

Overheads Cost.

Meaning :- On the basis of identifiability of cost items with cost centres and / or cost units, cost are classified into direct and indirect costs.

The indirect costs represents the costs which are not directly identifiable with the cost centres or cost units. These are known as overhead expenses. They are also called as O.H, OH expenses, O.H costs, O.H charges, O.H expenditure, on-cost, supplementary cost, non-productive cost, burden loading.

Definition :- CIMA, London has defined O.H Expenses as, the aggregate of indirect material costs, indirect wages and indirect wages.

Classification of OH Expenses :- It refers to the process of grouping items of O.H expenses into 2 or more groups on the basis of a common base or characteristic feature.

(a) Element-wise classification

- Indirect Material Cost
- Indirect Labour Cost
- Other indirect Expenses

(b) Behaviour-wise classification :- On the basis of how the items of O.H.E behave with respect of the levels of activity, they are classified into 3 broad categories.

- Variable OHE :- are those expenses which vary with the levels of activity in the same direction and more or less, in the same proportion.

Eg:- Power charges, commission to salesman, IDMC They are deemed to be constant per unit.

- Fixed OHE :- The OHE which do not vary with the levels of activity and which remain constant irrespective of the levels of activity.

Eg:- Rent of factory and office buildings, salary of supervisors.

- Semi-Variable OHE or Semi-fixed OH :- are those OHE which are partly fixed and partly variable. They remain constant upto a particular level of activity and if the level of activity crosses this particular level, they vary but not in proportion to the rate of change in the level of activity.

Eg:- Remuneration to salesman on the basis of monthly salary plus commission based on the value of goods sold, telephone charges

© Functional Classification :- On the basis of major functions of business enterprises, OHE are classified into 4 broad classification.

- Production OHE :- also called as factory OHE, factory burden, factory-on-cost, manufacturing OHE, Manufacturing Expenses, works-on-cost. All IDC incurred for the production of goods and services are known as production OHE.

Eg:- Rent of factory building, store-keeping expenses, depreciation on property, plant & equipment, supervisors' salary etc.

- Administration OHE :- All indirect costs incurred for formulating policies for planning and controlling activities and directing and motivating the human resources for achieving the corporate objective.

Eg:- Salary of office and administrative staff, printing and stationery for office, rent, rates and insurance of general administrative office

- Selling and distribution O.H.E:- The indirect cost incurred for seeking to create and stimulate demand, and for promoting sales and retaining customers are called selling O.H.E.

Eg:- Advertisement expenses, remuneration to sales personnel

The expenses incurred for handling the products from the time they are placed in the warehouse till they reach their destination represent distribution O.H.E.

Allocation and Apportionment of Overhead Expenses to production and Service Departments - Departmentalization of overhead Expenses.

The process of allocating and apportioning production overhead expenses to different departments or cost centres (i.e., both production and service departments) is called, departmentalization of overhead expenses. It is also called, primary distribution.

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 (a) Allocation of O.H.E:- It refers to the allotment / charging of exact amount of an item of production overhead expense to the department for which the expenditure was incurred. When the exact amount of overhead cost incurred in a department. This process of allotting / charging the whole amount of an item of overheads to a department or cost centre is called allocation.

⑥ Apportionment of O.H.E. :- The O.H.E. incurred for the benefit of more than one department and which cannot be identified directly with any particular department or cost centre one called 'common costs'. Distribution of this type of O.H.E. to different departments on suitable basis is called apportionment of O.H.E.

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Principal Bases for Apportionment of O.H.Es

S.No	Overhead Expenses	Base
1.	Rent, Rates and taxes, lighting and heating, depreciation on building, cost of repairs and maintenance of building, air conditioning, insurance of building, etc.	Floor area occupied
2.	Insurance and depreciation on plant and machinery, maintenance of plant and machinery, insurance on building etc.	Capital value of assets
3.	Welfare expenses, time-keeping and pay-roll office expenses, canteen expenses, recreation costs, supervision charges, medical expenses etc.	No. of employees
4.	Repairs and maintenance of plant and machinery,	Machine hours
5.	Works manager's remuneration, salary of supervisors, etc.	Direct labour hours
6.	Electricity charges	Light points or kilowatt hours

7. For distributing the expenses for which it is not possible to use any conventional basis-distribution is made on the basis of assessment made by the technical experts

Technical estimates

Principal of Apportionment :- Selection of appropriate and suitable basis for distribution or apportionment of production O.H.E to different cost centres.

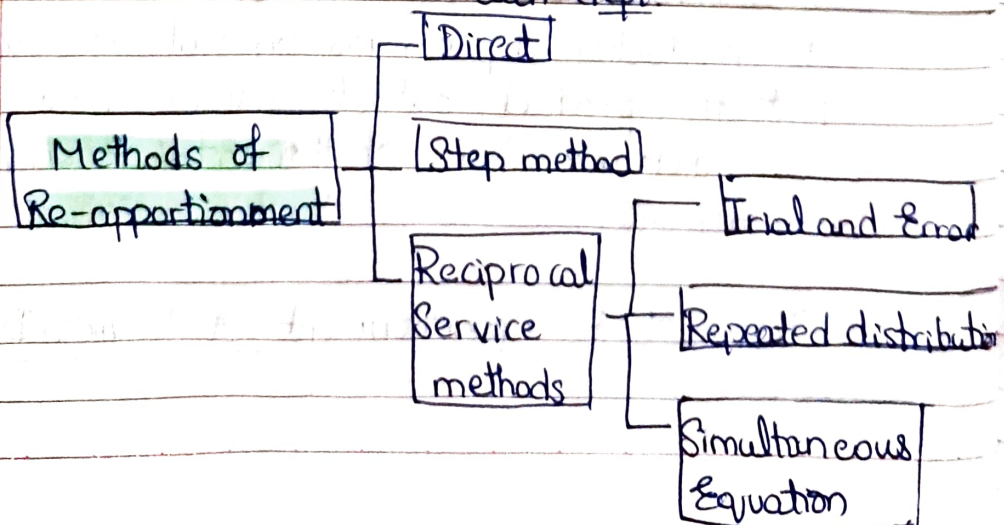
- (a) Utility / Service Principal
- (b) Ability to Pay
- (c) Survey / Analysis Method
- (d) Efficiency / Incentive Principle

Reapportionment of Service department Costs to Production Departments Secondary distribution

Service departments do not engage directly in the production of goods and services. But they provide valuable service to the production departments which produce the goods and services. Hence, it is necessary to distribute the costs of service dept. to production departments on suitable basis so that the product, output, job etc, bear ultimately, an equitable share of the costs of service departments.

Bases of Re-apportionment of Service Dept. OH

S/no	Service Dept.	Base for re-apportionment
1.	Purchase dept.	No. of purchase orders or value of materials purchased for each of the production dept.
2.	Store keeping (store office)	Value/quantity of materials issued to each of the prod ⁿ departments or no. of requisitions.
3.	Internal transport	Weight and distance, no. of movements
4.	Time-keeping, canteen welfare, recreation, medical, personnel, pay-roll etc,	No. of employees in each prod ⁿ dept., or total labour hours, or wages and salaries
5.	Maintenance dept.	Hours devoted/worked for each dept. or cost centre.
6.	Factory office	No. of employees
7.	Building service dept.	Relative area of each dept. or cost centre.
8.	Boiler house	Percentage of steam utilized
9.	Inspection dept.	Inspection hours devoted for each dept.



Absorption of Overhead Expenses

The overhead expenses of production departments includes,

- (a) Their specific O.H.E (allocated)
- (b) Their share in common O.H.E (apportioned)
- (c) Their share in the costs of service departments (re-apportioned)

The aggregate of all these three (a) + (b) + (c) represents the production O.H.E of different production departments which are directly engaged in the production of goods and services. The process of distributing / charging total O.H.E of the production dept. among the units produced in that dept. is called, O.H Absorption.

Also called as O.H application, O.H recovery, levy of O.H, OH costing etc.

