Contents

About ExPress Notes 3

1. The Nature, Source and Purpose of Management Information 7
2. Cost Accounting Techniques 12
3. Budgeting 21
4. Standard Costing 31
5. Performance Measurement 40
We are very pleased that you have downloaded a copy of our ExPress notes for this paper. We expect that you are keen to get on with the job in hand, so we will keep the introduction brief.

First, we would like to draw your attention to the terms and conditions of usage. It’s a condition of printing these notes that you agree to the terms and conditions of usage. These are available to view at www.theexpgroup.com. Essentially, we want to help people get through their exams. If you are a student for the ACCA exams and you are using these notes for yourself only, you will have no problems complying with our fair use policy.

You will however need to get our written permission in advance if you want to use these notes as part of a training programme that you are delivering.

**WARNING! These notes are not designed to cover everything in the syllabus!**

They are designed to help you assimilate and understand the most important areas for the exam as quickly as possible. If you study from these notes only, you will not have covered everything that is in the ACCA syllabus and study guide for this paper.

**Components of an effective study system**

On ExP classroom courses, we provide people with the following learning materials:

- The ExPress notes for that paper
- The ExP recommended course notes / essential text or the ExPedite classroom course notes where we have published our own course notes for that paper
- The ExP recommended exam kit for that paper.
- In addition, we will recommend a study text / complete text from one of the ACCA official publishers, but we do not necessarily give this as part of a classroom course, as we think that it can sometimes slow people down and reduce the time that they are able to spend practising past questions.

ExP classroom course students will also have access to various online support materials, including:

- The unique ExP & Me e-portal, which amongst other things allows “view again” of the classroom course that was actually attended.
- ExPand, our online learning tool and questions and answers database
Everybody in the World has free access to ACCA’s own database of past exam questions, answers, syllabus, study guide and examiner’s commentaries on past sittings. This can be an invaluable resource. You can find links to the most useful pages of the ACCA database that are relevant to your study on ExPand at www.theexpgroup.com.

How to get the most from these ExPress notes

For people on a classroom course, this is how we recommend that you use the suite of learning materials that we provide. This depends where you are in terms of your exam preparation for each paper.

<table>
<thead>
<tr>
<th>Your stage in study for each paper</th>
<th>These ExPress notes</th>
<th>ExP recommended course notes, or ExPedite notes</th>
<th>ExP recommended exam kit</th>
<th>ACCA online past exams</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior to study, e.g. deciding which optional papers to take</td>
<td>Skim through the ExPress notes to get a feel for what’s in the syllabus, the “size” of the paper and how much it appeals to you.</td>
<td>Don’t use yet</td>
<td>Don’t use yet</td>
<td>Have a quick look at the two most recent real ACCA exam papers to get a feel for examiner’s style.</td>
</tr>
<tr>
<td>At the start of the learning phase</td>
<td>Work through each chapter of the ExPress notes in detail before you then work through your course notes. Don’t try to feel that you have to understand everything – just get an idea for what you are about to study. Don’t make any annotations on the ExPress notes at this stage.</td>
<td>Work through in detail. Review each chapter after class at least once. Make sure that you understand each area reasonably well, but also make sure that you can recall key definitions, concepts, approaches to exam questions, mnemonics, etc.</td>
<td>Nobody passes an exam by what they have studied – we pass exams by being efficient in being able to prove what we know. In other words, you need to have effectively input the knowledge and be effective in the output of what you know. Exam practice is key to this. Try to do at least one past exam question on the learning phase for each major chapter.</td>
<td>Don’t use at this stage.</td>
</tr>
</tbody>
</table>
### Practice phase

<table>
<thead>
<tr>
<th>Your stage in study for each paper</th>
<th>These ExPress notes</th>
<th>ExP recommended course notes, or ExPedite notes</th>
<th>ExP recommended exam kit</th>
<th>ACCA online past exams</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work through the ExPress notes again, this time <strong>annotating</strong> to explain bits that you think are easy and be brave enough to cross out the bits that you are confident you’ll remember without reviewing them.</td>
<td>Avoid reading through your notes again. Try to focus on doing past exam questions first and then go back to your course notes/ExPress notes if there’s something in an answer that you don’t understand.</td>
<td>This is your most important tool at this stage. You should aim to have worked through and understood at least two or three questions on each major area of the syllabus. You pass real exams by passing mock exams. Don’t be tempted to fall into “passive” revision at this stage (e.g. reading notes or listening to CDs). Passive revision tends to be a waste of time.</td>
<td>Download the two most recent real exam questions and answers. Read through the technical articles written by the examiner. Read through the two most recent examiner’s reports in detail. Read through some other older ones. Try to see if there are any recurring criticisms he or she makes. You must avoid these!</td>
<td></td>
</tr>
</tbody>
</table>

### The night before the real exam

<table>
<thead>
<tr>
<th>Read through the ExPress notes in full. Highlight the bits that you think are important but you think you are most likely to forget.</th>
<th>Unless there are specific bits that you feel you must revise, avoid looking at your course notes. Give up on any areas that you still don’t understand. It’s too late now.</th>
<th>Don’t touch it!</th>
<th>Do a final review of the two most recent examiner’s reports for the paper you will be taking tomorrow.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Read quickly through the full set of ExPress notes, focusing on areas you’ve highlighted, key workings, approaches to exam questions, etc.</td>
<td>Avoid looking at them in detail, especially if the notes are very big. It will scare you.</td>
<td>Leave at home.</td>
<td>Leave at home.</td>
</tr>
</tbody>
</table>
Our ExPress notes fit into our portfolio of materials as follows:

- **express Notes**: Provide a base understanding of the most important areas of the syllabus only.
- **expedite Notes**: Provide a comprehensive coverage of the syllabus and accompany our face to face professional exam courses.
- **expert Notes**: Provide detailed coverage of particular technical areas and are used on our Professional Development and Executive Programmes.

To maximise your chances of success in the exam we recommend you visit www.theexpgroup.com where you will be able to access additional free resources to help you in your studies.

**START About The ExP Group**

Born with a desire to be the leading supplier of business training services, the ExP Group delivers courses through either one of its permanent centres or onsite at a variety of locations around the world. Our clients range from multinational household corporate names, through local companies to individuals furthering themselves through studying for one of the various professional exams or professional development courses.

As well as courses for ACCA and other professional qualifications, our portfolio of expertise covers all areas of financial training ranging from introductory financial awareness courses for non-financial staff to high level corporate finance and banking courses for senior executives.

Our expert team has worked with many different audiences around the world ranging from graduate recruits through to senior board level positions.

Full details about us can be found at www.theexpgroup.com and for any specific enquiries please contact us at info@theexpgroup.com.
Chapter 1
The Nature, Source and Purpose of Management Information

The Characteristics of Good Information

The qualities of good information can be summarized in the word "ACCURATE":

- Accurate,
- Complete,
- Cost-beneficial,
- User-targeted,
- Relevant,
- Authoritative,
- Timely and
- Easy to use.
KEY KNOWLEDGE
Management Accounting

The process of identification, measurement, accumulation, analysis, preparation, interpretation and reporting of information used by management to set targets, plan resource allocation, evaluate investment choices and monitor/control the operating performance and the orderly conduct of the business.

Differences in purpose and scope, compared to Financial Accounting

- Aimed at internal users (as opposed to financial accounting, which is aimed at external stakeholders)
- Focused on present and future performance (as opposed to financial accounting, which reports past performance)
- Not required by law and not regulated by accounting frameworks (as opposed to financial accounting, which is a legal requirement and is regulated by accounting frameworks)
- Focused on specific areas or activities (as opposed to financial accounting, which provides a holistic view of company’s performance)
- Employs non-financial indicators as well financial, while financial accounting uses only financial measures.

Managerial Processes

The key processes which face management can be divided into:

- Planning: Defining objectives and appropriate strategies for attaining them;
- Decision-making: Making choices, not only with regard to the selection of strategies, but also along the way as implementation proceeds;
- Control: Monitoring of performance during the course of business and taking remedial action steps as necessary
Planning

Planning occurs at different levels of the organisation:

- **Strategic**: covers the “big view” of the organisation. It answers the question “What business or businesses should we be in and what are our objectives?”

- **Tactical**: this embraces the short-term (budgetary periods);

- **Functional (or operational) strategy**: this refers to day-to-day target-setting.

Responsibility centers

Related to the above is the notion of responsibility that attaches to each level of an organisation:

- **Cost Centres**: Responsible for current expenses only

- **Revenue Centres**: Responsible for revenues, but not current expenses other than marketing expenses

- **Profit Centres**: Responsible for revenues and current expenses

- **Investment Centres**: Responsible for revenues, current expenses and capital expenditure
KEY KNOWLEDGE
Sources of data

The sources of data are almost infinite, and they must be selected and evaluated carefully based on reliability and relevance.

KEY KNOWLEDGE
Classifications of cost

In financial accounting, it is a convention to break down costs into:

KEY KNOWLEDGE
Production vs. Non-Production costs

Production costs: These are costs (both direct and indirect, also variable and fixed) which relate to the production of goods; this is also referred to as manufacturing or factory cost. It is these costs, accumulated, which provide the value at which goods are placed in inventory (prior to sale) and form the “cost of goods” value when sold.

Non-production costs: These are expenses that are incurred independent of production and include administrative, selling, distribution and finance costs. These costs can have the character of “period” costs, as they relate to the period of time in which they occur.

KEY KNOWLEDGE
Direct vs. Indirect costs

Direct costs: are costs that can be directly attributable to a product.

Indirect costs: these are costs that cannot be directly attributable to a product.
Fixed costs: are costs that remain constant regardless of the volume of production. A variety of indirect costs are fixed.

Variable costs: vary in proportion with the volume produced. Direct costs are by their nature variable in behaviour.

"Although a variable cost increases with the level of activity, the variable cost per unit remains fixed, while a fixed cost per unit falls with a rise in the level of activity."

Other types of costs:

Mixed costs: these are costs that contain a fixed and a variable element.

Step costs: costs that remain fixed within a defined range of production, but at a certain level of output increase in a significant way to a new (fixed) level.
Chapter 2

Cost Accounting Techniques

Materials

The ordering, receiving and issuing of materials from inventory must be controlled according to procedures and documented at all stages with forms appropriate to the purpose.

The controls and procedures are designed to monitor inventory movements so as to minimise discrepancies and losses and theft.

Economic Order Quantity

This is a method which seeks to minimize the costs associated with holding inventory.

To determine the total costs, the following data is required:

\[
\begin{align*}
Q & = \text{order quantity} \\
D & = \text{quantity of product demanded annually} \\
P & = \text{purchase cost for one unit} \\
C & = \text{fixed cost per order (not incl. the purchase price)} \\
H & = \text{cost of holding one unit for one year}
\end{align*}
\]
The total cost function is as follows:

Total cost = Purchase cost + Ordering cost + Holding cost

which can be expressed algebraically as follows:

\[ TC = P \times D + \frac{C}{Q} \times D + \frac{H}{2} \times Q \]

It is this total cost function which must be minimized.

Recognizing that:

- PD does not vary;
- Ordering costs rise the more frequently one places (during the year); and
- Holding costs rise the fewer times one places orders (due to larger quantities being ordered each time),

It follows that there is a trade-off between the Ordering and the Holding costs.

The optimal order quantity \(Q^*)\) is found where the Ordering and Holding costs equal each other, i.e.

\[ C \times \frac{D}{Q} = H \times \frac{Q}{2} \]

Rearranging the above and solving for \(Q\) results in

\[ Q^* = \sqrt{\frac{2CD}{H}} \]

Labour

Direct labour refers to work which is directly involved in the manufacture of a product.

Indirect labour (e.g. the supervisor’s salary or that of a security guard) forms part of overhead costs.
Absorption Costing

This is one method which seeks to make the link between overheads and (product) cost units. The diagram below provides a useful roadmap.

The focus (above) is production. Overhead costs that are not incurred at the time of production do not find their way into inventory.

It is useful to think of production costs as being those that end up as part of the inventory (valuation) while other (non-production) costs are incurred outside, and normally after the product leaves inventory.

Contribution

Contribution is defined as the difference between Sales revenue and the marginal cost of sales, or

\[ \text{Contribution} = \text{Sales} - \text{Variable costs (both production and non-production)} \]
Marginal costing

A marginal approach to costing focuses on the variable (marginal) costs generated in a business and considers fixed costs as period costs. This allows the company to be able to quantify the amount by which its costs rise, if it produces/sells an additional unit of output.

Example

Below is data on a manufacturing company.

Selling price (per unit): 120

Cost card (per unit):
- Direct materials 45
- Direct labour 18
- Variable production O/Hs 9
- Total variable costs 72

There is a variable selling cost of $2 per unit

<table>
<thead>
<tr>
<th></th>
<th>Year 1 (units)</th>
<th>Year 2 (units)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget (normal) production</td>
<td>1,100</td>
<td>1,100</td>
</tr>
<tr>
<td>Actual Production</td>
<td>1,000</td>
<td>1,100</td>
</tr>
<tr>
<td>Actual Sales</td>
<td>950</td>
<td>1,150</td>
</tr>
<tr>
<td>Actual fixed production O/Hs</td>
<td>$16,500</td>
<td>$16,500</td>
</tr>
<tr>
<td>Actual SGA costs</td>
<td>$7,000</td>
<td>$7,000</td>
</tr>
</tbody>
</table>

Based on the above data, a profit and loss statement for the Years 1 and 2 is shown on the next page.

Assume that the beginning inventory is zero.