

**E-contents for Mcom 4th  
semester  
Vaniya Mahavidyalaya, Patna  
University**

**Subject: Advanced cost accounting**

**Paper code: COMEC-2**

**Unit:5**

**Topic: ACTIVITY BASED COSTING**

**Nisha saha**

**Assistant professor(guest faculty)**

**Contact nu: 7488775377**

**nishasaha2000@gmail.com**

# **INTRODUCTION**

**it is a costing method that identifies activities in an organisation and assigns the cost of each activity to all products and services according to actual consumption by each.**

**With the increase in industrialisation the role of management accountant is constantly growing it is being realised that every resource must contribute to value or it is being wasting.**

**The key contribution of management accountant is informulation of a strategy for business decisions in context of changes in development of business environment.**

**In the old age most of the companies manufactured a narrow range of product and direct labour and direct material were dominant factory cost.**

**However in the present scenario companies produce wide range of products where in direct**

**labour and material represent only a small percentage of total cost. For eg.**

**Parker pen= Rs.500**

**Material is used for this=  
Rs.50(assume)**

**Direct labour cost= Rs.60**

**Total direct cost= Rs.50+60=110**

**So ,what do you think  $500-110=390$  is your profit?**

**390 is not the profit because in this gap lots of indirect cost like advertisement expense, selling expense, showroom rent and etc are included so it is very important to find out the correct costing of the product so that you can achieve or determine the desired profit.**

**With the help of ABC method we can easily determine the indirect cost of any product or services so that we can know about the real cost which is nebulous or unclear in the traditional method of costing.**

**FACTORS FOR RESPONSIBLE FOR  
ACTIVITY BASED COSTING**

- **Growing overhead cost on a regular basis as per manufacturing industry research the overhead cost had increased 5 times in the last decade.**
- **Increasing market competitions which is responsible for knowledge about more accurate product cost.**
- **Traditional costing fails to capture cause-and-effect relationship.**
- **Traditional costing often fails to highlight inter relationship among activities in different departments.**
- **Direct labour and direct material has shrunk as a percentage of total cost for majority of manufacturing companies.**

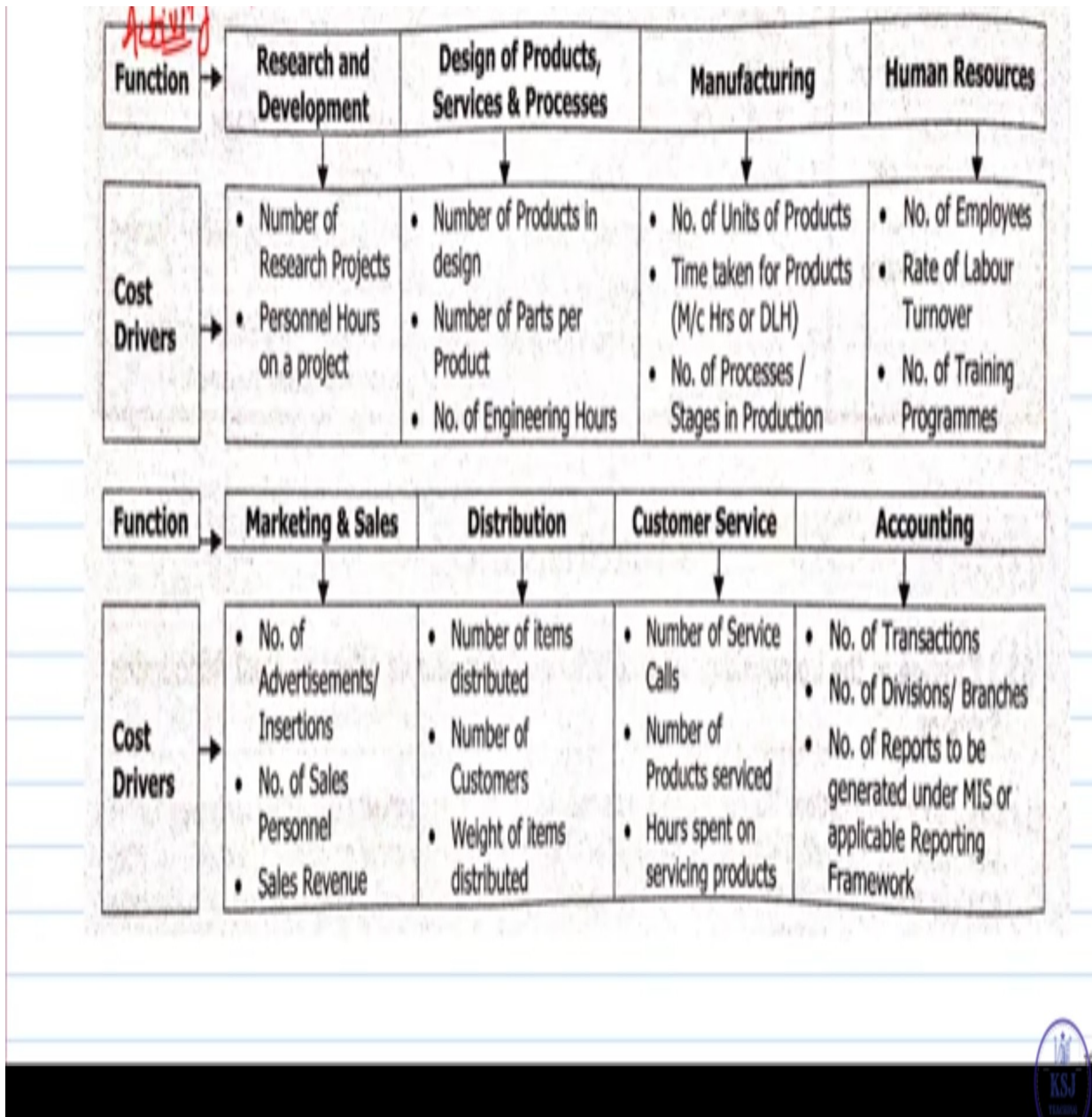
## **AREAS IN WHICH ACTIVITY BASED COSTING IS USED**

- **Pricing of product**
- **Transfer pricing**
- **Design and development of new products**
- **Market segmentation and distribution channels**
- **Make or buy decisions**
- **Evaluation of offshore production**
- **Export oriented production**
- **Product line profitability**

## **TERMINOLOGIES USED IN ACTIVITY BASED COSTING**

- **Activity-** An activity may be defines as a particular task or unit of work with a specific purpose.
- **Cost object-** It is an item for which cost measurement is required. For eg. A product, a service, a client and etc.

- **Cost driver-** It is a factor that influences the cost of an activity. It is a factor whose change may cause a change in the total cost of a related cost object.



## ACTIVITY BASED COSTING SYSTEM

**Activity based system based on the link made between activities and product by assigning cost to products based on individual consumption or demand for each activity accordingly activity based system is based on the following**

- **Identify major activities that take place in an organisation.**
- **Create a cost pool for each activity.**
- **Determine the cost driver for each major activity with respect to the cost pool.**
- **Assign costs product or services based on its consumption of activities.**

## **ADVANTAGES**

- **It helps understanding the behaviour of overhead costs.**
- **Profit analysis.**
- **Improvisation of competitiveness.**
- **Identify and eliminate the inefficient product or activities.**
- **Control the unnecessary costs.**
- **It provides information for measurement of performance.**

\*\*\*\*\*