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

8. Marginal and Absorption Costing

A. Harrrington Ltd., produces a single product. The company's profit and loss account for the year ended 31/12/2005, during which 60,000 units were produced and sold, was as follows:

	€	€
Sales		720,000
Materials	288,000	
Direct labour	144,000	
Factory overheads	51,000	
Administration expenses	96,000	
Selling expenses	68,000	647,000
Net profit		73,000

The materials, direct labour and 40% of the factory overheads are variable costs. Apart from sales commission of 5% of sales, selling and administration expenses are fixed.

You are required to calculate:

(a) The company's break-even point and margin of safety.

(b) The number of units that must be sold at €13 per unit to provide a profit of 10% of the sales revenue received from these same units.

(c) The profit the company would make in 2006 if it reduced its selling price to €11, increased fixed costs by €10,000 and thereby increased the number of units sold to 80,000, with all other cost levels and percentages remaining unchanged.

B. Cloud Ltd., produces 8,000 units of product Z during the year ended 31/12/2005. 6,000 of these units were sold at €6 per unit. The production costs were as follows:

Direct Materials	€0.50 per unit
Direct Labour	€0.80 per unit
Variable Overhead	€0.50 per unit
Fixed Overhead Cost for the year	€3,000

You are required to:

(a) Prepare Profit and Loss statements under Marginal and Absorption costing principles.

(b) Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.

(80 marks)