

Activity-Based Costing Takeaways

In this chapter we reviewed/learned 3 ways of allocating overhead. We will use the formula for Predetermined Overhead Rate (POHR) you have already learned.

Plantwide Overhead

Plantwide Overhead allocation means the company uses just one allocation rate (POHR) for the entire company. The rate is calculated as:

$$\frac{\text{Total Overhead for company}}{\text{Total Base for company}}$$

The base is typically direct labor but it doesn't have to be – it can be anything the company decides. To apply overhead, you will take the ACTUAL amount of whatever base was selected for a department, product, job, etc. and multiply by the Plantwide POHR.

Departmental Overhead

Departmental Overhead allocation means the each department selects a different BASE to be used to allocate overhead. The rate is calculated as:

$$\frac{\text{Total Departmental Overhead}}{\text{Total Departmental Base chosen by Department}}$$

The base can be anything the department decides but it will use the DEPARTMENT costs only and not total costs. You can have different rates for every department you choose.

To apply overhead, you will take the ACTUAL amount of whatever base was selected for a department and multiply by the Department POHR for that department.

Activity Based Overhead

In Activity-Based Overhead allocation, the company's overhead is divided into cost activities. These costs have a cost driver which is the object that causes the cost to increase or decrease. A cost pool is where costs that have the same cost drivers are added together to make an activity. Each activity will have its own overhead allocation rate (POHR). The rate is calculated as:

$$\frac{\text{TOTAL Overhead for the cost pool or activity}}{\text{TOTAL cost driver quantity (or base)}}$$

The base or cost driver can be anything but the rate is based on TOTAL amounts for that activity. You will have different rates for every activity or cost pool.

To apply overhead, you will take the ACTUAL amount of whatever base or cost driver *for the job, product or department you are assigning overhead to* (not TOTAL here just the specific amount for the overhead you are applying) and multiply by the Activity-based POHR for that activity.