

Cost Accounting Level 3



Model Answers

Series 4 2005 (Code 3016)

Vision Statement

Our vision is to contribute to the achievements of learners around the world by providing integrated assessment and learning services, adapted to meet both local market and wider occupational needs and delivered to international standards.



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Cost Accounting Level 3

Series 4 2005

How to use this booklet

Model Answers have been developed by Education Development International plc (EDI) to offer additional information and guidance to Centres, teachers and candidates as they prepare for LCCI International Qualifications. The contents of this booklet are divided into 3 elements:

- (1) Questions – reproduced from the printed examination paper
- (2) Model Answers – summary of the main points that the Chief Examiner expected to see in the answers to each question in the examination paper, plus a fully worked example or sample answer (where applicable)
- (3) Helpful Hints – where appropriate, additional guidance relating to individual questions or to examination technique

Teachers and candidates should find this booklet an invaluable teaching tool and an aid to success.

EDI provides Model Answers to help candidates gain a general understanding of the standard required. The general standard of model answers is one that would achieve a Distinction grade. EDI accepts that candidates may offer other answers that could be equally valid.

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QUESTION 1

Triple Products Ltd manufactures three products Alpha, Beta and Gamma. At present the company uses a traditional absorption costing system to establish the costs of production. Budgeted production data for the next period is as follows:

	Alpha	Beta	Gamma
Production output (units)	500	400	200
Material per unit @ £5.00 per kg	10kg	20kg	16kg
Labour per unit @ £9.00 per hour	2hrs	2hrs	3hrs
Machine time per unit	2hrs	1.5hrs	2hrs

Budgeted production overheads for the period are £76,300 absorbed on a machine hour basis.

Further investigation of this production overhead figure, has revealed the following activities and related overhead costs:

Activities	Costs (£)
Product inspection	32,000
Machine set-up	16,000
Machine maintenance	12,000
Product despatch	8,200
Material handling	<u>8,100</u>
	<u>76,300</u>

Other information

- (1) Orders budgeted: Alpha 10 orders; Beta and Gamma 5 orders each. Each order is expected to require one machine set up and two inspections.
- (2) Machine maintenance is carried out regularly based on a predetermined number of machine running hours.
- (3) Each product is packed and despatched in crates containing the following number of products per crate: Alpha 20 units, Beta 50 units and Gamma 25 units. The number of crates used influences product despatch costs.
- (4) Material handling costs are influenced by the quantity of material used.

REQUIRED

- (a) Calculate the production cost of one unit of each product using:
 - (i) Traditional absorption costing (6 marks)
 - (ii) Activity based costing. (10 marks)
- (b) Explain the meaning of the term cost driver. Your explanation should include **2** examples to illustrate your answer. (4 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 1

Syllabus Topic 1: Accounting for materials, labour overheads and processes (1.3)

(a) (i) Traditional absorption costing

Calculation of overhead absorption rate

	Units	Machine hours (per unit)	Total m/c hrs
Alpha	500	2	1,000
Beta	400	1.5	600
Gamma	200	2	400
			<u>2,000 hrs</u>
Production overheads	£76,300		
Absorption rate	76,300 / 2000 = £38.15 per machine hours		

Costs per unit(£)	Alpha	Beta	Gamma
Material	50.00	100.00	80.00
Labour	18.00	18.00	27.00
Production overhead	76.30	57.225 ½	76.30
Total unit cost	<u>144.30</u>	<u>175.225 ½</u>	<u>183.30</u>

MODEL ANSWER TO QUESTION 1 CONTINUED

(ii) Unit overhead cost for next period. (Activity based costing)

Activity	Alpha	Beta	Gamma
Product Inspection			
No of inspections	20	10	10
Total overhead(£000)	16 (32 x 20/40)	8 (32 x 10/40)	8 (32 x 10/40)
Overhead per unit	£32 (16,000/500)	£20 (8,000/400)	£40 (8,000/200)
Machine set-up			
No of machine set-ups	10	5	5
Total overhead(£000)	8 (16 x 10/20)	4 (16 x 5/20)	4 (16 x 5/20)
Overhead per unit	£16 (8,000/500)	£10 (4,000/400)	£20 (4,000/200)
Machine maintenance			
No of machine hours	1,000	600	400
Total overhead(£000)	6 (12 x 1,000/2,000)	3.6 (12 x 600/2,000)	2.4 (12 x 400/2,000)
Overhead per unit	£12 (6,000/500)	£9 (3,600/400)	£12 (2,400/200)
Product despatch			
No of crates	25	8	8
Total overhead(£000)	5 (8.2 x 25/41)	1.6 (8.2 x 8/41)	1.6 (8.2 x 8/41)
Overhead per unit	£10 (5,000/500)	£4 (1,600/400)	£8 (1,600/200)
Material handling			
Material (kg)	5,000	8,000	3,200
Total overhead(£000)	2.5 (8.1 x 5,000/16,200)	4 (8.1 x 8,000/16,200)	1.6 (8.1 x 3,200/16,200)
Overhead per unit	£5 (2,500/500)	£10 (4,000/400)	£8 (1,600/200)
 Total overhead per unit	 <u>£75</u>	 <u>£53</u>	 <u>£88 1</u>

Unit cost (Activity based costing)

	Alpha	Beta	Gamma
Material	50	100	80
Labour	18	18	27
Production overheads	75	53	88
Total unit cost	<u>£143</u>	<u>£171</u>	<u>£195</u>

MODEL ANSWER TO QUESTION 1 CONTINUED

(b) Cost Driver:

A cost driver is any factor which causes a change in the cost of an activity.

Examples:

- Number of inspections
- Number of machine set-ups

Additional acceptable answers could be:

- Number of machine hours
- Number of crates
- Quantity of material
- Units of output of each product

QUESTION 2

Easy Travel is a transport business operating six passenger vehicles. The business, owned solely by T Hope and located in rented premises, employs one full time administration officer. T Hope acts as Transport Manager and drivers are contracted from an agency on the basis of individual jobs. The business operates Type A vehicles and Type B vehicles.

It is budgeted that each vehicle will complete 48,000 km per year.

The following additional information is provided regarding the business:

Vehicle data	Type A	Type B
Number of vehicles	2	4
Number of seats per vehicle	48	15
Number of tyres per vehicle	6	4

Vehicle costs

Purchase price per vehicle	£60,000	£23,000
Trade-in value per vehicle (after 5years)	£2,800	£1,000
Road fund licence (per vehicle per year)	£800	£400
Insurance (per vehicle per year)	£1,600	£800
Servicing (every 12,000 km per vehicle)	£300 per service	£200 per service
Tyres (renewed per 48,000 km)	£200 per tyre	£100 per tyre
Fuel consumption (at £0.80 per litre)	1 litre per 3 km	1 litre per 5 km

Depreciation is charged at 20% annually, in equal instalments, on the purchase price of each vehicle less the cost of the tyres and less its trade-in value after 5 years.

Office costs

Rent	£12,000 per year
Insurance	£7,400 per year
Administration	£18,000 per year
T Hope (Transport Manager)	£25,000 per year

Office costs are apportioned to vehicle types on the total number of passenger seats.

Agency driver costs

Cost per day	Type A = £80	Type B = £60
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Jobs are charged with agency driver costs directly according to time taken.

Both vehicle costs and office costs are absorbed into the cost of jobs at a predetermined rate per kilometre for each type of vehicle

REQUIRED

(a) For **each** vehicle type calculate the:

- (i) vehicle cost absorption rate per kilometre (8 marks)
- (ii) office cost absorption rate per kilometre. (6 marks)

QUESTION 2 CONTINUED

The following information relates to a job enquiry:

- (1) A local club requires transport for 28 passengers to and from a sporting venue.
- (2) The distance from the local club to the sporting venue is 200 km.
- (3) Both types of vehicle are available for the job.
- (4) The job can be completed in one day.

REQUIRED

(b) Calculate the cost to transport the 28 passengers **to** and **from** the sporting venue assuming:

(i) Type A vehicle is used

(ii) Type B vehicles are used.

(6 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 2
Syllabus Topic 3: Marginal costing (3.2)

(a) (i) Vehicle cost per year	Type A £	Type B £
Depreciation [1]	11,200	4,320
Road fund licence	800	400
Insurance	1,600	800
Service [2]	1,200	800
Tyres [3]	1,200	400
Fuel [4]	12,800	7,680
	<u>28,800</u>	<u>14,400</u>

Workings

[1] Depreciation	Type A	$[60,000 - 2,800 - (6 \times 200)] \times 20\%$	= £11,200 per year
	Type B	$[23,000 - 1,000 - (4 \times 100)] \times 20\%$	= £4,320 per year
[2] Service every 12,000km =		$48,000 / 12,000$	= 4 per year
	Type A	4×300	= £1,200 per year
	Type B	4×200	= £800 per year
[3] Tyre change every 48,000 km		$48,000 / 48,000$	= 1 change per year
	Type A	$1 \times 6 \times 200$	= £1,200 per year
	Type B	$1 \times 4 \times 100$	= £400 per year
[4] Fuel	Type A	$0.8 \times 48,000 / 3$	= £12,800 per year
	Type B	$0.8 \times 48,000 / 5$	= £7,680 per year

Vehicle costs absorption rates:

Type A	$28,800 / 48,000$	= £0.60 per vehicle km
Type B	$14,400 / 48,000$	= £0.30 per vehicle km

(ii) Office costs per year	£
Rent	12,000
Insurance	7,400
Administration	18,000
T Hope	25,000
	<u>62,400</u>

Office costs apportioned on total number of passenger seats

Type A vehicle	$48 \times 2 = 96$ seats
Type B vehicle	$15 \times 4 = 60$ seats
Total available	156 seats

Office costs apportioned per vehicle

Type A vehicle	$(62,400 \times 96 / 156) / 2$	= £19,200
Type B vehicle	$(62,400 \times 60 / 156) / 4$	= £6,000

Office costs absorption rates:

Type A vehicle	$19,200 / 48,000$	= 0.4 per vehicle km
Type B vehicle	$6,000 / 48,000$	= 0.125 per vehicle km

(b) (i) (ii)	Type A	Type B
Number of vehicles required	1	2
Total distanced	400km	800km
Agency driver costs (£)	80	120
Vehicle costs (£)	240	240
Office costs (£)	160	100
Total costs (£)	<u>480</u>	<u>460</u>

QUESTION 3

A company plans to sell 120,000 units of its single product, in a period at a selling price of £15 per unit. Fixed overheads and net profit for the period are expected to be £440,000 and £520,000 respectively using the existing production process.

The company is considering a change to its production process. The change would increase the fixed overheads to £700,000 in the period and reduce the variable costs to £5 per unit. The selling price will remain constant regardless of production process.

Production capacity in both the existing and changed processes would be 150,000 units in the period.

REQUIRED

- (a) For the existing production process, calculate for the period the expected:
- (i) breakeven point in units (4 marks)
 - (ii) margin of safety as a % of sales (1 mark)
 - (iii) contribution sales ratio. (1 mark)
- (b) Advise management, using supporting calculations, whether to change the production process if sales are 120,000 units in the period. (5 marks)
- (c) Advise management, using supporting calculations, of the sales level (units) at which the changed process would become more profitable than the existing process. (5 marks)
- (d) Identify and explain 2 limitations of break-even analysis. (4 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 3
Syllabus Topic 3: Marginal Costing (3.4)

- (a) (i) Planned total contribution = Fixed overheads + Profits
= £440,000 + £520,000
= £960,000
Unit contribution = £960,000 / 120,000
= £8 per unit
Break-even point = Fixed overheads / unit contribution
= £440,000 / £8
= **55,000 units**
- (ii) Margin of safety = [(Unit sales - Break-even units) / Unit sales] x 100%
= [(120,000 - 55,000) / 120,000] x 100%
= **54.2%**
- (iii) Contribution / sales ratio = (Unit contribution / Unit sales price) x 100%
= (£8 / £15) x 100%
= **53.3%**

Syllabus Topic 3: Marginal Costing (3.5)

- (b) Supporting calculations for management advice

Existing method

Planned profit at 120,000 units output = £520,000

Changed method (Proposed)

Unit contribution = Selling price - Unit variable cost
= £15 - £5
= £10 per unit
Contribution at 120,000 units output = 120,000 x £10
= £1,200,000
Profit at 120,000 units output = Total contribution - fixed overheads
= £1,200,000 - £700,000
= £500,000

Advice

Continue with current method at 120,000 units of sales

- (c) Supporting calculations for management advice

Sales level is where total costs are equal for both methods

Total costs = Variable costs + Fixed overheads

Existing method = (£7 x output) + £440,000

Changed method = (£5 x output) + £700,000

Therefore

7 x output + 440,000 = 5 x output + 700,000

Level of output = (700,000 - 440,000) / (7 - 5)

= 130,000 units

Advice

The changed production process would be more profitable at sales levels in excess of 130,000 units.

MODEL ANSWER TO QUESTION 3 CONTINUED
Syllabus Topic 3: Marginal Costing (3.4)

(d) Limitations of break-even analysis

- (i) It assumes selling price remains constant regardless of how many products are sold.
- (ii) It assumes variable costs increase in a linear fashion. In practice, economies of scale, may mean variable costs do not rise as fast as output.

An additional acceptable answer could be:

- (iii) It assumes fixed costs remain constant. However, to achieve higher outputs, additional costs may be necessary thus producing stepped fixed costs

QUESTION 4

James is planning to start a new business on 1 January Year 6 by producing and selling a single product. James will invest £30,000 of his own capital of which £15,000 is available at the outset with the balance in July Year 6.

Prior to commencement of the business James intends to purchase factory machinery for £18,000. This purchase will be paid for in January. His bank manager has asked for a cash budget and profit statement to support a loan application.

James has provided the following budgeted information for the first year of trading:

Period (Three months)	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec
Sales (£)	30,000	36,000	44,000	48,000
Direct materials (£)	6,000	7,200	8,400	9,600
Direct labour (£)	10,000	13,000	14,000	16,000
Selling expenses (£)	4,000	4,500	5,000	5,500

The following other information is available:

- (1) Sales, which are all on credit, will be spread evenly within each three month period.
- (2) Customers will be allowed a two-month credit period. It is expected that bad debts will account for 1% of the sales value.
- (3) All products will be produced in the month of sale.
- (4) Direct materials, purchased in the month of production, are payable one month after purchase.
- (5) Direct labour is payable in the month incurred
- (6) 60% of the selling expenses are payable in the period incurred, the balance being paid in the following period.
- (7) Factory overheads, excluding depreciation, are expected to be £8,000 per three month period. 70% of this cost is payable in the period incurred, the balance being paid in the following period.
- (8) Office administration overheads of £1,000 per month are expected to be payable one month after being incurred.
- (9) Factory machinery is expected to have a 10-year life with no scrap value and will be depreciated in equal instalments over its life.
- (10) James has applied for a £20,000 bank loan to be received at the start of business.
- (11) No repayment of the loan is expected in the first year of business but interest, at 12% per annum, is payable monthly in the month after it is incurred

REQUIRED

For the first year of trading assuming that the bank loan is received:

(a) Prepare a cash budget for **each** of the three month periods. (14 marks)

(b) Prepare a single budgeted profit statement. (6 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 4
Syllabus Topic 4: Budgetary control (4.3)

(a)

	Cash budget			
	Jan - March	April - June	July - Sept	Oct - Dec
Receipts				
Sales [1]	9,900	31,680	38,280	44,880
Loan	20,000			
Capital	<u>15,000</u>		<u>15,000</u>	
	<u>44,900</u>	<u>31,680</u>	<u>53,280</u>	<u>44,880</u>
Payments				
Material [2]	4,000	6,800	8,000	9,200
Labour	10,000	13,000	14,000	16,000
Selling expenses [3]	2,400	4,300	4,800	5,300
Factory overheads [4]	5,600	8,000	8,000	8,000
Office overheads	2,000	3,000	3,000	3,000
Factory machinery	18,000	—	—	—
Loan interest [5]	<u>400</u>	<u>600</u>	<u>600</u>	<u>600</u>
	<u>42,400</u>	<u>35,700</u>	<u>38,400</u>	<u>42,100</u>
<i>Cash budget for the year ending December year 6</i>				
Net cash flow	2,500	-4,020	14,880	2,780
Opening bank	<u>0</u>	<u>2,500</u>	<u>-1,520</u>	<u>13,360</u>
Closing bank	<u>2,500</u>	<u>-1,520</u>	<u>13,360</u>	<u>16,140</u>

Syllabus Topic 4: Budgetary control (4.2)

(b)

<i>Budgeted profit statement</i>	
<i>for the year ending December year 6</i>	
Sales	158,000
Purchases of material	31,200
Direct labour	53,000
Factory overheads	32,000
Depreciation (factory machinery) [6]	<u>1,800</u>
Cost of sales	<u>118,000</u>
Gross profit	40,000
Selling expenses	19,000
Office overheads	12,000
Loan interest	<u>2,400</u>
Bad debts	<u>1,580</u>
Net profit after interest	<u>5,020</u>

MODEL ANSWER TO QUESTION 4 CONTINUED

Workings (a)

Sales receipts

Sales	30,000	36,000	44,000	48,000
Less bad debts	<u>300</u>	<u>360</u>	<u>440</u>	<u>480</u>
	29,700	35,640	43,560	47,520
Net sales per month	<u>9,900</u>	<u>11,880</u>	<u>14,520</u>	<u>15,840</u>
Cash flow (this three month sales)	1 x 9,900	1 x 11,880	1 x 14,520	1 x 15,840
Cash flow (previous three month sales)	-	2 x <u>9,900</u>	2 x <u>11,880</u>	2 x <u>14,520</u>
[1]	<u>9,900</u>	<u>31,680</u>	<u>38,280</u>	<u>44,880</u>

Material payments

Materials	6,000	7,200	8,400	9,600
Materials per month	<u>2,000</u>	<u>2,400</u>	<u>2,800</u>	<u>3,200</u>
Cash flow(this three month purchase)	2 x 2,000	2 x 2,400	2 x 2,800	2 x 3,200
Cash flow(previous three month purchase)	-	1 x <u>2,000</u>	1 x <u>2,400</u>	1 x <u>2,800</u>
[2]	<u>4,000</u>	<u>6,800</u>	<u>8,000</u>	<u>9,200</u>

Selling expense payments

Selling expense	<u>4,000</u>	<u>4,500</u>	<u>5,000</u>	<u>5,500</u>
Cash flow (this three month expense)	60% x 4,000	60% x 4,500	60% x 5,000	60% x 5,500
Cash flow (previous three month expense)	-	40% x <u>4,000</u>	40% x <u>4,500</u>	40% x <u>5,000</u>
[3]	<u>2,400</u>	<u>4,300</u>	<u>4,800</u>	<u>5,300</u>

Factory overheads payments

Factory overheads	<u>8,000</u>	<u>8,000</u>	<u>8,000</u>	<u>8,000</u>
Cash flow	70% x <u>8,000</u>	<u>8,000</u>	<u>8,000</u>	<u>8,000</u>
[4]	<u>5,600</u>	<u>8,000</u>	<u>8,000</u>	<u>8,000</u>

Loan Interest payment

Loan interest(200 per month)				
Cash flow	<u>2 x 200</u>	<u>3 x 200</u>	<u>3 x 200</u>	<u>3 x 200</u>
[5]	<u>400</u>	<u>600</u>	<u>600</u>	<u>600</u>

Monthly interest = $12\% \times £20,000 / 12 = £200$ per month

Working (b)

Depreciation:

Factory Machinery [6] $£18,000 / 10 = £1,800$ per year

QUESTION 5

A company uses batch production methods to produce a single product by combining two materials Tee and Pee. The company has budgeted for a material mix ratio of 60:40 for Tee and Pee respectively.

The following information relates to each batch:

Direct material input	200kg	
Material Tee standard price	£2 per kg	
Material Pee standard price	£3 per kg	
Standard yield	160kg of product.	
The waste generated has no value.		

Actual results for Month 10 were as follows:

Output	16,500 kg	
Material Tee	13,020 kg	£24,738
Material Pee	7,980 kg	£25,536

REQUIRED

- (a) Calculate the following variances:
- (i) Material price for each material and in total (3 marks)
 - (ii) Material mix for each material and in total (5 marks)
 - (iii) Material yield in total. (4 marks)
- (b) Explain the meaning of:
- (i) Material mix variance (2 marks)
 - (ii) Material yield variance (2 marks)
- (c) Calculate the material usage variance and reconcile this with the appropriate variances calculated in (a) above. (4 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 5
Syllabus Topic 5: Standard costing and variances (5.3)

(a) (i) Material Price Variance		
	(Actual Usage x Std Price) - Actual cost	
Tee	(13,020 x £2) - £24,738	1302F
Pee	(7,980 x £3) – £25,536	1596A
		<u>294A</u>

(ii) Material Mix Variance		
	Actual Usage in Std Proportions - Actual Usage) x Std Price	
Tee	[60% of (13,020 + 7,980) – 13,020] x £2	840A
Pee	[40% of (13,020 + 7,980) – 7,980] x £3	1260F
		<u>420F</u>

Alternative solution for (ii)

(Actual input quantity - budgeted material input quantity for output produced) x (Standard weighted average cost per unit - standard cost per input unit)

Tee	[13,020 – 16,500 / (160/200) x 0.6] x [2.4 - 2.0]	258F
Pee	[7,980 – 16,500 / (160/200) x 0.4] x [2.4 - 3.0]	162F
		<u>420F</u>

Workings:

Standard weighted average cost per unit
= 0.6 x £2 + 0.4 x £3 = £2.40

(iii) Material Yield Variance		
(1)	[(Actual material input quantity - budgeted material input quantity for the output produced) x standard weighted average cost per unit of material input]	
	or	
(2)	[(Actual output - budgeted output for the actual material input) x standard weighted average cost per unit of output]	
(1)	[(13,020 + 7,980) – 16,500 / (160/200)] x 2.4	900A
	or	
(2)	[(13,020 + 7,980) x (160/200) – 16,500] x 3.0	900A

Workings:

Standard weighted average cost per unit
Standard cost of mix
Tee 120kg x £2/kg = £240
Pee 80kg x £3/kg = £240
£480
Standard weighted average cost (material input)
= £480 / 200kg = £2.4/kg
Standard weighted average cost (material output)
= £480 / 160kg = £3.0/kg

MODEL ANSWER TO QUESTION 5 CONTINUED
Syllabus Topic 5: Standard costing and variances (5.4)

- (b) (i) Material Mix variances occur where substitutions within the mix of materials input are possible and when the materials are not mixed in standard proportions. It is a measure of whether the actual mix is cheaper or more expensive than the standard mix (at standard prices).
- (ii) A Yield variance arises where there is a difference between what the input should have been for the output achieved and the actual input.
or
 The difference between the output achieved and what should have been achieved with the material used.

Syllabus Topic 5: Standard costing and variances (5.3)

(c) Material Usage Variance		
(Std Usage - Actual Usage) x Std price		
{[16500 / (160/200) x 0.6] - 13020} x £2.00		
+{[16500 / (160/200) x 0.4] - 7980} x £3.00		
		480A
Material Mix Variance		
Tee	840A	
Pee	1260F	
Material Yield Variance		
Total	<u>900A</u>	480A

QUESTION 6

A manufacturing company operates a non-integrated accounting system. At the end of Month 1 of the financial year the following reconciliation statement was prepared.

	£	£
Profit as per cost accounts		29,000
<i>Add:</i>		
Raw material closing stock difference	1,200	
Work-in-progress opening stock difference	500	
Finished goods opening stock difference	2,500	
Selling and distribution overheads over absorbed	900	
Production overheads over absorbed	3,500	
Notional rent charge	<u>7,500</u>	16,100
<i>Deduct:</i>		
Raw material opening stock difference	1,100	
Work-in-progress closing stock difference	800	
Finished goods closing stock difference	2,600	
Administration overheads under absorbed	<u>1,500</u>	<u>6,000</u>
Profit as per financial accounts		<u>39,100</u>

In the cost ledger, overheads are absorbed as follows:

Production overheads	£12.50 per direct labour hour.
Administration overheads	10% of sales
Selling and distribution overheads	6% of sales

Any over/under absorbed overhead balance at the end of a month is carried forward to the following month in the cost ledger. Any balance remaining at the end of a financial year is transferred to the Profit and Loss Account.

Sales in Month 1 were £600,000 and 9,000 direct labour hours were worked.

In the financial ledger the following stocks relate to Month 1:

	Opening stock £	Closing stock £
Raw materials	110,000	120,000
Work-in-progress	30,000	40,000
Finished goods	300,000	350,000

REQUIRED

- (a) Calculate for Month 1:
- (i) The opening and closing stock values in the cost ledger. (9 marks)
 - (ii) The actual overhead expenditure for each of the three categories. (6 marks)
- (b) Suggest a reason why the cost and financial accounting valuations for raw material stock are different. (3 marks)
- (c) Explain what the item **Notional rent charge** means (2 marks)

(Total 20 marks)

MODEL ANSWER TO QUESTION 6

(a) (i) Stock values in cost ledger (£)

	Opening stock		Closing stock	
Raw materials	<u>108,900</u>	(110,000 – 1,100)	<u>118,800</u>	(120,000 – 1,200)
Work-in-progress	<u>30,500</u>	(30,000 + 500)	<u>40,800</u>	(40,000 + 800)
Finished goods	<u>302,500</u>	(300,000 + 2,500)	<u>352,600</u>	(350,000 + 2,600)

(ii) Actual overhead expenditure (£)

Production overhead:

Absorbed	112,500	(9,000 x 12.5)
less over absorbed	<u>3,500</u>	
Incurred	<u>109,000</u>	

Administration overhead:

Absorbed	60,000	(600,000 x 10%)
add under absorbed	<u>1,500</u>	
Incurred	<u>61,500</u>	

Selling and distribution overhead:

Absorbed	36,000	
less over absorbed	<u>900</u>	
Incurred	<u>35,100</u>	

(b) Stock valuation:

Different methods of raw material stock valuation could be used. The financial accounts might use the 'First in first out' method whereas the cost accountant might use the 'Last in first out' method.

(c) Notional rent charge:

A **notional rent charge** represents a cost of using a resource, that is owned by the company, and has no conventional actual cost.