Costing Report for Super Clean

Super Clean is a service company that provides commercial and residential cleaning services. An organization uses a costing system in which overhead is distributed on the basis of uninterrupted working time. Therefore, the company uses the number of labor hours to calculate the overhead rate. However, the company has realized that the traditional costing method of allocating overhead is inaccurate. The reason for this is that gas and depreciation costs do not vary with direct labor. Therefore, the company wants to use the activity-based-costing system to allocate the values of the receptionist, office supplies, gas and car usage (depreciation) to get more accurate cost estimates. The information generated from ABC costing is expected to help management to give more accurate quotes and improve the company’s profitability.

The current report calculates the overhead rate using the plantwide method (one rate), as well as the overhead valuations for each activity, cost pool for commercial and residential cleanings. This information is used to estimate the total overhead costs and overhead cost per unit hour for each job. The report also estimates total costs, which include direct labor and material, as well as the total cost per unit for position one and two. Job 1 refers to residential cleaning while position 2 denotes commercial cleaning. Finally, the report lists and explains three benefits and two disadvantages of ABC systems.

1. Overhead Rate using the Plantwide Method (One Rate)

According to Warren, Reeve, and Duchac (2016, p. 889; 2017, p. 151) and Drury (2008, p. 52), overhead Rate using the Plantwide Method = Total Overhead Costs /Total Direct Labour Hours.

Total Overhead Costs = $98,000

Total Direct Labour Hours = Direct Hours (Commercial) + Direct Hour (Residential)

= (10,000 + 10,000) + (6,000 + 6,000) =20,000 + 12,000 = 32,000

Overhead Rate using the Plantwide Method = $98,000/32,000

= $3.06 per Direct Labour Hour

Therefore, the overhead rate using the plantwide method is $3.06 per labour hour.

2. Overhead Rate using the Plantwide Method (One Rate2. Overhead Rate using the Departmental Method (Two Rates)

Commercial

Total Overhead Costs = $42,500

Total Direct Labour Hours = Direct Hours Commercial = 10,000 + 10,000 =20,000

Overhead Rate using the Departmental Method = $42,500/20,000

= $2.13 per Direct Labour Hour

Residential

Total Overhead Costs = $55,500

Total Direct Labour Hours = Direct Hours Residential = 6,000 + 6,000 =12,000

Overhead Rate using the Departmental Method = $55,500/12,000

= $4.63 per Direct Labour Hour

3. Overhead Rates for each Activity Cost Pool for Commercial and Residential Cleanings

Activity Cost Pool Commercial Cleaning Residential Cleaning

Gas

$0.13/KM

($13,000/100,000KM)

$0.13/KM

($19,500/150,000KM)

Depreciation

$0.15/KM

$15,000/100,000KM)

$0.15/KM

$22,500/150,000KM)

4. Total Overhead Costs and Overhead Cost per Unit Hour for Each Job

Total Overhead Costs

Activity Cost Pool Commercial Cleaning Residential Cleaning

Gas $213 (100 KM × 2.13) $695 (150 KM× 4.63)

Depreciation $213 (100 KM × 2.13) $695 (150 KM× 4.63)

Total Overhead Cost per Unit $430.26 $1,399.26

Overhead Cost per Unit Hour for Each Job

Activity Cost Pool Commercial Cleaning Residential Cleaning

Receptionist

$2.13

[$42.500/(10,000 + 10,000)]

$4.63

[$55,500/(6,000 + 6,000)]

Office supplies

$2.13

[$42.500/(10,000 + 10,000)]

$4.63

[$55,500/(6,000 + 6,000)]

5. Total Costs, including Direct Labour and Material and Total Cost per Unit for Job 1 (Residential) and Job 2 (Commercial)

Cost Item Job 1 (Residential) Job 2 (Commercial)

Direct labour $2,000 (100 hours × $20) $3,600 (180 hours × $20)

Cleaning materials 10 litres (100 hours × 0.1) 36 litres (180 hours × 0.2)

Direct material cost $55 (10 × $5.5) $198 (36 $5.5)

Cost of fuel $8,800 (1,600 KM × $5.5) $ 5,500 (1,000 KM × $5.5)

Depreciation $880 (1,600 KM × 0.1 × $5.5) $1,100 (1,100 KM × 0.1 × $5.5)

Total Cost $11,735 $10,398

Job 1 (residential) Job 2 (commercial)

Fixed costs (overhead)

Receptionist 2000.00 3600.00

Office supplies 55.00 198.00

Gas 8800.00 5500.00

Depreciation 880.00 1100.00

Total 11735.00 10398.00

Overhread cost per unit 6.86 8.19

Variable costs

Direct labour 2055.00 3798.00

Direct material 9680.00 6600.00

Total

Total costs 11735.00 10398.00

Total costs per unit 7.33 10.40

6. Benefits and Disadvantages of ABC Systems

Benefits

Activity Based Costing System (ABC) enhances accuracy in costing various product lines (Maingi, 2013). With ABC, the overhead of products and processes is easier to track to determine how the overall organizational resources are allocated to specific cost factors. (Weygandt, Kieso, & Kimmel, 2010, p. 161). It utilizes marginal cost or cost per unit, which depicts a more precise interpretation regarding the actual value of creating each product. ABC can be used for quality improvement purposes to identify the non-value adding or wasteful organizational activities (Hansen, 2017, p. 647). Finally, it is very comprehensive and user-friendly.

Disadvantages

Unfortunately, the process of collecting data for ABC costing takes a lot of time. It is also expensive to implement and maintain, hence may not be affordable for small organizations (Wilkinson, 2013). Besides, the system’s high level of transparency may conflict with some managers’ interests as most of them may want to keep the particular information secret from the company owners to cover the real performance and expenditure.

References

Drury, C. (2008). Management and cost accounting. London: Thomson Learning.

Hansen, D. (2017). Cornerstones of cost management. Boston, MA: Cengage Learning.

Maingi, J. (2013). Advantages and disadvantages of activity based costing with reference to economic value addition. GRIN Verlag.

Warren, C. S., Reeve, J. M., & Duchac, J. (2016). Financial & managerial accounting. Boston, MA: Cengage Learning.

Warren, C. S., Reeve, J. M., & Duchac, J. E. (2017). Managerial accounting. Boston, MA: Cengage Learning.

Weygandt, J. J., Kieso, D. E., & Kimmel, P. D. (2010). Managerial accounting: Tools for business decision making. Hoboken, NJ: Wiley Press.

Wilkinson, J. (2013, July 23). Activity-based costing (ABC) vs traditional costing. Retrieved from https://strategiccfo.com/activity-based-costing-abc-vs-traditional-costing/