



Coimisiún na Scrúduithe Stáit State Examinations Commission

LEAVING CERTIFICATE EXAMINATION 2021

ACCOUNTING - HIGHER LEVEL (300 marks)

WEDNESDAY 23 JUNE – AFTERNOON 2.00 – 5.00

This paper is divided into 3 Sections: New Format for 2021 exam.

Section 1: Financial Accounting (120 marks).

This section has four questions (Numbers 1 - 4). The first question (**A or B**) carries 120 marks and the remaining three questions carry 60 marks each.

Candidates should answer either **QUESTION 1 (A or B) only** OR attempt any **TWO** of the remaining three questions in this section.

Section 2: Financial Accounting (100 marks).

This section has three questions (Numbers 5 - 7). Each question carries 100 marks. Candidates should answer **ONE** of these questions.

Section 3: Management Accounting (80 marks).

This section has two questions (Numbers 8 and 9). Each question carries 80 marks. Candidates should answer **ONE** of these questions.

Calculators

Calculators may be used in answering the questions on this paper. It is very important that workings are shown in the answer book(s) so that full credit can be given for correct work.

SECTION 1 (120 marks) New Format 2021 exam.
Answer Question 1 (A or B)
 OR
 any **TWO** other questions

1. Answer (A) OR (B)

(A) Sole Trader – Final Accounts

The following trial balance was extracted from the books of A. Kenny on 31/12/2020:

	€	€
Land and buildings (cost €900,000)	795,000	
Delivery vans (cost €380,000)	310,000	
Equipment at cost	178,800	
Discount (net)		4,700
5% Fixed Mortgage (including €50,000 issued on 31/03/2020)		280,000
3% Investments acquired on 01/08/2020	210,000	
Stock 01/01/2020	68,700	
Sales		1,797,300
Purchases	1,105,000	
Salaries and general expenses	135,800	
Advertising (incorporating suspense)	36,000	
Investment interest received		2,200
Drawings	60,000	
Rates	43,200	
PAYE, PRSI, USC		3,875
VAT		29,900
Bank		52,100
Mortgage interest paid for the first three months	2,375	
Debtors and creditors	97,300	68,600
Bad debts provision		3,500
Capital	<u> </u>	<u>800,000</u>
	<u>3,042,175</u>	<u>3,042,175</u>

The following information and instructions are to be taken into account:

- (i) Stock at cost on 31/12/2020 was €72,100. This figure includes damaged stock which cost €12,400 but which now has a net realisable value of 25% of cost.
- (ii) Goods were sent to a customer on a 'Sale or Return' basis on 31/12/2020. These goods were recorded in the books as a credit sale of €28,000 which is a mark-up on cost of 25%.
- (iii) Provide for depreciation on delivery vans at the annual rate of 20% of cost from the date of purchase to the date of sale.

Note: On 31/03/2020 a delivery van which had cost €42,000 on 30/09/2016 was traded in against a new van which cost €67,000. An allowance of €11,000 was given on the old van. The cheque for the net amount of this transaction was entered in the bank account but was incorrectly treated as a purchase of trading stock. These were the only entries made in the books in respect of this transaction.

- (iv) During 2020 a storeroom which cost €75,000 and stock which cost €24,000 were destroyed by fire. The insurance company has agreed to contribute €90,000 in compensation for the fire damage. No entry had been made in the books in respect of the fire.

A new storeroom was built by the business's own employees. The cost of their labour €44,000 had been treated as a business expense and the materials costing €38,000 were taken from existing stock. No entry had been made in the books in respect of the new storeroom.

- (v) Buildings are to be depreciated at the rate of 2% of cost per annum (land at cost was €400,000). It was decided to revalue the land and buildings at €1,100,000 on 31/12/2020.
- (vi) The suspense figure arises as a result of the incorrect figure for mortgage interest (although the correct entry had been made in the bank account) and a payment of €2,900 to creditors entered only in the bank account.
- (vii) The figure for bank in the trial balance has been taken from the business bank account. However, a bank statement dated 31/12/2020 has arrived showing an overdraft of €29,200. A comparison of the bank account and the bank statement revealed the following discrepancies:
 - 1. A credit transfer for €1,800 had been received on 31/12/2020 in respect of a debt of €2,500 previously written off as bad. The debtor has agreed to pay the remainder within two months. No entry was made in the books to record this transaction.
 - 2. A cheque for €18,700 issued to a supplier had been entered in the books (cash book and ledger) as €17,800.
 - 3. A cheque for €4,800 issued to a supplier had been returned. This had not been entered in the books.
 - 4. A cheque for advertising €17,200 has not been presented for payment.
- (viii) Provision should be made for the following:
 - 1. Investment income due and mortgage interest due.
(Note: 20% of mortgage interest for the year refers to the private section of the building.)
 - 2. Provision for bad debts is to be adjusted to 6% of debtors.

Required:

- (a) Prepare a trading and profit and loss account for the year ended 31/12/2020. (75)
- (b) Prepare a balance sheet as at 31/12/2020. (45)

(120 marks)

1. (B) Company Final Accounts including a Manufacturing Account

Connolly Ltd has an authorised capital of €3,000,000 divided into 2,500,000 ordinary shares at €1 each and 500,000 5% preference shares at €1 each.

The following trial balance was extracted from the books on 31/12/2020:

	€	€
Factory buildings (cost €1,008,000)	860,000	
Plant and machinery (cost €860,000)	202,000	
Patents	76,000	
Discount (net)		3,700
4% Debentures (including €60,000 issued on 30/04/2020)		300,000
3% Investments acquired on 01/08/2020	180,000	
Stocks on hand 01/01/2020		
Raw materials	95,000	
Work in progress	26,700	
Finished goods	60,000	
Sales		1,750,000
Purchase of raw materials	655,000	
Direct factory wages	275,000	
General factory overheads (including suspense)	101,400	
Hire of special equipment	45,000	
Sale of scrap materials		20,000
Carriage on raw materials	13,100	
Selling expenses	87,000	
Administration expenses	121,800	
VAT		29,900
Bank	146,000	
Dividends paid	68,000	
Debenture interest paid	3,200	
Debtors and creditors	174,000	78,600
Bad debts provision		5,000
Issued share capital - ordinary shares		1,000,000
- 5% preference shares		360,000
Profit and loss balance 01/01/2020	<u>358,000</u>	<u> </u>
	<u>3,547,200</u>	<u>3,547,200</u>

The following information and instructions are to be taken into account:

- (i) Stocks on hand at 31/12/2020:
- | | |
|------------------|---------|
| Raw materials | €52,400 |
| Work in progress | €24,900 |
| Finished goods | €64,000 |
- (ii) Included in the figure for sale of scrap materials is €11,000 received from the sale of an old machine in 2020. This machine had cost €24,000 in 2014.
The cost of plant and machinery is to be written off on a straight-line basis over 10 years at the end of which plant and machinery will have a **scrap value of 5% of the original cost**. The policy is to apply a full year's depreciation in the year of acquisition and none in the year of disposal.
- (iii) Finished goods were sent to a customer on 31/12/2020 on a 'Sale or Return' basis. These goods were recorded in the books as a credit sale of €16,000 which is a mark-up on cost of 25%.
- (iv) The suspense figure arises as a result of discount allowed €1,400 entered only in the debtors account and credit purchases of raw materials €11,000 which were entered only in the purchases account.
- (v) The figure for bank in the trial balance has been taken from the firm's own records. However, a bank statement dated 31/12/2020 had arrived showing a balance of €148,300. A comparison of the bank account and the bank statement revealed the following discrepancies:
1. A cheque for €2,000 received from a debtor has been dishonoured. This has not been entered in the books.
 2. A cheque for €7,500 received from a debtor had been entered in the books (cash book and ledger) as €5,700.
 3. A cheque of €2,500 issued to a creditor has not been presented for payment.
- (vi) During the year stock of raw materials which had cost €8,000 were destroyed by fire. The insurance company agreed to pay compensation of 85%.
- (vii) Provision should be made for the following:
1. Investment income due and debenture interest due.
 2. Provision for bad debts to be adjusted to 4% of debtors.
 3. Patents are being written off over a 6 year period which commenced in 2018.
 4. The Sales Director should be paid a bonus commission of 2% on sales greater than €1,000,000, increasing to 3% on any sales above €1,500,000.

Required:

- (a) Prepare a manufacturing, trading and profit and loss account for the year ended 31/12/2020. (75)
- (b) Prepare a balance sheet as at 31/12/2020. (45)
- (120 marks)**

2. Tabular Statements

The financial position of Bergin Ltd, a grocer, on 01/01/2020 is shown in the following balance sheet:

Balance Sheet as at 01/01/2020			
	Cost	Dep to Date	Net
	€	€	€
Fixed Assets			
Land and buildings	390,000	15,000	375,000
Equipment	<u>144,000</u>	<u>47,800</u>	<u>96,200</u>
	<u>534,000</u>	<u>62,800</u>	471,200
Current Assets			
Stock		56,200	
Debtors (Less 4% provision)		99,840	
Expenses prepaid		<u>1,200</u>	
		157,240	
Less Creditors: amounts falling due within 1 year			
Creditors	39,400		
VAT	4,000		
Bank	<u>14,500</u>	<u>57,900</u>	<u>99,340</u>
			<u>570,540</u>
Financed by			
Capital and Reserves			
Authorised - 600,000 ordinary shares @ €1 each			
Issued - 450,000 ordinary shares @ €1 each		450,000	
Share premium		90,000	
Profit and loss balance		<u>30,540</u>	
			<u>570,540</u>

The following transactions took place during 2020:

- Jan Bergin Ltd decided to revalue the land and buildings on 01/01/2020 at €450,000. The land element of the new value is €120,000.
- Feb Bergin Ltd bought an adjoining business on 01/02/2020 which included buildings €78,000, equipment €38,000, debtors €10,000 and creditors €12,000. The purchase price was discharged by granting the seller 100,000 shares in Bergin Ltd at a premium of 20c per share.
- Mar Management decided that the provision for bad debts should be increased to 4.5% of debtors on 31/03/2020.
- May Received a bank statement at the end of May 2020 showing a direct debit of €7,500 to cover insurance for the year ended 28/02/2021 and a credit transfer received of €6,350 to cover rent received in advance for the period 01/05/2020 to 28/02/2021.
- Aug Goods previously sold for €1,107 by Bergin Ltd were returned. This figure includes VAT at 23% and a mark-up on cost of 20%. Bergin Ltd issued a credit note for €1,000 due to a delay in returning these goods.
- Nov A creditor who was owed €2,700 by Bergin Ltd accepted a fridge freezer, the net book value of which was €2,600, in full settlement of the debt. This fridge freezer had cost €5,000.
- Dec The depreciation charge on buildings for the year is to be 2% of net book value. The depreciation charge is to be calculated from date of revaluation or date of purchase as appropriate. The total depreciation charge on equipment for the year was €9,200.

Required:

Record on a tabular statement the effect each of the above transactions had on the relevant asset and liability and ascertain the total assets and liabilities on 31/12/2020.

(60 marks)

3. Depreciation of Fixed Assets

Ryan Transport Ltd prepares its final accounts to 31 December each year. The company's policy is to depreciate its vehicles at the rate of **15% of cost per annum** calculated from the date of purchase to the date of disposal and to accumulate this depreciation in a provision for depreciation account.

On 01/01/2019, Ryan Transport Ltd owned the following vehicles:

No. 1 purchased on 01/01/2015 for €60,000

No. 2 purchased on 01/04/2016 for €74,000

No. 3 purchased on 01/08/2017 for €84,000

On 01/06/2019, vehicle no. 3 was crashed and traded in against a new vehicle costing €90,000. The company received compensation to the value of €50,000 and the cheque paid for the new vehicle was €86,000.

On 01/09/2020, vehicle no. 1 was traded in for €16,000 against a new vehicle costing €96,000. Vehicle no. 1 had a refrigeration unit fitted on 01/07/2016 costing €24,000. This refrigeration unit was depreciated at the rate of 20% of cost for each of the first two years and thereafter at the rate of 15% of cost per annum.

You are required to show, with workings, for each of the two years 2019 and 2020:

- (a) The vehicles account. (6)
- (b) The provision for depreciation account. (32)
- (c) The vehicles disposal account. (14)
- (d) (i) Explain why a company charges depreciation in calculating profit.
(ii) Show the relevant extract from the profit and loss account year ended 31/12/2020. (8)

(60 marks)

4. Debtors Control Accounts

The debtors ledger control account of J. Cuddihy showed the following balances: €44,400 dr and €820 cr on 31/12/2020. These figures did not agree with the schedule (list) of debtors balances extracted on the same date.

An examination of the books revealed the following:

- (i) Discount disallowed to a customer of €75 had been recorded as discount allowed in the general ledger and credited as €57 in the customer's account.
- (ii) Interest amounting to €84, charged to a customer's overdue account had been entered correctly in the interest account but credited as €84 in the customer's account. Following a complaint by the customer this was reduced to €60. This reduction had not been entered in the books.
- (iii) Sales of €2,480 had been entered on the credit side of a customer's account. This included cash sales of €1,570.
- (iv) J. Cuddihy received €220 from a debtor in respect of a debt previously written off. This represents 80% of the original bad debt. The debtor has undertaken to pay the remainder as he wishes to trade with J. Cuddihy again. No entries were made in the books in respect of these transactions.
- (v) An invoice sent by J. Cuddihy to a customer for €2,590 had been entered in the appropriate day book as €2,950. When posting from this book to the ledger no entry had been made in the customer's account.
- (vi) J. Cuddihy accepted returns €450 from a customer and entered this correctly in the books. However, a credit note was sent showing a restocking charge of 10% of the sales price. The accounts clerk only made the necessary adjustment in the customer's account. Later this charge was reduced to 4% but this reduction was not reflected in the accounts.

Required:

- (a) Prepare the adjusted debtors ledger control account. (22)
- (b) Prepare the adjusted schedule (list) of debtors showing the original balance. (30)
- (c) Explain the importance of control accounts. (8)

(60 marks)

SECTION 2 (100 marks)

Answer **ONE** question

5. Interpretation of Accounts

The following figures have been extracted from the final accounts of Fauci plc, a manufacturer of computer security devices, for the year ended 31/12/2020. The company has an authorised capital of €350,000 made up of 200,000 ordinary shares at €1 each and 150,000 9% preference shares at €1 each. Fauci plc has issued all 200,000 ordinary shares and 100,000 9% preference shares.

Trading and Profit and Loss Account for year ended 31/12/2020		Ratios and information for year ended 31/12/2019	
	€		
Sales	908,000	Earnings per ordinary share	16c
Costs of goods sold	(560,000)	Dividend per ordinary share	6.4c
Operating expenses for year	(289,000)	Interest cover	3.2 times
Interest for year	<u>(20,000)</u>	Acid Test ratio	1.8:1
Net profit for year	39,000	Market value of one ord. share	€1.60
Dividends paid	<u>(13,000)</u>	Return on capital employed	9.07%
Retained profit	26,000	Gearing	62%
Profit and loss balance 01/01/2020	<u>45,000</u>	Dividend cover	2.5 times
Profit and loss balance 31/12/2020	<u>71,000</u>	Dividend yield	4%

Balance Sheet as at 31/12/2020			
	€	€	€
Fixed Assets			
Tangible fixed assets			255,000
Intangible fixed assets			<u>200,000</u>
			455,000
Current Assets			
Debtors	174,000		
Stock 31/12/2020	<u>62,000</u>	236,000	
Less Creditors: amounts falling due within 1 year			
Trade creditors	40,000		
Bank Overdraft	<u>30,000</u>	<u>(70,000)</u>	<u>166,000</u>
			<u>621,000</u>
Financed by:			
8% Debentures (2030 secured)			250,000
Capital and Reserves			
Ordinary shares @ €1 each		200,000	
9% Preference shares @ €1 each		100,000	
Profit and loss balance		<u>71,000</u>	<u>371,000</u>
			<u>621,000</u>

- (a) You are required to calculate the following for 2020:**
(where appropriate calculations should be made to **two** decimal places).
- (i) Cash sales if the period of credit given to debtors is 3 months.
 - (ii) Return on capital employed.
 - (iii) The current market price if the price earnings ratio is 12.
 - (iv) Dividend cover.
 - (v) Interest cover. (50)
- (b)** Indicate if the ordinary shareholders would be satisfied with the performance, state of affairs and prospects of the company. Use relevant ratios and other information to support your answer. (40)
- (c)** (i) What are the disadvantages to a business of having a high gearing?
(ii) Explain **two** ways to reduce the gearing of a company. (10)
- (100 marks)**

6. Published Accounts

Tedros plc has an authorised share capital of €1,250,000 divided into 1,000,000 ordinary shares at €1 each and 250,000 8% preference shares at €1 each.

The following trial balance was extracted from the books at 31/12/2020:

	€	€
Delivery vans at cost	508,000	
Delivery vans - accumulated depreciation on 01/01/2020		86,200
4% Investments (purchased 01/04/2020)	120,000	
Land and buildings at cost	840,000	
Buildings - accumulated depreciation on 01/01/2020		62,600
Investment income		2,400
Debtors and creditors	370,460	168,750
Stock 01/01/2020	58,600	
Patent 01/01/2020	120,000	
Administrative expenses	424,000	
Distribution costs	88,700	
Purchases and sales	1,123,000	2,036,600
Rental income		55,200
Profit on the sale of land		87,000
Dividends paid	42,000	
Bank	75,000	
VAT	24,500	
Issued Capital		
Ordinary shares		750,000
8% Preference shares		150,000
Provision for bad debts		14,800
7% Debentures 2025/2026		240,000
Discount		27,000
Profit and loss account 01/01/2020		127,710
Debenture interest paid	<u>14,000</u>	<u> </u>
	<u>3,808,260</u>	<u>3,808,260</u>

The following information is relevant:

- (i) Stock on 31/12/2020 was €72,660.
- (ii) The patent was acquired on 01/01/2014 for €360,000. It is being amortised over 9 years in equal instalments. This amortisation is to be included in cost of sales.
- (iii) Provision should be made for debenture interest due, investment income due, auditors' fees €12,000, directors' fees €64,000 and corporation tax €46,000.
- (iv) Included in distribution costs is the receipt of €18,000 for patent royalties.
- (v) During the year, land adjacent to the company's premises, which had cost €260,000 was sold for €347,000. (The remaining land had cost €350,000.)

Depreciation is to be provided for on buildings at a rate of 2% of cost per annum straight line and is to be allocated 25% to distribution costs and 75% to administrative expenses. There was no purchase or sale of buildings during the year.

At the end of the year the company revalued its land and buildings to €1,250,000 and wishes to incorporate this value in this year's accounts.

- (vi) Delivery vans are to be depreciated at a rate of 15% of cost per annum straight line.
- (vii) The company is being sued by a former employee who is claiming unfair dismissal. Legal advisors have stated that the company is **likely to be liable**. The liability is estimated at €60,000.

Required:

- (a) Prepare the published profit and loss account for the year ended 31/12/2020 and a balance sheet as at that date in accordance with the Companies Acts and appropriate accounting standards showing the following notes:
 - 1. Accounting policy note for tangible fixed assets and stock
 - 2. Operating profit
 - 3. Contingent liability
 - 4. Tangible fixed assets
 - 5. Interest payable (90)
- (b) (i) State what is meant by an "Exceptional Item" and give an example.
- (ii) Explain what is meant by an auditor's qualified report. (10)

(100 marks)

7. Cash Flow Statement

The following are the balance sheets of Reid plc as at 31/12/2020 and 31/12/2019.

Balance Sheets as at	31/12/2020		31/12/2019	
Intangible Assets	€	€	€	€
Patents		72,000		81,000
Fixed Assets				
Land and buildings	920,000		750,000	
Less accumulated depreciation	<u>(82,000)</u>	838,000	<u>(90,000)</u>	660,000
Machinery	300,000		240,000	
Less accumulated depreciation	<u>(134,000)</u>	166,000	<u>(120,000)</u>	120,000
Financial Assets				
4% Quoted investments		<u>40,000</u>		<u>40,000</u>
		1,116,000		901,000
Current Assets				
Stock	145,000		165,000	
Debtors	270,000		200,000	
Less bad debt provision	<u>(5,400)</u>		<u>(2,000)</u>	
Bank	68,000		27,000	
Government securities	60,000		20,000	
Investment income due	<u>1,000</u>		<u>400</u>	
	<u>538,600</u>		<u>410,400</u>	
Less Creditors: amounts falling due within 1 year				
Trade creditors	123,000		99,000	
Corporation tax	68,400		34,000	
Interest due	<u>10,000</u>		<u>15,000</u>	
	201,400	<u>337,200</u>	148,000	<u>262,400</u>
		<u>1,453,200</u>		<u>1,163,400</u>
Financed by:				
Creditors: amounts falling due after 1 year				
8% Debentures (€50,000 redeemed on 31/12/2020)		250,000		300,000
Capital and Reserves				
Ordinary shares @ €1 each	750,000		600,000	
Share premium	150,000		120,000	
Profit and loss account	<u>303,200</u>	<u>1,203,200</u>	<u>143,400</u>	<u>863,400</u>
		<u>1,453,200</u>		<u>1,163,400</u>

The following information is also available:

- (i) Buildings, which cost €100,000 and on which total depreciation of €28,000 was provided for were sold for €90,000.

There were no disposals of machinery during the year.
- (ii) Depreciation charged for the year on buildings in arriving at operating profit was €20,000.
- (iii) Patents are being amortised over a nine year period, commencing in 2020.
- (iv) The shares were issued at €1.20 per share on 01/01/2020.
- (v) The total dividend paid for the year was 6c per share, on shares held at 31/12/2020.
- (vi) Corporation tax due at 31/12/2019 was paid in full.

Required:

- (a)** (i) Prepare the abridged profit and loss account of Reid plc to ascertain the operating profit for the year ending 31/12/2020.
- (ii) Prepare the cash flow statement of Reid plc for the year ended 31/12/2020 including reconciliation statements.

(88)

- (b)** (i) Explain why earning profit may not always result in a corresponding increase in cash balances. Use figures from this question to support your answer.
- (ii) Outline reasons why Reid plc would prepare a cash flow statement.

(12)

(100 marks)

SECTION 3 (80 marks)Answer **ONE** question**8. Stock Valuation, Product Costing, Under and Over Absorption****(a) Stock Valuation**

Bolger Ltd is a retail store that buys and sells one product. The following information relates to the purchases and sales of the firm for the year 2020.

Period	Purchases on Credit	Credit Sales	Cash Sales
01/01/2020-30/04/2020	4,500 @ €5 each	1,100 @ €10 each	1,700 @ €10 each
01/05/2020-31/08/2020	3,600 @ €8 each	1,400 @ €11 each	1,200 @ €11 each
01/09/2020-31/12/2020	2,600 @ €7 each	1,600 @ €12 each	1,350 @ €11 each

On 01/01/2020 there was opening stock of 4,700 units @ €5 each.

Required:

- (i) Calculate the value of closing stock at 31/12/2020 using First in/First out, (FIFO) method.
- (ii) Prepare a trading account for the year ending 31/12/2020.

(b) Product Costing

The following is the budgeted yearly overhead details of Kinsella Ltd, a manufacturer of computer equipment that has three production departments.

Production Departments	Budgeted Overheads	Budgeted Labour Hours	Wage Rate Per Hour
Manufacturing	€840,000	42,000 hours	€19.00
Assembly	€389,400	22,000 hours	€16.00
Finishing	€187,000	8,500 hours	€18.50

Budgeted general administration costs for the year €435,000.

Details of Job Number 667

Direct material 45 kg at €12.20 per kg

Direct labour hours	Manufacturing	24 hours
	Assembly	8 hours
	Finishing	2 hours

All orders are priced using a profit margin of 20%.

Required:

- (i) Calculate the overhead absorption rates for each department.
- (ii) Calculate the selling price of Job Number 667.

(c) Under and Over Absorption

The information set out below refers to the budgeted and actual costs of Conroy Manufacturing Ltd.

Budgeted	Direct Labour Hours	Machine Hours	Total Overhead
Department A	14,000	36,000	€234,000
Department B	54,000	7,000	€64,800
Department C	26,000	---	€88,400

Actual	Direct Labour Hours	Machine Hours	Total Overhead
Department A	16,000	39,000	€262,500
Department B	50,000	8,150	€59,200
Department C	28,400	---	€98,200

Required:

- (i) Calculate departmental overhead absorption rates for Departments A, B and C.
- (ii) Show the under/over absorption by department and in total for the period.
Explain what these figures mean.

(80 marks)

9. Flexible Budgeting

Henry Ltd manufactures a component for the medical industry. The following flexible budgets have already been prepared for 55%, 75% and 95% of the plant's capacity:

Output levels	55%	75%	95%
Units	27,500	37,500	47,500
Costs	€	€	€
Direct materials	151,250	206,250	261,250
Direct wages	184,250	251,250	318,250
Production overheads	129,000	173,000	217,000
Other overhead costs	150,875	203,375	255,875
Administration overheads	<u>38,500</u>	<u>38,500</u>	<u>38,500</u>
	<u>653,875</u>	<u>872,375</u>	<u>1,090,875</u>

Profit is budgeted to be 20% of sales. All units produced are sold.

(a) Required:

- (i) Separate production overheads into fixed and variable elements.
- (ii) Separate other overhead costs into fixed and variable elements.
- (iii) Prepare a flexible budget for 90% activity level using marginal costing principles, and show the contribution.

(b) Henry Ltd is currently operating at 100% capacity and is considering two options as follows:

Option 1

Modernisation of machinery.

This will involve employing one new production supervisor at a cost of €40,000. This will save €1.40 per unit in the production overheads.

Option 2

Purchase of machinery which would increase the plant's capacity by 15% while reducing all fixed overheads (including administration) by 5%.

Required:

- (i) Prepare flexible budgets, using marginal costing principles and showing contributions, for both options taking the new cost structures into account.
- (ii) Advise the company on the best option.

(c) Required:

- (i) What is meant by the term sensitivity analysis?
- (ii) Outline why Henry Ltd would prepare a flexible budget.

(80 marks)

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