**Comparisons between the different methods of costing**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Marginal costing** | **Absorption costing** | **ABC** |
| **Uses** | For decision-making:  It identifies the extra costs and revenues incurred by the production & sale of an additional unit, e.g. make or buy decisions, limiting factors, breakeven analysis.  Direct Materials + Direct Labour + Variable production overhead = Total variable/marginal costs | For product costing:  Product costs include a share/portion of production/factory overheads absorbed into each cost unit using a predetermined absorption rate.  Direct Materials + Direct Labour + Production overhead = CPU  Production overhead is absorbed using predetermined rates based on direct labour hours [DLH]  e.g. £10 per DLH  and if 5 DLHs are used,  then the POH= 5 hrs x £10 = £50  For decision-making: to calculate the selling price using the pricing strategy of ‘full cost plus’ basis.  e.g. if CPU = £12/unit  Profit mark-up on CPU is by 50%  Then Selling Price = £18 | For product costing:  Product costs include a share/portion of production/factory overheads into each cost unit using cost driver rates; this produces more accurate product costs.  Direct Materials + Direct Labour + Production overhead = CPU  Use cost driver rates for various major production activities within the factory;  e.g. if set up costs = £100,000  Production volume = 50,000 units of A per run  Set up costs per unit = £100,000/50,000 = £2  Product B: Production volume = 10,000 units  Set up costs = £100,000/10,000 = £10  For decision-making: to use the more accurate product costs in calculating the selling price using a pricing strategy of ‘full cost plus’ basis.  For planning and control of costs: If the activity changes, the related effects of the overheads can be assessed and so costs can be controlled. |
| **Benefits** | Easily understood and applied in decision-making. Contribution is identified, which is useful, e.g. in make or buy decisions and where there are limiting factors. | All production costs are considered; so, the total production costs are identified and included. The effect of an increase in any one cost can be assessed, whether it is direct or an indirect cost. | Avoids apportioning & absorbing production overheads that may not be relevant. Batch sizes can influence costs which is ignored by absorption costing e.g. set-up costs are more expensive for small production runs. |
| **Limitations** | Overheads/indirect costs and are both divided into either variable costs or fixed costs. Fixed production overheads are not allocated to production cost centres and cost units. These fixed costs are regarded as time based and are linked to the accounting periods & written off in these periods. | The absorption rate used to absorb the production overheads into cost units may not be relevant to all the production overheads in the production department. New technology has led to the reduction of direct labour costs and a simultaneous increase in production overheads which renders absorption rates and absorption costing less accurate for product costing & pricing purposes. | This method is costly to set up and operate. It may only accurately account for production costs in situations where production overheads are high. Where production overheads are low and the product range is small, ABC may not significantly improve product cost information. |