

**ACCA**

**Applied Skills**

**Performance Management (PM)**

**Study Text**

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## How to use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

- 1 Detailed study guide and syllabus objectives
- 2 Description of the examination
- 3 Study skills and revision guidance
- 4 Study text
- 5 Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best to approach your learning.

The **Study text** comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes

- The **learning objectives** contained in each chapter, which have been carefully mapped to the examining body's own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.
- The **chapter diagram** provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.
- The **content** for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.
- **Test your understanding** sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.
- **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the examination. These diagrams should be used to check that you have covered and understood the core topics before moving on.
- **Question practice** is provided at the back of each text.

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Our Quality Coordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

### Icon Explanations



**Definition** – Key definitions that you will need to learn from the core content.



**Test your understanding** – Exercises for you to complete to ensure that you have understood the topics just learned.



**Illustration** – Worked examples help you understand the core content better.



**Supplementary reading** – These sections will help to provide a deeper understanding of core areas. The supplementary reading is NOT optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an exam question. **Reference to this text is vital when self-studying.**

### On-line subscribers

Our on-line resources are designed to increase the flexibility of your learning materials and provide you with immediate feedback on how your studies are progressing.

If you are subscribed to our on-line resources you will find:

- 1 On-line reference ware: reproduces your Study Text on-line, giving you anytime, anywhere access.
- 2 On-line testing: provides you with additional on-line objective testing so you can practice what you have learned further.
- 3 On-line performance management: immediate access to your on-line testing results. Review your performance by key topics and chart your achievement through the course relative to your peer group.

Ask your local customer services staff if you are not already a subscriber and wish to join.

# A revision of Management Accounting (MA) topics

## **Chapter learning objectives**

The contents of this chapter are now assumed knowledge from the Management Accounting ('MA') syllabus.

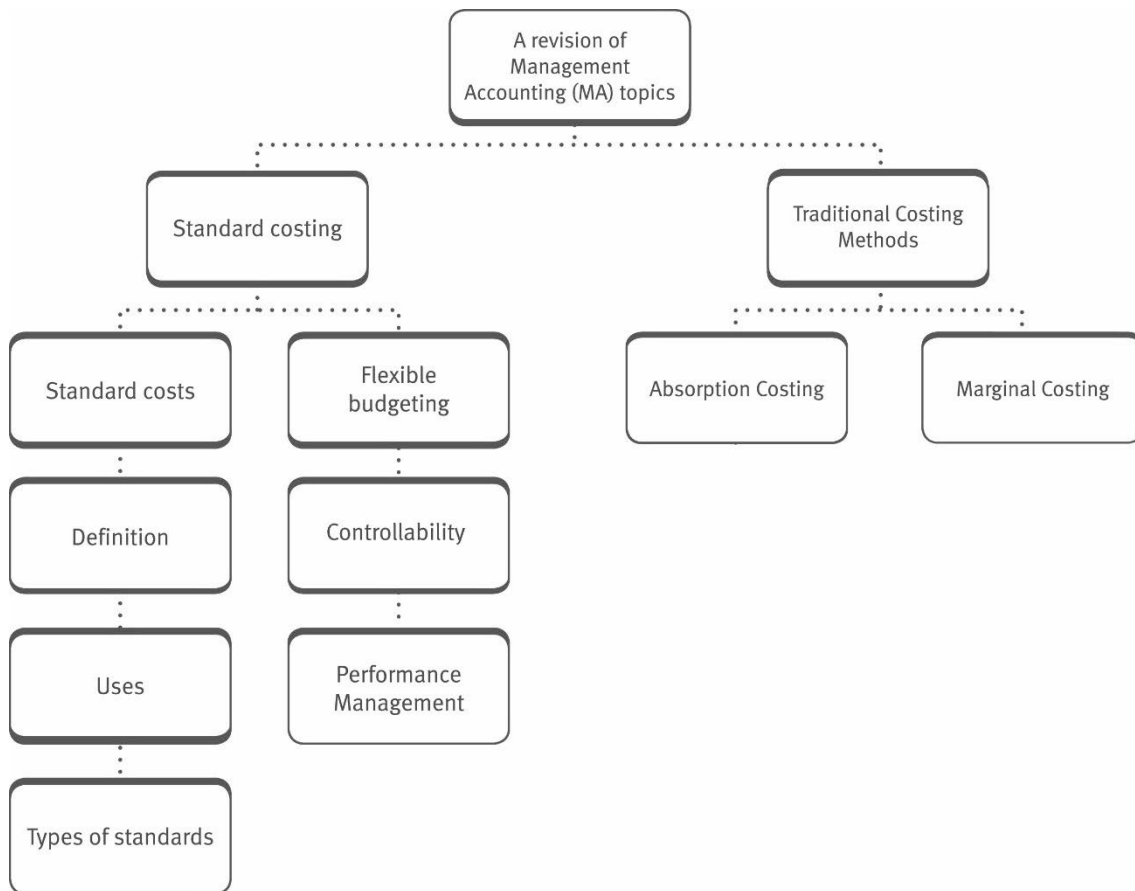
Absorption, marginal and standard costing, and the basics of variance analysis, were encountered in Management Accounting (MA).

In the ACCA Performance Management (PM) exam, you will have to cope with the following:

- new, more advanced variances,
- more complex calculations,
- discussion of the results and implications of your calculations.

Upon completion of this chapter you will be able to:

- Explain the use of standard costs.
- Outline the methods used to derive standard costs and discuss the different types of costs possible.
- Explain and illustrate the importance of flexing budgets in performance management.
- Explain and apply the principle of controllability in the performance management system.



## 1 What is the purpose of costing?

In Management Accounting (MA), we learnt how to determine the cost per unit for a product. We might need to know this cost in order to:

- Value inventory – the cost per unit can be used to value inventory in the statement of financial position (balance sheet).
- Record costs – the costs associated with the product need to be recorded in the statement of profit or loss.
- Price products – the business will use the cost per unit to assist in pricing the product. For example, if the cost per unit is \$0.30, the business may decide to price the product at \$0.50 per unit in order to make the required profit of \$0.20 per unit.
- Make decisions – the business will use the cost information to make important decisions regarding which products should be made and in what quantities.

How can we calculate the cost per unit? There are a number of costing methods available, most of them based on **standard costing**.

## Standard costing

A standard cost for a product or service is a predetermined unit cost set under specified working conditions.

The main purposes of standard costs are:

- **Control:** the standard cost can be compared to the actual costs and any differences investigated.
- **Planning:** standard costing can help with budgeting.
- **Performance measurement:** any differences between the standard and the actual cost can be used as a basis for assessing the performance of cost centre managers.
- **Inventory valuation:** an alternative to methods such as LIFO and FIFO.
- **Accounting simplification:** there is only one cost, the standard.

Standard costing is most suited to organisations with:

- mass production of homogenous products
- repetitive assembly work.

The large scale repetition of production allows the average usage of resources to be determined.

Standard costing is less suited to organisations that produce non-homogenous products or where the level of human intervention is high.



### McDonaldisation

Restaurants traditionally found it difficult to apply standard costing because each dish is slightly different to the last and there is a high level of human intervention.

McDonalds attempted to overcome these problems by:

- Making each type of product produced identical. For example, each Big Mac contains a pre-measured amount of sauce and two gherkins. This is the standard in all restaurants.
- Reducing the amount of human intervention. For example, staff do not pour the drinks themselves but use machines which dispense the same volume of drink each time.



**Test your understanding 1**

**Which of the following organisations may use standard costing?**

- (i) a bank
- (ii) a kitchen designer
- (iii) a food manufacturer
- (a) (i), (ii) and (iii)
- (b) (i) and (ii) only
- (c) (ii) and (iii) only
- (d) (i) and (iii) only

**Preparing standard costs**

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A standard cost is based on the expected price and usage of material, labour and overheads.



**Test your understanding 2**

K Ltd makes two products. Information regarding one of those products is given below:

Budgeted output/sales for the year: 900 units

**Standard details for one unit**

Direct materials	40 square metres at \$5.30 per square metre
Direct wages	Bonding department: 24 hours at \$5.00 per hour
	Finishing department: 15 hours at \$4.80 per hour
Variable overheads	\$1.50 per bonding labour hour
	\$1 per finishing labour hour
Fixed production overhead	\$36,000
Fixed non-production overhead	\$27,000

**Note:** Variable overheads are recovered (absorbed) using hours, fixed overheads are recovered on a unit basis.





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