

ASSOCIATION OF ACCOUNTING TECHNICIANS

GUIDANCE NOTES

AAT Accounting Qualification – Diploma Pathway

UNIT 6, Costing

Guidance by element

Element 6.1 Record and analyse information relating to direct costs

The purpose of element 6.1 is for students to demonstrate a competence in and understanding of costing techniques for direct materials and direct labour. This will include:

- An implicit understanding of the classification of direct costs and their behaviour.
- The construction of a system for the coding of costs.
- Relationship between the costing systems for direct costs and the accounting system.
- An understanding of job, batch, unit and process costing systems.

Materials

- The classification of materials into raw materials, work in progress and finished stock.
- The valuation of issues and stock using First In First Out, Last In First Out and Weighted Average Cost.
- The recording of costs of materials in the accounting records.

Labour

- Methods for and calculation of payments for labour.
- The recording of labour costs in the accounting records.

Element 6.2 Record and analyse information relating to the allocation, apportionment and absorption of overhead costs

The purpose of element 6.2 is for students to demonstrate competence in and understanding of costing techniques for indirect materials, indirect labour and indirect expenses. This will include:

- An implicit understanding of the classification of costs and their behaviour.
- Bases of allocating and apportioning overhead costs to responsibility centres, including direct and step down methods.
- Bases of overhead absorption including labour hour and machine hour methods.
- The arbitrary nature of overhead apportionment.
- The recording of overhead costs in the accounting system.
- An understanding of marginal and absorption costing.
- An understanding of job, batch, unit and process costing systems.
- An understanding of the adjustments required for under and over recovered overhead costs.

Element 6.3 Prepare and evaluate estimates of costs and revenues

Guidance

The aim of this element is for students to demonstrate competence in using cost and revenue information to help organisations make decisions. Students need to know about cost behaviour and apply it appropriately to managerial decisions for both short and long term planning purposes. Element 6.3 includes:

- Methods of presenting information through verbal and written reports.
- Analysis of the effect of changing activity levels on product costs.
- Analysis of the critical factors affecting costs and revenues.
- Cost-volume-profit analysis.
- The identification of limiting factors and their uses for planning purposes.
- Methods of project appraisal including payback and discounted cash flow methods.
- An understanding of marginal and absorption costing.

Assessment Strategy

This unit is assessed by examination only.

Examination

The examination will consist of two sections and will be a case study based on a single organisation. This costing system will be appropriate to the needs of that organisation.

Section 1 will assess competence in elements 6.1 and 6.2. Examples of tasks which may be assessed in this section include:

- Methods of stock control and pricing of materials to include First In First Out, Last In First Out and Weighted Average Cost.
- Preparation of cost accounting entries for material, labour and overhead costs of the organisation.
- Calculation of direct labour costs.
- The allocation and apportionment of indirect costs to responsibility centres including direct and step down methods.
- Calculation of departmental absorption rates using different absorption bases.
- Calculation of product cost using absorption and marginal costing.

Section 2 will assess competence in element 6.3. Examples of tasks which may be assessed in this section include:

- The separation of variable and fixed costs and the effect of changing capacity levels.
- Preparation of estimates of future income and costs.
- Short term planning tasks involving cost-volume-profit analysis for a single product.
- Product mix decisions using limiting factor analysis.
- Long term planning tasks using net present value and payback techniques. Tasks will not be set which require the computation of a project's internal rate of return (IRR) but students should be aware of its meaning.
- Preparation of a report.

The tasks detailed above are indicative of those which may be assessed but are not exhaustive. It is important to understand that the examination is based on the Standards of Competence and that all

areas in the Standard are assessable. Students should note that process costing is now included within the revised Unit 6 standard. Process costing will be examined to the following extent:

- The organisation will have no more than two processes.
- The student should be able to prepare process, normal loss, abnormal loss and abnormal gain accounts when there is no ending work in progress. This will include accounting for scrap sales.
- The calculation of unit costs where there is closing work in progress but neither opening work in progress nor process losses.
- By products and joint products will not be examined.

Students should note that they could be required to prepare a report in section 2. Since competence must be demonstrated in both sections it is important that students practice their report writing. In this context, the following points should be borne in mind:

- Plan the report and check that the plan deals with the tasks set.
- Be aware of the context in which the report is written.
- Make sure all work is legible.
- A well constructed report needs to be expressed in clear and concise English.

The examination will be three hours in duration (with 15 minutes' reading time) and the two sections will normally take the same time to complete. Specific guidance will, however, be given on time allocation in the examination paper.