

INCENTIVES UNDER HYBRID ACTIVITY-BASED COSTING SYSTEMS - Case Study -

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ABSTRACT

The case study at hand deals with a carpenter firm in the luxury segment. The analysis of this case involves a closer look at activity-based costing (ABC) practices that are applied within a hybrid costing system. Top management has decided to leave as much of the old costing system intact as possible, and engages in dialogue with its middle managers why certain changes were necessary. The case also addresses subsequent issues such as changes in transfer pricing between departments. Students are then encouraged to reflect upon the implication of these accounting changes for the incentive provided to middle managers.

Keywords: Activity-based Costing; transfer pricing; instructional case study; incentive systems; performance measurement.

1. INTRODUCTION

CTR is carpenter firm in the EU. It produces individually designed top-of-the-line counters that furnish fancy hotels, shopping malls, and the offices of the liberal professions (private clinics, international advisory firms etc.). It offers two general lines of counters: EverLast (EL) and Luscious Splendor (LS).

2. TIME-DRIVEN ACTIVITY-BASED COSTING (APPROX. 40 MINUTES)

CTR gets many of its orders through competitive bidding. For this reason, the company needs a costing system that realistically reflects the consumption of resources for each unique order. All direct cost (material, labor) are traced directly to each order.

The direct manufacturing labor rate is 28 EUR per hour. For the overheads, management opted for a hybrid system of activity-based costing (ABC) approaches. The ABC system uses four activity cost pools, which have the following budget capacity per year:

Activity cost pool [and measure]	Activity measure (i.e., the basis for allocation)	Budgeted activity [per year]
Direct manufacturing labor support [in hours]	Direct labor hours	91,250
Order processing [in # orders]	# of orders	2,002
Design support [in hours]	Custom design hours	18,350
Other facility-sustaining cost [in hours]	Direct labor hours	55,750

These activity cost pools link to the four overhead cost types as follows: