# COST ACCOUNTING

B. Com (Prog.) Semester IV

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## CHAPTER - 5

## OVERHEADS - DISTRIBUTION

* **COST OBJECT** : You may want to know the cost of a particular 'thing' and such a 'thing' is called a cost object.

| Cost object | Examples |
|---|---|
| Product | Car |
| Service | Taxi service |
| Process | Melting process in a steel mill |
| Activity | Developing a website |

* **COST CENTRE** : The whole organisation is divided into small parts or sections. Each small section is treated as a cost centre. It may be a location (a department, a sales area), an item of equipment (a machine, a delivery van), a person (a salesman, a machine operator) or a group of these (two automatic machines operated by one workman).

**TYPES OF COST CENTRE**

- Personal cost centre
  - Consists of a person or a group of persons.
- Impersonal cost centre
  - Consists of a location, an item of equipment or group of these
    - Production cost centre (Actual production takes place)
    - Service cost centre (Ancillary to production cost centre)

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* **COST UNIT** : The quantity upon which cost can be conveniently allocated is known as a cost unit.

**TYPES OF COST UNIT**

Units of production
↓
example :
a ream of paper
a tonne of steel etc.

Units of service
↓
example :
passenger miles
cinema seats etc.

* Indirect material + Indirect labour + Indirect expenses = Overheads

1. Manufacturing / work / factory / Production overheads
2. Office and Administrative overheads
3. Selling and Distribution overheads

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* Direct costs are charged directly to the cost centres without difficulty. But this is not possible in overhead costs because overhead costs cannot be identified with individual cost centres. Therefore, such costs are analysed and distributed to various cost centres on some suitable or equitable bases.

* STEPS IN OVERHEADS DISTRIBUTION

① Classification and collection of overheads

It is a method of grouping of similar type of expenses in one heading. A code number is allotted to each heading of expense. Allotment of codes to individual heads of expense is termed as codification of overheads. Code number given to a factory overhead item is termed as a standing order number.

Code number given to an administration and selling and distribution overhead item is termed as a cost account number.

② Departmentalisation of overheads (Primary distribution of overheads)

Departmentalisation is the process of allocation and apportionment of overheads to different departments or cost centres. A factory is divided into two types of departments:

ⓐ Production departments  ⓑ Service departments

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Examples of :

Production departments ⇒ Crushing department
Mixing department
Grinding department
Polishing department

Service departments ⇒ Purchasing department
Stores department
Personnel department
Accounting department

(i) Allocation of overheads : certain items with exact amount of overhead costs can be directly identified with a particular department. Allotment of such costs to concerned department is known as allocation. For example, indirect wages.

(ii) Apportionment of overheads : It is the process of dividing total overhead cost among various departments on some suitable or equitable basis.
For example, factory building rent

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## * BASES OF APPORTIONMENT (Factory Overheads)

| Overhead cost | Bases of Apportionment |
|---|---|
| ① Costs related to factory building : Rent, Depreciation, Repair & Maintenance, Heating, lighting, air-conditioning | Floor Area |
| ② Costs related to factory Plant & Machinery: Depreciation, Insurance, Repairs & Maintenance | value of asset |
| ③ Factory power or Motive power | Horse Power (HP) or kilowatt hours (Kwh.)<br>Note : If working hours of machines are different then power expense should be divided in the ratio of [H.P * Machine Hrs.] = $\boxed{xxx}$ |
| ④ Supervision | Ist preference → Number of employees<br>IInd preference → Floor Area |
| ⑤ Lighting | Ist preference → Number of light points<br>IInd preference → Floor Area |

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| Overhead cost | Bases of Apportionment |
|---|---|
| (6) Stores overheads or Material handling | Ist preference → Material Requisition<br>IInd preference → Value of Direct Material |
| (7) Indirect wages | Direct labour cost |
| (8) General overheads / Miscellaneous expenses / Sundry expenses | Ist preference → Direct wages<br>IInd preference → Machine hours<br>IIIrd preference → labour hours |

(3) Apportionment of service department overheads to production departments. (Secondary distribution)

Once the overheads have been allocated and apportioned to production and service departments and totalled, the next step is to re-apportion the service department costs to production departments. This is necessary because our ultimate objective is to charge overheads to cost units, and no cost units are produced in service departments.

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* BASES OF APPORTIONMENT OF SERVICE DEPARTMENT COSTS TO PRODUCTION DEPARTMENTS ARE AS FOLLOWS :

| Service department | Bases of apportionment |
|---|---|
| ① Store-keeping department | Ist preference — Material requisitions<br>IInd preference — Value of Direct Material |
| ② Purchase department | Ist preference — Value of material purchased<br>IInd preference — Number of purchase Order placed. |
| ③ Time-keeping / Payroll department | Ist preference — Number of employees<br>IInd preference — Machine hours<br>IIIrd preference — Direct labour hours |
| ④ Personnel department / Welfare department (canteen, recreation services) | Number of employees |
| ⑤ Maintenance department | Number of hours worked |
| ⑥ Internal transport service | Ist preference — Value or weight of goods transported<br>IInd preference — distance covered |