

# Management Accounting

PRACTICAL CLASS 8



# (In) Direct Costs

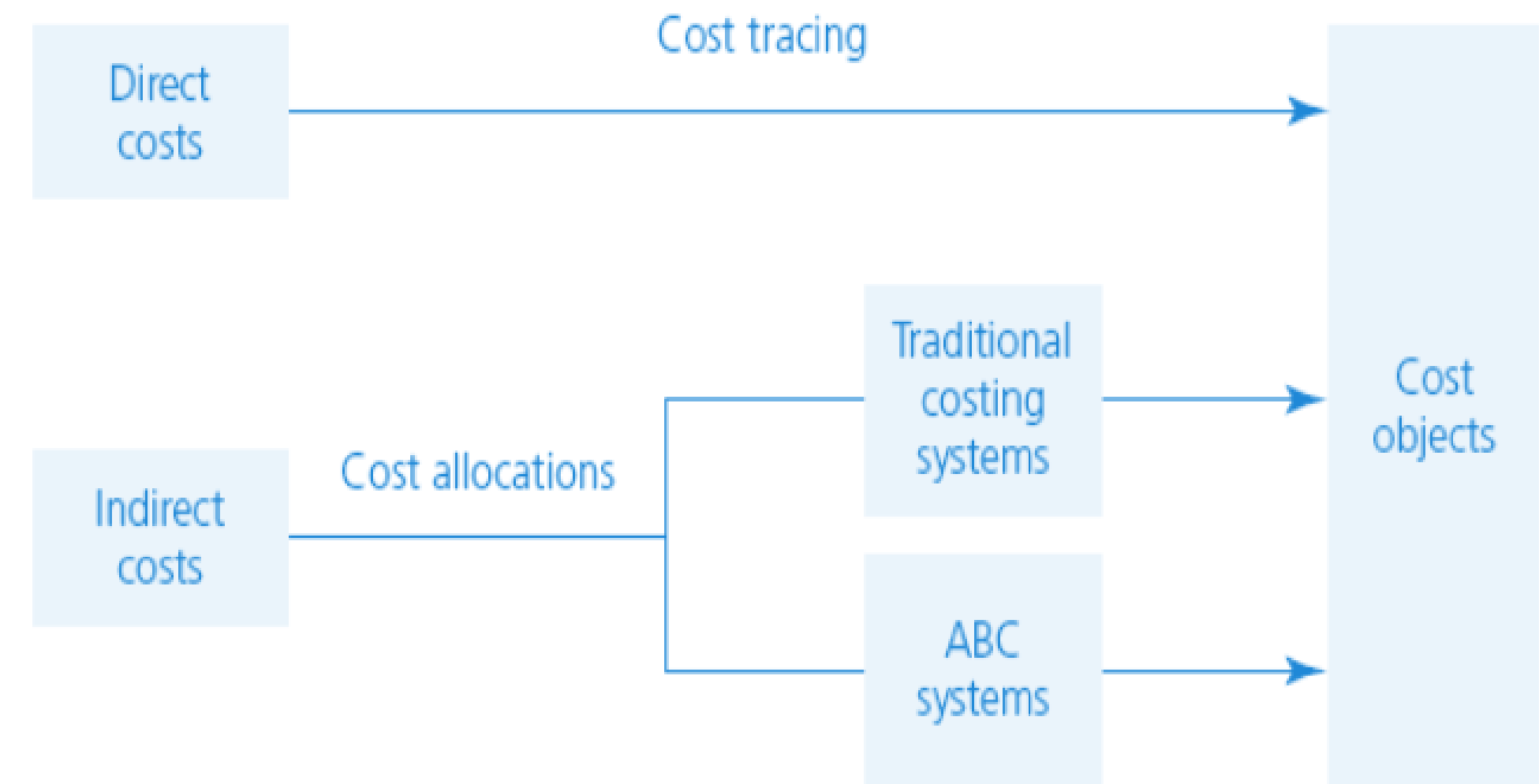
ADDING SOME ~~COMPLEXITY~~ REALISM

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*

# 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.

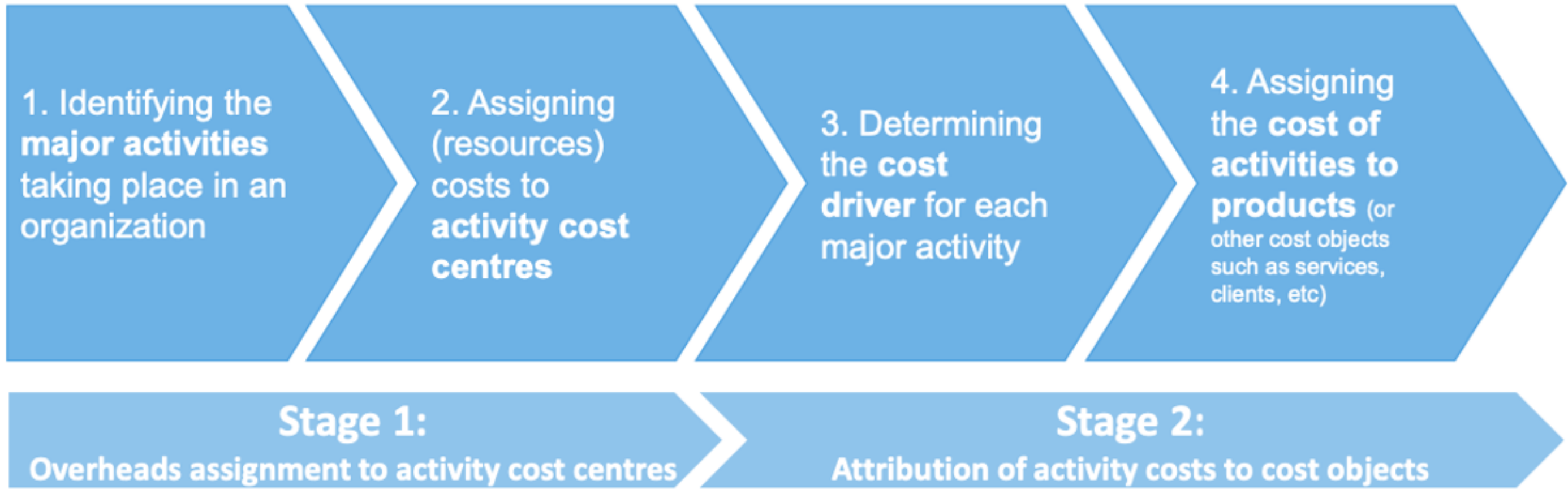
**Note:** ABC can be used to NMOH's  
**It looks like MOR, quite straight forward, right?**

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!

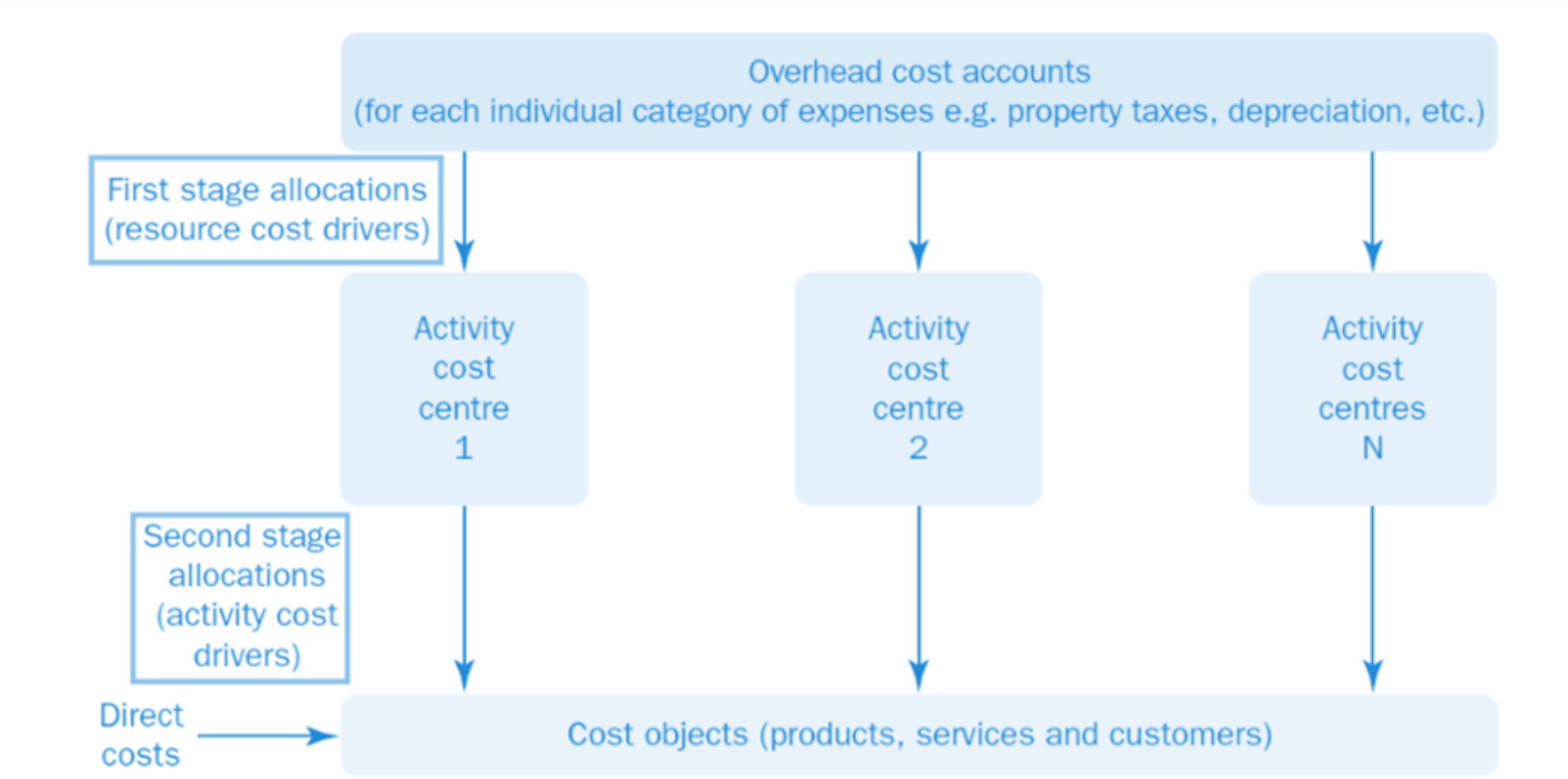
Step by Step ABC	Example
1) Identify different activities	Stapling
2) Identify Activity Cost Drivers	Nr Staples Stapled
3) Calculate Cost Driver Rate (CDR)	$\frac{Total\ Costs\ of\ Stapling}{Total\ Staples\ Stapled}$
4) Attribute Cost Driver Rate	$Nr\ Staples * CDR$

# ABC Method

## IN PRACTICE



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# 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
<b>Total</b>	<b>121 000</b>	

## Single Overhead Rate:

$$SOH = \frac{121\,000}{10\,000} = 12.1$$

$$Star_{MHO} = 12\,100$$

$$Square_{MHO} = 108\,900$$

## ABC:

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

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

$$Star_{MHO} = 10 * 4\,000\text{€} + 5\,000 * 1\text{€} = 45\,000\ \text{€}$$

$$Square_{MHO} = 10 * 4\,000\text{€} + 36\,000 * 1\text{€} = 76\,000\ \text{€}$$

# Exercise

21 – THE SUPERMERCADO DA ESTRELA