

## Activity Based Costing Quick Revision

**Activity Based Costing** is an accounting methodology that assigns costs to activities rather than products or services. This enables resources and overhead costs to be more accurately assigned to products and services that consume them.

Resources are assigned to activities



Activities to cost objects based on consumption estimates

**Activity:** refers to an event that incurs cost.

**A Cost Object:** It is an item for which cost measurement is required example product or a customer.

**A Cost Driver:** It is any factor or activity that causes a change in the cost of an activity. It has a direct cause and effect relationship with the resources consumed. There are two categories of cost driver:

1. **A Resource Cost Driver:** It is a measure of the quantity of resources consumed by an activity. It is used to assign the cost of a resource to an activity or cost pool.
2. **An Activity Cost Driver:** It is a measure of the frequency and intensity of demand, placed on activities by cost objects. It is used to assign activity costs to cost objects.

Below are few activities and related cost drivers for easy remembrance:

Activity Cost Pools	Related Cost Drivers
Ordering and receiving materials cost	Number of purchase orders
Setting up machines costs	Number of set-ups
Machining costs	Machine hours
Assembling costs	Number of parts
Testing costs	Number of tests
Painting costs	Number of parts
Supervising costs	Direct labour hours
Maintenance of equipments	Number of hours
Machine operation and maintenance	Machine hours
Inspection	Number of production runs
Finished goods packing	Number of equivalent boxes

$$\text{Activity Cost Driver Rate} = \frac{\text{Total Activity Cost}}{\text{Activity Driver}}$$