#### Tutorial - ABC & ABM

### Question 1

Johns Ltd. produces 4 products, namely P1, P2, P3 & P4. The following figures represent the budget information per unit of each product.

Product	Annual Volume (units)	Material per unit Rs.	Direct Labor hours per unit	Selling price per unit (Rs)
P1	100	60	5	110
P2	1000	60	5	110
Р3	100	180	15	330
P4	1000	180	15	330

The budgeted cost per direct labor hour is Rs.5. The company currently absorbs overheads into products on the basis of direct labor overhead absorption rate. The budgeted overhead for the year is Rs. 66,000and the amount related to each activity is shown bellow.

Activity	Annual	Cost driver	Annual consumption of cost driver by product				
	Overhead		P1	P2	Р3	P4	Total
	cost (Rs)						
Setting up jobs	30,000	Number of setups	2	10	5	13	30
Ordering	15,000	Number of material	4	4	2	5	15
materials		orders					
Material	21,000	Number of times	6	50	20	24	100
handling		materials handled					
	66,000						

The company uses a full cost plus pricing system. The sales manager of the company is currently worried about P4 since sales of this product seem to be under pressure from competitors in a market which is becoming particularly price sensitive.

# **Required:**

- 1. Calculate unit cost per product using the company's traditional method of absorbing Overhead costs into product.
- 2. Calculate the unit cost per product using Activity Based Costing as the method of absorbing Overhead costs into products.
- 3. Discuss the results disclosed by a comparison between the two methods of absorbing Overheads into the products and the implications for the company.

# Question 2

Williams Corporation is a multi-product company. It produces a product named 'A' which is a low volume and a complex product. Departmental Material handling cost per month is \$ 50000. Average direct labor hours per month are 40000. Each month the production of "A" is 100 units.

To produce one unit of "A" it takes one hour of direct labor.

Under the ABC system Williams identified 3 primary activities done by the material handling department; receive parts, receive materials, and disburse parts to the production floor. Following information is given.

	Receive parts	Receive materials	Disburse parts & material
Activity cost driver	No of part receipts	No of material receipts	No of production runs
Activity cost	\$ 25000	\$ 12500	\$ 12500
Driver quantity	2500 receipts	1000 receipts	500 runs

Product "A" is quite a complex product with more than 50 separate purchased parts and several different types of raw materials required to assemble a finished product. Producing the 100 units of 'A' during the month typically requires one production run, 20 purchased parts shipments, and four raw material shipments (many shipments are required even for only one production run because of the large number of different parts and materials required to produce "A").

- 1. Find out material handling burden rate and material handling cost to be allocated to product 'A' under traditional cost system.
- 2. Using the activity cost drivers assign the material handling cost to be allocated to product 'A'.
- 3. Discuss the results of estimating product costs using two different methods of absorbing overheads.

#### **Question 3**

- Define *activity based management* (ABM).
  Differentiate between operational and strategic dimensions of ABM.
- State <u>four</u> decisions for which activity based cost information is useful. Briefly explain <u>one</u> of them.
- 3. State <u>four</u> deficiencies and misconceptions of traditional costing system.