

Activity-Based Costing (ABC)

Activity-Based Costing (ABC) is that costing in which costs begin with tracing of activities and then to producing the product.

The
Concept



Activity-Based Costing

Stages in Activity-Based Costing:

- Identify the different activities within the organization.
- Relate the overhead cost to the activities.
- Support activities are then spread across the primary activities.
- Determine the activity cost drivers.
- Calculate the activity cost drivers rate, the quantity of cost driver used by each product.

Difference Between Activity-Based Costing & Traditional Costing



Activity-Based Costing

- It begins with identifying activities and then to producing the products
- It mainly focuses on activities performed to produce products
- Cost Drivers used for identifying the factors that influence the cost of particular activity
- Overhead costs are assigned to Cost Centre or Cost Pools
- Overhead costs are assigned to products using Cost Drivers Rates

Activity-Based Costing

- Variable overhead is appropriately identified to individual products
- In ABC many activity based on Cost Pools or Cost Centre's are created
- There is no need to allocate and re- distribution of overhead of service departments to production departments
- It assumes that fixed overhead costs vary in proportion to changes in the volume of output.

Traditional Costing

- It begins with identifying cost and then to producing the products
- It emphasizes mainly on ascertainment of costs after they have been incurred
- Cost unit is used for allocation and accumulation of costs
- Overhead costs are assigned to production departments or service departments
- Overheads allocated on the basis of departmental overhead allocation rate

Traditional Costing

- Costs may be allocated or assigned either on actual cost incurred or on standard cost basis
- Overheads are pooled and collected department wise
- The process of allocation and re-distribution of the costs of the service departments to production department is essential to find out total cost of production
- It assumes that fixed overheads do not vary with changes in the volume of output.

Advantages of Activity-Based Costing



Advantages of Activity-Based Costing

- It brings accuracy and reliability of the costing data in determination of the cost of the products.
- It facilitates cause and effect relationship to exercise effective cost control.
- It provides necessary cost information to the management to take decisions on any matter, relating to the business
- It is much helpful in fixing the cost and selling price of a product.

Advantages of Activity-Based Costing

- It facilitates overhead costs allocate directly to the specific product.
- It enables to manage the activities rather than costs.
- It helps to remove all types of wastages and inefficiencies.
- It provides valuable information to evaluate on the relative efficiencies of various plants and machinery.
- Cost Driver Rates will help in significant impact on the development of new products or modification of existing products.

Thank you for attention !

