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COST AND WORKS ACCOUNTING
(Overheads and Methods of Costing-II)
T.Y.B.COM

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- Types of Overhead Rates
INTRODUCTION:

Overheads are absorbed on the basis of absorption rates. Overhead absorption rates are determined for the purpose of absorption of overheads in costs of job, process or products. There are several methods of determination of overhead absorption rates. The basic procedure followed in these methods is to divide the amount of overheads by the total number of units of the base selected. The base may be units of products, direct labour cost, labour hours, machine hours or direct material cost. The rate so determined is multiplied by the units of the base in each individual product or job to decide cost of the each unit.
The following formula may be used to calculate the overhead absorption rate:

\[
\text{Overhead Absorption Rate} = \frac{\text{Amount of Overheads Absorbed}}{\text{Quantity or Value of Base}}
\]

Amount of overhead absorbed in a product = Units of the base × Overhead Rate

**Basic Objectives of fixation of overhead rates:**

1. To facilitate absorption of overhead to cost units on a logical basis.
2. To estimate overheads cost in advance of production.
3. To even out the fluctuations in the overhead rates.
4. To facilitate quick computation of cost on completion of production.
5. To help in prompt calculation of cost of work-in-progress.
TYPES OF OVERHEAD RATES:

The important types of overhead rates are as follows:

1. Actual Rate:

Actual rate is determined by dividing actual overheads incurred during the accounting period by actual quantity or value of the base selected. Actual Overhead Absorption Rate is calculated as follows:

\[
\text{Actual Rate} = \frac{\text{Actual overhead expense incurred during a certain period}}{\text{Actual quantity or value of the base selected to production during a certain period}}
\]
As far as possible, recovery of overheads should be done on actual basis. However, in practice it is not possible due to the following reasons:

1. Actual rate can be determined only after the accounting period is over. This may delay determination of cost.
2. The incidence of same of the overhead expenses is not uniformly spread over all the accounting periods. Similarly, actual volume of activity is affected by seasonal and cycle factors.
3. Actual rates do not provide any basis for cost control.
2. Pre-determined Rate:

Pre-determined rate is determined on the basis of budgeted overheads and the budgeted base is for the period. Pre-determined overhead absorption rate is calculated as follows:

\[
\text{Pre-determined Rate} = \frac{\text{Budgeted overheads for the period}}{\text{Budgeted base for the period}}
\]

Pre-determined rate facilitates computation of cost in advance. This helps in preparation of bills promptly. No extra clerical work is involved in determination of overhead rate in an organisation where budgetary control system is adopted.
3. Blanket Rate:

Blanket rate is the single or general overhead rate applicable to the whole factory. Blanket overhead absorption rate is calculated as follows:

\[
\text{Blanket Rate} = \frac{\text{Overhead cost for the entire factory}}{\text{Total quantum of the base selected}}
\]

Blanket rate is suitable in those factories where only one major product is manufactured in a continuous process. It is also suitable where the work performed by every department is fairly uniform.
4. Multiple Rate:

Multiple rate is also known as ‘Departmental Overhead Rate’. These are the rates for different departments in the factory. A separate rate is determined for each department. Multiple overhead absorption rate is calculated as follows:

\[
\text{Multiple Rate} = \frac{\text{Overhead costs allocated and apportioned to each departments cost centre or product}}{\text{Corresponding base}}
\]

Multiple rates are applied where the product lines are varied, or machinery is used to a varying degree in different departments, i.e. the conditions in the factory are not uniform.
Thank You