



Overheads : Classification of overheads

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Concept of overheads

- 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.
- Overheads are the expenditure which cannot be conveniently traced to or identified with any particular cost unit. Such expenses are incurred for output generally and not for a particular work order.
- Overheads are incurred not only in the factory of production but also on administration, selling and distribution.
- e.g., wages paid to watch and ward staff, heating and lighting expenses of factory etc.
- Overheads are also very important cost element along with direct materials and direct labour. Often in a manufacturing concern, overheads exceed direct wages or direct materials and at times even both put together.
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OVERHEAD

CLASSIFICATION OF OVERHEADS

- **FUNCTION WISE**
- **BEHAVIOUR WISE**
- **ELEMENTS WISE**
- **CONTROL WISE**

| | Description | Example |
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| By Function: | | |
| Factory or Manufacturing or Production Overhead | Manufacturing overhead is the indirect cost incurred for manufacturing or production activity in a factory. Manufacturing overhead includes all expenditures incurred from the procurement of materials to the completion of finished product. | (i) Stock keeping expenses, (ii) Repairs and maintenance of plant, (iii) Depreciation of factory building, (iv) Indirect labor, (v) cost of primary packing (vi) Insurance of plant and machinery etc. Production overhead include administration costs relating to production, factory, works or manufacturing. |
| Office and Administrative Overheads | Office and Administrative overheads are expenditures incurred on all activities relating to general management and administration of an organization. It includes formulating the policy, directing the organization and controlling the operations of an undertaking which is not related directly to production, selling, distribution, research or development activity or function. | (i) Salary paid to office staffs, (ii) Repairs and maintenance of office building, (iii) Depreciation of office building (iv) postage and stationery, (v) Lease rental in case of operating lease (in case of finance lease, lease rental excluding finance cost) (vi) accounts and audit expenses etc. |
| Selling and Distribution Overheads | (i) Selling overhead: expenses related to sale of products and include all indirect expenses in sales management for the organization. (ii) Distribution overhead: cost incurred on making product available for sale in the market. | (i) Salesmen commission, (ii) Advertisement cost, (iii) Sales office expenses etc. (i) Delivery van expenses, (ii) Transit insurance, (iii) warehouse and cold storage expenses, (iv) secondary packing expenses etc. |

| By Nature | | |
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| Fixed Overhead | These are the costs which are incurred for a period, and which, within certain output and | (i) Salary paid to permanent employees, |
| | 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. | (ii) Depreciation of building and plant and equipment, (iii) Interest on capital, (iv) Insurance |
| Variable Overhead | These costs tend to <u>vary</u> with the volume of activity. Any increase in the activity results in an increase in the variable cost and vice-versa. | (i) Indirect materials, (ii) Power and fuel, (iii) lubricants, (iv) 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. | (i) Electricity cost, (ii) water cost, (iii) telephone and internet expenses etc. |

| By Element | | |
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| Indirect materials | Materials which do not normally form part of the finished product (cost object) are known as indirect materials. | <p>(i) Stores used for maintaining machines and buildings (lubricants, cotton waste, bricks etc.)</p> <p>(ii) Stores used by service departments like power house, boiler house, canteen etc.</p> |
| Indirect labour | Labour costs which cannot be allocated but can be apportioned to or absorbed by cost units or cost centres is known as indirect labour. | <p>(i) Salary paid to foreman and supervisor</p> <p>(ii) Salary paid to administration staff etc.</p> |
| Indirect expenses | Expenses other than direct expenses are known as indirect expenses, that cannot be directly, conveniently and wholly allocated to cost centres. | <p>(i) Rates & taxes, (ii) insurance, (iii) depreciation, (iv) advertisement expenses etc.</p> |

| Controllability | | |
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| Controllable costs | These are those costs which can be controlled by the implementation of appropriate managerial influence and proper | (i) Materials cost, (ii) wages and salary, (iii) power and fuel etc. |
| | policies. | |
| 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. | (i) Rates and taxes, (ii) Depreciation, (iii) Interest on borrowings |