

Job Costing Key Points

Here is some basic information you need to know about these accounts:

Account	Account Type	Financial Statement	Increases with	Decreases with
Raw Materials Inventory	Asset	Balance Sheet	Debit	Credit
Work in Process (or goods in process) Inventory	Asset	Balance Sheet	Debit	Credit
Finished Goods Inventory	Asset	Balance Sheet	Debit	Credit
Cost of Goods Sold	Expense	Income Statement	Debit	Credit
Sales	Revenue	Income Statement	Credit	Debit

Factory Payroll and Factory Overhead are temporary accounts that act like assets/expenses meaning Debit will increase and Credit will decrease. Both accounts are zeroed out at the end of the period so they will not appear on a financial statement.

Job costs include the TOTAL costs incurred for direct materials, direct labor and overhead. Direct materials can be traced to a specific job. Direct labor hours and dollars can be traced to a specific job. Overhead are indirect costs that cannot be traced to a specific job and include things like indirect materials, indirect labor, factory utilities, factory depreciation, factory rent, etc.

When a job is started, the costs (direct materials, direct labor, and applied overhead) go into Work in Process or Goods in Process Inventory. When the job is finished, the job cost gets transferred to Finished Goods Inventory and is removed from Work in process inventory.

A predetermined overhead rate can be established to budget overhead expenses to jobs. The predetermined overhead rate is used to APPLY overhead costs to jobs in Work in Process Inventory. The predetermined overhead rate (POHR) can be based on anything the company chooses – direct labor dollars, direct labor hours, machine hours, jobs finished, etc. The most common we will see is direct labor.

The formula for calculating the predetermined overhead rate is:

$$\frac{\text{ESTIMATED OVERHEAD}}{\text{ESTIMATED BASE}}$$

with the base being whatever is decided upon (again, examples include direct labor, machine hours, etc.).

Actual overhead costs are recorded in the Factory overhead account. Applied overhead uses the Predetermined Overhead Rate and applies the overhead to jobs in Work in Process Inventory by taking **the ACTUAL amount of the BASE x the Predetermined Overhead Rate**. At the end of the period, the actual overhead costs (debits to factory overhead) are compared to the applied overhead costs (credits to factory overhead) to make sure they agree – which they won't since applied is an estimate. You will need to do an adjusting entry to Cost of Goods Sold to make the Factory Overhead account zero. If applied overhead (credits) are more than the actual overhead (debits), overhead is OVER-applied. If applied overhead is less than actual overhead, overhead is UNDER-applied.