Costing

Business & Management

Absorption, marginal and activity-based costing, and when each misleads.

Absorption costing

- Overhead allocated to every unit
- Required for external reporting
- Can make low-volume products look cheap
- Uses a blanket rate — labour hours, often

Marginal costing

- Only variable cost per unit
- Contribution = price − variable cost
- Better for short-run decisions
- Fixed costs treated as period costs

THE DIFFERENCE THAT MATTERS

Activity-based costing sits between: overhead traced to activities and then to products via cost drivers. More accurate, more

Under absorption costing, producing more units into inventory increases reported profit. That incentive is why it is scrutinised.