1. **Appendix 7A: ABC action analysis** (slide #1 is a title slide)

*Learning Objective 6: Prepare an action analysis report using activity-based costing data and interpret the report.*

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#### Key definitions/concepts

* + 1. A conventional ABC analysis does not identify potentially relevant costs. An **action analysis report** can help in this regard because it shows what costs have been assigned to a cost object and it indicates how difficult it would be to adjust those costs in response to changes in the level of activity.

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#### Baxter Battery – revisited

* + 1. **The first-stage allocation** **process**
       1. In addition to computing an overall activity rate for each activity cost pool, **an activity rate is computed for each type of overhead cost** that is consumed supporting a given activity.

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* + - * 1. For example, the customer orders activity has **six activity rates** that sum to the total of **$452** from the conventional ABC analysis.

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* + 1. **The second-stage allocation** **process** (this stage requires assigning product costs by **each type of overhead cost.)**

6

* + - 1. In the Baxter Battery illustration, there are, for example, **six activity cost assignments** from the customer orders activity to the SureStart batteries. These six assignments total **$1,808,000** as in the conventional ABC analysis.
         1. Notice, the total ABC costs assigned to SureStart batteries is **$4,928,000** which is the same as in the conventional ABC analysis.

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* + - 1. As another example, there are **six assignments** from the design changes activity to the LongLife batteries. These six assignments total **$3,040,000** as in the conventional ABC analysis.

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* + - * 1. Notice, the total ABC costs assigned to the LongLife batteries is **$7,832,000** which is the same as in the conventional ABC analysis.
    1. Labeling costs using an **ease of adjustment code**
       1. Key definitions

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* + - * 1. **Green costs** adjust more or less automatically to changes in activity level without any action by managers.

For example, direct materials cost would automatically change in response to changes in activity level without management action.

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* + - * 1. **Yellow costs** can be adjusted to changes in activity level, but it would require management action to realize the change in cost.

For example, direct and indirect labor may be classified as yellow costs because management action would be required to hire or layoff employees.

* + - * 1. **Red costs** can be adjusted to changes in activity level only with a great deal of difficulty and with management intervention.

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For example, a factory building lease would be a red cost because it would be very difficult and expensive to break the lease.

* + - 1. Calculating Baxter Battery’s **green, yellow, and red margins**.
         1. The green, yellow, and red margins for the LongLife batteries would be **$11,700,000**, **$478,000**, and **($1,132,000)**, respectively.

In this example, before managers would decide to eliminate the LongLife batteries product line, they would need to commit to taking management action where required to reduce costs or redeploy resources.

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