Contents

The CIMA Learning System
How to use your CIMA Learning System xi
Guide to the Icons used within this text xii
Study technique xii
Computer-Based Assessment xiv
Fundamentals of Management Accounting and Computer-Based Assessment xv
Learning Outcomes and Indicative Syllabus Content xvi

1 Basic Aspects of Cost Accounting 1
   Learning Outcomes 3
   1.1 Introduction 3
   1.2 Why organisations need costing systems 3
   1.3 What is meant by ‘cost’? 4
   1.4 Cost units 4
      1.4.1 Composite cost units 5
   1.5 Cost centres 6
   1.6 Cost objects 6
   1.7 Classification of costs 7
      1.7.1 Classification of costs according to their nature 7
      1.7.2 Classification of costs according to their purpose: direct costs and indirect costs 8
   1.8 Elements of cost 9
   1.9 Cost behaviour 12
      1.9.1 Fixed cost 12
      1.9.2 Variable cost 14
      1.9.3 Semi-variable cost 15
      1.9.4 Analysing semi-variable costs 16
      1.9.5 Using historical data 18
      1.9.6 The importance of time scale in analysing cost behaviour 18
   1.10 Summary 19

Revision Questions 21
Solutions to Revision Questions 27

2 Accounting for the Value of Inventories 31
   Learning Outcomes 33
   2.1 Introduction 33
   2.2 Valuing inventory at cost 33
   2.3 First in, first out (FIFO) 34
   2.4 Last in, first out (LIFO) 35
   2.5 Cumulative weighted average (AVCO) 35
### 4 Cost–Volume–Profit Analysis

#### Learning Outcomes

- **4.1 Introduction**
- **4.2 Breakeven or cost–volume–profit analysis**
  - **4.2.1 The concept of contribution**
  - **4.2.2 Calculating the breakeven point**
- **4.3 The margin of safety**
- **4.4 The contribution to sales (C/S) ratio**
- **4.5 Drawing a basic breakeven chart**
- **4.6 The contribution breakeven chart**
- **4.7 The profit–volume chart**
  - **4.7.1 The advantage of the profit–volume chart**
- **4.8 The limitations of breakeven (or CVP) analysis**
- **4.9 The economist’s breakeven chart**
- **4.10 Using CVP analysis to evaluate proposals**
- **4.11 Limiting factor analysis**
  - **4.11.1 Decisions involving a single limiting factor**
- **4.12 Summary**

#### Revision Questions

#### Solutions to Revision Questions

### 5 Standard Costing and Variance Analysis

#### Learning Outcomes

- **5.1 Introduction**
- **5.2 What is a standard cost?**
- **5.3 Performance levels**
  - **5.3.1 A standard**
  - **5.3.2 Ideal standard**
  - **5.3.3 Attainable standard**
  - **5.3.4 Current standard**
- **5.4 Setting standard costs**
  - **5.4.1 Standard material price**
  - **5.4.2 Standard material usage**
  - **5.4.3 Standard labour rate**
  - **5.4.4 Standard labour times**
  - **5.4.5 Variable production overhead costs**
- **5.5 Updating standards**
- **5.6 Standard costing in the modern business environment**
- **5.7 What is variance analysis?**
- **5.8 Variable cost variances**
  - **5.8.1 Direct material cost variances**
  - **5.8.2 The direct material price variance and inventory valuation**
  - **5.8.3 Direct labour cost variances**
  - **5.8.4 Variable overhead cost variances**
CONTENTS

5.9 Sales variances  129
  5.9.1 Sales price variance  129
  5.9.2 Sales volume contribution variance  130
5.10 Summary  130

Revision Questions  131

Solutions to Revision Questions  137

6 Further Standard Costing  143
  Learning Outcomes  145
  6.1 Introduction  145
  6.2 Reconciling actual contribution with budgeted contribution  145
  6.3 Idle time variances  148
  6.4 Interpreting variances  149
    6.4.1 The reasons for variances  149
    6.4.2 The significance of variances  150
  6.5 Standard hour  152
  6.6 Labour incentive schemes  153
    6.6.1 Bonus schemes  153
    6.6.2 Piecework systems  154
    6.6.3 Guaranteed minimum wage  155
    6.6.4 Differential piece rate  155
    6.6.5 Piecework hours  156
    6.6.6 Group incentive schemes  156
  6.7 Summary  157

Revision Questions  159

Solutions to Revision Questions  163

7 Integrated Accounting Systems  169
  Learning Outcomes  171
  7.1 Introduction  171
  7.2 An integrated accounting system  171
  7.3 Accounting for the cost of labour  172
    7.3.1 Deductions from employees’ wages  172
    7.3.2 Overtime premium  172
    7.3.3 Bonus earnings  173
    7.3.4 Idle time  173
    7.3.5 Example: analysis of labour costs  173
  7.4 Integrated accounts in operation  174
    7.4.1 Example: the main accounting entries in an integrated system  174
    7.4.2 Accounting for under- or over-absorbed overheads  176
    7.4.3 Example: integrated accounts  177
  7.5 Standard cost bookkeeping  184
  7.6 Recording variances in the ledger accounts  184
    7.6.1 General rules for recording variances  184
    7.6.2 The income statement  185
  7.7 Standard cost bookkeeping: an example  185
  7.8 Valuing material inventory at actual cost  192
    7.8.1 Which inventory valuation method is generally preferred?  193
7.9 Summary 193

Revision Questions 195

Solutions to Revision Questions 203

8 Specific Order Costing 207

Learning Outcomes 209

8.1 Introduction 209

8.2 Job costing 209

8.2.1 Job cost sheets and databases 210
8.2.2 Collecting the direct costs of each job 210
8.2.3 Attributing overhead costs to jobs 212
8.2.4 A worked example 213
8.2.5 Preparing ledger accounts for job costing systems 214

8.3 Batch costing 218

8.3.1 Example: batch costing 218

8.4 Contract costing 220

8.4.1 Architect’s certificates and progress payments 220
8.4.2 Retention money 220
8.4.3 Contract accounts 220
8.4.4 Accounting for contract materials 221
8.4.5 Accounting for plant used on the contract 221
8.4.6 Cost classification in contract costing 221
8.4.7 Calculating contract profit and preparing balance sheet entries 222
8.4.8 Contract costing: a worked example 222
8.4.9 Accounting for a loss-making contract 226
8.4.10 Contract costing: a second example 227
8.4.11 Contract costing: a final example 230

8.5 Summary 232

Revision Questions 233

Solutions to Revision Questions 239

9 Process Costing 245

Learning Outcomes 247

9.1 Introduction 247

9.2 Process accounts 247

9.3 Losses in process 249

9.4 Abnormal losses and gains 250

9.5 Closing work in progress: the concept of equivalent units 252

9.6 Previous process costs 256

9.7 Opening work in progress 256

9.8 Process costing: a further example 258

9.9 Contrasting process costing and specific order costing 260

9.10 Summary 260

Revision Questions 263

Solutions to Revision Questions 271
10 Presenting Management Information

Learning Outcomes

10.1 Introduction

10.2 Subjective and objective classification
  10.2.1 Responsibility centres
  10.2.2 Reporting management accounting information

10.3 Coding of costs
  10.3.1 Composite codes
  10.3.2 The advantages of a coding system
  10.3.3 The requirements for an efficient coding system

10.4 Preparing financial statements that inform management
  10.4.1 Value added
  10.4.2 Contribution
  10.4.3 Gross margin

10.5 Managerial reports in a service organisation
  10.5.1 Establishing a suitable cost unit
  10.5.2 Establishing the cost per unit
  10.5.3 The instantaneous and perishable nature of services
  10.5.4 Managerial reporting in a charity: example

10.6 Summary

Revision Questions

Solutions to Revision Questions

11 Financial Planning and Control

Learning Outcomes

11.1 Introduction

11.2 The purposes of budgeting
  11.2.1 Budgetary planning and control
  11.2.2 What is a budget?
  11.2.3 The budget period
  11.2.4 Strategic planning, budgetary planning and operational planning

11.3 The preparation of budgets
  11.3.1 Coordination: the budget committee
  11.3.2 Participative budgeting
  11.3.3 Information: the budget manual
  11.3.4 Early identification of the principal budget factor
  11.3.5 The interrelationship of budgets
  11.3.6 Using computers in budget preparation
  11.3.7 The master budget

11.4 Preparation of functional budgets
  11.4.1 Budget interrelationships

11.5 The cash budget
  11.5.1 Preparing cash budgets
  11.5.2 Interpretation of the cash budget

11.6 A complete exercise

11.7 Rolling budgets
11.8 Budgets for non-operating functions
11.8.1 Incremental budgeting 322
11.8.2 Zero-based budgeting 323
11.9 Budgetary control information
11.9.1 Budget centres 323
11.9.2 Budgetary control reports 324
11.10 Fixed and flexible budgets
11.10.1 Flexible budgets: an example 325
11.10.2 Preparing a flexible budget 325
11.10.3 The total budget variance 327
11.10.4 Using flexible budgets for planning 328
11.10.5 Flexible budgets: another example 328
11.10.6 Extrapolating outside the relevant range 331
11.10.7 Example: producing a flexible budget control statement 331
11.11 Using budgets as a basis for rewards 333
11.11.1 Example 333
11.11.2 Factors to consider in the design of budget reward schemes 333
11.12 Summary 334

Revision Questions 335

Solutions to Revision Questions 343

Preparing for the Assessment 351
Format of the assessment 353
Revision technique 353
How to tackle the assessment 355

Revision Questions 357

Solutions to Revision Questions 389

Mock Assessment 1 423

Mock Assessment 2 451

Index 479