ACTIVITY BASED COSTING

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The Activity-Based Costing (ABC) is a costing system, which focuses on activities performed to produce products. ABC is that costing in which costs are first traced to activities and then to products.

Activity Based Costing is a technique which involves identification of cost with each cost driving activity and making it as basis for apportionment of costs over different cost objects or jobs or products or customers or services.

FEATURES OF ACTIVITY BASED COSTING

- ABC is a two stage product costing method that first assigns costs to activities and then allocates them to products based on each product's consumption of activities

- An activity is any discrete task that an organisation undertakes to make or deliver a product or service.

- ABC is based on the concept that products consume activities ad activities consume resources.

- ABC can be used by any organisation that wants a better understanding of the costs of the goods and services it provides, including manufacturing, service and even non-profit organizations.

OBJECTIVES OF ACTIVITY BASED COSTING

- **To improve product costing**

- **To identify non-value adding activities in the production process which might be a suitable focus for attention or elimination**

- **To provide required information for decision making**

- **To encourage managers to evaluate the efficiency of internally provided services**

TERMINOLOGY OF ACTIVITY BASED COSTING

Cost Object:

It is an item for which cost measurement is required e.g. Product, job or a customer.

A Cost Driver:

In an ABC system, the allocation basis that are used for applying costs to services or procedures are called cost drivers. It is a factor that causes a change in the cost of an activity

Unit level cost, Batch level cost, Product-level cost, Facility-level cost, Organizational-level cost

Cost Pool:

Costs are grouped into pools according to the activities, which drive them. In this all costs associated with procurement i.e. ordering, inspection, storing etc would be included in this cost pool and cost driver identified.

STAGES IN DEVELOPING ACTIVITY BASED COSTING

Step 1:   **Identify resources**

Step2:   **Identify activities**

Step 3:   **Identify cost objects**

Step 4:   **Determine resource drivers**

Step 5:   **Determine cost (activity) drivers**

Step 6:   **Assign costs to the cost objects**