



AAT (Diploma in Accounting) Level 4

Budgeting

Topic

The Budgeting Environment

Sources of data

- When preparing for budget exercise, accounting technicians must identify the internal and external source of information.
- It is important to understand the impact of the external environment on costs, prices, demand, availability of resources and availability and cost of finance.
- Management must monitor a range of external sources of information so that their decisions on managing costs and setting prices fit in with the prevailing environment.

Sources of data

- Sources of information can be split into INTERNAL and EXTERNAL sources.
- In considering the information we can distinguish between that information which is internal to the organization and that which is external.
- This distinction will have implications for the methods and techniques considered for the collection of the information.
- You must be able to suggest an appropriate, reliable source for each piece of information required in budget construction.

Budgeting

- Budgeting is used in management accounting systems.
- There are internal and external sources of information for budgeting needed by managers.
- Some of the examples of external sources are:
 - Trade associations
 - Financial Press
 - Market research.

Internal resources

- You must be able to demonstrate that you know which internal source, or which member of the organization to go for any specific data.
- Financial information can be obtained from accounting records and inventory holding data.

Internal resources

- The sales ledgers hold information about the number and value of invoices, the volume of sales, the volume of sales analysed by the customer, the value of sales analysed by product.
- The purchase ledger holds information about the number and value of invoices; the value of purchases analysed by a supplier.

Internal resources

- The sales and marketing department can provide information about the types of customers and market research results.
- The HR department/ The payroll system holds information about the number of employees, the number of hours worked, the output is achieved, the wages earned, the amount of NIC/PAYE tax deduct

Internal resources

- Management accounting data includes information such as that contained in a SWOT Analysis.
- The non-current assets register holds data about dates of purchase, initial cost, the location of asset, depreciation method, rate, service history and production capacity.
- The operations director/production planning manager holds data about machine breakdown times and a number of rejected units.

Methods of costing

There are different methods of costing

- Absorption costing
- Marginal Costing
- Activity based costing

Absorption costing

- Its a system that determines a full Cost of each unit of output.
- It includes both direct and indirect costs. Direct cost is directly linked to the units of output:
 - Direct material
 - Direct labour and
 - Direct expenses

Steps in absorption costing

- Cost is divided into direct and indirect costs.
- Indirect costs are allocated to one cost centre if the cost relates to one cost centre or allocated to several cost centres if they relate to more than one cost centres.
- If the costs have now accumulated into service centres, the total cost of each service cost centre is shared amongst the production cost centres that benefits from the service provided.

Steps in absorption costing

- Costs that have been gathered in the production cost centers can now be absorbed into the units of output by using an absorption rate based on the expected activity level.

Marginal Costing

- This system categorizes costs according to their cost behavior.
- There are four main ways in which the cost could behave within a range of activity levels;
 - Variable costs
 - Fixed costs
 - Step cost
 - Semi-variable costs

Activity based costing (ABC)

- This method of costing identifies the indirect activities and then groups their cost into cost pools, one for each major activity.
- For each cost pool, there must be a factor that drives the cost.
- This cost driver is identified, and the rate of this driver is calculated by dividing the cost pool by the cost driver for that pool.

Costing methods and profit

- Different methods of costing give different cost per unit which will result in different results in inventory valuation and this will affect the profit calculation when inventory level changes.
- The cost of production and opening inventory must equal the cost of sales added to the cost of the closing inventory.
- This effect on closing inventory and cost of sale will affect the recorded profit.

Cost behavior

- As we seen that marginal costing uses cost behavior to divide costs into variable and fixed costs.
- There are four main types of cost behavior;
 - **Variable cost-** costs where the total amount varies in proportion to the activity level when the activity level changes. It is also known as marginal cost.
 - **Fixed costs-** costs that do not change when the level of activity (or output of units) changes.

Cost behavior

- **Step costs-** costs that change in steps at a certain level of activity and the remaining stays unchanged or fixed.
- **Semi-variable-** Costs where the part of the cost acts as a variable cost and a part acts as fixed cost.

High – Low method

- This method is used to calculate the variable and fixed part of the semi-variable cost.
- It can be used where the total of a semi-variable cost is known at least for two different activities. Using this method:
 - Identify the highest and lowest cost totals and levels of activity
 - Calculate the difference between the two cost totals
 - Calculate the difference in cost units between the two levels of activity

High – Low method

- Divide the difference in cost by the difference in units; this gives the variable cost per unit.
- Use the variable cost per unit to calculate the variable part of one of the cost totals
- Deduct the variable part from the cost total to obtain the fixed part

Any Questions



Thanks

