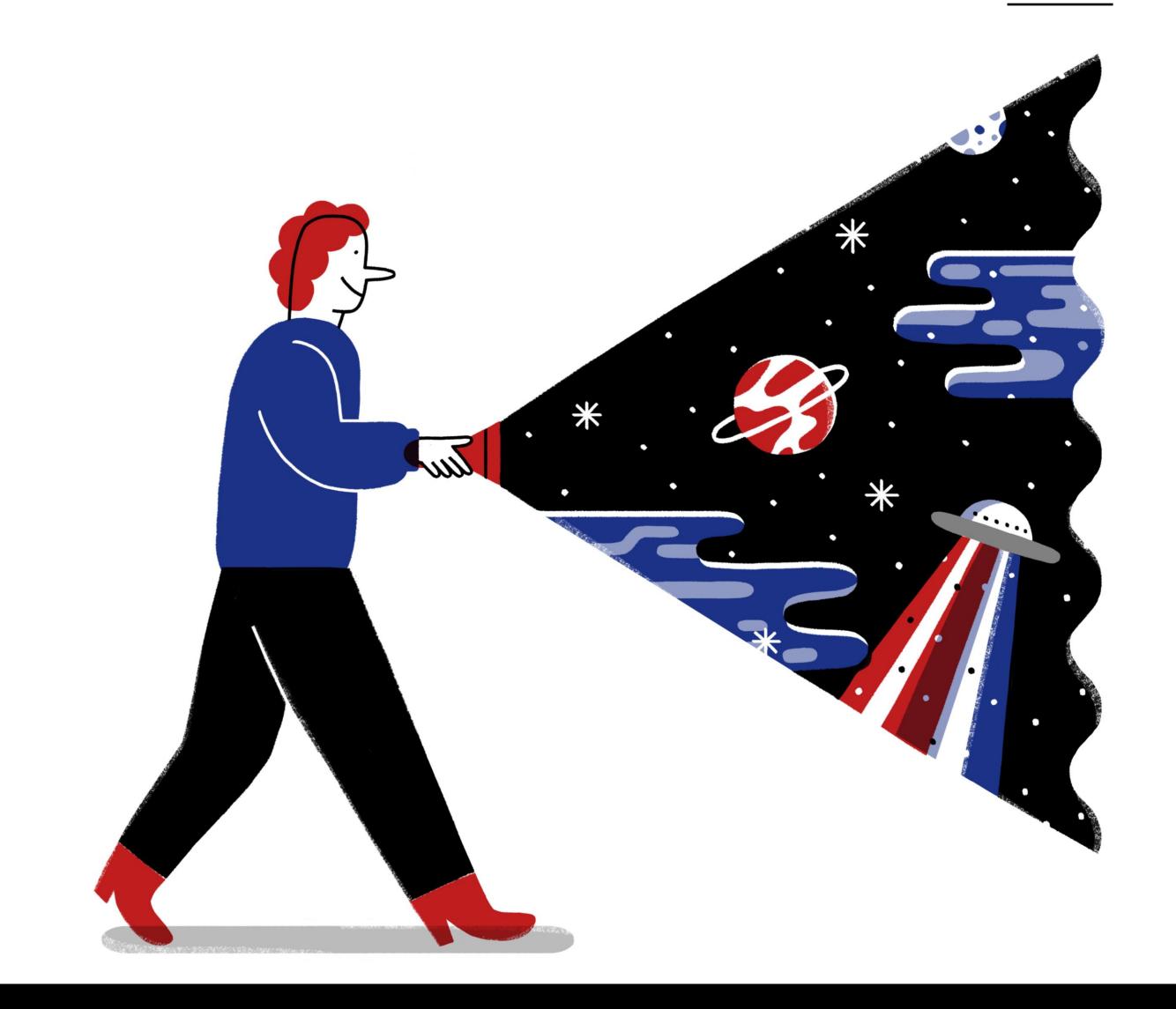
Management Accounting

PRACTICAL CLASS 8





MANAGEMENT ACCOUNTING SPRING 2025

(In) Direct Costs

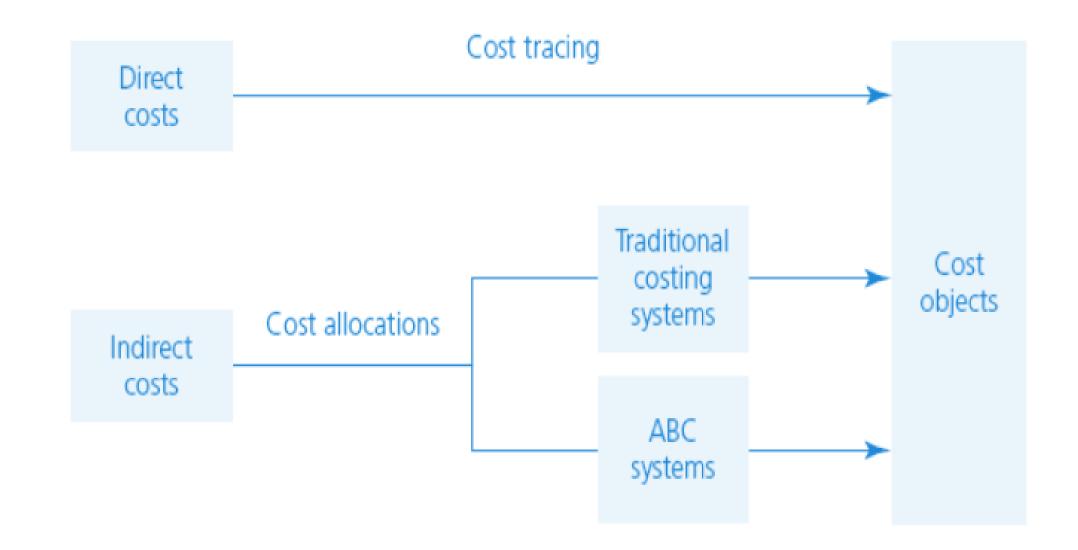
ADDING SOME COMPLEXITY REALISM

So far, we have worked with very **simple** but *unrealistic* companies that **produce only one good**.

In real life, companies produce **hundreds** of **SKU's** (*Stock Keeping Units*) in a **single plant**.

While **Direct Costs** are easy to trace, how should we assign **Indirect Costs?**

Note: Remember that the precision of costing is a business decision. There's a trade-off between costs and benefit.



Direct Costs

Can be **traced** easily and accurately to a cost object. *e.g. DM and DL*

Indirect Costs

Cannot be traced to cost objects and should be **allocated** based on estimates *e.g. MOH*



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Activity Based Costing

THE MOST PRECISE METHOD

Instead of assigning MOH to **Departments** we will allocate them to the activities themselves.

ABC recognizes that **activities cause costs** (not departments): the more activity that is undertaken, the more costs are incurred.

Note: ABC can be used to NMOH's

It looks like MOR, quite straight forward, right?

Yes, but here its all about activities, not departments. ABC is relatively simple in the exercises.

In practice is very costly to be this precise in tracking the costs.

Think about paying someone to count staples!

Step by Step ABC	Example
1) Identify different activities	Stapling
2) Identify Activity Cost Drivers	Nr Staples Stapled
3) Calculate Cost Driver Rate (CDR)	Total Costs of Stapling Total Staples Stapled
4) Attribute Cost Driver Rate	Nr Staples * CDR



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ABC Method

IN PRACTICE

4. Assigning 1. Identifying the 2. Assigning 3. Determining the cost of major activities (resources) the cost activities to taking place in an costs to driver for each products (or organization activity cost other cost objects major activity centres such as services, clients, etc) Stage 1: Stage 2: Overheads assignment to activity cost centres Attribution of activity costs to cost objects

Overhead cost accounts (for each individual category of expenses e.g. property taxes, depreciation, etc.) First stage allocations (resource cost drivers) Activity Activity Activity cost cost cost centres centre centre N Second stage allocations (activity cost drivers) Direct Cost objects (products, services and customers)

Mateus Rodrigues, 2022 Mateus Rodrigues, 2022



ABC Method

EXAMPLE

Company X is a firm which produces high-end Cookie Cutters in Star and Squared shapes. Given that the difference in shapes, machines have different calibration windows. **Compute MOH per product under SOH and ABC**. Use production units as the allocation base for the SOH.

	Star	Square
Production	1 000	9 000
#Shapes per Calibration	100	900
Nr Bends per Shape	5	4

	Total	Activity Driver
Cost in Setups	80 000	Nr Setups
Bending Costs	41 000	Total Bends
Total	121 000	

Single Overhead Rate:

$$SOH = \frac{121\ 000}{10\ 000} = 12.1$$
 $Star_{MHO} = 12\ 100$
 $Square_{MHO} = 108\ 900$

ABC:

Cost per Setup =
$$\frac{80\ 000}{\frac{1\ 000}{100} + \frac{9\ 000}{900}} = 4\ 000 \notin per\ setup$$

Cost per Bend = $\frac{41\ 000}{1000 * 5 + 9\ 000 * 4} = 1 \notin per\ bend$

Star_{MHO} = 10 * 4000€ + 5000 * 1€ = 45000 €

Square_{MHO} = 10 * 4000€ + 36000 * 1€ = 76000 €



Exercise

21 – THE SUPERMERCADO DA ESTRELA

