

ABC vs Traditional costing methods

Costing issues are often incorrectly misconstrued as merely an issue of the manufacturing industry, whereas they also concern others.

The most popular method of costing is the Traditional Costing method due to its simplicity. However due to the current ever-evolving environment choosing the right costing method might be essential to survive. This is why ABC Costing should be considered by all companies.

Outline of how the costs are derived:



Traditional Costing:

- A way of costing company products using one cost driver which drives the cost of the activity.
- All of the costs (manufacturing and non-manufacturing) are recognised and charged to the products even if they are not relevant for the production of the particular output.
- The rate used to calculate the costs are based on the budgeted level of activity.
- Due to this process, the traditional costing method is highly inaccurate and not valuable for decision making (as it uses historical data).

ABC Costing:

- Costs products using multiple cost drives, which are created based on main activity for specific overhead costs (e.g. for a setup cost – the driver could be time spent on each of the products).
- The fixed costs are firstly assigned to an activity and after to products. This way only relevant and needed costs are recognised in product production.

The ABC method is more appropriate for the current fast-paced environment due to:

- More accurate financial information available, which improves decision making - Recognise non-value added activities, allowing managers to remove them
- Tools used by them are more accurate and helpful in planning and creating strategies
- As a result of more accurate fixed cost allocation, determining the sales price is more accurate, which results in a possible increase in sales due to better pricing and becoming more competitive

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