

ASSOCIATION OF ACCOUNTING TECHNICIANS

GUIDANCE NOTES

ACCOUNTING QUALIFICATION - DIPLOMA PATHWAY

UNIT 33: MANAGEMENT ACCOUNTING

The purpose and content of this unit

Unit 33 is concerned with the application of management accounting techniques to help managers in the processes of planning, controlling and measuring performance. There are three major strands, or elements.

In the first element, candidates have to develop forecasts and budgets of demand, turnover, expenditure, resources to be consumed and capital expenditure requirements. These forecasts are then used to prepare budgets for income and expenditure. This may involve changing the initial budget to take account of revised information about factors that limit the operations of the organisation.

The second element focuses on the identification and analysis of costs. Candidates will have to monitor and analyse costs against trends and standards and explain any difference between actual and planned or expected costs. For both elements 1 and 2, candidates will need to make certain that all relevant data has been included and accurately recorded, and understand how that data is reported. All of this involves knowing the major sources of information on prices, costs and availability as well as how costs change with changes in the activity of the organisation.

The third element is concerned with monitoring the performance of an organisation or parts of an organisation and making recommendations that will enhance the organisation's value. In this element candidates have to identify and calculate performance indicators, monitor the performance of part or all of the organisation and make proposals that will enhance the value of the organisation. To do this, candidates will need to collect, analyse and interpret relevant information of help to managers. They will find some of this information within the organisation, but other information, such as competitors' prices and market trends, will come from external sources. Sometimes they will be able to analyse information by making comparisons, perhaps by comparing the collected information with what should have happened; at other times, they will need to see if there is any pattern in the information – and if there is, to use that pattern to forecast the future.

Unit 33 and the Diploma pathway Standards

Each Unit of the Diploma pathway Standards for Accounting is divided into elements and each element is then subdivided into performance criteria.

Candidates will have to show they can successfully carry out the performance criteria in all elements to be assessed as competent in a Unit. To help them understand the breadth and depth of those performance criteria, the Standards include range statements for each element. The Standards also identify the knowledge and understanding that candidates will need to achieve.

the performance criteria. For Unit 33 this knowledge and understanding relates to:

- the business environment;
- accounting techniques;
- accounting principles and theory; and
- the organisation.

Unit 33 has three elements:

- In element 33.1 candidates have to prepare forecasts and budgets;
- In element 33.2 candidates will have to collect, analyse and disseminate
- In element 33.3 candidates have to monitor performance and make recommendations to enhance value.

Element 33.1 Prepare forecasts and budgets

Performance criteria

To be assessed as competent in this element candidates have to successfully:

- identify relevant data for preparing forecasts and budgets from internal and external sources;
- communicate with budget holders and agree draft budgets with them;
- prepare forecasts and budgets in a clear format with explanations of assumptions and projections;
- review and revise the validity of forecasts and budgets in the light of any significant anticipated changes.

Range statement

Data:

- accounting information;
- wage and salary information;
- information about suppliers and availability of inputs;
- information about customers and markets;
- general economic information

Forecasts and Budgets:

- income;
- expenditure;
- resource budgets (production budget, material budget, labour budget, fixed overhead budget);
- capital budgets.
- Responsibility centres (expense, profit and investment centres)

Projections:

- trends:
- seasonal variations.

Understanding the performance criteria

In element 33.1 candidates need to know how to identify relevant data for forecasting, how to prepare forecasts and how to review and revise those forecasts in the light of significant changes. The knowledge and understanding for Unit 33 identifies, as an accounting technique, basic statistical methods. Statistical methods are used in two ways: (a) to summarise or describe a large amount of data and (b) to infer or forecast new information.

Basic statistical methods:

Basic statistical methods relate to that part of the performance criteria where candidates will have to identify relevant information from both internal and external sources. Statistical methods are used in two ways: (a) to summarise or describe a large amount of data and (b) to infer or forecast new information from existing data. Summarised data could include the average number of patients seen per doctor at each surgery. That statistic is telling candidates, in a single figure, something about all of the doctors. Inferential statistics is somewhat different: it uses a piece of statistical data to say something new. The result of a sample, for example, might allow candidates to say something about the whole population. Alternatively, candidates might develop a trend and from that trend be able to forecast future results.

Basic statistical methods: what candidates need to know:

Candidates will need to know how to calculate basic statistics. They must be able to calculate index numbers and some aspects of time series; and to calculate and interpret simple indices and be familiar with indices containing a variety of items. They will not, however, be asked to calculate weighted indices (such as the Paasche and Laspeyres indices) as these are outside the competencies.

Indices are often relevant to the preparation of resource budgets. Some production, for instance, might be wasted. In that case, it's necessary to produce more than is required for sales purposes to allow for the wastage. For example, assume 10% of production is wasted. The organisation will need to produce 100%/90% of the required production to take account of the wastage. As a result, material and labour requirements will also be based on this gross figure. Candidates should take care particularly when reading the task data. If the wastage only relates to the materials or labour, candidates must not adjust the production volume. Instead, they will need to purchase extra materials or extra labour to allow for the wastage. Candidates must know how to develop time series using moving averages and seasonal variations although they will not have to calculate from base data the formula $y = a + bx$ in time series using linear regression. Instead, they will be given the values of a and b, allowing them to calculate the value of y.

In addition, candidates need to have a good qualitative understanding of the strengths and limitations of statistical data, methods and issues including: historical, in-house data; leading and lagging indicators; census vs. sampling; forms of sampling, e.g. random and stratified; market research; primary data; secondary data (including awareness of general sources of published statistics); the use and limitations of published statistics; the possible composition and weightings of indices.

At all times, candidates need to understand how valid is a particular statistical method to the current problem. They will not, therefore, be expected to have a detailed statistical understanding of the normal distribution, nor inferential statistics such as confidence levels and hypothesis testing. They do, however, need a good qualitative understanding; to relate that understanding to the circumstances of specific tasks; and to know if a particular form of sampling is appropriate to a specific problem.

Similarly, candidates will need to understand the assumptions of linear regression and how that technique might not necessarily be appropriate to the problem being reviewed. They need to be aware that a sample could be biased (and the ways this could happen). Sales personnel, for example, could have asked customers about their future needs. Candidates need to know how bias can occur. The sales personnel might distort the findings (perhaps understating the forecasts so that they can more easily achieve the likely budget). Alternatively, they might only ask customers they like. Customers, on the other hand, might give wrong information or refuse to tell the sales personnel, perhaps as a bargaining ploy to obtain a better price. There is also the possibility of sampling error – particularly from small samples. For example, candidates could believe that the average demand per customer per week will be 20 units. A sample, however, might suggest the average demand per customer will be 25 units. Is the difference due to sampling error or has there been a change in demand? In this and all other statistical problems, candidates will need to relate the answer to both the specific scenario developed in the task data and to the precise task requirements.

Memorised, general lists will rarely help answer the task. Unit 33 is about the planning and control of resources and planning depends on forecasts. Forecasts can be derived from many different sources, and candidates will need to know the major sources of data for forecasts and the statistical techniques (such as time series) that might be of help in making a forecast. They will then need to know how to develop a trend using either moving averages or a linear regression formula, and to know how to develop a forecast by extrapolating that trend and adjusting for seasonal variations. Candidates should, however, also understand that forecasts are not always based on statistical techniques, such as samples, surveys and trends. Forecasts can also be based on established patterns of behaviour.

One example of this is the product life cycle. Some industries do not have clearly defined product life cycles. Where they do, however, it is possible to use the pattern in the product life cycle to forecast future demand. Candidates should be able to do this by identifying the stages within the product life cycle and scanning the environment for signs of those different stages.

Element 33.2 Collect, analyse and disseminate information about costs

Performance criteria

To be assessed as competent in this element candidates will have to successfully:

- A. identify valid, relevant information from internal and external sources;
- B. compare standard costs with actual costs and analyse any variances;
- C. analyse the effect of organisational accounting policies on reported costs;
- D. consult relevant staff in the organisation about the analysis of variances;
- E. present reports to management in an appropriate format that highlight significant variances.

Range statement

Methods of presenting information:

- Written analysis and explanation;
- table.

Variance analysis:

- material price and usage variances;
- labour rate and efficiency variances;
- fixed overhead expenditure, volume, capacity and efficiency variances;
- sales volume and sales price variances;
- subdivision of variances.

The build up of costs:

- absorption costing,
- marginal costing,
- activity-based costing.

Understanding the performance criteria

In element 33.2 candidates will have to identify, monitor and analyse relevant costs. They will need to know the major sources of cost data, how that data is collected, and the strengths and limitations of the data collection methods. They will also have to identify if the data is relevant or meaningful to the issues raised in a particular task. Often candidates will also have to identify if the data is relevant or meaningful to the issues raised in a particular task. Often they will have to compare actual results against what should have happened and make recommendations in a user-friendly way to non-specialists, perhaps by using diagrams or tables, or by writing a report.

The knowledge and understanding for Unit 33 identifies two accounting techniques of particular importance to element 33.2. These are:

- standard costing; and
- methods of presenting information.

Standard costing

Standard costing is an important control mechanism and is a significant part of element 33.2. The range statement of element 33.2 identifies the following standard costing variances: material price and usage variances; labour rate and efficiency variances; fixed overhead expenditure, volume, capacity and efficiency variances. It also identifies the subdivision of variances.

Standard costing: what candidates need to know

Candidates must be able to calculate all of the variances in the range statement. In addition, they must also be able to:

- prepare a statement using the variances to reconcile the standard cost of actual production or operations to the actual cost of actual production or operations;
- subdivide a variance – perhaps using index numbers – to develop a greater insight into the reasons for a variance;
- interpret the variances – using the task scenario – and make recommendations.

There are two main formats for a standard costing task. The first gives candidates the standard

costs per batch or unit together with the actual results. The second gives budgeted and actual data. Both can be used to assess competence and candidates must be familiar with both approaches.

Before being asked to calculate the standard costing variances, candidates may be asked to calculate additional accounting information, which may be of help when calculating the subsequent variances.

Methods of presenting data

Well-presented data is important for two reasons. First, it helps communicate findings to managers. Second, it helps demonstrate competence to the assessor. The range statement emphasises written analysis and explanation, tables, and diagrams as methods of presenting data.

Methods of presenting data: what the student needs to know

Sometimes a task will state the way to present data. In standard costing, for example, candidates may be required to prepare a statement reconciling the standard and actual costs of production. They may also be asked to prepare a memo, letter or report, to address issues arising from a task, in the appropriate style.

A task might concern several issues. In a memo, letter or report, candidates should make clear which issue is being addressed. They can do this in a variety of ways: by identifying the task number in the margin and/or providing a subheading to each task.

Sometimes it is quicker and clearer to use a table or a diagram to show the answer rather than write a paragraph. The Standards do not explain the meaning of the word *diagram* but it clearly includes the use of a chart, illustration or graph. The Standards leave the choice to the candidate, who might want to use a pie diagram or a bar chart to communicate data. Because the Standards leave a choice, candidates will not be asked to explain what any particular diagram is nor asked to only use one type of diagram.

Even if a task is purely numerical, good presentation is equally important. Candidates might, for example, be asked to calculate several pieces of information such as the standard costing variances discussed earlier. A tabular approach often makes answers stand out. But what else should be included apart from the individual answers? If preparing that information in the workplace, candidates would most likely include workings, as a reminder. It is highly unlikely that any formal definition would be included.

A similar approach is required in the examination. Formal definitions will not gain any credit as they simply demonstrate recall, rather than showing that candidates can correctly identify valid data or apply techniques and ideas. Simply writing the final answer is a high-risk strategy. One silly error and the candidate might appear to have a totally different answer to the correct one. Without workings, no credit can be given. With workings, however, the assessor can see the candidate's logic and give credit for the correct process.

To gain credit for the correct process, candidates need to clearly link answers to workings and to make workings totally clear. By far the easiest way to do this is to include workings in the table of answers. Consider, for example, a standard costing task and assume that the standard cost of material per kg. was £4.00, the actual cost per kg. was £4.10 and the actual amount used was 30,000 lkg. The material price variance can be shown clearly and efficiently in a single line as: Material price variance: $(£4.00-£4.10) \times 30,000 = £3,000$ (A).

Element 33.3 Monitor performance and make recommendations to enhance value

Performance criteria

To be assessed as competent in this element candidates should be able to successfully:

- A. analyse routine cost reports and budgets, compare them with other sources of information and identify any implications;
- B. prepare and monitor relevant performance indicators, interpret the results and identify potential improvements and estimate the value of potential improvements;
- C. consult relevant specialists and assist in identifying ways to reduce costs and enhance value;
- D. prepare exception reports to identify matters which require further investigation;
- E. make specific recommendations to management in a clear and appropriate form.

Range statement

Budgets:

- budgets for income and expenditure
- resource budget
- fixed and flexible budgets
- responsibility centres (expense, profit and investment centres)

Performance indicators to measure:

- financial, customer, internal business, and learning and growth perspectives;
- efficiency, effectiveness and productivity;
- unit costs; resource utilisation;
- profitability;
- quality of service;
- cost of quality.

Recommendations

- efficiencies;
- modifications to work processes;
- benchmarking.

Understanding the performance criteria

In element 33.3 candidates will have to prepare and monitor performance indicators as well as analyse and interpret those indicators and produce routine cost reports. They will also have to identify possible improvements together with the value of those improvements, and make recommendations to managers in a clear and appropriate form.

Performance indicators

Organisations exist for a reason. They have a purpose or objective. Sometimes the reasons are easy to identify. Two important reasons why a police service exists are to prevent and to detect

crimes. But this raises many questions. Is the service achieving what it is supposed to do, and how effectively, economically and efficiently is it achieving these objectives?

To answer these and other questions requires information being prepared to measure the performance of the organisation. Once these performance indicators have been developed and calculated, they then have to be interpreted. And after being interpreted, proposals may have to be made, perhaps by comparing the performance indicators with those of similar organisations or perhaps by forecasting what the indicators might be if changes are agreed.

When interpreting the current performance or proposing changes, however, candidates will need to consider the effect on managers and other employees. There is always a danger that the performance indicators might not be a perfect measure of the wider objective. As a result, managers might focus on achieving the performance indicator without considering the wider implications for the organisation.

Performance indicators: what candidates need to know

Candidates will be asked to calculate a range of performance indicators. Some, such as the return on capital employed or the current ratio, would be applicable to many organisations, whilst others might be unique to a particular type of organisation. For example, if the task related to a police service, candidates might be given data and asked to calculate the average time taken to arrive at a crime scene.

Candidates may also be asked to *develop* performance indicators of their own. This requires them to know what purpose performance indicators serve. Performance indicators might be attempting to measure efficiency, effectiveness or productivity and so candidates need to know what is meant by these terms. Candidates also need to know about techniques that have been developed to help in measuring performance. Two examples are benchmarking and the Balanced Scorecard.

If candidates understand what is meant by efficiency, effectiveness and productivity, and are familiar with benchmarking and the Balanced Scorecard, they will be able to develop new performance indicators and also calculate any unfamiliar indicators required.

By way of example, candidates could be asked to calculate the average wait between a customer placing an order and receiving the goods. This indicator appears to be measuring how effectively the company meets customer needs. If the candidates were told that a company started selling a product one year ago, and that during the year it received orders for 30,000 units but only produced and sold 24,000, they should be able to derive the average wait to receive the product. The company is producing, on average, 2,000 units per month. There is a waiting list for 6,000 units and so the average delay in supplying product to customers is three months.

Having calculated the performance indicators, candidates might then be asked to address other tasks. These could include:

- developing new indicators to measure particular aspects of the organisation;
- criticising the existing indicators;
- discussing the role of managers in developing indicators;
- discussing the use of performance indicators as measures of management performance;
- forecasting future performance indicators if benchmarked levels of performance are achieved.

If candidates are asked to develop a new performance indicator, the task will have to tell them the aspect to be measured and provide them with a range of data to choose from. For example, if the task related to a college, candidates might be asked to develop a possible measure of lecturer productivity and a possible measure of student satisfaction using the task data provided.

Whenever candidates are asked to criticise an existing performance indicator, they should ask themselves two fundamental questions:

- Firstly, does the performance indicator measure what it is supposed to be measuring? For example profitability indicators may not necessarily measure the efficiency of the production workforce. Revenue is part of profit and production, employees do not directly affect revenue.
- Secondly, how is the performance indicator actually being measured? To be told that 97% of aircraft arrive on time sounds impressive, but candidates need to look behind this and ask pertinent questions. What is meant by on time? It might be defined as arriving at the *final* destination within 15 minutes of the due time. This says nothing about the punctuality of flights to intermediate destinations or whether being late by 20 minutes should be called punctual. Are all flights measured or merely a sample? If a sample, could it be biased? What *if* sampling is used and the airline fails to stop at some intermediate airports in order to arrive on time at the final destination. Is punctuality still a valid measure of satisfying customer needs?

Candidates also need to know about the role of, and effect on, managers in setting performance measures and being measured.

Having prepared performance indicators, candidates are then faced with taking action. They might be given benchmark data and be asked to show what the results would have been had those benchmarks been achieved. Alternatively, they may be asked to forecast the performance indicators for the next period based on a set of assumptions.

This involves scenario planning or ‘what if’ analysis. With scenario planning, candidates have to understand how elements in the profit and loss account and balance sheet are linked. For example, (assuming no changes in unit variable costs or existing assets) a 10% increase in sales will lead to a 10% increase in variable costs but no increase in fixed costs. The net assets of the business will then increase by the projected profit providing no dividends are paid or funds raised. The effect on individual assets can also be modelled – perhaps by taking account of revised performance indicators. If, for example, the revised turnover is £300,000 and the target average age of debtors is 2 months, then the forecast debtors will be £50,000. Having completed this and other adjustments, candidates then have the revised data to develop other forecast performance indicators such as the return on capital employed.

Cost management

Costs are not merely recorded and analysed: they also have to be managed. The accounting principles and theory aspect of the knowledge and understanding underpinning Unit 33 identifies the following aspects of cost management:

- life cycle costing;
- target costing (including value engineering);
- activity-based costing;
- principles of Total Quality Management (including the cost of quality).

Cost management: what candidates need to know

Traditional costing systems tend to record costs only once they have been incurred. In the modern world, however, many costs are *committed* long before they are incurred. Agreeing the design of a new aircraft, for example, commits the manufacturer to around 80% of the aircraft's total lifetime product costs. In addition by matching expenses against revenues in the traditional way, product profitability might be distorted. This is the issue facing life-cycle costing. Cost management is, therefore, most effective during the planning and design stages of a product. This awareness of life-cycle costs and the timing differences between costs being committed and incurred lies behind the technique of target costing. Both life cycle-costing and target costing are most effective during a product's planning and design stage.

Although Activity Based Costing and Total Quality Management are also relevant at the planning and design stage, both ideas can be applied subsequently. In an activity based costing task, candidates might be given an organisation's fixed costs together with an analysed breakdown of those costs and possible cost drivers. The candidate would then be asked to allocate the analysed fixed costs using suitable drivers. In the case of a Total Quality Management task, the candidate may have to identify the *cost of quality*. This might then feed in to a subsequent task, perhaps using scenario planning.

The Assessment

The structure of the assessment

Unit 33 will be assessed using an unseen examination that is set and marked by the AAT. The Examination is likely to be divided into three sections, and will last for three hours (plus 15 minutes' reading time). The examination will test a broad range of the performance criteria from the Standards.

Normally, there will be a number of tasks in each section and candidates will have to reach a minimum standard in all three sections to be assessed as competent in the whole unit.

The examination will normally be centred around a mini case study. Candidates will be given a series of realistic workplace type problems and asked to solve them. Sometimes the techniques to apply will be obvious – as when candidates are asked to calculate standard costing variances, but other times, candidates may have to identify the technique or knowledge and understanding for themselves.

The three sections will not necessarily be the same as the three elements because some performance criteria can either be logically assessed in any section, or assessed together because they are closely connected.

Generally, the first section will be concerned with the preparation of forecasts and budgets, the second with the collection, analysis and dissemination of information about costs, and the third with the wider aspects of the management of performance and enhancement of value. An indicative guide to how the knowledge and understanding of Unit 33 relates to the three sections is shown below. Candidates must, however, remember that this is indicative only, and is neither exhaustive nor exclusive.

Section 1

- The relationship between budgets, forecasts and planning and product-life cycles.
- Preparation of production, resource and revenue budgets from forecast sales data.
- Co-ordination of the budget system.

- The effect of capacity constraints, other production constraints and sales constraints on budgets; limiting (key or budget) factor.
- Different types of budgets: budgets for income and expenditure; resource budgets (production, material, labour and other resource budgets); capital budgets
- Budgets for control: flexible budgets.
- Budgets for responsibility centres: expense centres; profit centres; investment centres.

Section 2

- Standard costing.
- Variance analysis: material price and usage variances, labour rate and efficiency variances, fixed overhead expenditure, volume, capacity and efficiency variances, sales volume and price variances, subdivision of variances.
- Analysing the significance of budget variances and possible responses required by managers.

Section 3

- Analysis of budgets for income and expenditure, resource budgets, fixed and flexible budgets, responsibility centres.
- The Balanced Scorecard: financial, customer, internal business and learning and growth perspectives.
- Performance indicators: efficiency, effectiveness, productivity, bench marking; unit costs and resource utilization, profitability.
- The principles of Total Quality Management (including measures of quality of service and of the cost of quality).

Any section

- External sources of information on costs and prices: government statistics, trade associations, financial press, quotations, price lists.
- General economic environment.
- Basic statistical methods: index numbers; sampling techniques; time series analysis (moving averages, linear regression and seasonal trends).
- Use of relevant computer packages.
- Methods of presenting information in graphical, diagrammatic and tabular form.
- Marginal and absorption costing: cost recording, cost reporting, cost behaviour.
- Cost management: life cycle costing; target costing (including value engineering); activity based costing;
- The use and limitation of published statistics.
- Effect of budgetary systems and accounting controls on behaviour of managers and other employees.
- How the accounting systems of an organisation are affected by its organisational structure, its administrative systems and procedures and the nature of its business transactions.
- The organisation's external environment and specific external costs.
- The contribution of functional specialists in an organisation (e.g. marketing, design, engineering, quality control, etc.) to cost reduction and value enhancement.

What candidates need to know

Some of the knowledge and understanding that can appear in any section relates to the

organisation's wider background while other parts are specific and detailed.

Specific and detailed knowledge and understanding

The use of basic statistical methods and relevant computer packages are specific techniques that apply to all three sections.

Statistical methods

Statistical methods might be used in section 2 if candidates are asked to subdivide and further analyse a standard costing variance. The candidate might, for example, be given indices of price movements and asked to show how much of the material price variance was due to generally rising prices and how much was due to other reasons. Likewise, in section 3 the candidate might be asked to estimate what an organisation's performance should have been had it achieved the industrial growth as measured by an index.

At other times, the candidate may be asked to consider the validity of a particular statistical technique. This involves being aware of the purpose and limitations of the technique as well as the task scenario. Recalling examples of benefits and limitations from a memorised list will rarely gain candidates credit. The candidate's answer has to address the specific problem – and that problem revolves around the task scenario. Candidates might, for example, be told that a product had only been in existence for one year and no one else makes the product. They might then be asked for advice on forecasting methods available to the company. With only one year's data, no form of time series could be used for forecasting, and if there were no competitors, obtaining information from competitors would also not be available.

Computer packages

Computer packages are also relevant to both sections. Any task relating to computer packages will be restricted to generic packages such as a spreadsheet.

The general background to the organisation

Some of the general background knowledge and understanding relates to the organisation's external environment and some to its internal environment.

The external environment

Knowledge and understanding relating to the external environment includes:

- the general economic environment;
- external sources of information;
- the use and limitations of published statistics; and
- the organisation's external environment and specific external costs.

It is important that candidates take account of the external environment provided in the task data and structure their answers to take account of that environment. Remembering lists from textbooks will rarely be acceptable as lists rarely relate to the task's environment.

Candidates might, for example, have to calculate the standard costing variances for an airline. The task data might tell candidates that the pilot and cabin crew hours flown and the usage of fuel were greater than planned because adverse weather conditions caused each flight to take longer than planned. As a result overtime payments were incurred and extra fuel was used.

A subsequent task might ask candidates to identify possible reasons for these adverse variances and/or ways of reducing them. To demonstrate competency, candidates need to consider the

environment. Suggesting the use of part-time staff to avoid the overtime payments or the possibility of pilferage of fuel to explain an adverse material usage variance would gain no credit. Candidates need to think about the task scenario. Both the extra hours worked and the extra fuel used were related to the extra flight time due to the adverse weather conditions.

The internal environment

Knowledge and understanding relating to the internal environment includes:

- the effect of accounting controls on behaviour of managers and other employees;
- marginal and absorption costing: cost recording, cost reporting, cost behaviour;
- how the accounting systems of an organisation are affected by its organisational structure, its administrative systems and procedures and the nature of its business transactions; and
- the contribution of functional specialists in an organisation (e.g. marketing, design, engineering, quality control, etc.) to cost reduction and value enhancement.

Candidates have to know that there are two major ways of measuring and reporting expenses: absorption and marginal (or variable) costing. These are related to cost behaviour. Fixed costs are costs that do not change with changes in volume, whilst marginal (or variable) costs do change as volume changes.

For reporting purposes, organisations often use absorption costing, and for financial reporting purposes, it can often be mandatory (as, for example, in the UK). Absorption costing, however, may not always be ideal for managing the activities of the organisation. Because of this, candidates need to know the linkages between absorption cost *reporting* and cost *behaviour*.

In section 2, candidates could be asked to analyse fixed overhead variances using either marginal or absorption costing. Candidates might also be asked to interpret the meaning of the variances. In section 3, candidates could be asked to forecast the performance of an organisation. To forecast profit, candidates need to know which costs remain the same and which costs change as activity changes.

The absorption/marginal costing issue is part of the wider issue of the organisation's accounting systems. In addition, candidates need to know that the organisation's structure can influence the way it collects costs.

All of these issues have implications for how managers behave when either setting or being judged by accounting controls. Rarely is there an unambiguous answer when candidates are asked how managers might react. Instead, what candidates need to know are the circumstances that might tend to cause a manager to act in one way rather than another. For example, candidates cannot unambiguously say that allowing managers to participate is the best way to develop performance indicators. It is *contingent*. It depends on many issues: the commitment of managers to the organisation; their technical understanding of matters and many other factors. Because of this, tasks are more likely to ask for a description of the circumstances that might make participation a better policy or tasks might describe a scenario and ask if participation would be advisable in those circumstances.

How to succeed in Unit 33

1. Developing budgets for future activity together with forecasting methods and flexible budgets are a major part of section 1. Because of that, candidates need a thorough understanding of these

areas. Without that thorough understanding, candidates are unlikely to be assessed as competent. Candidates, therefore, need to understand the linkages involved in planning budgets such as the relationship between production and sales. They should be familiar with the calculation of the cost of sales from their knowledge of earlier Units. If candidates know that:

$\text{Unit opening stock} + \text{Unit production} - \text{Unit closing stock} = \text{Units sold}$

then they should be able to rearrange that equation to derive the production required given the sales volume and the stock levels. As well as being able to correctly derive the production required, the material required often involves a similar approach:

- If the budget involves more than a single period, then closing stock of one period forms the opening stock of the next;
- If wastage is at the production stage, it can affect material and labour required as both are used in making the faulty production. If wastage only affects materials prior to being issued to production, then there is no effect on labour required or production levels;
- Candidates need to understand how to handle wastage when expressed as an index. If 3% of production is lost due to wastage, you need to produce 100%/97% of good production.

Candidates must understand the difference between the behaviour of fixed and variable costs as activity changes – particularly when handling a flexible budgeting task.; and the linkage between absorption costing profit and marginal costing profit.

2. Standard costing is a major part of section 2 and performance indicators are a major part of section 3. It is, therefore, essential that students have a thorough understanding of both areas. Without that thorough understanding, candidates are unlikely to be assessed as competent. Candidates, therefore, need to understand:

- the logic of all standard costing variances. Memorising formulae will rarely work as the data may be presented in a different way to the formulae;
- all concepts underpinning performance indicators as well as the relationships between accounting elements that underpin those indicators.

3. Candidates also need a good understanding of the other areas that can appear in any section (particularly statistical techniques, including sampling, and the effect of budgetary controls on managerial behaviour). Most often, these are assessed in terms either of an earlier task relating to standard costing or performance indicators, or they draw on the same scenario.

4. Where a task asks for advice, candidates should fully understand the task scenario and develop answers in the context of that scenario. Use the task data for clues and avoid memorised answers unrelated to the task data (such as the {ever popular} morale of the workforce). If the task relates to an aircraft route and there is an adverse labour efficiency variance think why that could be. Suggesting that pilots are working less hard is unlikely to gain credit as their hours are dictated by the speed of the aircraft and the route-miles flown.

5. Candidates must clearly identify what the task is asking, rather than simply identify the general area and write all that is known about it, which only wastes time. Instead, identify the essential aspects.

Sometimes these can be summarised in a single word or phrase. If, for example, candidates were asked to consider the validity of linear regression in forecasting, they should think about what the technique is all about. There are only two variables, one of which is time, and a linear

relationship is assumed between the two variables. So there are three limitations: the assumption of linearity; the assumption that whatever it is candidates are measuring is based on time; and the assumption that there are only two variables. Once candidates have identified these, they should write the answer in the format required.

6. Where a task asks for a memo, prepare an answer in the form of a memo. Where a task asks for a report, prepare an answer in the form of a report. If the task is made up of several parts, clearly identify each and every part.

7. Candidates are likely to meet both marginal and absorption costing in the workplace. Candidates, therefore, need to know the difference between these two approaches and how that difference affects accounting numbers. In measuring profit, the difference between marginal and absorption costing profit is simply the part of fixed overheads carried forward in closing stocks (on the balance sheet) rather than written off as a period cost (to the profit & loss account).

In standard marginal costing, there is only one fixed overhead variance – the expenditure variance – whereas in standard absorption costing there is also a volume variance that, in turn, can be divided into the capacity and efficiency variances.

8. Where candidates make a numerical mistake, they should understand that although credit may be lost for that specific error, further credit is not lost from using the wrong figure in subsequent parts of the task.

9. Finally, remember that in general terms the Chief Assessor is looking to see if candidates:

- have a good and wide knowledge and understanding of the techniques applicable to Unit 33;
- can apply those techniques to the task scenarios;
- can offer valid advice in the context of the task scenarios;
- can successfully carry out the performance criteria associated with the Unit.