**Activity Based Costing**

**Goal: Become familiar with the concept and how the information can be used.**

* A much different approach to dealing with factory overhead costs.
* The ABC system provides supplemental Information that can be used to help control costs.
* It can identify inefficiencies in the production process and help reduce costs in a business enterprise.
* It can also help in making internal decisions – for example, it can help in determining a product’s “true” cost, which may be useful in setting selling prices.
* It is VERY USEFUL for controlling operations. However, management has to be careful when creating EXTERNAL financial statements. (More advanced topic for accounting majors. ABC is not acceptable for GAAP – so again, the information is considered CRITICAL but SUPPLEMENTAL to other traditional costing methods.)

**Disadvantages:**

* It is EXPENSIVE to implement.
* It takes many hours of observation to determine how a product is made, what the significant activities are, and how best to track the costs.
* Often times accountants, engineers, and kinetic specialties are involved in the OBSERVATION PROCESS.
* Accounting Systems (general ledger accounts) have to be overhauled or re-designed to pool the cost data by activity.
* This is EXPENSIVE.

**As with all business decisions, it comes down to what is the cost versus what is the benefit.**