



Accounting for Decision Making Prof. Narasimhan M S Cost Allocation and Activity Based Costing

Decolam Corporation is a mid-size company manufacturing wooden flooring of different kinds and colours. The products are manufactured in different batches based on instructions received from Sales Department. The company was using traditional costing system for product costing but recently adopted activity based costing. To understand how costing under ABC will be different, the product manager decides to cost three recent orders executed by the production department under both methods of costing. The order and other details are given below:

	Prime Shield	Sponge Soft	Glazed Supreme
Quantity Produced (per Sq. Ft.)	200000	50000	120000
Machine hour	1200	500	695
Material	9000000	3600000	12600000
Production Labour Wages	4600000	4300000	9500000
Production Overhead	1380000	1290000	2850000

Activity List and Costing

Activity	Cost Driver	Activity Cost
Material Handling	Material Cost	20% of material cost
Set Up*	Number of set up	Rs. 2 lakhs per set up
Machining	Machine Hour	Rs. 3000 per machine hour
Finishing	Quantity Produced	Rs. 20 per Sq. Ft.
Quality Control	Quantity Produced	Rs. 10 per Sq. Ft.

^{*}Each order requires one setup

Note: Some values are rounded off

Under traditional costing, production overhead is charged at the rate of 30% on production Labour Wages. The company currently adds 20% mark-up of total product cost.

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Required

- 1. Find the cost per unit of three products under traditional costing and Activity Based Costing.
- 2. Compare the total production cost under traditional costing and Activity Based Costing.
- 3. Compute the price currently charged by the company and evaluate the product profitability.
- 4. ABC consultant suggests to change the pricing methodology such that profit is added as a percentage of cost of activities [mark-up on activity cost]. If this method of pricing is accepted, what should be the product price such that the company earns same total profit?