

# **COST AND MANAGEMENT ACCOUNTING – II**

**(For Undergraduate Classes)**

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## PREFACE

This Text-Book of **Cost and Management Accounting - II** is specially prepared for undergraduate Students. It is prepared in accordance with the latest syllabus given in this book.

I do not claim any originality in the subject-matter of this book. I have drawn immense material from many standard books on this subject. Yet, this book is original in the exposition and presentation of the subject-matter. The subject-matter has been dealt with exhaustively and in very simple language.

I express my profound gratitude to my well-wishers for their encouragement in the preparation of this book. I am also thankful to the **United Publishers, Mangalore and United Publishers' Printing Press, Mangalore** for bringing out this book.

I shall consider my efforts amply rewarded if this book is found useful by the teachers and the students.

Suggestions for improvement of this book will be gratefully accepted.

**Mangalore,**

**B.S. Raman**

# SYLLABUS

## COST AND MANAGEMENT ACCOUNTING–II

### **Chapter - I : Overheads :**

Meaning - Collection of overheads - classification of overheads on the basis of functions, elements and behaviour.

Allocation and apportionment of overheads to Cost Centres (Departmentalisation of Overheads)

Problems on Primary Distribution of factory overheads.

### **Chapter - II : Secondary Distribution of Overheads :**

Meaning - Basis of Apportionment, Methods of reapportionment- Direct Distribution, Step-ladder method - Reciprocal Service Method, Simultaneous equation method and Repeated Distribution method.

Problems on all the methods of secondary distribution.

### **Chapter - III : Absorption of Overheads :**

Meaning - Methods of absorption : Percentage on direct material cost, direct labour cost, prime cost, direct labour hour rate and Machine hour rate.

Problems on direct labour hour rate and machine hour rate.

### **Chapter - IV : Accounting for costs : Non-Integrated Accounting System :**

Meaning, features, books maintained. Journal entries and ledger accounts.

### **Chapter - V : Integrated Accounting System :**

Meaning, features, merits, limitations, Journal entries and ledger Accounts.

### **Chapter - VI : Reconciliation of Cost and Financial Accounts :**

Need for reconciliation, Reasons for disagreement in profit. Procedure for reconciliation.

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# CHAPTER 1 :

# OVERHEADS

## Introduction:

Besides direct cost or prime cost (i.e., direct materials cost, direct wages and direct expenses), every form of production involves some more expenses called **overhead costs, overhead expenses, overheads, indirect costs, oncosts or supplementary costs.**

## Definition and Meaning of Overheads:

According to Blocker and Weltmer, “Overhead costs are the operating costs of a business enterprise which cannot be traced directly to a particular unit of output.”

In the words of Wheldon, “Overhead may be defined as the cost of indirect materials, indirect labour and such other expenses, including services as cannot conveniently be charged direct to specific cost units. Alternatively, overheads are all expenses other than direct expenses.”

ICMA, London has defined overheads as “the aggregate of indirect material cost, indirect wages and indirect expenses.”

From these definitions, it is clear that overheads are the costs or expenses that cannot be conveniently identified with or attributed to any particular cost centre or cost unit (i.e., any particular product, job or process), and so, cannot be wholly allocated (i.e., charged entirely) to any particular product or job, but can be apportioned or absorbed by (i.e., distributed among) two or more products or jobs. In other words, they are the costs or expenses incurred over and above the direct or prime cost. In short, they are the aggregate or total of indirect materials cost, indirect labour cost and indirect expenses.

## Features of Overheads:

### The main features of overheads are:

1. They are the aggregate of indirect materials cost, indirect wages and indirect expenses.
2. They are indirect costs, i.e., they cannot be conveniently identified with any particular cost centre or cost unit (i.e., any particular product or job). In other words, they are the expenses incurred not exclusively for any particular product or job, but for the concern as a whole, i.e., for two or more products or jobs.

3. As they are the expenses incurred for the concern as a whole, and not for any particular product or job, they cannot be wholly allocated (i.e., charged entirely) to any particular product or job, but can be apportioned to or absorbed by (i.e., distributed among) two or more products or jobs.
4. Unlike the direct costs, which are, generally, incurred in the production departments, overhead costs are incurred in all the departments, i.e., in the production department, service department, administrative department and selling and distribution department.
5. As the overheads are incurred in all the departments and for two or more products or jobs, there is, first, the problem of apportionment of overheads among different departments or cost centres, and then, there is the problem of absorption of the overheads apportioned to each department or cost centre among the various products or jobs.
6. While the benefits of direct costs can be measured, the benefits of indirect costs or overheads cannot be measured.

### **COLLECTION OF OVERHEADS**

#### **Meaning of Collection or Accumulation of Overheads:**

**Collection or accumulation of overheads means obtaining details relating to overhead costs from various source documents and recording them (i.e., the overheads) under their respective account heads (i.e., overhead accounts) which are coded as standing order numbers in the case of factory overheads and cost account numbers in the case of administrative, selling and distribution overheads.**

#### **Process of Collection of Overheads:**

For the purpose of collection of overheads, a separate ledger called “**Overheads Ledger**” is maintained. In the overheads ledger, accounts are opened for each of the standing order numbers and cost account numbers (i.e., for each of the factory, administrative, selling and distribution overheads). Normally, all the overheads are collected at monthly intervals.

As overheads are, normally, collected at monthly intervals, after collecting the overheads (i.e., after obtaining and recording the overheads) under their respective account heads (i.e., the respective standing order numbers and cost account numbers) for a month, at the end of the month, the overheads under each of the account heads are summarised (i.e., totalled up, and the summarised figures (i.e., the totals of the various



overheads) are extracted (i.e., written up) on an **Overhead Schedule or Statement** for the month. The overhead (summary) schedule or statement for the month gives the total overhead expenses incurred during the month and the analysis of the overheads under various account heads. The overhead summary schedule or statement gives a start to the process of distribution of overheads.

### **Sources or Source Documents from which Details of Overheads are Obtained:**

**The details of overheads are obtained from several source documents. The various documents from which the details of overheads are, usually, obtained are:**

#### **1. Stores or Materials Requisitions:**

Details relating to indirect materials, such as oils, soaps, grease, cotton waste, brushes, etc. drawn or issued from stores are collected or obtained from **the stores requisitions or materials requisitions**.

When indirect materials are issued from stores against stores or materials requisitions, their respective standing order numbers (or cost account numbers) and the departments to which the indirect materials are issued are noted down in the stores requisitions at the time of issue. At the end of every month, the stores requisitions for the month are summarised in a sheet called **materials issue analysis sheet**. From the materials issue analysis sheet, the totals of the indirect materials for the month are posted to the debit of **Factory Overheads Control Account** and to the credit of **Stores Ledger Control Account**.

#### **2. Invoices and Purchases Journal:**

Details relating to indirect materials which do not pass through the stores (i.e., materials which are not requisitioned by the store-keeper, but are directly requisitioned by any of the departments requiring them) are collected from **invoices and purchases journal**.

When some indirect materials are obtained for any of the departments against its purchase requisition, the invoices for the purchases of those materials are entered in the **purchases journal** specially designed for cost collection. In the purchases journal, the various items in the invoices are analysed according to their standing order numbers and the totals are also extracted. At the end of the month, the total of the purchases journal is posted to the debit of **Factory Overheads Account** and to the credit of **Cost Ledger Control Account**.

### 3. Wages Analysis Sheet:

Details relating to indirect wages, such as wages of sweepers, wages of service departments, fringe benefits of workers, etc. are collected from **wages analysis sheet**.

With the help of time cards or jobs cards, wages paid for indirect labour for a month are collected, and recorded in the wages analysis sheet against standing order numbers and against the concerned departments. From the wages analysis sheet, the total indirect wages for the month is obtained and posted to the debit of **Factory Overhead Account** and to the credit of **Wages Control Account**.

### 4. Salary or Pay Bills and Payrolls

Details relating to the salary of staff other than those indirect workers whose remuneration is not recorded in the wages analysis sheet are collected from **payrolls**.

Salaries paid to the staff whose remuneration is not recorded in the wages analysis sheet is collected from their salary or pay bills. At the end of the month, all the salary or pay bills are recorded in the payrolls. The total salary, as shown by the pay rolls, is posted to the debit of **Factory Overhead Account** and to the credit of **Cost Ledger Control Account**.

### 5. Expense Vouchers:

Details relating to the indirect expenses for the services rendered by outside parties are obtained from **expenses vouchers**. The monthly total of such expenses is posted to the debit of **Factory Overhead Account** and to the credit of **Cost Ledger Control Account**.

### 6. Cash Book or Petty Cash Book:

Details relating to petty items of overhead for which payments are made frequently are collected from the **cash book or petty cash book**.

All petty items of overhead paid in cash frequently are recorded in the cash book or petty cash book. From the cash book or petty cash book, the petty expenses paid in cash are collected against standing order numbers (or cost account numbers) and the total is posted to the debit of **Factory Overhead Control Account** and to the credit of **Cost Ledger Control Account**.

### 7. Journal Entries in the General Journal:

Details relating to overheads which do not result in current cash outlay and need some adjustments, such as notional rent, interest on capital, accrued expenses, prepaid expenses, etc. can be collected from journal entries passed in the general journal.