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COST AND WORKS ACCOUNTING
(Overheads and Methods of Costing-II)
T.Y.B.COM

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Selection of Suitable Cost Drivers
COST DRIVERS:

Meaning:

Cost Drivers are the forces that cause the activities. There are certain important factors that influence the cost of a particular activity and certain basis that drives the consumption of the activity.

Under activity based costing, overhead costs are grouped together according to what causes them to be incurred and finally these costs drivers are used as a suitable basis for absorption.
COST DRIVERS:

Definitions:
1. Chartered Institute of Management Accountants:

   “A Cost Driver is the unit of an activity that causes the change in activity’s cost. Cost Driver is an any factor which causes a change in the cost of an activity”.

2. A Cost Driver triggers a change in the cost of an activity.

3. Cost Driver is a factor that influences the cost of an activity.
R. Hansen and Maryanne M. Mowen, pointed out, that at least two major factors should be considered in selecting cost drivers.

Both of them suggested the following major factors in selecting cost drivers:

i) Cost of measurement
ii) Degree of co-relation between the cost driver and the actual consumption of overhead.

Following are the important factors that should be considered in selecting cost drivers:
1. Cost of Measurement:

In Activity Based Costing, a large number of cost drivers can be selected and used. Accordingly where possible, it is important to select cost drivers that use information that is readily available. Information that is not available in the existing system must be produced and this production will increase the cost of the firm’s information system. A homogenous cost pool could offer a number of possible cost drivers. For this situation any cost driver that can be used with existing information should be chosen. This choice minimises the cost of measurement.
2. Indirect Measures and the Degree of Co-relation:

The existing information structure can be exploited in another way to minimise the costs of obtaining cost driver quantities. It is sometimes possible to replace a cost driver that directly measures the consumption of an activity with a cost driver that indirectly measures that consumption. e.g. inspection hours could be replaced by the actual number of inspections associated with each product, this number is more likely to be known. This replacement works, of course, only if hours used per inspection are approximately equal for each product.
3. Multitude of Cost Drivers:

In traditional product costing, the number of cost drivers used are few such as direct labour hours, machine hours, direct labour cost, units produced. But activity based costing may use a multitude of cost drivers that relate costs more closely to the resources consumed and activities occurring.

4. Pool Rate:

After cost pool is defined and cost drivers are identified, the cost per unit of the cost driver is computed for that pool which is called the pool rate.
This pool rate links costs drivers with the resource use. This pool rate can be based on either planned or actual activity levels.

5. Charging of Overheads:

The cost of each overhead pool are traced to products who are the users of the resources. Thus, at the final stage, the cost pool, cost driver and the pool rate continue to determine how much cost should be assigned to each product. The pool rate measure is simply the quantity of cost driver used by each product.
Thank You