

Management accounting

Finance



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Management Accounting It has been said that ' modern developments such as ABC are sometimes implemented because they are fashionable and not because they provide extra information to management.

Discuss the above statement.

One of the costing techniques used by firms is activity base costing (ABC). This is used in the determination of costs the firm incurs in its activities such as production. Under ABC costing, cost objects are used in the allocation of direct overhead costs. The method assembles the overhead costs into similar cost groups (pools). The cost driver in a particular group is selected depending on the cause effect link in the cost object and the firm's ability to have overhead costs. The Institute of Management Accounting indicates that ABC is advantageous when undertaking a two stage assignment plan for overheads since cost allocation to intermediate pools is carried out at the initial stage while the second stage involves cost allocation to the products from the intermediate pools (Barnett & Dawkins, 2006).

A number of scholars hold the opinion that ABC method of costing is undertaken by firms because it is considered fashionable, and not that it gives more detailed information for use by the management. It is a fact that this costing method does not give extra information to management since it determines the costs of the firm in a way that is different from the traditional or conventional method of costing (Rosati et al., 2008).

The traditional costing method brings together all the costs of the organization then allocates them to the products that have been manufactured depending on the hours of labor spent directly per product. On the other hand, ABC concentrates majorly on the activities carried out prior to the completion of the products' production. Here, the costing process is <https://assignbuster.com/management-accounting-essay-samples-4/>

intermediate and is carried out by a firm to assign overhead costs to the products so as to see to it that there is accuracy on the information on the costs of the good. In other instances, the cost activity becomes the activity. Here, ABC provides no additional information and instead divides the costing process to see to the correctness of the cost information that is given for every unit or each product that is produced.

Accounting heavily relies on the accuracy and transparency of information. The conventional cost techniques assign all kinds of overheads, which include product level, batch level, and facility depending on the allocation or assignment that suits the unit level best. On the other hand, ABC taps the structure of costs to illustrate the correctness in the information, presenting a particular reason for its preference by a number of firms.

ABC primarily concentrates on activities that relate to the production activities of the firm. The engagement of activities spreads through a number of departments in a firm and necessitates involvement of all the managers in the firm who head the departments. Hence, use of ABC technique would lead to improved communication levels, which would translate, into enhanced cooperation within the firm (Gosselin, 2006). This costing technique (ABC) has grown to form an integral consulting product for a number of firms since most of the accounting firms are employed to carry out costing using this method. Regardless of this, the accuracy given by the technique does not lead to a reduction in costs. With the employment of the method as a consulting product, its liking and popularity has risen, confirming that increased employment of the method is not due to its supply of extra information to the manager, but due to the fact that it is fashionable to use.

The accounting firms make use of the technique as a tool to be employed.

ABC gives the impact of variations in activities and alterations in products on costs (Barnett & Dawkins, 2006). Other advantages of ABC include:

Enhanced measurement of profitability as it gives more accurate information

Leads to process improvement as it breaks down the production process and analyses the various stages

Facilitates better decision making by the management

Leads to accurate cost estimation therefore leading to better pricing

ABC has a number of limitations (Gosselin, 2006). They include:

Some costs lack activity drivers.

Omission of some costs associated with with good such as advertising costs, research and development costs among others.

It is costly and time consuming to develop and also implement.

References

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