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

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CLASSIFICATION OF ACTIVITIES
ACTIVITY BASED COSTING:

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:

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.”
CLASSIFICATION OF ACTIVITIES:

Under Activity Based Costing system, activities are identified and classified into different categories or segments of the production process. The grouping of activities is preferably done using the different levels at which activities are performed. Broadly, activities are classified into one of the four activity categories, viz., unit level activities, batch level activities, product level activities and facility level activities. Classification of activities is as follows:
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1. Unit Level Activities:

Unit level activities are those activities, which are performed each time a unit is produced. They are repetitive activities. For example- direct labour hours, machine hours, power, they are used each time a unit is produced. Direct materials and direct labour activities are also unit level activities, although they are not overhead cost of unit level activities, and vary with the number of units produced.
2. Batch Level Activities:

Batch level activities are those activities, which are performed each time a batch of goods or product is produced. The cost of batch level activities vary with the number of batches, but are fixed with respect to the number of units in each batch. Machine set-up inspections, production scheduling, materials handling are examples of batch level activities which are related to batches, but not to individual products.
3. Product Level Activities:

Product level activities are those activities, which are performed to support the production of each different type of product. Maintenance of equipment, engineering charges, testing routines, maintaining bills of materials, handling materials are some examples of product level activities.
4. Facility Level Activities:

Facility level activities are those activities, which are needed to sustain factory’s manufacturing process. These activities are common to a variety of products and are most difficult to produce specific activities. Examples of facility level activities are factory management, maintenance, security, plant depreciation etc.
In Activity Based Costing system, facility level activities and costs are treated as period costs as they are found difficult to assign to different products. The cost associated with the first three categories, viz., unit level, batch level and product level are assigned to products, using cost drivers that reflect the cause and effect relationship between activity consumption and cost.
Thank You