



# **SNS COLLEGE OF TECHNOLOGY**

**(An Autonomous Institution)**



## **TRADITIONAL COSTING APPROACH AND ACTIVITY BASED COSTING**



# Introduction



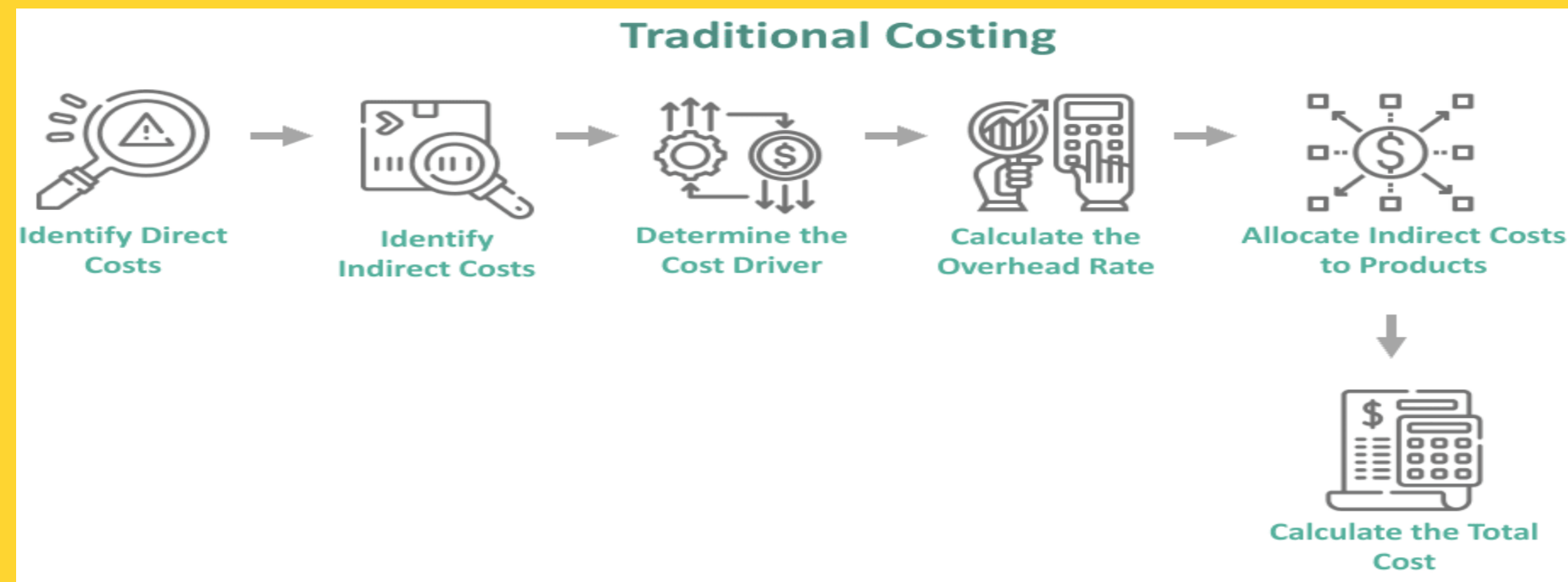
- Companies need accounting systems to track the costs of their operations. Two of the most commonly used systems are traditional costing and activity-based costing.
- One of these is easy to use and inexpensive to implement, while the other costs more to use but gives you greater accuracy.



# TRADITIONAL COSTING METHOD



- Traditional costing is a method used to assign costs to products based on the volume of resources used, such as labor hours or machine hours.
- It aims to determine the cost of producing or providing a service by allocating indirect costs to the products based on the volume of resources consumed, such as direct labor or machine hours. It aims to allocate indirect costs to products based on a predetermined cost driver. This method assumes that all overhead costs result from a single factor. For example, direct labor hours or machine usage, and this factor is the primary driver of overhead expenses.





# TRADITIONAL COSTING METHOD



- Traditional costing is a method that allocates indirect costs to products. This is based on a single cost driver, such as direct labor or machine hours.
- It is a simple method of cost allocation that is easy to understand and implement.
- It has limitations. It includes the potential for inaccurate cost allocation and the inability to account for the impact of non-volume-related cost drivers.
- It is less expensive and time-consuming than more sophisticated costing methods. This makes it suitable for small businesses or those with simple production processes.



# ACTIVITY BASED COSTING (ABC) APPROACH



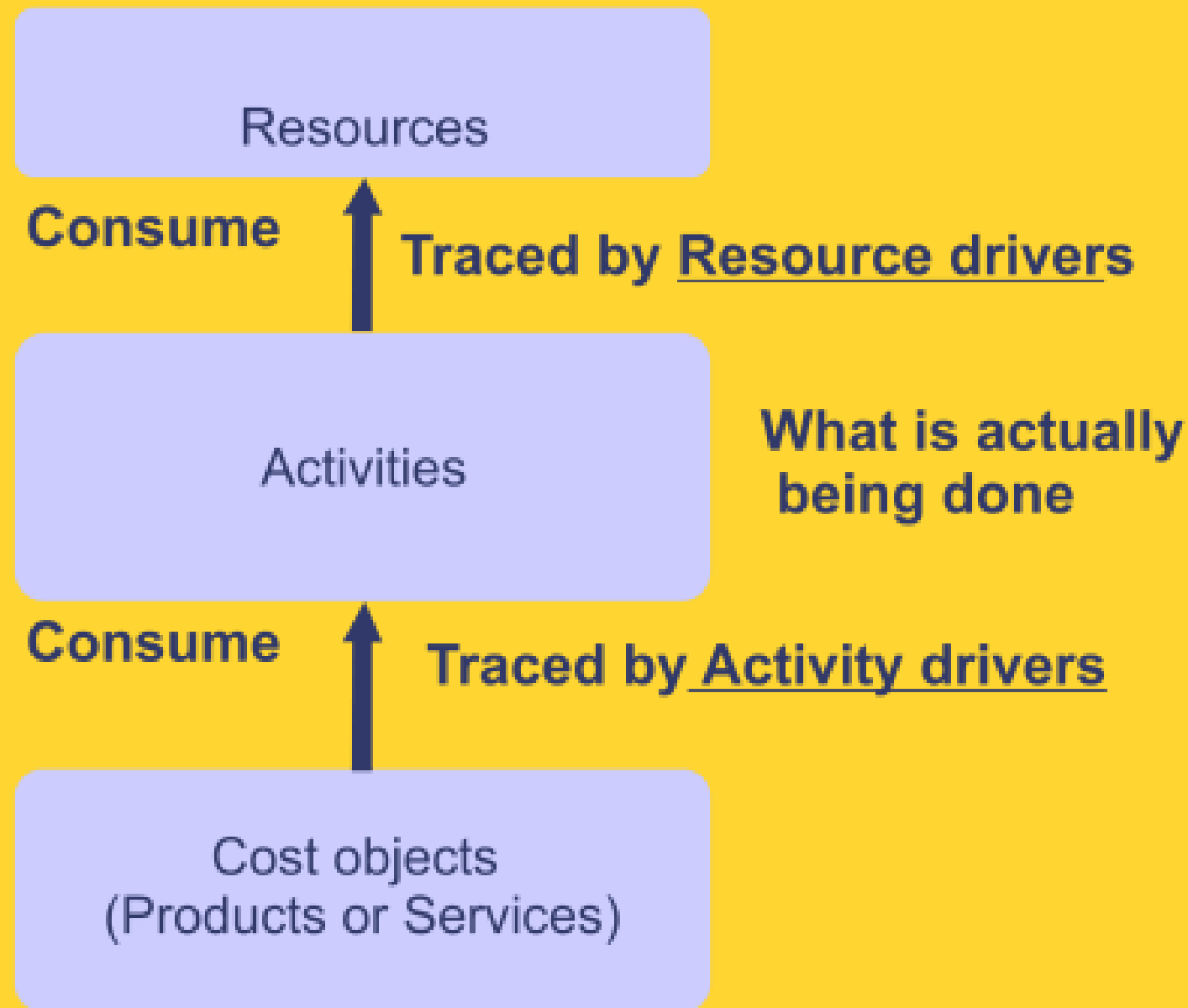
- Activity-Based costing is allocating costs to the activities involved in the production. It can be defined as a system of costing that recognizes activities involved in producing a product and then traces the cost incurred in performing each activity.
- ABC costing system consists of two stages of the cost of the product. In the first stage, the cost is assigned to the production activities, and then in the final stage, the cost is allocated to the final product.
- It follows the approach of accumulated activity-related costing.
- The activity considered for estimation of cost should be any task undertaken for the production of any product or for delivering any services.
- ABC system follows the concept that the products consume activities, and the activities consume resources.
- ABC costing method can be used by any manufacturing or service delivery firm that wants to ease cost accounting.



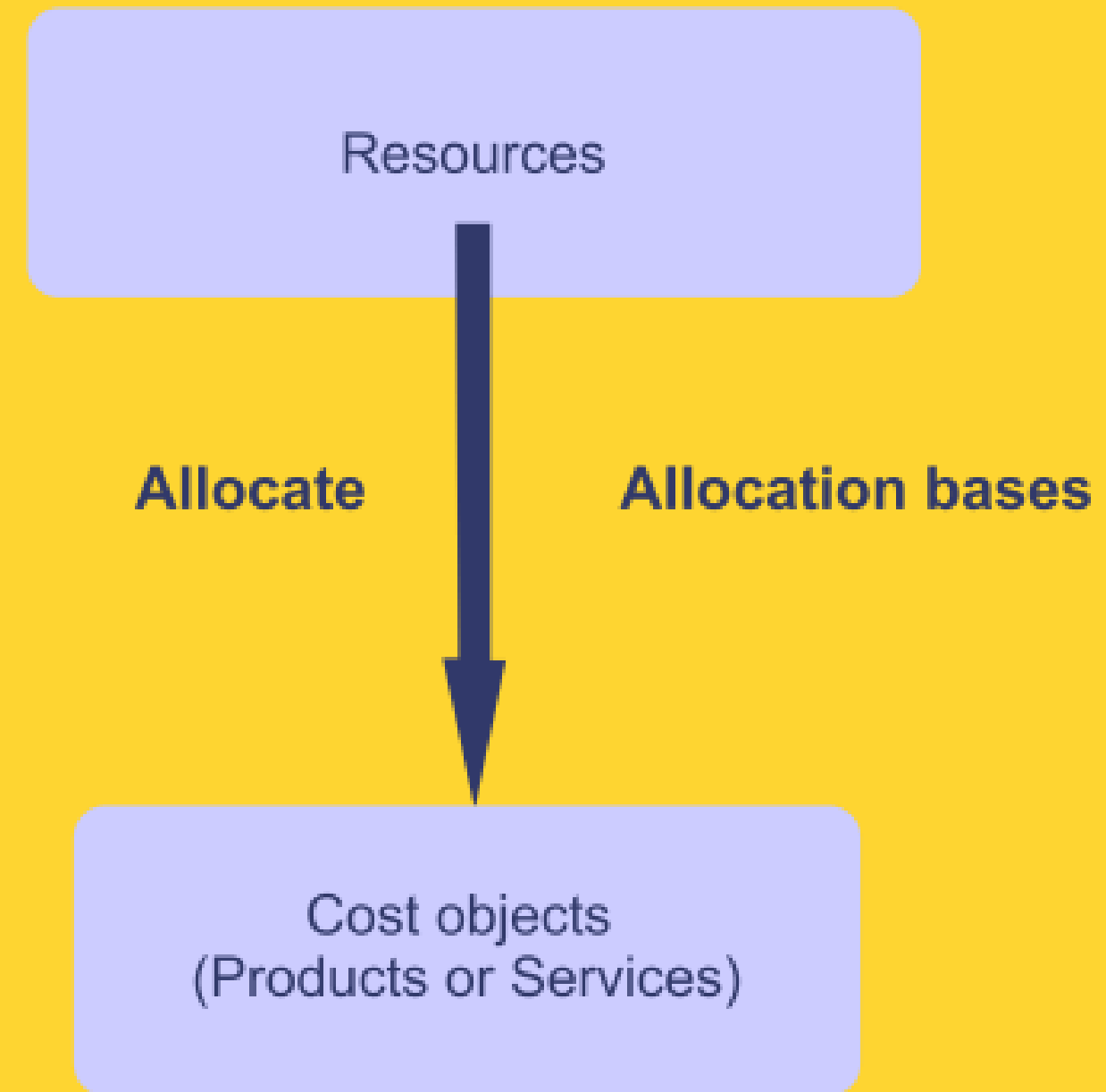
# Difference between traditional costing and ABC approach



## Activity Based Costing (ABC)



## Traditional Cost Accounting (TCA)







# Difference between traditional costing and ABC approach



Traditional Absorption Costing	Activity-Based Costing
In this, the overhead expenses are first allocated to departments or units.	In this system, the overhead expenses are assigned to production activities or passed to cost pools.
It consists of only two types of activities; they are Unit level activities and Facility level activities.	Here the cost is assigned to all the activities included under the manufacturing hierarchy, like Unit level, batch level, product level, and facility level.
In this system, the cost is allocated to the cost centres or locations where costs are incurred.	In this system, the costs are assigned to the production activity factors.
Here only the cost of production of products can be ascertained.	In this system, apart from the cost of the product, other objects or activities involved in the production process can be ascertained, like costs incurred under customer segments, distribution, packaging, etc.



# THANK YOU