COSTING TECHNIQUES: MARGINAL COSTING AND ACTIVITY-BASED COSTING

MARGINAL COSTING:
DEFINITION:

Marginal costing is a costing technique where only variable costs are considered for decision-making. It segregates fixed and variable costs to determine the cost of producing one additional unit.

KEY FEATURES:

- Only variable costs are considered in the product cost.
- Fixed costs are treated as period costs and are not assigned to products.
- Useful for short-term decision-making.

EXAMPLE:

Suppose a company produces 1,000 units of a product with the following costs:

1. Variable Cost per Unit: $20
2. Fixed Costs: $10,000

Calculation:

Total Variable Costs = Variable Cost per Unit * Number of Units = $20 * 1,000 = $20,000

Total Cost = Total Variable Costs + Total Fixed Costs = $20,000 + $10,000 = $30,000

Marginal Cost per Unit = Total Variable Costs / Number of Units = $20,000 / 1,000 = $20 per unit

ACTIVITY-BASED COSTING (ABC):

DEFINITION:

Activity-Based Costing is a costing method that identifies and assigns costs to activities based on their consumption of resources. It provides a more accurate way of assigning costs to products and services by considering the specific activities that drive costs.

Key Features:

- Allocates costs to activities, then to products based on their use of those activities.
- Provides a detailed understanding of how costs are incurred.
- Useful for businesses with diverse products and processes.

EXAMPLE:

Consider a company that produces two products, A and B. It has the following activities and associated costs:
Activity 1: Setup Costs - $5,000
Activity 2: Machine Hours - $10,000

Allocation:

1. Product A requires 2 setups and 100 machine hours.
2. Product B requires 1 setup and 50 machine hours.

CALCULATION:

Activity Rate for Setup = Setup Costs / Total Number of Setups = $5,000 / 3 = $1,666.67 per setup
Activity Rate for Machine Hours = Machine Hours Costs / Total Machine Hours = $10,000 / 150 = $66.67 per machine hour

Product Costs:

Product A Cost = (2 setups * $1,666.67) + (100 machine hours * $66.67) = $3,333.34 + $6,666.67 = $10,000.01
Product B Cost = (1 setup * $1,666.67) + (50 machine hours * $66.67) = $1,666.67 + $3,333.34 = $4,999.99

COMPARISON:

- Marginal Costing focuses on variable costs only, simplifying short-term decision-making.
- Activity-Based Costing considers all costs, offering a detailed understanding of cost distribution based on activities.
- Marginal Costing suits simpler scenarios, while ABC is more suitable for complex, diverse operations.

CONCLUSION

In summary, Marginal Costing is straightforward and ideal for short-term decisions, while Activity-Based Costing provides a more nuanced approach for businesses with complex operations. Choosing between them depends on the nature and complexity of the business environment.