Activity-Based Costing

- If elements in the overhead cost pool are not all consumed at same rate, costs will be distorted. Non uniform consumption = distortion of costs.
- Two major factors impair ability of unit-based rates on overhead costs
    1. Proportion of non-unit based related overhead costs to total overhead costs is large
        a. Non-Unit Level Activity Drivers i.e. batch, product-sustaining and facility-sustaining.
    2. Degree of product diversity is great.
        a. Meaning products consumer overhead activities in systematically different proportions doe to product size/complexity, setup time, size of batches.
- An **activity** is action taken or work performed by equipment or people, for other people.
- **Activity drivers** measure consumption of activities by products and other cost objects.
- **Consumption ratio:** Amount of activity driver per product/ Total Driver quantity
- **Unit cost =** (Overhead cost + Prime Cost) / Units produced
- **Overhead rate:** total overhead costs/ total direct labour hours
- **Resource Drivers** measure consumption of resources by activities.

Cost-Volume-Profit (CVP Analysis)

- Many companies consist of separate business units called profit centres; segmented income statement must be developed for each profit centre.
- Two methods of computing income:
    1. **Variable costing:** Fixed overhead is treated as a period expense and excluded from product cost (charged in total against revenues of period).

Sales	2,400,000
Less: Variable expense	
Variable cost of goods sold	(1,600,000)
Contribution Margin	**800,000**
Less: Fixed expenses	
Fixed overhead	(250,000)
Fixed selling and admin	(100,000)
Operating income	**450,000**

    2. **Absorption costing:** assigns all costs to product including fixed overhead through use of a pre-determine rate and not expensed til product sold.

Sales	2,400,000
Less Cost of Goods Sold	(1,800,000)
Gross Margin	**600,000**
Less selling and admin expenses	(100,000)
Operating Income	**500,000**