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Pages 89-91 | Published online: 01 Feb 2007

Cite this article https://doi.org/10.1080/09585200500033139

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Accounting, Business & Financial History
Vol. 15, No. 1, 89–91, March 2005

Routledge
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Direct Versus Absorption Costing: A Comment

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In November 2003, *Accounting, Business and Financial History* published a notable article on 'Battles in the costing war' by David Dugdale and T. Colwyn Jones. The 'war' was between supporters of direct costing and of absorption costing. Their disputes broke out from time to time in the nineteenth and twentieth centuries, and filled many pages in journals such as *The Cost Accountant* (as it was then). The 'war' was sometimes fierce: the article quotes with relish words such as 'horror', 'passion', 'distress', and 'rising blood pressure'.

The article suggests that neither side has been a clear winner in this war: some firms use direct figures, but absorption costing is probably the most common. Since the topic is important for accountants, some extension of the article's analysis may be useful.

The Roles of 'Cost'

The 'cost' in question is that of a firm's unit of product or activity (here a 'job'). This figure may serve as a measure of value, for example, in financial reporting. And it acts as a handy guide to many decisions. Thus, it can be compared with a product's sale price; if cost of a unit is less than price, the product may be worth making.

A cost not only points to outflow of cash or other assets, but also warns of a job's claims on the firm's productive capacity – and consequent loss of revenue from alternative work.

Direct Costing

The advocates of direct cost hold that cost can be found only by looking at figures that can be traced home to the job – notably those of materials and labour. Figures that the job does not change, no matter how alluring, should be ignored. Thus overhead is here irrelevant.

Advocates of direct costing have long cited its usefulness in practice. But lately it has found intellectual backing in the economists' teaching on marginal analysis, stressing that

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0958-5206 Print/1466-4275 Online/05/010089–03 © 2005 Taylor & Francis Group Ltd
DOI: 10.1080/09585200500033139

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