WEEK 7_WS_3: Activity Based Budgeting

Prepare answers to the following questions and to discuss them with your classmates.

Qn1.

The Raven's Wing Manufacturing Company produces a range of electric guitars that are sold under a variety of names such as Kender, Tibson, and Moon. The company only produces four models but, by using a variety of labels and finishes, a wide range of apparently different products is sold. The company has operated an activity based costing system for a few years. The company now wishes to introduce an activity based approach to its 2000/1 budget, using the experience it has gained through activity based costing. This approach will replace the incremental approach to budgeting which the company has used for more than a decade.

The company's accountant has collected together the following data for the 1999/2000 budget year.

Activity	**1999/2000 cost driver rate**
Assembly	£4.50 per direct labour hour (DLH)
Material handling	£25.00 per batch of material received
Despatch	£50.00 per batch of products despatched
Production planning	£150.00 per production order
Marketing and Sales	£4.75 per instrument sold
Administration and General	15% of total of other overhead costs

Expense type analysis

Cost Pool	**Wages & Salaries**	**Occupancy**	**Other**
Assembly	65%	20%	15%
Material handling	50%	25%	25%
Despatch	40%	20%	40%
Production planning	75%	10%	15%
Marketing and Sales	55%	10%	35%
Administration and General	50%	10%	40%

Product data	**Model A**	**Model B**	**Model C**	**Model D**
No of bought-in parts per unit	6	8	12	15
No of DLH per unit	2.5	3.0	4.2	5.5

The 2000/1 budget is to be based on the following assumptions:-

(i)

Product data	**Model A**	**Model B**	**Model C**	**Model D**
Production/sales volume	120,000	50,000	20,000	10,000
Average production order	2,000	2,000	500	200
No of despatches per production order	10	25	50	50

(ii) Each production order is produced as a batch, with appropriate batches of the required parts being brought in.

(iii) The 1999/2000 cost driver rates are to be used as the basis for calculating the 2000/1 overhead budget.

Note: Due to an anticipated swing in the music market away from girl or boy singing groups to guitar based bands, the 2000/1 volumes for models A and B are 20% greater than those for 1999/2000, whilst the 2000/1 volumes for models C and D are 25% greater than in 1999/2000.

Required:

(a) Using the above assumption, calculate the company's 2000/1 total overhead budget analysed by expense type.

(b) Comment on the budget calculated in part (a), discussing in particular the validity of the assumptions used.