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

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Distinction between Traditional Product Costing Approach and Activity Based Costing Approach
TRADITIONAL PRODUCT COSTING APPROACH:

Introduction:

In traditional costing method, overhead is usually applied based on either the amount of direct labour hours consumed or machine hours used. The problem with traditional costing is that, factory overhead may be much higher than the basis of allocation, so that a small change in the volume of resources consumed triggers a massive change in the amount of overhead applied. The traditional costing method is also called the conventional method.
Definitions: (Traditional Product Costing Approach)

1. Traditional Costing is the allocation of factory overhead to products based on the volume of production resources consumed.

2. The traditional method of costing refers to the allocation of manufacturing overhead costs to the products manufactured.

This method assigns or allocates the factory indirect costs to the items manufactured on the basis of volume such as the number of units produced, the direct labour hours or the production machine hours.
ACTIVITY BASED COSTING APPROACH:

Introduction:

Activity based costing is an upcoming and more polished approach for charging of overheads to products and ascertaining the product costs more accurately and scientifically. Activity based costing is a system which focuses on activities performed to produce products. In activity based costing activities become the focal points for cost accumulation. In activity based costing, overheads are first calculated separately for each activity and then are charged to various cost objects on the basis of activities consumed by these cost objects.
Definitions: (Activity Based Costing Approach)

1. Cooper and Kalpan:
“Activity Based Costing systems calculate the costs of individual activities and assign costs to cost objects such as products and services on the basis of activities undertaken to produce each product or service”.

2. CIMA, London:
“Cost attribution to cost units on the basis of benefits received from indirect activities, i.e., ordering, setting up, assuring quality etc.”.
**DISTINCTIO BETWEEN TRADITIONAL PRODUCT COSTING APPROACH AND ACTIVITY NASED COSTING APPROACH:**

<table>
<thead>
<tr>
<th>Traditional Pro. Costing Approach</th>
<th>Activity Based Costing Approach</th>
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<tbody>
<tr>
<td>1. Traditional Pro. Costing approach is a subjective approach because it uses arbitrary bases for apportionment of overheads.</td>
<td>1. Activity Based Costing approach is an objective approach because it uses for distribution of overheads. It aims at identifying as many costs as possible to be subsequently accounted as direct cost of production.</td>
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Traditional Pro. Costing Approach | Activity Based Costing Approach

2. Traditional pro. costing approach is based on the assumption that end products consume resources in proportion to the volume of production.

2. Activity based costing approach is based on the assumption that end products consume resources in proportion to the volume of production.
Traditional Pro. Costing Approach

3. Overheads are first allocated and apportioned to various production departments and service departments, then overheads of service departments are re-apportioned to production departments and then overheads of production departments are charged to end products.

Activity Based Costing Approach

3. Activity Based Costing is a technique of charging overheads to cost objects i.e. products, services, jobs, customers etc. under which overheads are first calculated separately for each activity and then are charged to various cost objects on the basis of activities consumed by these cost objects.
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<td>4. Traditional product costing</td>
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<td>approach is not so accurate as</td>
<td>accurate system of costing</td>
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<td>Activity based costing does</td>
<td>because the distribution of</td>
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<td>not facilitate the identification</td>
<td>overheads is based on the</td>
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<td>of unnecessary activities.</td>
<td>cause-and-effect relationship</td>
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<td>in the cost incurrence. However,</td>
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<td>of unnecessary activities.</td>
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5. Traditional product costing approach does not facilitate the control over those activities which cause fixed overheads.

5. Activity Based Costing facilitates the control over those activities which cause fixed overheads. This is possible because behavior of fixed overheads costs in relation to activities become more visible and clear.
Thank You