Absorption, Marginal and ABC Costing

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# Example 1: ABC Costing

Hensau Ltd has a single production process for which the following costs have been estimated for the period ending 31 December 20X1:

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Material receipt and inspection costs 15,600

Power costs 19,500

Material handling costs 13,650

Three products – X, Y, and Z are produced by workers who perform a number of operations on material blanks using hand held electrically powered drills. The workers are paid $4 per hour.

The following budgeted information has been obtained for the period ending 31 December 20X1:

**Product X Product Y Product Z**

Production quantity (units) 2000 1500 800

Batches of Material 10 5 16

Data per product unit:

Direct material (square meters) 4 6 3

Direct material costs ($) 5 3 6

Direct labour (minutes) 24 40 60

No of power drill operations 6 3 2

Overhead costs for material receipt and inspection, process power and material handling are presently each absorbed by product units using rates per direct labour hour.

An activity based costing investigation has revealed that the costs drivers for the overhead costs are as follows:

Material receipt and inspection: Number of batches of material

Process power: Number of power drill operations

Material handling: Quantity of material (square meters) handled

**Required:**

Prepare summary which shows the budgeted product cost per unit for each product of X, Y and Z for the period ending 31 December 20X1 detailing the units costs for each cost element using:

* 1. The existing method for the absorption of overhead costs and
  2. An approach which recognizes the cost drivers revealed in the activity based costing investigation.

**(22 marks)**

# Example 2: Target Costing

Great Games, a manufacturer of computer games, is in the process of introducing a new game to the market and has undertaken market research to find out about customers’ views on the value of the product and also to obtain a comparison with competitors’ products. The results of this research have been used to establish a target selling price of $60. This is the price that the company thinks it will have to sell the product to achieve the required sales volume.

Cost estimates have been prepared based on the proposed product specification.

Manufacturing cost $

Direct material 3.21

Direct labour 24.03

Direct machinery costs 1.12

Ordering and receiving 0.23

Quality assurance 4.60

Non-manufacturing costs

Marketing 8.15

Distribution 3.25

After-sales service 1.30

The target profit margin for the game is 30% of the target selling price.

**Required**

Calculate the target cost of the new game and target cost gap.