipts from share premium	22,000	(1)		(43,000)	
Decrease in cash			(2)	(15800)	

Reconciliation of net cash flow to movement in net debt

Decrease in cash during period	(15,800)	(1)
Cash used to purchase Government securities	12,000	
Cash used to purchase debentures	105,000	(1)
Change in net debt	101,200	(1)
Net debt at 1/1/2005	(169,000	
Net debt at 31/12 2005	(67,800)	(1)

Question 3 – continued.

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(b) To show the cash inflows and outflows during the past year
To help predict future cash flows
To help financial planning
To provide information to assess liquidity
To show that profits do not equal cash
To comply with legal requirements

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(c) **Non-cash expense** Depreciation**,** increase in provision for bad debts
Non-cash gain Reduction in provision for bad debts, profit on sale of assets

Workings

Depreciation			
Depreciation on machinery for year		60,000	
Depreciation on buildings for year		15,000	
Total depreciation for year			75,000
Profit/ Loss on disposal of fixed assets			
Amount received for machine		35,000	
Cost of machine disposed	70,000		
Depreciation on disposed machine [180,000 + 60,000 – 202,000]	38,000		
Book value		(32,000)	
Profit on sale of machinery			3,000
Dividends paid			
Dividends due at 31/12/2004		34,000	
Add interim dividends 2005		21,000	
Amount paid during 2005			55,000
Taxation			
Taxation due at 31/12/2004		43,000	
Taxation for year 2005		45,000	
		88,000	
Less taxation due 31/12/2005		(50,000)	
Taxation paid			38,000
Interest			
Interest for year 2005		8,000	
Less interest due 31/12/2005		(1,200)	
Interest paid			6,800

Question 4

48

(a) Profit and Loss Account of Ross PLC for the year ended 31/12/2005

	Workings			€	
Turnover				1,221,000	(3)
Cost of Sales (70,000 + 700,000 – 72,000 +8,000)				(706,000)	(6)
Gross profit				515,000	
Distribution costs	**W1**	(51,000)	(2)		
Administrative expenses	**W2**	(314,700)	(5)	(365,700)	
				149,300	
Other operating income					
Discount				6,260	(1)
Operating profit				155,560	
Profit on sale of land				80,000	(2)
Investment Income				18,000	(3)
				253,560	
Interest payable				(13,300)	(3)
Profit on ordinary activities before taxation		(1)		240,260	
Taxation				(40,000)	(1)
Profit after taxation				200,260	
Dividends paid		29,000	(2)		
Dividends proposed		32,000	(2)	(61,000)	
Profit retained for year				139,260	
Profit brought forward at 1/1/2005				78,000	(1)
Profit carried forward at 31/12/2005				217,260	(3)

Notes to the Accounts

1. Tangible Fixed Assets (5)

	Land	**Buildings**	**Vehicles**	**Total**
Cost or valuation 1/1/2005	150,000	530,000	140,000	820,000
Disposal	(100,000)	-	-	(100,000)
Revaluation surplus	110,000	170,000	-	280,000
Value at 31/12/2005	160,000	700,000	140,000	1,000,000
Depreciation at 1/1/2005	-	-	64,000	64,000
Depreciation charge for year	-	12,300	28,000	40,300
		12,300	92,000	104,300
Net book value 1/1/2005	150,000	530,000	76,000	756,000
Net book value 31/12/2005	160,000	687,700	48,000	895,700

2. Stock (1)

Stocks are valued on a first in first out basis at the lower of cost and net realisable value.

3. Dividends (3)

Ordinary dividends		
Interim paid 7.0c per share	21,000	
Final proposed 8.0c per share	24,000	45,000
Preference dividends		
Interim paid 5.0c per share	8.000	
Final proposed 5.0c per share	8,000	16,000

4. Operating Profit (2)

The operating profit is arrived at after charging:

Depreciation on tangible fixed assets	40,300
Patent amortised	8,000
Directors remuneration	89,000
Auditors fees	8,400

5. Profit on sale of property (2)

The company sold land for €80,000 greater than it cost. Cost was €100,000.

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(b) Audit (4)

An audit is the independent examination of, and the expression of opinion on the financial statements of an enterprise by an appointed auditor.

The main objective of an audit is to enable the auditor, in keeping with the requirements of the Companies Acts, to report on the truth and fairness shown by:

- the balance sheet, the profit or loss shown by the profit and loss account and
- any other information required to be disclosed in the financial accounts.

The Companies Acts do not require the auditor to certify that the company records are correct or accurate but that the accounts give a *true and fair view* of the financial position of the business.

Qualified Auditor's Report (8)

A qualified auditor's report is when an auditor in his/her opinion is **<u>not satisfied</u>** or is unable to conclude that all or any of the following apply:

- the financial statements give a <u>true and fair view</u> of the state of affairs of the company at the end of the year and of it's profit and loss account for the year.
- the financial statements are prepared in accordance with the Companies Acts
- all the information necessary for the audit was available
- the information given by the directors is consistent with the financial statements
- the net assets are more than 50% of the called up capital

The report will state the elements of the accounts or of the director's report that are unsatisfactory.

Workings

1	Cost of sales		
	Stock 1/1/2005	70,000	
	Purchases	700,000	
	Patents written off	8,000	
	Stock 31/12/2005	(72,000)	706,000
2.	Distribution costs		
	Advertising	23,000	
	Depreciation – delivery vans	28,000	51,000
3.	Administrative expenses		
	Directors fees	89,000	
	Salaries and general expenses	175,000	
	Rent	30,000	
	Auditors fees	8,400	
	Depreciation – Buildings	12,300	314,700

Question 5

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(a) **Interest Cover**

Net profit before interest / Interest	=	75,000 / 20,000	=	3.75 times (9)

Earnings per share

Net profit after Pref Div / Number of ordinary shares	=	52,000 / 300,000	=	17.33c (9)

Cash Sales

Debtors x 12 / Credit sales = 2 Credit Sales	=	48,000 x 12 / 2		
Credit sales	=	288,000		
Cash sales	=	890,000 – 288,000	=	€602,000 (9)

Period to recoup price

Market price / Dividend per share	=	200 / 15	=	13.34 years (9)

Dividend yield for 2004

Dividend per share x 100 / Market price	=	18 x 100 / 210	=	8.57% (9)

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(b) **The debenture holders would be dissatisfied with the following:**

Dividend Policy (7)

Based on this years earnings the dividends proposed €48,000 are excessive. The dividend cover is 1.15 Times. More of the profits should be retained or put aside for the repayment of the debentures.

Security - Real value of Fixed assets (7)

The debentures are secured on the fixed assets. The debenture holders would be interested in the size of the assets to make sure that there is enough security for the loan. There are fixed assets of €575,000 of which, intangible assets are €150,000 leaving net assets excluding intangibles of €425,000. It would be prudent to ascertain the real value of fixed assets. However the debenture holders would feel secure because of the excess in value of fixed assets over loan, particularly because of the investments of €90,000.

Question 5 - continued

Profitability (7)
The return on capital employed for 2005 is 12.56%. Last year the return was 14.2%. This fall indicates an unhealthy trend. The company is in a profitable position as the return of 12.56% is better than the return from risk free investments of less than 5% and is above the debenture interest rate of 10%. If the downward trend continues there is a risk of having to sell the fixed assets in order to repay debentures.

Liquidity (7)
The company has a serious liquidity problem. Last year, the quick ratio was 1.2:1. This year the quick ratio has fallen to 0.7:1. The company now has only 70c available for every euro owed in the short term. The worsening of the ratio indicates a difficulty paying debts including future interest. If this trend continues ability to pay interest would come under pressure and funds would not be available to invest for the purpose of repaying loan.

Gearing - Interest Cover (7)
The company is lowly geared. In 2005, the gearing was at 41.8%. The gearing has slipped from 35% of total capital in 2004. Interest cover was 5 times but is now down to 3.75 times. This worsening trend could jeopardise interest payment

Sector (5)
The long–term prospects are not encouraging in the dairy industry. There is a risk of over production and low cost competition.

Market Value
The market value of one share in 2004 was €2.10 while in 2005 it has dropped to €2. The earnings per share has dropped from 19c to 17.33c. The share may be overpriced as it takes 11.54 years to recover its market price.
These would indicate a lack of public confidence in the company and may discourage investment.

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(c) Raise cash and improve liquidity by:

1. Paying out lower dividends
2. Selling investments rather than issuing debentures.
3. Issuing more shares.
4. Improving gross profit percentage of 21.9% by reducing cost of sales or by passing on the increased costs.
5. Diversifying into other areas
6. Collection of debts more quickly
7. Sale and lease back

Question 6

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	1/1/2005	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Oct	Nov	Dec		31/12/2005	
		(2)	(3)												
Land & Buildings	260,000	120,000	170,000									(3)		550.000	
Depreciation	(25,000)		25,000					(3)				(8,000)		(8,000)	
Equipment	50,000		(3)					(900)				(2)		49,100	
Depreciation	(20,000)	(2)						500				(9,700)		(29,200)	
Goodwill		4,000			(3)			(3)						4,000	(1)
Stock	70,000	(2)			640		(3)				(2)			70,640	(1)
Debtors	90,000	10,000		(3)	(720)		270				(270)			99,280	(1)
Bad Debts Provision	(4,500)			(I,500)	(3)	(2)						(2)		(6,000)	
Insurance						2,000						(1,500)		500	
	420,500	134,000	195,000	(1,500)	(80)	2,000	270	(400)	-	-	(270)	(19,200)		730,320	
		(2)								(3)					
Ord. shares	290,000	80,000								30,000				400,000	(1)
Share Premium	14,000	16,000		(2)	(2)		(2)	(2)	(2)	10,000				40,000	
P&L Balance	29,000	(2)		(1,500)	(80)		900	100	(18,500)	(3)		(17,700)	(2)		
												(1,500)	(1)		
		(2)						(3)				3,840	(1)	(5,440)	(3)
Creditors	61,000	38,000				(3)	(3)	(500)	(3)	(3)	(2)			98,500	
Bank	23,000					(2,800)	(630)		18,500	(40,000)	(270)			(2,200)	(1)
Expense due	3,500		(3)											3,500	(1)
Revaluation Reserve			195,000			(2)						(2)		195,000	
Rent Rec.						4,800						(3,840)		960	
	420,500	134,000	195,000	(1,500)	(80)	2,000	270	(400)	-	-	(270)	(19,200)		730,320	

<u>Question 7</u>

(a) 50

		Dr	Cr
(i)	Purchases account	13,000 (3)	
	Equipment account	3,100 (3)	
	Suspense account		1,800 (2)
	Creditors account		14,300 (2)

Being correction of incorrect recording of the purchase of a motor car on credit.

		Dr	Cr
(ii)	Purchases returns account	2,300 (3)	
	Creditors account	11,800 (3)	
	Suspense account		14,100 (3)

Being recording of return of motor car and credit note incorporating a restocking charge.

		Dr	Cr
(iii)	Debtor account	850 (3)	
	Bank account		800 (3)
	Discount account		50 (3)
	Bad debts account	850 (3)	
	Debtor account		850 (3)

Being recording of a dishonoured cheque and a bad debt.

		Dr	Cr
(iv)	Drawings account	770 (3)	
	Discount account	50 (3)	
	Debtors account		820 (3)

Being recording of owner's private debt offset against a business debt for repairs owed to firm.

		Dr	Cr
(v)	Rent/ profit and loss account	1,800 (2)	
	Rent/ balance sheet	450 (2)	
	Capital account		2,250 (3)

Being private funds used to pay twelve months rent for the current year and three months rent for the following year.

(b) 6

Suspense Account

	€			€
Original difference	15,900	Equipment	(i)	1,800 (3)
		Creditors	(ii)	14,100 (3)
	15,900			15,900

Question 7 - continued

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(c)

Statement of corrected net profit

					€	
Original Net Profit as per books					64,100	(1)
Add Discount allowed disallowed		(iii)			50	(2)
					64,150	
Less	Purchases	(i)	13,000	(2)		
	Purchases returns	(ii)	2,300	(2)		
	Bad debts	(iii)	850	(1)		
	Discount	(iv)	50	(1)		
	Rent	(v)	1,800	(2)	(18,000)	
Correct Net Profit					46,150	(3)

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(d)

Balance Sheet as at 31/12/2005

		€		€		€	
Fixed assets							
Premises						700,000	½
Equipment	(60,000 + 3,100)					63,100	(2)
Furniture						20,000	½
						783,100	
Current Assets							
Stock	(91,400 - 15,900)	75,500	(2)				
Debtors	(35,200 + 850 – 850 - 820)	34,380	(4)				
Cash		500	½				
Rent prepaid		450	½	110,830			
Less Creditors: amounts falling due within 1 year							
Creditors	(54,000 + 14,300 – 11,800)	56,500	(3)				
Bank	(28,000 + 800)	28,800	(2)	(85,300)		25,530	
						808,630	
Financed by							
Capital	(790,000 + 2,250)			792,250	(2)		
Add Net Profit				46,150			
				838,400			
Less Drawings	(29,000 + 770)			(29,770)	(2)	808,630	
						808,630	(1)

10

(e)

An error of commission occurs when the correct amount is posted to the correct side of the incorrect account. E.g Goods sold on credit to Pat O'Brien debited in error to John O'Brien's account

An Error of Principle arises when an item is posted to the incorrect class of account. E.g. An electrical shop owner purchased a vehicle and entered it in the purchases account instead of the vehicles account

Question 8

80

			€	€ per unit)
(A)	Sales		720,000	12.00
	Less Variable Costs			
	Direct materials	288,000		
	Direct labour	144,000		
	Factory overheads (40%)	20,400		
	Sales commission (5% x 720,000)	36,000	(488,400)	8.14
	Contribution		231,600	**3.86**
	Less Fixed costs			
	Factory overheads (60%)	30,600		
	Administration expenses	96,000		
	Selling expenses (excluding commission)	32,000	158,600	
	Net Profit		73,000	

(a) **Break even point** = $\frac{\text{Fixed Costs}}{\text{CPU}}$ = $\frac{158{,}600\ (3)}{3.86\ (4)}$ = (3) 41,089 units

Margin of safety = Sales – break even point

= (4) 60,000 – 41089 (3) = (3) 18,911 units

(b) $\frac{\textbf{Fixed costs}}{\textbf{Contribution – 10\% of S.P.}}$ $\frac{158{,}600\ (4)}{(6)\ 4.81 – 1.3\ (6)}$ = (4) 45,186 units

(c) **Profit if selling price dropped to €11**

Sales	(80,000 x 11)	880,000	(4)
Less variable costs	(80,000 x 8.09)	647,200	(6)
Contribution		232,800	
Less fixed costs	(158,600 + 10,000)	168,600	(6)
Profit		41,200	(2)

Question 8– continued

(B)

(a) **Absorption Costing**

		€	€
Sales (6,000 x €6)			36,000 (1)
Less production cost of 8,000 units			
Direct materials	(8,000 x 0.50)	4,000 (1)	
Direct labour	(8,000 x 0.80)	6,400 (1)	
Variable overhead	(8,000 x 0.50)	4,000 (1)	
Fixed overhead		3,000 (1)	
		17,400	
Less closing stock	(1/4 of 17,400)	(4,350) (1)	(13,050)
Profit			22,950

Marginal costing

		€	€
Sales			36,000 (1)
Less production costs			
Direct materials		4,000 (1)	
Direct labour		6,400 (1)	
Variable overhead		4,000 (1)	
		14,400	
Less closing stock (1/4 of 14,400)		(3,600)	(10,800)
Contribution	(1)		25,200
Less fixed cost			(3,000) (1)
Profit			22,200

(b) (5)

There is a different profit figure because closing stock is valued differently.
Marginal costing does **not** include fixed costs when costing a product whereas absorption costing does include the fixed costs.
Therefore closing stock under marginal costing is valued lower than under absorption costing because a share of fixed costs is included in the value of stock under absorption costing but not included under marginal costing.

Under absorption costing, closing stock is valued at a ¼ of the production cost of 17,400
Under marginal costing, closing stock is valued at ¼ of the production cost of 14,400.

Closing stock -Absorption costing	4,350
Closing stock - Marginal costing	(3,600)
Difference	750

The profit difference is 22,950 – 22,200 = 750

Absorption costing should be used as it agrees with standard accounting practice and concepts and matches costs with revenues. (5)

Question 9

80

(a)

(i)

Direct materials	(2)	Variable
Direct wages	(2)	Variable
Production overheads	(2)	Mixed
Other overhead costs	(2)	Mixed
Administration expenses	(2)	Fixed

(ii) Production overheads

	Units	Total Cost
		€
High	17,000	122,000
Low	10,000	73,000
Difference	7,000	49,000

The variable cost of 7,000 units is 49,000
Therefore the variable cost per unit is **€7** (6)

Total production overhead cost	73,000	108,000	122.000	
Less variable costs	70,000	105,000	119,000	
Therefore, fixed cost	3,000	3,000	3,000	(6)

(iii) Other overhead costs

	Units	Total Cost
		€
High	17,000	60,000
Low	10,000	39,000
Difference	7,000	21,000

The variable cost of 7,000 units is 21,000
Therefore the variable cost per unit is **€3** (6)

Total other overhead costs	39,000	54,000	60,000	
Less variable costs	30,000	45,000	51,000	
Therefore, fixed cost	9,000	9,000	9,000	(6)

(iv) Production overheads at the required flexible budgeted level of 95% - (19,000 units)

		€
Variable cost	(19,000 x 7)	133,000
Fixed cost		3,000
Total cost		136,000

Other overhead costs at the required flexible budgeted level of 95% - (19,000 units)

		€
Variable cost	(19,000 x 3)	57,000
Fixed cost		9,000
Total cost		66,000

Question 9– continued

Construction of a flexible budget for a 95% activity level

		Flexible Budget	
Activity level		**95%**	
Units		**19,000**	
		€	
Direct materials	(19,000 x 14)	266,000	(3)
Direct wages	(19,000 x 11)	209,000	(3)
Production overheads		136,000	(6)
Other overheads		66,000	(6)
Administration overheads (fixed)		28,000	(4)
Total cost (76% of sales)		705,000	

(v) Flexible Budget in Marginal costing format

		€	€	
Sales			927,632	(1)
Less Variable costs				
Direct materials		266,000 (1)		
Direct wages		209,000 (1)		
Variable production overhead		133,000 (1)		
Other overhead costs		57,000 (1)	665,000	
Contribution	(1)		262,632	
Less Fixed cost				
Production overheads		3,000 (1)		
Other overheads		9,000 (1)		
Administration		28,000 (1)	40,000	
Profit			222,632	(3)

(b) An adverse variance is where actual costs exceed budgeted costs (3)
An adverse variance in direct material costs may arise if the purchase price of materials is higher than expected or if the quantities of material used are higher than expected. (3)

(c) **Controllable Costs:** Are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs. E.g.- all variable costs are controllable (3)

Uncontrollable Costs: Are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. E.g.- rates to the local authority are uncontrollable (3)