Overhead: Factory Functional Analysis

Overhead is business costs related to the daily operation of a business. Unlike operating expenses, overheads cannot be returned to a specific cost unit or business. Instead, they support the company's overall income-generating activities.

For example, a car retailer pays a premium for a workspace in an area with sufficient space to accommodate the showroom. Excellent rent is one of the overhead costs for work. The company must pay its overhead costs continuously, regardless of whether or not their products are selling. Overhead costs tend to be fixed, which means that they do not change from period to time. Examples of fixed overhead costs are depreciation and rent. Less frequently, overheads vary directly with the level of sales, or they vary somewhat as the level of activity changes.

Another type of expense is direct costs, which are costs required to create products and services, such as direct materials and direct labor. The general and direct costs, when combined, include all expenses incurred by the company.

The company must set prices for its long-term products at levels that represent overhead and direct costs. Doing so allows her to make a profit in the long run. However, the general costs of pricing one-off special deals can be ignored, as the minimum price must only exceed the relevant direct costs.

Classification of Overheads

1. Element wise classification:

This classification method follows the definition of overhead. In this way, overheads are divided into three components, indirect materials, indirect labor and indirect expenses.

(A) Indirect labor:

This includes types of wages that cannot be allocated, but can be allocated only to cost centers or cost units. Examples include maintenance workers 'wages, shopkeeper and general manager's salary, overtime bonus and night work, employer's contribution to money, vacation pay, vacation pay, etc.

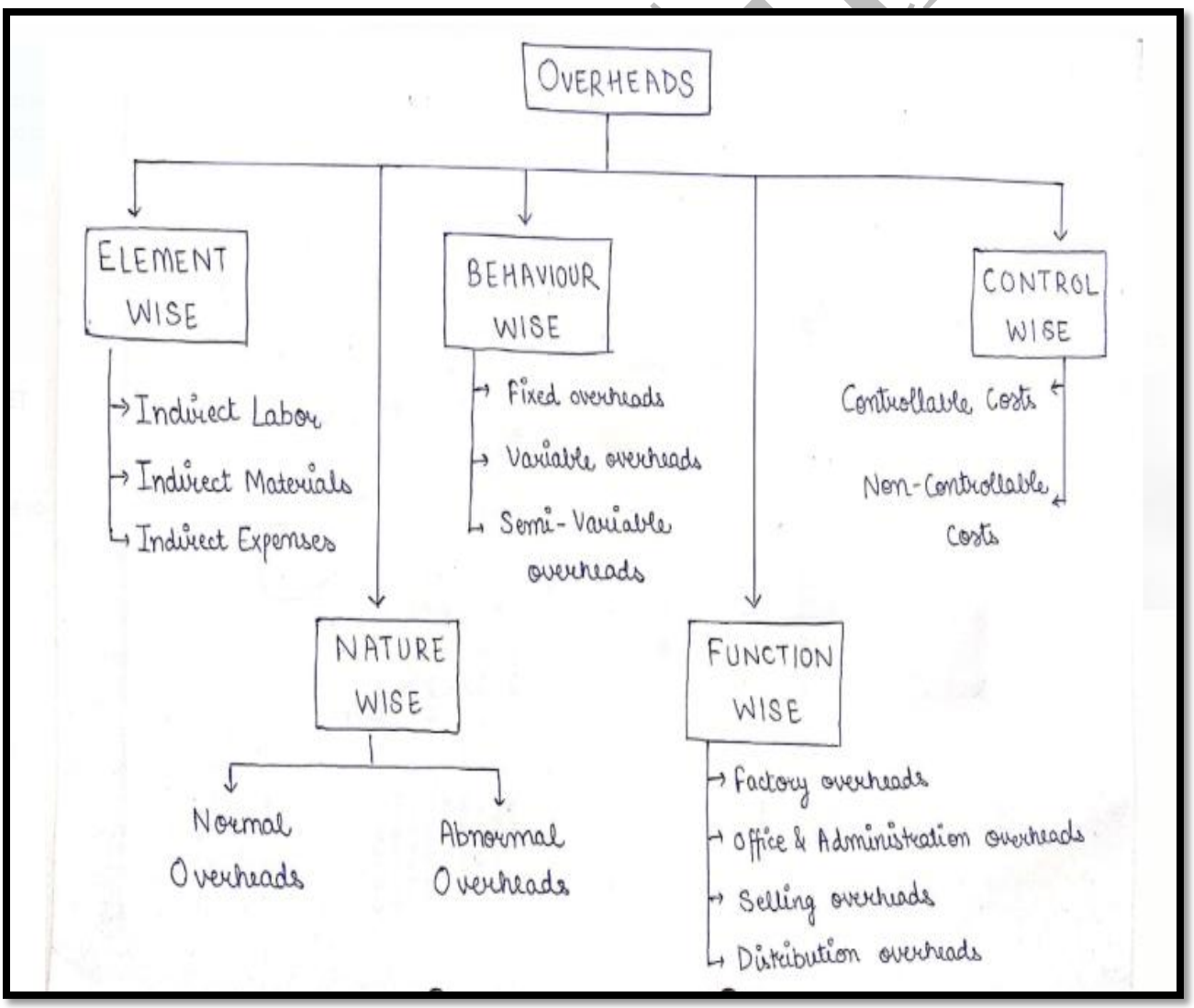
(B) Indirect materials:

It is part of the cost of materials that cannot be allocated to a particular job or production but is indirectly absorbed by cost centers or cost units. Some examples are fuel, lubricating oil, consumables for repair and maintenance, cotton waste, etc.

(C) Indirect expenses:

Expenses that cannot be allocated directly but that can only be allocated or absorbed by cost centers or cost units are known as indirect expenses. Common examples are - rent, insurance, taxes, phone expenses, canteen and luxury expenses, lighting and heating, consumption, etc.

It should be noted that this classification method is usually used to classify the general expenses of the factory but not the general expenses in general.



2. Nature-Wise Classification:

(i) Normal Overheads – These are the expenses which are expected to be incurred in producing a given output. They cannot be avoided. They are included in production cost.

(ii) Abnormal Overheads – These are the expenses which are not expected to occur in producing a given output. For example, abnormal idle time, abnormal wastage, etc. These expenses are transferred to costing P&L A/c.

3. Behavior-Wise Classification:

This classification is made on the basis of the behavior or nature of the overhead. The nature of expenses is that some change with the activity level of the organization, while others remain constant. Consequently, overhead costs can be classified according to behavior into fixed, variable and semi-variable overheads.

(A) Fixed overhead:

These are the expenditures that remain unchanged in total for a certain period despite fluctuations in production volumes. Examples include: rent, prices, administrative salaries, building consumption, postage, stationery, legal expenses, etc.

(B) Variable overheads:

They represent those costs that differ directly with the volume of production. Examples include: fuel, energy, commission paid to sales agents, indirect materials (supplies), indirect labor, etc.

(C) Semi-variable or semi-fixed overhead:

There are certain expenses that do not fall into the category of fixed costs or variable costs. These expenses are known as semi-variable or semi-fixed overheads. They remain constant at certain levels of production, while they differ at other levels but are not proportional to production. For example, in phone charges, the rental component is a fixed cost while call charges made are variable costs.

4. Function wise:

Refers to categorizing overheads by referring to the different major sections of activity they concern.

(A) factory overhead:

Factory general expenses refer to all expenses other than direct material costs, direct wages, and direct expenses incurred in the factory with respect to manufacturing operations.

Examples of factory general expenses - factory building rent, municipal taxes and factory building insurance, factory building consumption, plant factory consumption and insurance, factory building and machinery repair, factory manager salary and other plant employees, factory power and lighting, small tools cost, consumer stores Lubricating oil, cotton waste, storekeeper salary, store keeping expenses, fuel, gas, water, office salary withdrawals, factory stationery, lost time cost, overtime pay (if not treated as direct cost), and factory phone charges , And the cost of td Yep new workers, and the expenses of the care workers, etc..

(B) Administration Overheads:

General management expenses refer to all expenses related to direction, control, and management (not directly related to the production, sale, or distribution) of a project.

Examples of general administrative expenses - salaries of public administration, salaries of public office employees, office rent, office building consumption, office building price and insurance, office lighting and air conditioning, office furniture and office machinery consumption, office building repair and maintenance, office furniture and office machinery, review fees , Legal fees, office stationery, office phone fees, bank charges, managers fees, office salary calculations, etc.

(C) Selling overheads:

Overheads refer to all costs of seeking to create and incentivize demand or secure orders.

Examples of general sales - sales office expenses, advertising, sales manager salaries, salaries of other sales staff, sales commission, travel expenses, travel agent expenses, price lists cost, catalogs and samples, bad debts, rental-offer-room, showroom consumption, Showroom insurance and prices, lighting and showroom cleaning, subsidiary expenses, sales and advertising expenses, vendor training cost, sales related postal expenses, legal debts for bad debts, customer entertainment cost and market research expenses The cost of preparing bids, etc.

(D) Distribution Overhead:

Distribution overhead refers to all expenditures incurred from the time the product ends at the factory until delivery to customers or end consumers.

Examples of overheads for distribution are - warehouse rent, warehouse consumption, insurance, warehouse lighting and rates, consumption, operation and maintenance of delivery vehicles, truckers 'salaries, sales transport, packing materials and packing fees, and the cost of post-sales service, warehouse keeper salary, and the like .

5. Control-Wise Classification:

(I) controllable cost - this part of the cost can be controlled by effective management. For example, idle time, wastage, etc.

(2) Uncontrollable cost - This part of the cost that the administration cannot control. For example, government fees or taxes, or price increases by the authority.

Overhead: Factory Functional Analysis

Factory overhead is most commonly defined as "manufacturing costs that are not classifiable as direct material or direct labor."

Factory overhead costs include indirect materials, indirect labor, and factory expenses.

In standard costing, predetermined amounts are used to facilitate better control and faster recording of costs. Standard costing allows management to determine areas that deviate from established standards, to be able to investigate and take corrective actions.

Factory overhead costs are better analyzed when they are segregated into variable and fixed.

Variable Factory Overhead Variance

The computation and analysis of variable factory overhead (VFOH) is pretty much similar to that of direct labor.

The only difference is the rate applied. Also, variable overhead rates may use direct labor hours or machine hours as its base.

VFOH variance = Total actual VFOH cost – Total standard VFOH cost

The total actual variable overhead cost and total standard variable overhead cost may be computed as follows:

Total actual VFOH cost = Actual hours used x Actual rate per hour

Total standard VFOH cost = Standard hours for actual production x Standard VFOH rate per hour

Note that the "hour" used refers to direct labor hour or machine hour, depending upon which is used by the company. Capital-intensive industries tend to use machine hours. Other bases may also be used, especially when using activity-based costing.

VFOH Spending and Efficiency Variances

Variable factory overhead may be split into: VFOH spending variance and VFOH efficiency variance.

VFOH spending variance = (Actual rate – Standard rate) x Actual hours VFOH efficiency variance = (Actual hours – Standard hours) x Standard rate Fixed Factory Overhead Variance

The computation for fixed factory overhead (FFOH) variance is similar to that of variable factory overhead. Note, however, that fixed factory overhead amounts are almost always given in total figures (thus, it may or may not require additional computations).

FFOH variance = Total actual FFOH cost – Total standard FFOH cost

The total actual fixed overhead cost is almost always given in total amount; hence no additional computation is needed. The total standard fixed overhead cost (or applied fixed factory overhead) may be computed as follows:

Total standard FFOH cost = Standard hours for actual production x Standard FFOH rate per hour

FFOH Spending and Volume Variances

Fixed factory overhead variance may be split into: FFOH spending variance (a.k.a. budget variance) and FFOH volume variance (a.k.a. capacity variance).

FFOH spending variance = Actual FFOH – Budgeted FFOH

FFOH volume variance = Budgeted FFOH – Standard FFOH

The budgeted fixed factory overhead is also given in total amount – for a given level of production. The total standard FFOH is computed as shown earlier, and is also known as "applied fixed factory overhead".

Absorption of Selling & distribution overhead:

(a) As a rate per article: For obtaining the rate per article, the total selling & distribution overhead are divided by the number of units sold. By this method, recovery of transport, advertisement etc. may be done. If there is uniformity in the units of sales, then this method becomes appropriate.

(b) As a % of selling price of each article: By this method, recovery can be made of those expenses which are of fixed nature, like finance cost ,general administration cost & direct selling cost. By the analysis of the past records, the % is ascertained & can be worked out as below:

Fixed selling & distribution expenses for the period * 100 Total turnover for the period

(c)As a % of works cost: Under this method, for the purpose of absorption of selling & distribution overhead, a certain % on works cost of the goods sold may be taken as a basis. By analyzing the past result, the % of selling & distribution overhead on the works cost can be worked out. Also, for absorption of selling & distribution overhead which are of fixed nature, this method is used.

Rate per article method, of all the above discussed methods, is considered as best, particularly, when the units of production are uniform in nature.

As per as accounting entries are concerned, to the selling & distribution account, all the selling & distribution overhead incurred are debited. Similarly, debit is given to cost of sales account & credit is given to the selling & distribution overhead account, for recovery of such overhead.

Control of Selling & Distribution overhead:

Due to the under mentioned reasons, control of selling & distribution overhead is a very tough job:

(a) It is not possible to exercise control upon the customers & competitors.
(b) Correct estimation of market potential is difficult.
(c) Fluctuation of market price does not always depends upon the cost factors.
(d) It is not possible to predetermine correctly the capacity of any sales organization.

However, for the purpose of control, the following methods should be adopted:

(a) It is possible to prepare selling & distribution cost control reports & compare the results with the past records.
(b) It is possible to prepare flexible budgets to show the expenses at different levels of activities & to compare actual figures with the budgeted figures.
(c) It is possible to set up standards & to compare the actual expenses with the predetermined standards.