

Course: B.Com Part III

Paper: V

Topic: Direct and Indirect Expenditure

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Direct and Indirect Expenditure:

It is usual to distinguish the total expenditure into two categories—direct and indirect. Direct expenditure is that which can be conveniently allocated to a particular job or product or unit of service. For example, when a book is printed it is rather easy to know how much money has been spent on the paper used and also on wages paid to the workers who were engaged in composing the matter, proof reading and machining the book.

Making of some blocks can also be put down to that book. Such are the instances of direct expenditure. But in addition to these expenses, there will be a number of other expenses which will be incurred not for the sole purpose of the book but for the benefit of all the work which is going on. For example, the building is used for all the work done.

Therefore, it is not easy to say what exact amount out of rent is to be allocated to the book. Similarly, the wages of clerical labour, supervisory staff, etc. cannot be easily allocated. Such expenses are known as indirect expenditure and it can be defined as that expenditure which cannot be conveniently allocated to a particular product or a job or a unit of service and which is incurred for the benefit of output generally.

The distinction between direct and indirect expenses turns largely on convenience. We can find out the share of an article in large number of expenses incurred, but the time and money spent on this may be out of all proportion to the benefits obtained.

We may obtain reasonably, correct figure of cost by treating such difficult cases as indirect. Also, the nature of the business will determine what is Direct Cost and what is Indirect Expenses. In case of big contracts, for example, almost one entire expenditure is direct, while in a firm manufacturing a large variety of articles, most of the expenditure, apart from materials and labour, will be indirect.

Direct Expenditure is made up of:

- (1) Direct Materials;
- (2) Direct labour; and
- (3) Direct Expenses or Charges

Indirect Expenditure can be classified into:

- (1) Works or Factory Expenses;
- (2) Office and Administrative Expenses; and
- (3) Selling and Distributive Expenses.

Direct Materials:

Materials which directly enter the product and form a part of finished product are direct materials. These can be identified in the product and can be measured and directly charged to the

product. Examples of direct materials are timber in furniture making, cloth in dress making and pig-iron in foundry.

Indirect Materials:

Materials which are used for maintenance and repair of machinery, the running of service department, spare and components, packing materials etc. are indirect materials. These do not normally form a part of the finished product.

Direct Labour:

Labour is treated as direct if it can be conveniently allocated to different jobs or products, etc. If we know how much time a worker spent on each of the various jobs he undertook during a particular period, his wages would be treated as direct. Thus wages of workers put on definite jobs or products will be direct.

Indirect Labour:

Wages which cannot be allocated to different jobs or products are treated as indirect labour. Indirect wages are a part of factory expenses. Wages paid to watch and ward staff, repair gangs, supervisor, etc. are indirect.

Other Direct Expenses or Charges:

Expenses which can be allocated conveniently to a unit of cost (other than direct materials and direct labour) are called other direct expenses or charges. Carriage on materials bought for particular job (if not included in the cost of materials) will be direct charge. Royalty paid on the basis of quantity of goods produced is another example of direct expenses.

Manufacturing (Works or Factory) Expenses or Overheads:

The term manufacturing include all operations and process starting from the receipt of raw materials and ending with storage of finished good. All expenses incurred in these operations and process, other than direct materials, direct labour and other direct expenses are classified as manufacturing or works expenses. Some examples are depreciation on plant and machinery, depreciation on works building, insurance charges and repair of plant machinery and factory building, power consumption coal and other fuel charges.

Thus all expenses incurred inside a factory and for the benefit of manufacture as such will be included in factory expenses.