

**UNIT III**  
**OVERHEAD**

# OVERVIEW

- MEANING OF OVERHEADS
- CLASSIFICATION OF OVERHEADS
- ACCOUNTING OF OVERHEADS
- ALLOCATION AND APPORTIONMENT
- APPORTIONMENT OF SERVICE DEPARTMENT COSTS
- ABSORPTION OF FACTORY OVERHEAD
- ABSORPTION OF ADMINISTRATION OVERHEAD
- ABSORPTION OF SELLING AND DISTRIBUTION OVERHEAD
- UNDER AND OVER ABSORPTION OF OVERHEAD
- TREATMENT OF SPECIAL ITEMS OF OVERHEAD
- ACTIVITY BASED COSTING (ABC) APPROACH

# MEANING OF OVERHEADS

- Total cost is divided into direct cost and indirect cost
- The total of all direct costs (DM+DL+DE) is termed as Prime Cost and the total of all indirect costs (IM+IL+IE) is known as overheads
- Overheads are the operating costs of a business enterprise which cannot be traced directly to a particular unit of output.
- Overhead is also known by other terms like oncost, supplementary costs, non-productive costs, burden, etc.

# CLASSIFICATION OF OVERHEADS

**Classification  
Of  
Overheads**

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graph TD; A[Classification Of Overheads] --> B[By Functions]; A --> C[By Elements]; A --> D[By Behaviour];
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**By Functions**

**By Elements**

**By Behaviour**

# CLASSIFICATION ACCORDING TO FUNCTIONS

## ■ Production Overhead

- Also known as factory overhead, works overhead or manufacturing overhead.
- It means indirect expenditure incurred in connection with production operations
- It is the aggregate of factory indirect material cost, indirect wages and indirect expenses
- Examples- consumable stores, factory power and light, lubricants, depreciation of factory building, storekeeping expenses, etc.

## ■ Administration Overhead

- This consists of all expenses incurred in the direction, control and administration of an undertaking which is not related directly to production, selling and distribution functions.
- Examples- general management salaries, audit fees, legal charges, postage and telephone, etc.

## ■ Selling Overhead

- These are the costs of seeking to create and stimulate demand or of securing orders.
- Examples- advertising, salaries and commission of sales personnel, showroom expenses, travelling expenses, bad debts, etc.

## ■ **Distribution Overhead**

- It comprises of all expenditure incurred from the time product is completed in the factory until it reaches its destination or customer.
- Examples- packing costs carriage outward, delivery van costs, warehousing costs, etc.



# CLASSIFICATION ACCORDING TO ELEMENTS

## ■ Indirect Materials

- Material costs which cannot be allocated but which are to be apportioned to or absorbed by cost centres or cost units.
- Examples- fuel, lubricants, tools for general use, etc.

## ■ Indirect Wages

- Those wages which cannot be allocated but which are to be apportioned to or absorbed by cost centres or cost units.
- Examples- wages of sweeper, idle time wages, maintenance and repair wages, leave pay, etc.

## ■ Indirect Expenses

- Expenses which cannot be allocated but which are to be apportioned to or absorbed by cost centres or cost units.
- Examples- power, depreciation, insurance, taxes, rates and rent, etc.

# CLASSIFICATION ACCORDING TO BEHAVIOUR OR VARIABILITY

## ■ Fixed Overhead

- Remain unaffected or fixed in total amount by fluctuations in volume of output
- Examples- rent and rates, managerial salaries, building depreciation, postage, etc.

## ■ Variable Overhead

- Costs which, in aggregate, tends to vary in direct proportion to changes in the volume of output
- Variable overheads per unit remain fixed.
- Examples- indirect materials, indirect Labour, salesman's commission, power, light, fuel, etc.

## ■ Semi-Variable Overhead

- Partly fixed and partly variable
- Costs vary in part with the volume of production and in part they are constant, whatever be the volume of production.
- Examples- supervisory salaries, depreciation, repairs and maintenance, etc.

# ACCOUNTING OF OVERHEADS

## ■ Basic Problem

- Direct costs are charged direct to the cost centres or cost units without difficulty
- But this is not possible in overhead costs because these cannot be identified with individual cost units and there are no accounting means of exact distribution
- Therefore, such costs are analysed and distributed to various cost centres and cost units on arbitrary basis.

## ■ Steps in Distribution of Overheads

- Collection of overhead under separate headings
- Allocation and apportionment to production and service departments
- Re-apportionment of total overheads of each service department to production departments
- Absorption of overhead

# ALLOCATION AND APPORTIONMENT (PRIMARY DISTRIBUTION)

- **Departmentalization of overheads**
  - The distribution of overheads to various departments is known as departmentalization of overheads.
  - This is done by allocation and apportionment of various items of overhead to various departments.
  
- **Allocation**
  - Means charging the full amount of overhead cost to a cost centre, e.g., to a department, to a process, etc.
  - If a particular item of cost can be easily identified to a particular cost centre, it is allocated
  - Example- salary of a foreman in a production department can be easily identified and allotted to this department
  
- **Apportionment**
  - Where an item of cost is common to various cost centres, it is allotted to different cost centres proportionately on some equitable basis
  - Example- rent of factory building is not allocated but apportioned to various departments on some suitable basis, i.e., area occupied by departments concerned

# BASES OF APPORTIONMENT OF OVERHEAD

	<b>OVERHEAD COST</b>	<b>BASES OF APPORTIONMENT</b>
<b>1</b>	(i) Rent and other building expenses (ii) Lighting and heating (iii) Fire precaution service (iv) Air condition	<b>Floor Area, or Volume of Department</b>
<b>2</b>	(i) Fringe benefits (ii) Labour welfare expenses (iii) Time-keeping (iv) Personnel office (v) Supervision	<b>Number of Workers</b>
<b>3</b>	(i) Compensation to workers (ii) Holiday pay (iii) ESI and PF contribution	<b>Direct Wages</b>

# BASES OF APPORTIONMENT OF OVERHEAD

	OVERHEAD COST	BASES OF APPORTIONMENT
4	General overhead	Direct Labour Hours, or Direct Wages, or Machine Hours
5	(i) Depreciation of plant & machinery (ii) Repairs and maintenance of plant & machinery (iii) Insurance of stock	Capital values
6	(i) Power/Steam consumption (ii) Internal transport (iii) Managerial salaries	Technical Estimates

	<b>OVERHEAD COST</b>	<b>BASES OF APPORTIONMENT</b>
<b>7</b>	<b>Lighting expenses</b>	<b>Number of Light Points, or Area</b>
<b>8</b>	<b>Electric power</b>	<b>Horse Power of Machines, or Number of Machine Hours, or Value of Machines</b>
<b>9</b>	<b>(i) Material handling (ii) Stores overhead</b>	<b>Weight of Materials, or Volume of Materials, or Value of Materials</b>



# OVERHEAD DISTRIBUTION SUMMARY

The following information is supplied from a firm:

	Rs.		Rs.
Rent	20000	Insurance	10000
Maintenance	12000	Employer's contribution to P.F	3000
Depreciation	9000	Energy	18000
Lighting	2000	Supervision	30000

	<u>Departments</u>		
	X	Y	Z
Floor Space(Sq. ft.)	2000	1000	1000
Numbers of Workers	25	15	10
Total Direct Wages(Rs.)	1 Lakh	1 Lakh	1 Lakh
Cost of Machinery(Rs.)	3 Lakh	2 Lakh	1 Lakh
Stock of goods(Rs.)	30000	10000	10000

Prepare a statement showing appointment of costs to various departments.

# OVERHEAD DISTRIBUTION SUMMARY

## OVERHEAD DISTRIBUTION SUMMARY (PRIMARY)

Expenses	Basis of appointment	Total	X (Rs.)	Y (Rs.)	Z (Rs.)
Rent	Floor space	20000	10000	5000	5000
Maintenance	Cost of Machinery	12000	6000	4000	2000
Depreciation	-do-	9000	4500	3000	1500
Lighting	Floor space	2000	1000	500	500
Insurance	Stock of goods	10000	6000	2000	2000
Employer's cont. to P.F.	Direct wages	3000	1000	1000	1000
Energy	Cost of Machinery	18000	9000	6000	3000
Supervision	No. of workers	30000	15000	9000	6000
<b>Total</b>		<b>104000</b>	<b>52500</b>	<b>30500</b>	<b>21000</b>

**THANK  
YOU**