



INTER 2025



COSTING **THEORY है ज़रूरी**

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CHAPTER 4 OVERHEADS
COSTING



Theory Chart

Chp4 Overheads

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INTRODUCTION

Meaning

- Overheads are the expenditure which **cannot be** conveniently **traced** to or identified with any particular cost object.
- Such expenses are **incurred** for output **generally** and **not for a particular work** order e.g., wages paid to watch and ward staff, heating and lighting expenses of factory etc.
- Overheads also represent expenses that have been incurred in providing certain **ancillary facilities** or services which facilitate or make possible the carrying out of the production process; by themselves these services are not of any use. Example: Boiler House is useless if steam is not required.
- Overheads are incurred not only in the factory of production but also on administration, selling and distribution.

Functional Classification of Overheads

Factory/ Production/ Mfg./Works Overheads	- All expenditures from procurement of materials to completion of Finished Goods. - Example: repair / dep. of factory building, primary packing, repair/ insurance of P&M, indirect labour, admin of factory etc.
Office & Admin. Overheads	- Expenditures incurred on all activities relating to General management and admin of organization. - Example: salary to office staff, repair/ dep of office building, postage, stationery, lease rental, accounting and audit expense etc.
Selling & Distribution Overheads	Selling: - expenses related to sales of products and include all indirect expenses in sales management for the organization. - Example: Salesman Commission, Advertisement Cost, Sales office Exp. etc. Distribution - Cost incurred for making product available in the market. - Example: delivery van expenses, transit insurance, warehouse, cold storage, secondary packing etc.

Classification of Overheads by Nature

- Fixed Overhead:** These are the costs which are incurred **for a period**, and which, **within** certain output and turnover **limits**, tend to be **unaffected** by fluctuations in the levels of activity (output or turnover). They do not tend to increase or decrease with the changes in output. Example: Salary paid to permanent employees, Depreciation of building and plant and equipment, Insurance etc.
- Variable Overhead:** These costs tend to **vary with the volume** of activity. Any increase in the activity results in an increase in the variable cost and vice-versa. Example: Indirect materials, Power and fuel, lubricants, tools and spares etc.
- Semi-Variable Overheads:** These costs contain **both fixed and variable** components and are thus **partly** affected by fluctuations in the level of activity. Example: Electricity cost, water cost, telephone and internet expenses etc.

Element-wise classification of Overheads

- Indirect Materials:** Materials which do **not normally form part** of the **finished product** (cost object) are known as indirect materials. Examples: Stores used for maintaining machines and buildings (lubricants, cotton waste, bricks etc.), Stores used by service departments like power house, boiler house, canteen etc.
- Indirect Employee Cost:** Employee costs which cannot be allocated but can be apportioned to or absorbed by cost units or cost centres is known as indirect employee. Example: Salary paid to foreman and supervisor., Salary paid to administration staff etc.
- Indirect Expenses:** Expenses other than direct expenses are known as indirect expenses, that cannot be directly, conveniently and wholly allocated to cost centres. Example: Rates & taxes, insurance, depreciation, advertisement expenses etc.

Classification of Overheads by Control

- Controllable Costs:** These are those costs which can be **controlled** by the implementation of appropriate **managerial influence and proper policies**. Example: Materials cost, wages, power and fuel etc.
- Uncontrollable Costs:** Overhead costs which **cannot be controlled** by the management even after the implementation of appropriate managerial influence and proper policies are known as uncontrollable costs. Example: Rates and taxes, Depreciation, etc.

Advantages of Classification into Fixed and Variable

- Controlling Expenses:** **Fixed** are not related to output so they are more or less **uncontrollable**. Variable expenses vary with the volume of activity and the responsibility for incurring such expenditure is determined in relation to the output
- Preparation of Budget Estimates:** The segregation of overheads into fixed and variable part helps in the preparation of **flexible budget**.
- Decision Making:** decisions regarding the price to be charged during depression or recession or for export market, decisions on **make or buy**, **shut down or continue**, etc., are also taken after separating fixed costs from variable costs.

APPROACHES TO CHARGE MANUFACTURING OVERHEADS

Actual Overheads distribution

- One method of working out the distribution of overheads over the various products could be to **ascertain the amount** of **actual overheads** and distribute them over the products.
- This, however, creates a **problem** since the actual amount of overheads can be **known only after the financial accounts** are **closed**.
- If we **wait that long**, the cost sheets **lose** their main **advantages and utility** to the management. All the decisions for which cost sheets are prepared are **immediate decisions** and cannot be postponed till the actual overheads are known.

Pre-determined rates for absorbing overheads

- These rates are worked out **before an accounting period begins** by **estimating** the amount of overheads and the level of activity in the ensuing (upcoming) period.
- This implies that the overheads are charged on an estimated basis
- when the actual overheads are known, the **difference between the overheads charged to the products** and actual overheads is worked out and adjusted.

PROCEDURE FOR ACCOUNTING OF MANUFACTURING OVERHEADS

Estimation and Collection of Mfg. Overheads

- The first stage is to **estimate the amount** of overheads, keeping in view the **past figures** and adjusting them for known **future changes**
- The **sources** available for the collection of factory overheads may include (a) **Invoices**, (b) Stores **requisition**, (c) **Wage analysis book** (d) **Journal** entries, etc.

Assignment of Manufacturing Overheads

- The guiding principle for assignment of manufacturing overheads to a cost object is the **traceability** of the overheads in an economically feasible manner.
- Assignment of the manufacturing overhead is done on the basis of either of the following **two principles**:
 - Cause and Effect**: Cause is the process or operation or activity and effect is the incurrence of cost.
 - Benefit received**: Manufacturing overheads are to be apportioned to various cost objects in proportion to the benefits received by them.
- Steps under assignment**:
 - Cost Allocation**: the term 'allocation' refers to the **direct assignment** of cost to a cost object which can be traced directly. Example: if a separate power meter has been installed for a department, the entire power cost ascertained from the meter is allocated to that department.
 - Cost Apportionment**: there are some items of estimated overheads (like the salary of the works manager) which cannot be directly allocated to the various departments and cost centres, that are to be **spread over the various departments or cost centres on the basis** of two principles.
 - Re-apportionment**: **Service departments** are those departments which do **not** directly take **part in the production** of goods or providing services. The process of assigning service department overheads to production departments is called reassignment or re-apportionment

Absorption

- This **process of recovering** overheads of a department or any other cost center from its output is called recovery or absorption.
- Absorption of manufacturing overheads shall be as follows:
 - Variable** Manufacturing overheads: The variable manufacturing overheads shall be absorbed on the basis of **actual production**.
 - Fixed** Manufacturing overheads: The fixed manufacturing overhead shall be absorbed on the basis of **normal capacity**.

ESTIMATION & COLLECTION OF OVERHEADS

How to do

- The amount of overheads is required to be estimated.
- The estimation is usually done with **reference** to **past** data adjusted for known future changes.
- The overhead expenses are usually collected through a **system of standing orders**.

Standing Orders

- Standing Orders denotes **sanction** for **indirect expenses** under various heads of expenditure
- System under which a **number is allotted** to each item of **expense** for the purpose of identification and the same is **continued from year to year**
- The extent of such analysis and the **nomenclature** adopted are **settled by the management** according to the needs of the industry

ASSIGNMENT OF OVERHEADS OVER VARIOUS DEPARTMENTS

Allocation

- Factory overheads which are related to any of the production or service departments are **allocated to these departments**.
- A department may be **sub-divided** into various **cost centres** for better cost control and performance evaluation.
- When **costs are collected** by setting up cost centres, several items can be **ascertained definitely** and the **element of estimation is reduced** considerably.
- Advantages of Departmentalization**:
 - Better Estimation** of Expenses: accuracy of estimation of overheads will be higher.
 - Better Control**: to know which department has been over spending
 - Ascertainment of Cost for each department**: It is not necessary that a job must pass through all the departments or that the work required in each department should be the same for all jobs. It is, therefore, necessary that only appropriate charge in respect of the work done in the department is made. This can be done only if overheads for each department are known separately.
- Suitable Method of Costing**: A suitable method of costing can be followed **differently for each department** e.g., batch costing when a part is manufactured, but single or output costing when the product is assembled.

Apportionment

- Overheads which are related to more than one department are required to be **distributed between/ among the departments**.
- This distribution of overheads between/ among the departments is called apportionment.
- The example of overheads may include e.g. rent of building, power, lighting, insurance, depreciation etc.
- To apportioning these overheads over different departments benefiting thereby, it is necessary at **first to determine the proportion of benefit received by each department** and then distribute the total expenditure proportionately on that basis.
- Other Principles to set basis of apportioning overhead costs:
 - Analysis or Survey of existing conditions**: At times it may not be possible to determine the advantage of an item of expenses without undertaking an analysis of expenditure. For example, lighting expenses can be distributed over departments only on the basis of the number of light points fixed in each department.
 - Ability to pay**: It is a principle of taxation which has been applied in cost accounting as well for distributing the expenditure on the basis of **income of the paying department**, on a proportionate basis. Example: Service Costing of Hotels
 - Efficiency or Incentives**: Under this method, the distribution of overheads is made on the **basis of pre-determined levels of production or sales**. Higher production will lead lower cost per unit and vice-versa

Special Note

- Students will thus see that the whole discussion as above is meant to **serve the following two purposes**:
- to **charge** various products and services with an **equitable portion** of the total amount of factory overheads; and
 - to **charge** factory overheads **immediately** as the product or the job is completed **without waiting** for the figures of **actual** factory overheads.

Overhead Cost	Bases of Apportionment
Rent, Maintenance and other building expenses, Lighting and heating (conditioning), Fire precaution service, Air-conditioning	Floor area, or volume of department
Perquisites, Labour welfare expenses, Time Keeping, Personnel office, Supervision	Number of workers
Compensation to Workers, Holiday Pay, ESI and other welfare contribution, Perquisites	Direct Wages
General overhead	Direct labour hour, or Direct wages, or Machine hours.
Depreciation of plant and machinery, Repairs and maintenance of plant and machinery, Insurance of stock	Capital Values
Power/steam consumption, Internal transport, Managerial salaries	Technical estimates
Lighting expenses (light)	No. of light points, or Area or Metered units
Electric power (machine operation)	Horse power of machines, or Number of machine hour, or value of machines or units consumed.
Material handling, Stores overhead	Weight of materials, or volume of materials, or value of materials or unit of materials.

Allocation	Apportionment
- Allocation deals with the whole items of cost, which are identifiable with any one department. - Allocation is a direct process of charging expenses to different cost centres	- Apportionment deals with the proportions of an item of cost - Apportionment is an indirect process because there is a need for the identification of the appropriate portion of an expense to be borne by the different departments benefited.

General Note:

- The allocation or apportionment of an expense is not dependent on its nature, but the relationship between the expense and the cost centre decides that whether it is to be allocated or apportioned.
- Allocation is a much wider term than apportionment.**

Re-apportionment of Service Dept OH to Prod. Dept
Service departments are those departments which do not directly take part in the production of goods or providing services. The process of assigning service department overheads to production departments is called reassignment or re-apportionment. It is also called as Secondary Distribution.

Service Department Cost	Basis of Reapportionment
Maintenance and Repair shop Planning and progress Tool room	Direct labour hours, Machine hours, Direct labour wages, Asset value x Hours worked
Canteen and Welfare Hospital and Dispensary Personnel Department	No of direct workers No. of employees etc.
Time Keeping	No. of card punched, No. of employees
Computer Section	Computer hours, Specific allocation to departments
Power House (electric lighting cost)	Floor area, Cubic content, electric Points, Wattage.
Power House (electric power cost)	Horse power, Kwh, Horse power × Machine hours, Kwh × Machine hours
Stores Department	No. of requisitions, Weight or value of Materials issued.
Transport Department	Crane hours, Truck hours, Truck mileage, Truck tonnage, Truck tonhours, Tonnage handled, No of packages of standard size
Fire Protection	Capital values
Inspection	Inspection hours
Repairs included in repairs shop cost, building maintenance cost included in maintenance shop cost etc.	Capital Values

Direct Re-distribution Method
- Service department costs under this method are apportioned over the production departments only. - This method is applicable only when service departments render services to production department only and not the other Service Department

Step Method or Non- Reciprocal Method or Step Ladder Method
- In this method, services rendered by one service to other service department are also considered. - The sequence here begins with the department that renders maximum number of services to the other service department(s) - It is also called as Step Ladder Method because re-apportionment statement formed looks like a ladder.

Reciprocal Method of Reapportionment
- This method is applicable when service departments render services to each other. - There are three sub methods:

Simultaneous Equation Method	- Here we calculate final amount of service overheads that includes share of other service dept and calculation is done by forming equation (linear equation in two variables) - Reapportionment is done by agreed ratio by taking overheads amount cal by equation
Repeated Distribution Method	- In this all overhead cost of service departments are apportioned to production department in the agreed ratio. - This process is continued till the balance of service dept. cost gets exhausted.
Trial and Error Method	- Here the approach is similar to simultaneous equation method with the change in approach of calculation of final overheads amount - The cost of another service centre plus the share received from the first cost centre is again apportioned to the first cost centre. This process is repeated till the amount to be apportioned becomes negligible and then we get final amount of service overhead to be apportioned. - Reapportionment is done in agreed ration taking final service oh amount.

METHODS OF ABSORPTION OF FACTORY OVERHEADS

Method Selection

The **method** selected for charging overheads to products or jobs should be such as **will ensure**:

- that the total amount **charged** (or recovered) in a period does **not differ materially** from the **actual** expenses incurred in the period.
- that a **distinction** should be made between jobs done by **skilled** workers and those done by **unskilled** workers
- that jobs done by **manual** labour and those done by **machines** should be distinguished.

Popular Methods

% of Direct Materials	$\frac{\text{Total Production Overheads of a department}}{\text{Direct material cost}} \times 100$
% of Prime Cost	$\frac{\text{Total Production Overheads of a department}}{\text{Prime cost}} \times 100$
% of Direct Wages	$\frac{\text{Total Production Overheads of a department}}{\text{Direct Wages}} \times 100$
Labour Hour Rate	$\frac{\text{Total Production Overheads of a department}}{\text{Direct Labour Hour}}$
Machine Hour Rate	Detailed discussion below
Per unit of Output	$\frac{\text{Total Production Overheads of a department}}{\text{Number of Units produced}}$

Analysis of methods

- The job or product on which **more time** has been **spent** would entail **larger** manufacturing **expenses** than the job requiring less time. The factor is ignored altogether by the first method and largely by the second method.
- Percentage of materials** cost may, however, be used for the **limited purpose** of absorbing material handling and store overheads.
- Labour hour rate method** is an **improvement** on the percentage of **direct wage basis**, as it fully recognises the significance of the **element of time** in the incurring and absorption of manufacturing overhead expenses.
- Labour hour rate method** is admirably **suited** to operations which **do not involve** any large use of **machinery**.

Machine Hour Rate Method

Direct Machine Hour Rate:

- When each **machine or group of machines** is treated as a **cost centre**, overheads apportioned to a production department are further apportioned to machines or group of machines.
- These apportioned costs are **divided by** the estimated **productive machine hour of that machine** to get machine hour rate.
- Formula

$$\frac{\text{cost apportioned to machine cost centre}}{\text{estimated productive machine hour of that machine}}$$

Comprehensive Machine Hour Rate:

- When a **single rate** is used for **entire dept/** cost centre
- Here estimated overheads of department are divided by **entire machine hours of department**
- Formula

$$\frac{\text{Total Production Overheads of a department}}{\text{Estimated Productive machine hours of department}}$$

Special Note on Machine Hour Rate

Note: Sometimes even it is preferred to **add the wages** paid to the **machine operator** in order to get a comprehensive rate of working a machine for one hour

- The machine overheads are further divided into fixed cost or **standing charges and variable cost**.
- Costs which remain constant irrespective of operation of machine are treated as fixed cost or standing charges. Example: fixed cost include insurance premium for machine, rent for premises, supervisor's salary, depreciation
- Costs which vary with the operation of the machine are treated as variable cost. Examples: cost for power, cost for consumables (lubricants, oils etc.), repairs and maintenance, depreciation (if it relates to activity) etc.

Advantages of Machine Hour Rates

- Where **machines** are the **main factor** of production, it is usually the **best method** of charging machine operating expenses to production.
- The **under-absorption** of machine overheads would indicate the extent to which the machines have been **idle**.
- It is particularly **advantageous** where one operator attends to several machines (e.g. automatic screw manufacturing machine), or where several operators are engaged on the machine e.g. the belt press used in making conveyer belts.

Disadvantages of Machine Hour Rates

- Additional **data concerning the operation time** of machines, not otherwise necessary, must be recorded and maintained.
- As general department rates for all the machines in a department computation may be suitable, the of a separate machine hour rate for each machine or group of machines would mean **further additional work**.

TYPES OF OVERHEAD RATES

Normal Rate

- Overhead Recovery rate which is calculated **based on actual figures**
- Not useful** as we require overhead recovery rates at the beginning of the period
- Formula:**
$$\frac{\text{Actual amount of overheads}}{\text{Actual Base}}$$

Pre-determined Rate

- Overhead Recovery Rates which is calculated **before the period starts** and is based on the estimated/ budgeted data
- Formula:**
$$\frac{\text{Estimated amount of overheads}}{\text{Estimated Base}}$$

Blanket Overhead Rate

- No department wise split, only **one rate for entire factory**.
- Useful only when either only **one department** or **only one product** is produced
- Formula:**
$$\frac{\text{Total Estimated overheads for the Factory}}{\text{Estimated Base for the Factory}}$$

Departmental Overhead Rate

- Used when there are multiple production departments
- Formula:**
$$\frac{\text{Estimated overheads of the Dept}}{\text{Corresponding base}}$$

UNDER / OVER ABSORBED OVERHEADS

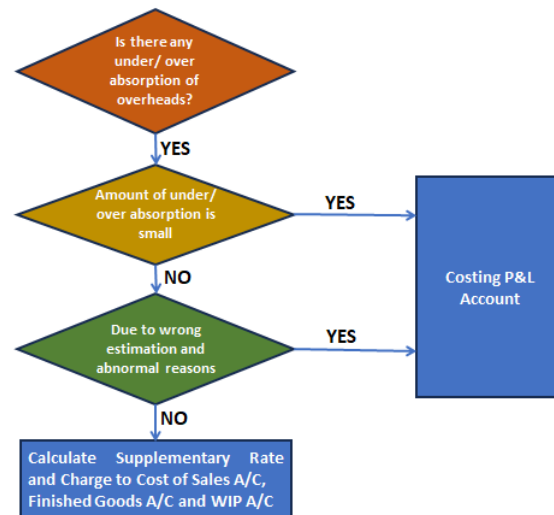
Meaning

- **Overheads Absorbed:** Amount of Overheads distributed / added to the cost of cost object by way of absorption method.
- **Overheads Incurred:** Actual Overheads Incurred which is known after the period is over.
- **Formula:** Over/ (Under) Absorbed Overheads = Overheads Absorbed – Overheads Incurred

Treatment of Under/ Over Absorption

- If **difference** under/ over absorption is **very large** it would be **desirable to adjust the cost** of products manufactured, as otherwise the cost figures would be **unreasonable and misleading**.
- The adjustment to the cost can be made by using supplementary overhead rate
- **Production** of any period can be identified in the three forms
 - Goods finished and sold
 - Goods finished and held in stock (unsold)
 - Goods semi-finished (WIP)
- **Cost Ledgers** to be maintained:
 - Goods finished and sold: **Cost of Sales A/c**
 - Goods finished and held in stock (not yet sold): **Finished Goods A/c**
 - Semi-finished (WIP): **WIP A/c**
- **Supplementary Rate:**

$$\frac{\text{Under / Overabsorbed OH to be charged to cost accounts}}{\text{Units Produced}}$$



ACCOUNTING OF ADMINISTRATIVE OVERHEADS

Meaning

- The sum of those costs of **general management** and of **secretarial, accounting** and **administrative** services,
- which cannot be directly related to the production, marketing, research or development functions of the enterprise.

Accounting

There are three approaches to treat this in costing

- **Apportioning Admin Overheads between Production and Sales Department**
 - **Logic:** administrative overheads are incurred for the **benefit of both** of these departments.
 - Here, administrative overheads **lose their identity** and get **merged** with production and selling and distribution overheads.
 - Disadvantages:
 - **Difficult** to find suitable **base** for apportionment
 - Lot of **clerical work**
 - **Not justified** to apportion all admin OH to production and sales only when other departments are also there.
- **Charging to Profit and Loss Account**
 - Logic 1: the administrative overheads are concerned with the formulation of **policies** and thus are **not directly** concerned with either the **production or the selling** and distribution functions
 - Logic 2: **Apportionment was difficult** due to lack of suitable base and these OH are fixed
 - Disadvantages:
 - **Cost** of products is **understated** as administrative overheads are not charged to costs.
 - The **exclusion** of administrative overheads from cost of products is **against sound accounting** principle
- **Treating Admin. Overheads as a separate addition to Cost of Production**
 - Logic: This method considers **administration** as a **separate function** like production and sales
 - Costs relating to formulating the **policy, directing** the organisation, and **controlling the operations** are taken as a separate charge to the cost of the jobs or a product, sold along with the cost of other functions.
 - Bases generally used absorb Admin OH to Job or Product
 - Works Cost
 - Sales Value/ Quantity
 - Gross Profit
 - Quantity Produced
 - Conversion Cost etc.

Controlling

- **Mostly** administrative overheads are of **fixed nature**, and they arise as a result of management policies. These fixed overheads are **generally non-controllable**.
- But at the same time these overheads should **not be allowed to grow disproportionately**. Some degree of control has to be exercised over them.
- The methods usually adopted for controlling administrative overheads are as follows:
 - **Classification and analysis** of overheads by administrative departments according to their functions, and a **comparison** with the accomplished results.
 - Control through **Budgets and Standards**

ACCOUNTING OF SELLING AND DISTRIBUTION OVERHEADS

Meaning

- Selling cost or overhead expenses are the expenses incurred for the purpose of promoting the marketing and sales of different products.
- Distribution expenses, on the other hand, are expenses relating to delivery and dispatch of goods sold.

Accounting

There are various bases on which S&D can be distributed:

- Sales value of Goods Sold:** It is considered that the sale value is ordinarily the most logical basis, there being some connection between the amount of sales and the amount of expenses incurred to achieve them.
- Cost of Goods Sold:** COGS, however, is not as satisfactory basis as it may not have any direct relationship with the selling and distribution cost.
- Gross Profit on Sales:** The basis of gross profit on sales results in a larger share of the selling overhead being applied to goods yielding a large margin of profit and vice versa. The basis therefore follows the principle of 'ability to pay', it may not reflect costs or incurred efforts.
- Estimated amount per unit:** The best method for absorbing selling and distributing expenses over various products is to separate fixed expenses from variable expenses.
 - Fixed Expenses: Apportion the fixed expenses according to the benefit derived by each product and thus ascertaining the fixed expenses per unit.
 - Variable Expenses: These are expenses which are variable per unit of sale so it can be directly charged (similar to direct cost) Examples: Packaging, freight outwards, insurance in transit, commission to salesman, discount/ rebate to customers etc.

Accounting Controlling

Control of selling and distribution expenses is a difficult task. The reasons for this are as follows:

- The incidence of selling and distribution overheads depends mainly on external factors, such as distance of market, extent and nature of competition, terms of sales, etc. which are beyond the control of management.
- These overheads are dependent upon the customers behaviour, their liking and disliking, tastes etc. Therefore, as such control over the overheads may result in loss of customers.
- These expenses being of the nature of policy costs are not amenable to control.
- In spite of above difficulties, it can be controlled by a) Comparison with past performance, b) Budgetary Control, c) Standard Costing

CONCEPT RELATED TO CAPACITY

- Installed/ Rated Capacity:** Maximum capacity of producing goods or providing services, this capacity is unachievable practically hence called as theoretical capacity
- Practical Capacity:** This capacity takes into account loss of time due to repairs, maintenance, minor breakdown, idle time, set up time, normal delays, Sundays and holidays, stock taking etc. Generally it is 80% to 90% of installed capacity.
- Normal Capacity:** Volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.
- Actual Capacity:** It is the capacity actually achieved during a given period. It is presented as a percentage of installed capacity.
- Idle:** It is that part of the capacity of a plant, machine or equipment which cannot be effectively utilized in production
- Normal Idle Capacity:** It is the difference between Installed capacity and Normal capacity
- Abnormal Idle Capacity:** It is the difference between Normal capacity and Actual capacity utilization where the actual capacity is lower than the normal capacity
- Treatment of Idle capacity costs:**
 - If the idle capacity cost is due to unavoidable reasons such as repairs, maintenance, changeover of job etc. a supplementary overhead rate may be used to recover the idle capacity cost. In this case, the costs are charged to the production capacity utilised.
 - If the idle capacity cost is due to avoidable reasons such as faulty planning, power failure etc.; the cost should be charged to costing profit and loss account.
 - If the idle capacity cost is due to seasonal factors, then, the cost should be charged to the cost of production by inflating overhead rates.

Installed capacity	xxx
Adjustments for:	
i. Time lost due to scheduled preventive or planned maintenance	xxx
i. Holidays, normal shut down days, normal idle time	xxx
i. Normal time lost in batch change over	xxx
Normal Capacity	xxx

TREATMENT OF CERTAIN ITEMS IN COSTING

Interest and financing charges

- Interest on borrowings, financing charges in respect of finance leases, cash discount allowed to customers.
- It does not include imputed costs.
- Interest and financing charges shall be **presented in the cost statement as a separate item** of cost of sales.

Expenses on Removal and Re-erection of machines

- Such expenses may be incurred due to factors like **change in the method of production**; an addition or alteration in the factory building, change in the flow of production, etc. All such expenses are treated as **production overheads**
- When amount of such expenses is **large**, it may be **spread** over a period of time.
- If such expenses are incurred due to **faulty planning** or some other abnormal factor, then they may be charged to Costing **Profit and Loss Account**.

Carriage and cartage expenses

Transportation expenses related to direct material may be **included in the cost of direct material** and those relating to indirect material (stores) may be treated as factory overheads.

Depreciation

- Depreciation “is the diminution in the intrinsic value of an asset due to use and/or the lapse of time.”
- It shall be traced to the cost object to the extent economically feasible.
- Where it is not directly traceable it should be assigned using either or two principles:
 - (i) Cause and Effect and
 - (ii) Benefit received.

Bad debts

- There is no unanimity among different authors of Cost Accounting about the treatment of bad debts.
- One view is that ‘bad debts’ should be **excluded from cost**. According to this view bad debts are **financial losses** and therefore, they should not be included in the cost of a particular job or product
- Another view it should form **part of selling and distribution overheads**, especially when they arise in the normal course of trading. Therefore bad debts should be treated in cost accounting in the same way as any other selling and distribution cost. However **extra ordinarily** large bad debts should **not be included** in cost accounts.

Expenses for welfare activities

- All expenses incurred on the welfare activities of employees in a company are part of **general overheads**
- Such expenses should be apportioned between factory, office, selling and distribution overheads on the **basis of number of persons** involved.

Packing expenses

- Cost of primary packing **necessary for protecting** the product or for convenient handling, should become a **part of the production cost**.
- The cost of **packing to facilitate the transportation** of the product from the factory to the customer should become a part of the **distribution cost**.
- If the cost of **special packing** is at the request of the customer, the same should be **charged to the specific work order** or the job.

Training Expenses

- Training expenses of **factory workers** are treated as part of the **cost of production**.
- The training expenses of office; sales or distribution workers should be treated as office; sales or distribution overhead as the case may be.
- These expenses can be **spread over various departments** of the concern on the basis of the number of workers on roll.

Night shift allowance

- Workers in the factories, which operate during **night time** are paid some **extra amount** known as ‘night shift allowance’.
- This extra amount is generally incurred due to the **general pressure of work beyond normal capacity level** and is treated as production **overhead** and recovered as such.

Fringe benefits

- These are the **additional payments or facilities** provided to the workers apart from their salary and direct cost-allowances like house rent, dearness and city compensatory allowances.
- These indirect benefits stand **to improve the morale, loyalty and stability** of employees towards the organisation.
- If the amount of fringe benefit is considerably **large**, it may be recovered as direct charge by means of a **supplementary wage or labour rate**; otherwise these may be collected as part of **production overheads**.

Canteen expenses

- The **subsidy** provided or **expenses** borne by the firm in running the **canteen** should be regarded as a **production overhead**.
- If the canteen is meant only for factory workers therefore this expenses should be apportioned on the basis of the number of workers employed in each department.
- If office workers also take advantage of the canteen facility, a **suitable share** of the expenses should be treated as office overhead

Research and Development Expenses

- **Research:** the expenses of **searching for new or improved products**, new application of materials, or new or improved methods.
- **Development:** the expenses of the process which begins with the implementation of the decision **to produce a new or improved product**
- R&D for factory is usually part of **Production overheads**