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

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Accounting Treatment For Disposal of Under and Over-Absorbed Overheads
UNDER-ABSORPTION OF OVERHEADS:

Definition:

“When the amount of overheads absorbed is less than the amount of overheads incurred, is called under-absorption or under-recovery”.

Under absorption is the effect of under-stating the cost because the overheads incurred are not fully recovered in the cost of jobs, processes etc.
OVER-ABSORPTION OF OVERHEADS:

Definition:

“When the amount of overhead absorbed is more than the amount of overhead incurred, is called over-absorption or over-recovery”.

Over- absorption is the effect of over-stating the cost of jobs, processes etc.
Accounting Treatment For Disposal of Under and Over-absorbed Overheads:

The under and over absorbed overheads may be disposed off by any one of the following three methods:

1. Supplementary Rate Methods
2. Writing off to Costing Profit and Loss Account Method
3. Carry over to next Accounting Period Method
1. Supplementary Rate Method:

a) When to use:

1. When the amount of under/over-absorption of overheads is quite large.
2. The under or over-absorption of overheads is due to normal reasons like increase in material prices or labour rates. Supplementary rate may be calculated as follows:

   \[
   \text{Supplementary Rate} = \frac{\text{Amount of under/over-absorbed overheads}}{\text{Actual Base}}
   \]
b) How to use:

1) In case of under-absorption-

   The cost of sales, stocks of finished goods and work-in-progress are increased by applying positive supplementary rate.

2) In case of over-absorption-

   The cost of sales, stocks of finished goods and work-in-progress are reduced by applying negative supplementary rate.
2. Writing off to Costing Profit and Loss Account Method:

a) When to use:

1. This method is usually used when the amount of under / over absorbed overheads is not very large and

2. The under or over absorption of overheads is due to abnormal reasons like defective planning, idle capacity etc. In this case, even large amounts are written off to Costing Profit and Loss Account.
b) How to use:

The amount of under absorbed overheads is transferred to the debit side of Costing Profit and Loss Account and amount of over-absorbed overheads is transferred to the credit side of Costing Profit and Loss Account.
3. Carry Over to Next Accounting Period Method:

a) When to use:

This method is usually used when,

1) The period of normal business cycle is more than 1 year and overhead rates are determined on a long-term basis.

2) In case of new projects, more output in the next periods than that in initial stages is expected.
b) How to use:

The amount of under-absorbed overheads is transferred to the debit side of overhead reserve or suspense account and the amount of over-absorbed overheads is transferred to the credit of overhead reserve or suspense account.
Thank You