

Case study #1

Comparing costs from ABC and single-rate systems

Corbertt Pharmaceuticals manufactures an over-the-counter allergy medication. The company sells both large commercial containers of 1,000 capsules to health-care facilities and travel packs of 20 capsules to shops in airports, train stations, and hotels. The following information has been developed to determine if an activity-based costing system would be beneficial:

<u>Activity</u>	<u>Estimated Indirect Activity Costs</u>	<u>Allocation Allocation Base</u>	<u>Estimated Quantity of Allocation Base</u>
Materials handling	\$ 98,000	Kilos	24,500 kilos
Packaging	200,000	Machine hours	2,000 hours
Quality assurance	118,000	Samples	2,000 samples

Total indirect costs \$416,000

Other production information includes the following:

	<u>Commercial Containers</u>	<u>Travel Packs</u>
Units Produced	2,800 containers	43,000 packs
Weight in Kilos	8,000	6,000
Machine Hours	1,800	600
Number of Samples	100	200

Requirements

1. Compute the cost allocation rate for each activity.
2. Use the activity-based cost allocation rates to compute the activity costs per unit of the commercial containers and the travel packs. (Hint: First compute the total activity costs allocated to each product line, and then compute the cost per unit.)
3. Corbertt's original single-allocation-base costing system allocated indirect costs to products at \$152 per machine hour. Compute the total indirect costs allocated to the commercial containers and to the travel packs under the original system. Then compute the indirect cost per unit for each product.
4. Compare the activity-based costs per unit to the costs from the single-allocation-base system. How have the unit costs changed? Explain why the costs changed as they did.