

The traditional costing systems accounting essay

[Business](#), [Accounting](#)



Activity-based costing emphasizes the demand to obtain a better apprehension of the behaviour of operating expense costs, and therefore ascertains what causes overhead costs and how they relate to merchandises. ABC recognizes that in long tally, most fabrication costs are non fixed, and it seeks to understand the forces that cause overhead costs to alter over clip. (Colin Drury, 1995 p. 275)

The definition of accounting supplied by Zlatkovich, et. Al. (1966) is the procedure of identifying, measurement, and pass oning economic information to license informed opinions and determinations by users of the information.

ABC besides can be defined as a method of bing activities that are necessary for the production of merchandises or services (i. e. activities being undertaken) (Dandago, 2003) .

Whatever the definition of ABC, this method was originally developed by Cooper and Kaplan in 1988 as a solution to the insufficiency of traditional direction accounting techniques that used volume based methods to apportion operating expenses to merchandises. ABC is a method of apportioning overhead costs. Eventhough, it is similar to the direct method of overhead costs allotment found in traditional method, but there are two important different. In the traditional direct method, overhead costs are identified by service and production sections while in ABC operating expense costs are identified by activities which likely non the same as sections.

In the traditional direct method, service section costs are allocated straight to production sections and so overhead allotment rates are prepared from

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these combined costs. Overhead costs are so assigned from the production section cost pool to the merchandises processed through this section. The different with ABC method this intermediate measure has been eliminated. Overhead costs are collected by activity and so straight allocated straight to the merchandise. In traditional method direct, the cost object is the terminal merchandise or service. And the premier costs and production costs are charged straight to merchandise or service whereas non-production costs will non bear down to merchandise or service.

There are five (5) chief advantages of following ABC methods are:

Accurate Information

ABC offers more accurate estimations. Business typically have to compare an point 's monetary value and merchandising record to see if it is deserving bring forth, and one of the benefits of ABC is better analysis of both profitable and non-profitable merchandises. Overhead costs can be a major job with some merchandises, but this method will place the costs and helps cut down operating expense. Directors frequently can work better under this costing method, because they have more accurate information.

Accurate Product-Creation Cost

Another benefit of ABC method is a more accurate product-creation cost. By following this bing method, analysts can calculate out the per-product cost and, therefore, more realistic prosodies are used for appraisal.

Competitive Placement

ABC is helpful in choosing which merchandises are profitable and which 1s should be eliminated. If a merchandise is identified as non-profitable, the concerns seldom continuously sell a merchandise. This is because the ABC method enables the concerns to find more accurate merchandise pricing and therefore competency placement of the merchandise in the market place.

Better Decision Making

Since ABC provide accurate information on costs, more appropriate capital investing determinations can be made as a consequence of better burdening being determined on assorted facets.

Future Planing

ABC helps the concerns estimates the cost of all activities or processes that associated to future merchandise planning accurately determined before it is launched. This can so assist with finding pricing, and any associated outgo. By implementing ABC method, the concerns besides could place which production line is inefficiently. This enables the concerns to make up one's mind whether to go on the procedure or activity in-house or outsourcing the procedure or activity to 3rd party.

Despite the advantages of implementing ABC, the method besides has disadvantages and restriction. The disadvantages of the method are elaborated in the following paragraph.

Complexity

The most obvious disadvantage of ABC is complexness in nature. It prevents the system to widespread into other companies. This ensuing the ABC methods normally remain hard to grok and dearly-won to run. ABC requires direction to non merely estimate the costs of each activities and identify and step the cost drivers for such activities, but besides update the same on a regular footing. This utilise much of the organisation 's resources such as direction clip and cost.

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Premises

ABC while it institutes a complex methodological analysis to delegate costs to activities, the method remains far from perfect. The major defects include:

Certain overhead costs remain impossible to split and apportion on a per-product usage footing.

Not all productive activities will add value to merchandises.

Most activity based bing methods assign such 'business prolonging ' costs to merchandises on a proportionate footing or based on premises, and this makes the method far from perfect.

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The Big Picture

ABC places excessively much attending to detail and command on procedures. This causes a terrible restraint in that it obscures the bigger

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image by doing the organisation to lose sight of strategic long term aims in a pursuit for short term nest eggs.

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Confirmation to Standards

This method, while supplying for better direction control over the concern procedure, does non conform to by and large recognized accounting rules (GAAP) . This means that for the companies that practising GAAP demand to duplicate their attempts by keeping two cost systems and separate accounting books for internal usage and external studies.

Replacing Procedure

Finally, ABC method does non replace an bing occupation order or procedure cost system, but instead supplement the same. Indirectly, this will be seen as excess procedure.

Eventhough the method has disadvantages ; it has proven that it still taking method to bring forth the most dependable, accurate bing information particularly for fabricating companies today. Although this method may non be easy to implement, since it utilizing activities to follow costs but it provides more accurate information ensuing in better scheme, better planning, and better prediction. However, the most influential facet of ABC is the ability to salvage cost. If company has a more accurate image of costs, so it is in a place to accomplish higher net incomes which straight maximize the stockholder wealth.

Case Studies

The following paragraph discussed on the execution of the ABC method in four (4) different states with different civilization and industries. The analysis was based on the research documents conducted in these states.

The first research paper by Wen-Hsien Tsai and Jui-Ling Hsu. The survey was carried out to analyse the operational costs of a hot spring hostel in the Yang-Ming-Shan country of Taiwan. The ABC method was used to calculate housing, hot spring usage and repast helping costs per client. Based on the consequence of the research, it was reported that the cost of merchandises was lower than utilizing other methods eventhough duringwinter season. The research worker besides compares the ABC method with the traditional costing method and concludes that the ABC method is practical and appropriate for such a hot spring state hostel and outputs more accurate information for cost direction and pricing determinations.

The following research paper was carried out by Ahmet Agca and Ali Cagri Buran in implementing ABC method in Third Party Logistics (3PL) houses at Turkey. This survey was carried out for selected endeavors that are expertise in logistic activities at Turkey. The successful factors for these houses are the service they provide and accommodating their clients to their procedures in an optimum manner.

The 3PL houses can plan their services in a two different manner to run into their clients ' outlooks i. e. service-oriented and customer-oriented. By following ABC, it shown that either service-oriented or customer-oriented, both theoretical accounts need to find the optimal cost degree for accurate

pricing determinations to enable them to find the profitability of clients or services. Therefore, the method they use needs to be qualified adequate to run into the demand for accurate cost information.

The houses have found out that, ABC method has proved the optimum method in both state of affairs. As this method allocates costs by the activities ; so, it is the method supplying the most accurate cost information both in logistic activities and finding the costs of clients and services/products.

The 3rd research paper was carried out by Francesca Bartolacci for logistic procedure in Italy. In this instance survey, Francesca defined logistics as portion of the supply concatenation procedure that plans, implements and controls the effectual and efficient flow of goods, services and related information from the point of beginning to the point of ingestion. Nowadays, the market really competitive, the merchandises, monetary value and quality are easy imitated and the velocity of the physical and information flows plays a cardinal function for the accomplishment of the company objectives. Excellence client service can be the cardinal component for the company to be at the competitive border and one of the maps evidently plays a critical function in the success or failure of a company is logistic.

Eventhough Francesca Bartolacci has identified some disadvantages and drawback in implementing the ABC method in logistic, nevertheless ABC method has references to work out the jobs referring the usage of traditional cost accounting system based on volume and the betterment of concern profitability. The method provides directors with utile information about

labor and other resources, including ingestion for merchandises, consumers and providing channels, taking to the direction and control of the operating expenses nowadays in the company.

The analysis besides managed to place the factors that determine the operating expense consumed. By following this method it is possible to do the logistics activities more efficient by extinguishing redundant or unneeded undertakings, and optimizing resource allotments to activities adding more value to the merchandise or client.

Other advantage of the method is, ABC permits the planning of more efficient collaborative relationships among the companies in the supply concatenation. Francesca concludes that `` the designation of costs in return influenced allows for a pick of coactions as a method which is more convenient for the whole partnership. Correct information about the differential costs originating from possible change of the coaction relationships aid companies to do those appropriate strategic determinations with their logistics activities. This in bend helps them gain, with other companies, how best to modify the object of the cooperation in order to do the whole supply concatenation more competitory " .

The concluding research paper was analysing the consequences of following of ABC methods in service sectors at United State of America by Ashford C. Chea.

It was reported that the acceptance of ABC to efficaciously apportion resources and to find monetary values was the primary aim in the instance

of a big regional bank. Previously, the bank had no clear manner to be services or find how resources were being consumed by different activities. In add-on, since some of the clients were related parties, the bank wished to demo that the charges being made to them were effort-and-use-based, i. e. , there was a direct correlativity between the nature of service provided and the charge for this service. ABC method assisted the bank to turn to both i. e. internal pricing and strategic pricing.

For planetary insurance company, the determination to follow ABC method simply for revenue enhancement intents. The method was adopted to find its allotment methodological analysis for external transportation pricing intents. This is because the company wanted to guarantee that its charges to its abroad affiliates were accurate and defensible to revenue enhancement governments. By following ABC, the company ensured that the services provided to all abroad affiliates were tracked through the ABC systems, ensuing in charges straight related to the economic benefit received by the receiver. As a consequence, the company was able to take down its effectual revenue enhancement rate.

Decision

ABC was introduced in the 1920 's and over period of clip the method continually bettering. As shown in four (4) instance surveies, ABC is non merely allow for usage in a fabricationenvironment; it is besides reported to be most appropriate for service organisations such as fiscal establishments, thehealthcare industry, and authorities organisations. In fact, some banking and fiscal establishments have been using the construct for old ages under

other names. One of them is unit costing, which is used to cipher the cost of banking services by finding the cost and ingestion of each unit of end product of maps required to present the service.