Day 3 – Activity Based Costing (ABC)

Miniseminar: Gateway to NEXT

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"Measure what is measurable, and make measurable what is not so."

– Galileo Galilei

Types of Accounting

Financial Accounting The process of producing financial statements for external constituencies—people outside the organization, such as shareholders, creditors, and governmental authorities. This process is heavily constrained by standard-setting, regulatory, and tax authorities and the auditing requirements of independent accountants (contrast with management accounting).

Management Accounting A value-adding improvement process of planning, designing, measuring, and operating nonfinancial and financial information systems that guides management action, motivates behavior, and supports and creates the cultural values necessary to achieve an organization's strategic, tactical, and operating objectives.

Atkinson, Banker, Kaplan, and Young

Cost Types

Direct costs *(direkte omkostninger)* Costs that may be physically traced to each cost (production) item.

Indirect costs *(indirekte omkostninger)* Costs incurred in support of the fundamental activities of manufacturing and selling.

Example to consider: What are the direct and indirect costs for Microsoft in bringing Microsoft Excel to the market?

Also, opportunity costs *(offeromkostninger)* are profits abandoned by not selecting another alternative.

Cost Types (cont'd)

Fixed costs *(faste omkostninger)* Costs that do not vary with production within the given time horizon of decision making.

Variable costs *(variable omkostninger)*Costs that vary with the number of units produced.

Costing Models

1. Variable costing (AKA Contribution-margin costing) *(Danish: Dækningsbidragsmodellen)*

2. Full costing (AKA Absorption costing) *(Danish: Fuldfordelingsmodellen)* [1]

3. Activity-Based Costing

[1] In R&D sectors "successful efforts costing" is sometimes used as an alternative to full costing.

Motivating Example – Cooper Pens

Kaplan et al. pages 161 and 169.

Variable Costing

Only variable manufacturing costs are included in inventory value, i.e. direct materials, direct labor and variable manufacturing overhead.

Absorption Costing

All manufacturing costs are absorbed (included in inventory or capitalized), that is, direct materials, labor as well as variable and fixed overhead.

Activity-Based Costing

Inventor and zealous proponent: Robert Kaplan (Harvard University)

Product-related, product series-related and product unit-related costs are allocated to activities according to the resource consumption of the identified cost drivers.

Facility-maintaining activities are not allocated to products/customers.

Postulate: Full costing favors small orders because overhead is shifted to product with high direct labor hours.

The Danish Contribution Margin Costing

Proponents at CBS: Zakken Worre and Palle Hansen

Four dimensions:

1. Account (in a classical financial sense)

2. Department

3. Process (equivalent to Kaplan's notion of an activity)

4. Purpose (ie. product or customer)

Account data is not only currency, but also resource use and load units etc.

Use direct costing!

Exercises

- Discuss similarities and dissimilarities between REA costing, CM costing, full costing and Activity Based Costing.

$Q \wedge A$