



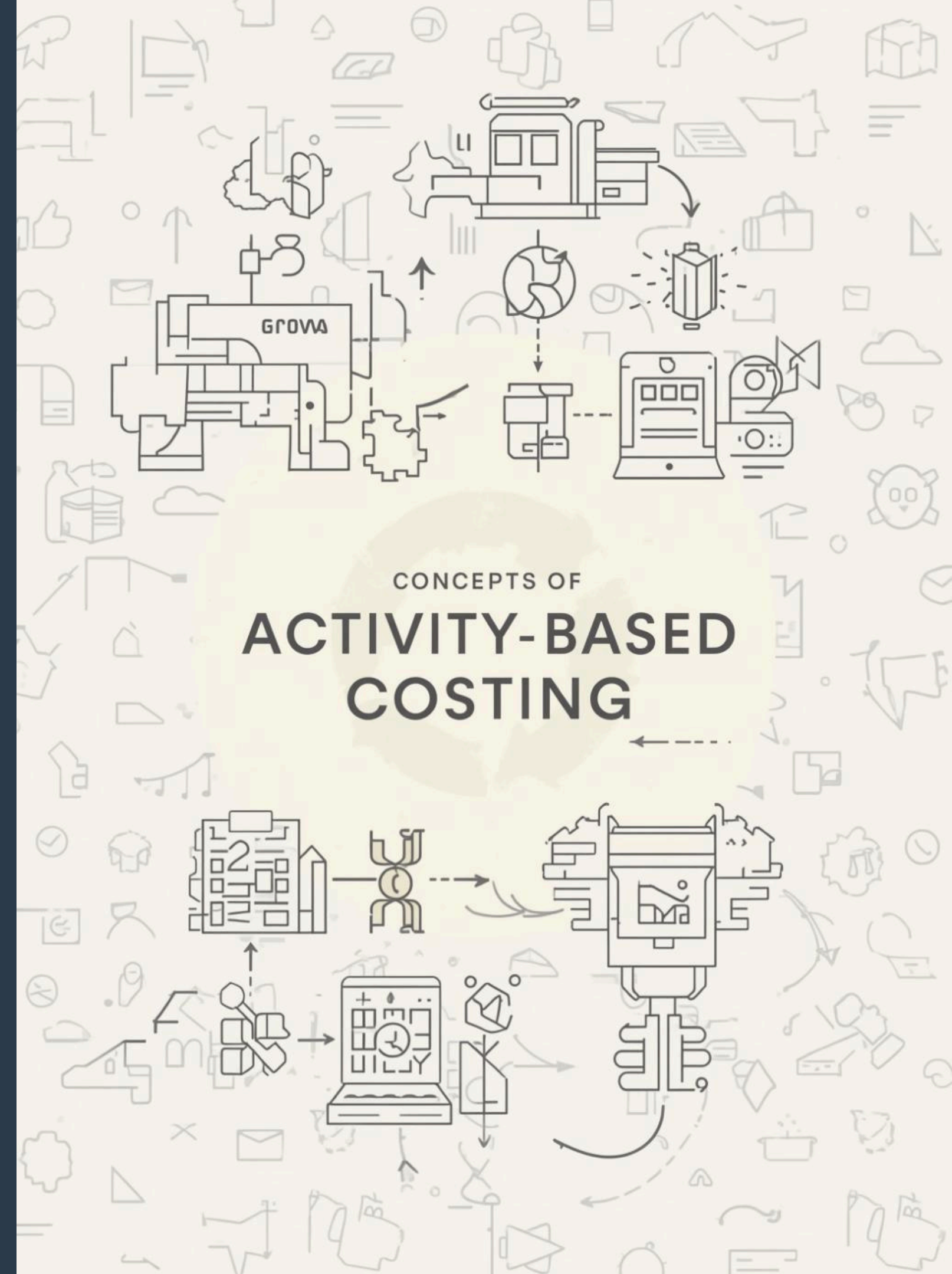
Activity-Based Costing

PRESENTED BY

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What is ABC?

Activity-Based Costing (ABC) is a method that allocates overhead costs based on **actual activities** performed, leading to more precise product costing and better decision-making for businesses.



Why ABC Matters

MANUFACTURING FLOOR

Efficient Production



OFFICE OPERATIONS

Streamlined Processes



QUALITY CONTROL

Ensuring Standards



Key Concept – Activities

Activities are defined as resource-consuming tasks that contribute to the production of goods or services. Understanding these activities is essential for accurate cost allocation in Activity-Based Costing (ABC).

Service Vector

Clean Vector seatid desigr iterphentard ciepkote



Custurking



Machine



Activity



Feourne



Labulity



Packaging



CA Ouality



Packaging



Incorced

Key Concept – Cost Drivers

NUMBER OF SETUPS

The **number of setups** refers to the frequency of machine configurations or adjustments needed for different production runs, significantly impacting overall operational costs.

TESTING HOURS

Testing hours are the time spent validating product quality and performance, which can lead to increased costs if extensive testing is required for compliance and assurance.

UNITS PRODUCED

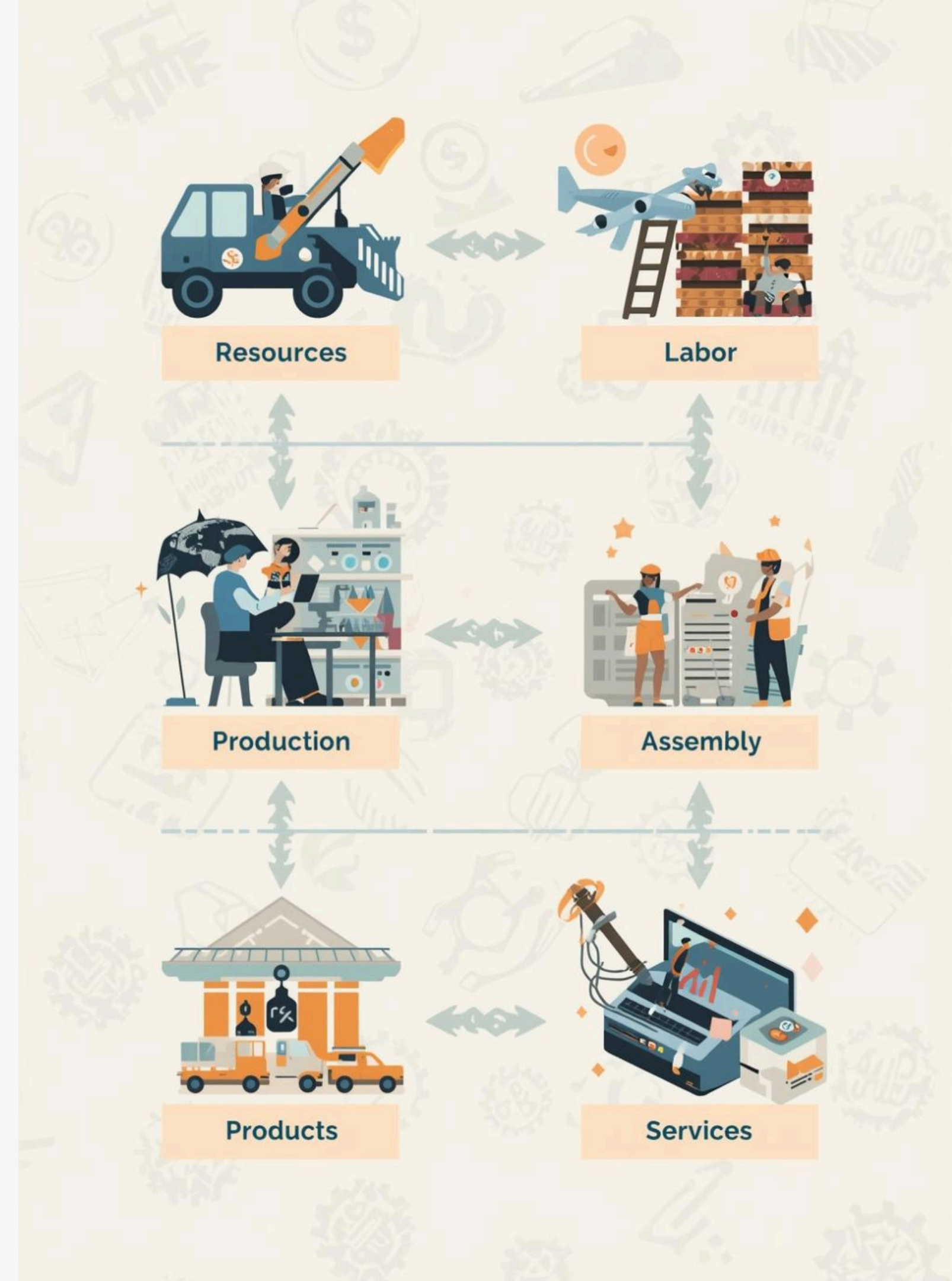
The **units produced** directly affect cost efficiency; as production volume increases, fixed costs are spread over more units, generally decreasing the per-unit cost of production.

Cost Pools

Cost pools refer to the **grouping of costs** associated with specific activities, allowing for a more accurate allocation of overhead expenses and enhancing overall financial analysis.

Resource Allocation

Resource allocation is the process of assigning costs from resources to activities and then to products or services, aiming for improved accuracy in financial reporting and decision-making.



Steps to Implement ABC

IDENTIFY ACTIVITIES

The first step is to **identify major activities** within your organization to capture those that consume resources and significantly impact costs.

DETERMINE DRIVERS

After assigning costs, determine the cost drivers that influence activity expenses, focusing on specific factors that cause variations in costs.

ASSIGN COSTS

Next, assign costs to these activities by creating cost pools that reflect the resources consumed, ensuring accurate tracking of overhead expenses.

CALCULATE RATES

Finally, calculate cost driver rates to allocate costs appropriately to products or services, enhancing accuracy in financial reporting and decision-making.

Implementation Timeline

ACTIVITY
IDENTIFICATION



Identify and outline major activities that consume resources within the organization.

COST
ASSIGNMENT



Assign costs accurately to the identified activities for effective resource management.

DRIVER RATE
CALCULATION



Calculate the rates for each cost driver based on the assigned activities and total costs.

FULL COST
ASSIGNMENT



Complete the cost assignment process by allocating costs to products and services accurately.

Advantages of ABC

ACCURATE COSTING

Activity-Based Costing provides a **more precise** method for allocating overhead costs, ensuring that product costs reflect the actual resources consumed, leading to better financial insight.

PRICING SUPPORT

Accurate costing through ABC aids businesses in making informed **pricing decisions** that reflect true costs, enhancing profitability and competitive positioning in the market landscape.

IDENTIFY INEFFICIENCIES

ABC highlights inefficiencies within processes by **tracing costs** directly to activities, enabling organizations to pinpoint areas for improvement and streamline operations for greater productivity.

PROCESS IMPROVEMENT

By revealing cost drivers and resource usage, ABC fosters **continuous improvement** initiatives, empowering organizations to refine their processes and enhance operational efficiency over time.

Limitations of Activity-Based Costing

COMPLEXITY

Implementing ABC can be **complex and time-consuming**, requiring significant changes in existing accounting systems and processes, which may overwhelm organizations with limited resources.

DETAILED DATA

ABC necessitates **detailed data collection**, which can be burdensome for companies, especially if they lack robust data management systems or face challenges in capturing necessary information accurately.

SMALL ORGANIZATIONS

Many small organizations may find that ABC is not suitable for their needs, as the intricacies involved can outweigh the benefits compared to simpler costing methods.

\$50,000

Machine setup cost

The total machine setup cost allocated for production was \$50,000, which is crucial for determining the overall cost per product based on actual activity usage.



ABC vs Traditional Costing

TRADITIONAL COSTING

Traditional costing approaches spread overhead evenly across products, often leading to inaccuracies in cost attribution. This method fails to reflect true resource usage, resulting in misleading profitability assessments.

ACTIVITY-BASED COSTING

In contrast, activity-based costing assigns overhead based on actual activities, providing more precise cost data. This approach enhances decision-making by revealing the true cost drivers behind products and services.

Key Takeaways

ALLOCATES COSTS

Activity-Based Costing allocates costs based on **real activities**, ensuring that overhead is assigned according to the actual consumption of resources by different products or services.

REQUIRES EFFORT

Implementing ABC requires a **significant effort** in terms of data collection and analysis, but the insights gained from this process can provide substantial benefits to the organization.

IMPROVES ACCURACY

By focusing on accurate cost allocation, ABC improves costing accuracy, allowing organizations to make informed decisions regarding pricing, budgeting, and resource allocation to enhance profitability.

COMPLEX ORGANIZATIONS

ABC is particularly useful for **complex organizations** with multiple products or services, enabling them to understand cost drivers and optimize their operational efficiency for better financial outcomes.