NOVA SCHOOL OF BUSINESS & ECONOMICS

Management Accounting

Fall 2024
Practical class 8

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AGENDA

THEORETICAL RECAP

Activity Based Costing

CHAPTER 7

Problem 21

Theoretical Class Recap (or not)

Cost allocation Systems

Activity Based Costing

- A system that first accumulates indirect resource costs for each of the activities of the area being costed, and then assigns the costs of each activity to the products, services, or other cost objects that require that activity
- 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
- ABC leads to higher product costing accuracy:
  - Greater #cost centres in the 1st stage
  - Greater # and variety of cost drivers in the 2nd stage of the two-stage allocation process
  - Cost drivers express the “real” consumption of activity resources by cost objects

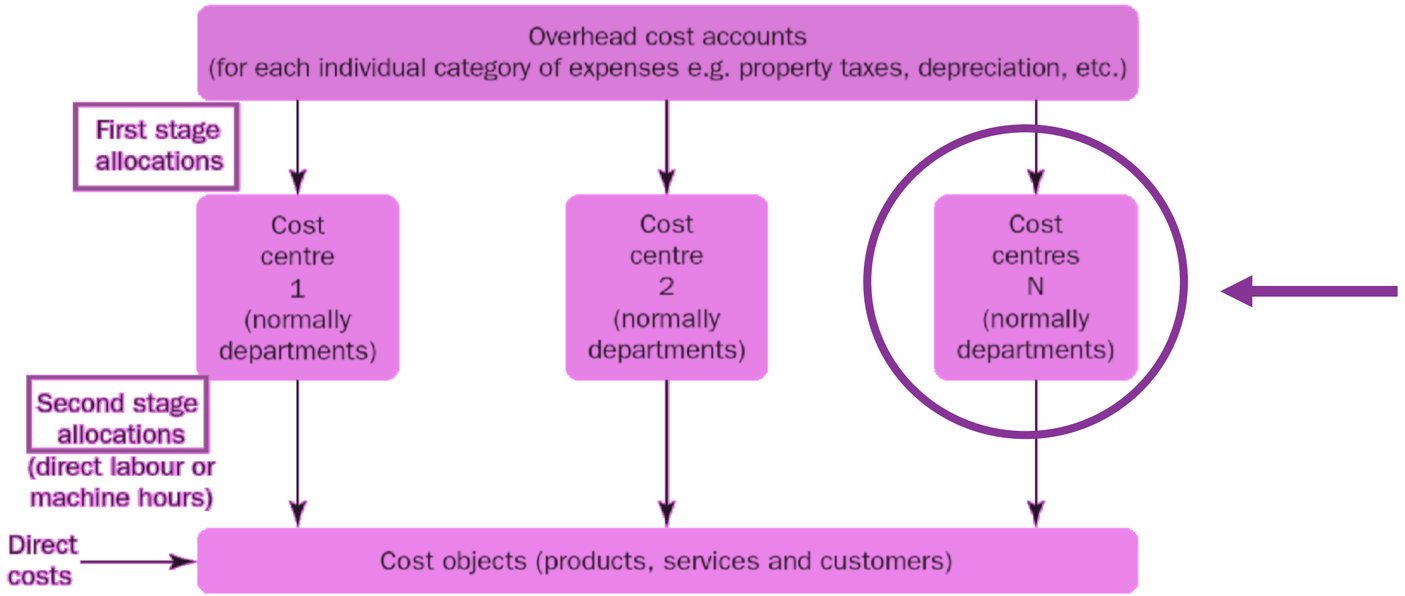
Theoretical Class Recap (or not)

Step by step allocation process

Cost Driver Rate (SOR) = $\frac{Activity\ Costs}{Volume\ of\ Cost\ Driver}$

Activity Based Costing

- 1st Assign overheads initially to activity cost centres
- 2nd Attribution of activity cost to cost objects
- 3rd Calculate the Cost Driver Rate
- 4th Attribute the Cost Driver Rate to products = Cost driver rate x Volume of cost driver used by products



Key takeways from exercise

DIFFERENCES BETWEEN COSTING SYSTEMS

- You can see the different systems as different “zoom”/precision levels that we look at our MOH’s.
- With SOR you’re not very precise, but you have a broad picture of your Costs. Reality might seem one thing but be different (product might seem profitable).
- With ABC you have all the detail possible by breaking down departments into activities. You know exactly what is going on (you realize the product is not profitable)
- The problem is that a big zoom only comes in expensive smartphones (MRO and ABC are expensive)