

Day 1 Session 2 (iii)

Costing

Notes

- Costing relevant to Output budgeting and in a service or production environment
- Different program or output costing tools
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Accrual information and Full costing of services

- Accrual accounting involves revenue, expense, asset, liability and equity transactions and balances.
- Transactions are recorded in the period in which they occur, as opposed to when the subsequent cash flow takes place. This means that periodic performance as measured more closely reflects the economic substance of change over the period.
- Non cash outflows such as depreciation are estimated and recorded again in the period to which the outflow relates.
- This means that full costs are able to be determined and reflected in a price.
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- Costing is the allocation of costs to a product, activity or job.
- Activity Based Costing (ABC)
- A cost accounting method that measures the cost and performance of process related activities and cost objects. It assigns cost to cost objects, such as products or customers, based on their use of activities.
- ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs.
- A major advantage of using ABC is that it avoids or minimizes distortions in product costing that result from arbitrary allocations of indirect costs. By tracing costs through activities, ABC provides more accurate service or product costs.
- This approach is a bottom up approach, allowing due analysis of the activities making up a process, and of the input costs involved for each activity within a process. Efficiencies can be gained through this analysis of process.
- So there needs to be a mapping of each activity within a process so that all input costs and cost behaviours are identified.
- A major disadvantage of ABC is the cost of applying the methodology. For large scale process related activities, the benefits may outweigh the costs. For smaller activities and volumes the costs may outweigh any potential benefits.
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- Absorption costing
- Is a method whereby cost is determined by including the appropriate share of both variable and fixed costs, with the latter allocated on the basis of units of production at normal operating capacity. The principle is that the volume of output must ultimately absorb all costs, whether fixed or variable.

- Direct costing
- Where costs is determined by allocating an appropriate share of variable costs only (thus contrasting markedly with absorption costing).

- Standard costing
- A system where cost components are predetermined using standards (labour rate, cost of materials etc) that assume an efficient operation operating at normal capacity. The standard cost is then compared to the actual cost and the variances explained in terms of price or quantity.
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- Job costing
- An appropriate system of costing when an individual product can be identified separately. This technique is best suited to large one off projects.
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- Process costing
- Costs are calculated on the basis of total costs per process or operation, based on the expected numbers of products to be passed through each process. A unit cost per process is then calculated, which is then applied to each unit as they pass through the process.
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- An expedient top down methodology was a practical interim solution for agencies in Australia was suggested by Department of Finance and Deregulation, which went as follows:
 - Specify all outputs produced by the agency
 - Identify all costs incurred for a financial period in which the outputs are being costs
 - Identify all direct costs
 - Decide on methods of cost allocation to be applied
 - Calculate the direct costs of the output
 - Identify all indirect costs
 - Decide on the cost drivers to be applied
 - Apportion the indirect costs of the outputs
 - Add direct and indirect costs to arrive at the full cost of producing the output.

The Australian Experience

- Australian government departments authorised to employ whichever costing approach was appropriate to their own output environment provided it was robust reliable and can be justified.
- Full accrual basis of costs

- A DOFD document was produced and subsequently updated which included guidance on types of costing techniques, and a suggested step by step approach to costing of outputs.
- Many agencies adopted Activity Based Costing methodology.
- Whole new appropriation and outputs framework encouraged agencies to explore approaches to better understanding their output processes with a view to gaining efficiencies and relevant output performance measures.

Policies**Issues and Challenges related to costing**

Group Task	Group Response
What costing tools are used in Malaysia Federal Government and for what purpose?	
Discuss the strengths and weaknesses of a bottom up approach to costing	
Discuss the strengths and weaknesses of a top down approach to costing	
Discuss what costing methodology would be appropriate to Malaysia as part of the financial management reforms.	
Once an output cost is identified how to we cost outcomes? What are the issues involved?	

