

Costs and Revenues

Learning Area Overview



Welcome to this learning area overview for Costs and Revenues, prepared by AAT.

In this overview we'll explain what Costs and Revenues is all about, and how it fits into the bigger picture of the AAT Accounting Qualification.

We'll explore the main topics you can expect to cover, and how the knowledge and skills you'll pick up will be of practical use to you in the workplace.

Finally, we'll explain how this learning area relates to the others you've already studied, and those you'll study in the future.

What you'll learn in Costs and Revenues

There are two main elements that make up this learning area. The first is concerned with developing your knowledge of the principles of costing, which you first met at level 2. The second element focuses on how organisations apply different costing techniques to aid management decision making.

Among the various topics covered by Costs and Revenues, you'll learn about the different ways organisations record, analyse and report costs and revenues.

Such costs and revenues are often treated differently from one organisation to the next. The treatment can depend on the accepted practice within the business sector in which the organisation operates, and the specific measurement rules chosen by the individual organisation.

At level 2 you were introduced to the three main methods of valuing inventories or stock. At level 3 you'll cover the different techniques that organisations use to control inventories, such as:

- inventory buffers
- lead times
- minimum/maximum order quantities
- the Economic Order Quantity.

You'll also learn about the principles of marginal and absorption costing, and the impact that these two different approaches can have on reported profits and inventory values in any one period.

Another important topic covered by Costs and Revenues is how to allocate and apportion overheads. Here you'll look at the problem of shared costs, and the various ways these can be "split out" across different parts of the organisation in order to give a clearer picture about how particular areas of operation are performing. These individual areas of operation are often referred to as responsibility centres.

There are several types of costing systems in day to day use: job, batch, unit, process and service costing. The type of costing system used by a particular organisation depends largely on the nature of its business. For example, a shipbuilder is likely to use job costing, whereas an oil refinery is more likely to use process costing.

You'll learn about each of these systems and the implications for an organisation of using one system over another in terms of the way it operates and the information it generates.

Management needs accurate information for both short term and long term decision making, and also for planning and control purposes. Break-even analysis and limiting factor analysis are two of the techniques you'll learn in this area that aid management decision making in the short term.

Capital investment appraisal looks more to the longer term and decisions about whether it's going to be financially worthwhile for an organisation to adopt a particular strategy. You might already have heard of some key concepts associated with investment appraisal, like discounting, net present value and internal rate of return. You'll encounter all of these aspects in this learning area.

One of the main tools to assist management in planning and control is variance analysis. You should already be familiar with what variance analysis is from Basic Costing at level 2.

At level 3 you'll learn how to identify some more specific cost and revenue variances, and how to explain the meaning and significance of them. This includes being able to identify the likely causes and effects of each variance, and being able to advise management on how to address significant deviations from those expected. An example of this is that you may suggest that an adverse material variance can be resolved either by reducing the amount of materials wasted, or through buying them at a cheaper price.

How Costs and Revenues will help you in the workplace

You should already be aware of the distinction between financial accounting and management accounting. Costs and Revenues is very much concerned with management accounting.

As a consequence, this particular learning area is likely to be of most relevance to those members working in industry and commerce, or in the public sector. If you're working in management accounting there's a good chance you'll have come across a number of the topics covered in Costs and Revenues already.

All commercial organisations need up-to-date information about costs and revenue. They need this information not just to determine how they're doing at the moment, but also to decide what they should be doing in the future.

So the role of the management accountant is to develop and operate systems that are capable of collating relevant cost and revenue information, and also to explain clearly what the implications are of all the possible actions that result.

How Costs and Revenues relates to other learning areas

Costs and Revenues builds directly on the Basic Costing learning area you covered at level 2. The emphasis at level 3 is on learning about more sophisticated costing techniques, and being able to understand how organisations use cost and revenue information for decision-making purposes.

Costs and Revenues is one of the seven compulsory learning areas at level 3. The others are:

- Accounts Preparation I
- Accounts Preparation II
- Cash Management
- Indirect Tax
- Professional Ethics in Accounting and Finance
- Spreadsheet Software.

Although none of the other learning areas at level 3 are directly related to Costs and Revenues, several of them share at least some overlap in terms of knowledge and skills. We'll take a quick look at these now.

Costs and Revenues is concerned purely with management accounting. In contrast, Accounts Preparation I and Accounts Preparation II are the main financial accounting learning areas at level 3.

These learning areas pick up on the bookkeeping principles to which you've previously been introduced, and show you how to prepare an extended trial balance and final accounts.

The focus of management accounting is very different from financial accounting. However, you'll see that the basic accounting processes that businesses need to have in place to produce final accounts also provide management with a lot of the planning information they need to monitor the build up of product and service costs.



Cash Management introduces the principles of managing cash balances to ensure the ongoing liquidity of a business. It focuses on preparing cash budgets and helping you to understand the different options available to businesses for raising additional finance and investing surplus cash. Cash budgets are an important source of management accounting information, and are a key tool used in internal decision making processes.

In Spreadsheet Software, you'll be tested on your ability to use software applications that record data in particular formats. In the majority of instances the data analysed will be financial information extracted from an organisation's accounting records.

Beyond level 3, there are two further management accounting units at level 4 that will complete the picture in terms of the knowledge and skills you've developed in Basic Costing and Costs and Revenues – these are Budgeting and Financial Performance.

Budgeting will explain how and why organisations prepare forecasts and budgets.

Financial Performance then picks up on this by covering how budgeted information allows organisations to set targets which can subsequently be compared against actual performance data.