

Management Accounting: Costing – Section 3

3A's Example: Part 1

The illustration below demonstrates the process of allocation, apportionment and absorption.

Fox Furniture Ltd makes tables and chairs for school and college use. There are two production lines – tables and chairs – and two service departments – stores and maintenance.

The total overheads were as follows:

Stores depreciation	£5,000	← This can be allocated in full to stores
Indirect labour		
Tables dept	£6,000	← These costs have been allocated to the respective cost centres so can be allocated to them as listed
Chairs dept	£3,000	
Stores dept	£2,000	
Maintenance dept	£2,000	
Rent	£18,000	← This is a shared cost to be apportioned
TOTAL	£36,000	

1. The specific overheads can be **ALLOCATED** to the cost centres as follows:

Overhead	Basis	Total	Tables	Chairs	Stores	Maintenance
Stores depreciation	Allocate	5,000			5,000	
Indirect labour	Allocate	13,000	6,000	3,000	2,000	2,000

2. The shared costs must then be **APPORTIONED** between the cost centres using a fair basis. The rent should be apportioned on the basis of area used by each cost centre.

Cost centre	Area sq m
Tables	5,000
Chairs	2,500
Stores	1,000
Maintenance	500
Total	9,000

The total overhead per sq m of area is calculated by:

$$\frac{\text{TOTAL OVERHEAD}}{\text{TOTAL AREA}} = \frac{\text{£18,000}}{9,000 \text{ sq m}} = \text{£2 per sq m}$$

This can be used to apportion the cost to each cost centre:

Overhead	Basis	Total	Tables	Chairs	Stores	Maintenance
Stores depreciation	Allocate	5,000			5,000	
Indirect labour	Allocate	13,000	6,000	3,000	2,000	2,000
Rent	Area	18,000	10,000	5,000	2,000	1,000
Total		36,000	16,000	8,000	9,000	3,000

The service centre costs now need to be re-apportioned to the production centres. The service centres do not produce any units that can be sold, therefore any costs incurred by these departments must be transferred to the production centres.