



BANGLADESH
COST ACCOUNTING
STANDARDS
BCAS - 7

Job Order Costing

BCAS 7: Job Order Costing

7.1 Introduction

Job order costing is a very important cost accumulation method for product costing. Traditionally, job order costing was used mostly in every situation as it is very easy to use. This standard gives a detail guideline of applying job order costing for cost accumulation and ultimate product costing purpose. Job order costing can also be applied in some special managerial accounting issues like special order decisions, costing for customized products etc.

7.2 Objectives

- a) Primary objective of this standard is to provide a guideline for determining the cost of any goods produced or services rendered under job costing environment.
- b) In addition to the primary objectives the standard also focuses on -
 - i) the basis of preparation and presentation of cost of goods sold (COGS) in the income statement under job costing environment;
 - ii) the application of predetermined overhead; and
 - iii) the disposal of over- and under-applied overhead.

7.3 Scope

- 7.3.1 This standard is applicable to such situations where adherence to customers' requirements as specified in work order or proforma invoice is very important.
- 7.3.2 Some industries where job order costing is the most appropriate one can be listed below, though the list is not an exhaustive one, rather given as example:
 - a) Large woven, knitting, denim textiles or garments manufacturing industry where goods are being shipped/supplied to customers according to the specification given in order;
 - b) Small and medium enterprises (SMEs) like furniture or toys making companies; and
 - c) Service providing organization like dental services, hospitality industries, diagnostic services, audit services etc.
- 7.3.3 The standard is to be followed by all public limited companies where cost audit is made mandatory through Government's gazette notification from time to time.

7.4 Key Features

The key features of this standard are pointed below-

- a) Identifying the elements of costs in delivering a job to customers;
- b) Recording different elements of costs in the books of accounts;
- c) Visualizing the flow of costs in job costing environment;
- d) Prescribing the methodology of charging overheads to jobs;

- e) Disposing any difference between applied and actual amount of overheads;
- f) Illustrating the application of job order costing in a dummy situation; and
- g) Prescribing different formats to bring standardization in practice.

7.5 Definitions

The following terms are used in this standard with the meanings specified -

- 7.5.1 Job order costing: Job order costing should have the following characteristics:
- a) A costing system used for an entity that produces many different types of products in a given period of time and require computing cost of each category of products separately.
 - b) A method of cost accounting by which the total cost of a given unit or quantity is determined by computing the costs that go into making a product as it moves through the manufacturing process.
 - c) It is used to compute the cost of an individual job or unit of production. Information about the cost of individual jobs is essential when the consumption criterion of each job is substantially different. The accuracy is very important in job costing environment because the price charged to the customer for the job is often based on the cost computed for the jobs.
- 7.5.2 Product cost distortion: Distortion in product costing means a situation when product is either over or under-allocated due to the application of wrong product costing methodology. Neither of these is expected and good. In a cost-plus pricing environment, consistently under-costing of a certain type of job can lead to chronic losses because that type of job appears to be more profitable than it is. Similarly over-costing of a job in a cost reimbursement environment can lead to charges of fraud and the loss of future business.
- 7.5.3 Direct costs: As defined in BCAS 1.5.8.
- 7.5.4 Indirect Costs: As defined in BCAS 4.5.1.

7.6 Standards

- 7.6.1 ***The costing system should ensure that a direct cost is properly attributed to the job that consumes the resources.***
- 7.6.2 ***The primary issue relating to indirect costs is that they should be accumulated and allocated to jobs in a manner that promotes a reasonable basis of cost allocation.***
- 7.6.3 ***There are secondary issues relating to allocating indirect costs to jobs and these issues include the segregation of flexible and committed costs during the allocation process.***
- 7.6.4 Flexible costs vary in proportion to the organization's underlying activity levels. These costs reflect the costs of resources that are acquired as needed.
- 7.6.5 Committed costs, also called capacity-related costs, vary in proportion to the amount of capacity acquired. These costs are committed in advance of the organization's choice or

level of activity, and therefore do not vary in proportion to the activity level.

- 7.6.6 ***This standard focuses on the issue that the cost of flexible and committed resources should be allocated separately. The reason is that these costs have different drivers.***
- 7.6.7 The treatment of the cost of idle capacity should be economically justifiable and the role of standard costs in job order costing is properly acknowledged if the market has a norm of doing so.
- 7.6.8 ***This standard prefers that the cost of idle capacity should be charged to periodic income, not to product cost.***
- 7.6.9 The costing system can use standard costs to assign both direct and indirect costs to jobs. However, the standard costing system should be justifiable from the perspective of both the organization and the industry.

7.7 Recording and Reporting

- 7.7.1 At the beginning of production process, a document known as bill of materials is used for a product. Bill of material is a document that lists the type and quantity of each item of materials needed to complete a unit of product.
- 7.7.2 Every company should have well designed materials requisition form so that the production department can fill up a materials requisition form to pick materials from storeroom and at the same time can record the consumption of material by different jobs. It is an important source document to control the flow of materials into production and also for making accounting entries in specific job.
- 7.7.3 Direct labor cost is handled in much the same way as direct materials cost. Direct labor consists of labor charges that are easily traced to a particular job. Labor charges that cannot be easily traced to any job are treated as part of manufacturing overhead. One important document used to compute labor cost is the time ticket which includes the hours spent by worker on particular job. This time ticket is also used to pass accounting entries for labor cost.
- 7.7.4 Manufacturing overhead must be added with direct material and direct labor on the job cost sheet since manufacturing overhead is also a product cost. However, assigning manufacturing overhead to units of product is based on predetermined overhead rates and any adjustment of over or under applied overhead at the end of the period should be made to cost of goods sold (COGS). Predetermined overhead rate is computed by dividing estimated manufacturing overhead by appropriate allocation base.
- 7.7.5 When a single predetermined overhead rate is used for the entire factory it is called plant wide overhead rate. This is fairly common practice, particularly in smaller companies. When a full job is complete by multiple departments and the resource consumption pattern varies significantly, the multiple overhead rates may be used for a single plant.
- 7.7.6 Since the predetermined overhead rate is established before a period begins and is based entirely on estimated data, the overhead cost applied to work in process (WIP) will generally differ from the amount of overhead cost actually incurred during a period which is required to be adjusted periodically.
- 7.7.7 Over or under applied factory overhead will be disposed-off by debiting or crediting of applied factory overhead with cost of goods sold (COGS) or allocating the amount

between cost of goods sold, work in process and finished goods inventory.

- 7.7.8 For disposal, allocating the over or under applied amount between inventories and cost of goods sold is more sensible as it is equivalent to the application of actual overhead rates. Sometimes, when the amount of over or under applied amount results material, accountants prefer to allocate such amount between inventories and cost of goods sold to avoid any unusual impact of disposal on only cost of goods sold.
- 7.7.9 Companies typically base their predetermined overhead rates on the estimated or budgeted amount of allocation base for the upcoming period. However, companies must have their own definition of capacity and the choice of allocation base depending on the choice of capacity which usually is a choice between expected actual and normal capacity. Theoretical and practical capacities are used for exceptional situation under the management by exception (MBE) norm.
- 7.7.10 In addition to manufacturing costs, companies also incur administrative and selling costs. These costs should be treated as period costs and charged directly to the income statement and therefore should not go into the manufacturing overhead account.
- 7.7.11 When a job has been completed, the finished output is transferred from the production department to the finished goods warehouse. By this time, the accounting department will have charged the job with direct materials and direct labor cost and manufacturing overhead will have been applied using the predetermined overhead rate.
- 7.7.12 Job order costing is also used in service organizations such as law firms, movie studios, hospitals, and repair shops, as well as manufacturing companies.
- 7.7.13 Application of information technology to record and process data in job costing environment is highly encouraged. For example, bar code technology can be used to record labor time to reduce the drudgery in that task and increasing accuracy.

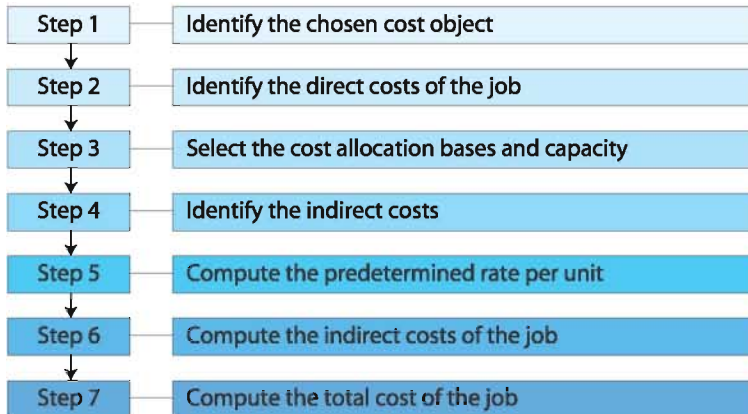
7.8 Effective Date

This standard will be effective from January 1, 2015 onwards.

Appendix 7A

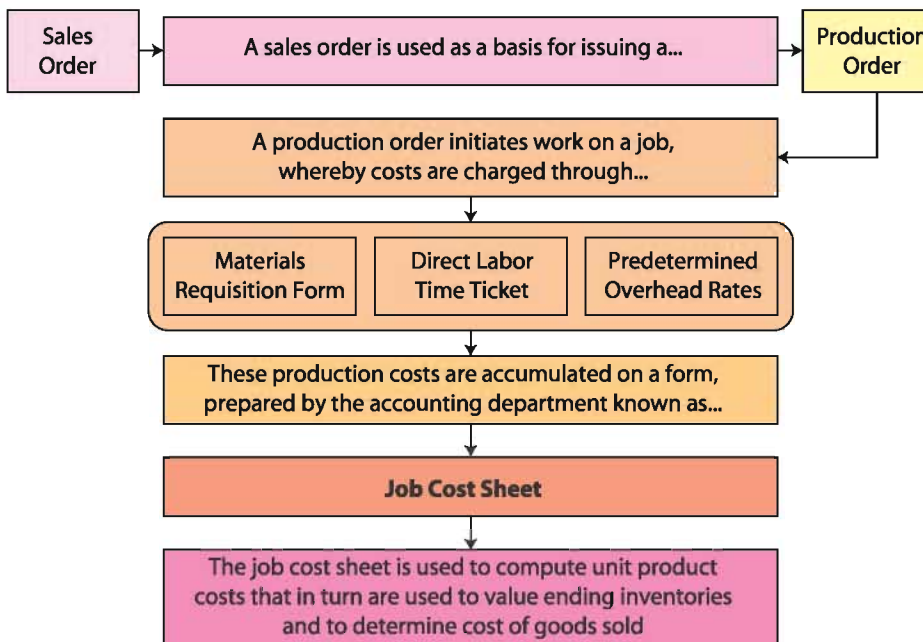
Steps of Job Order Costing

Job order costing is a seven-step process as identified below:



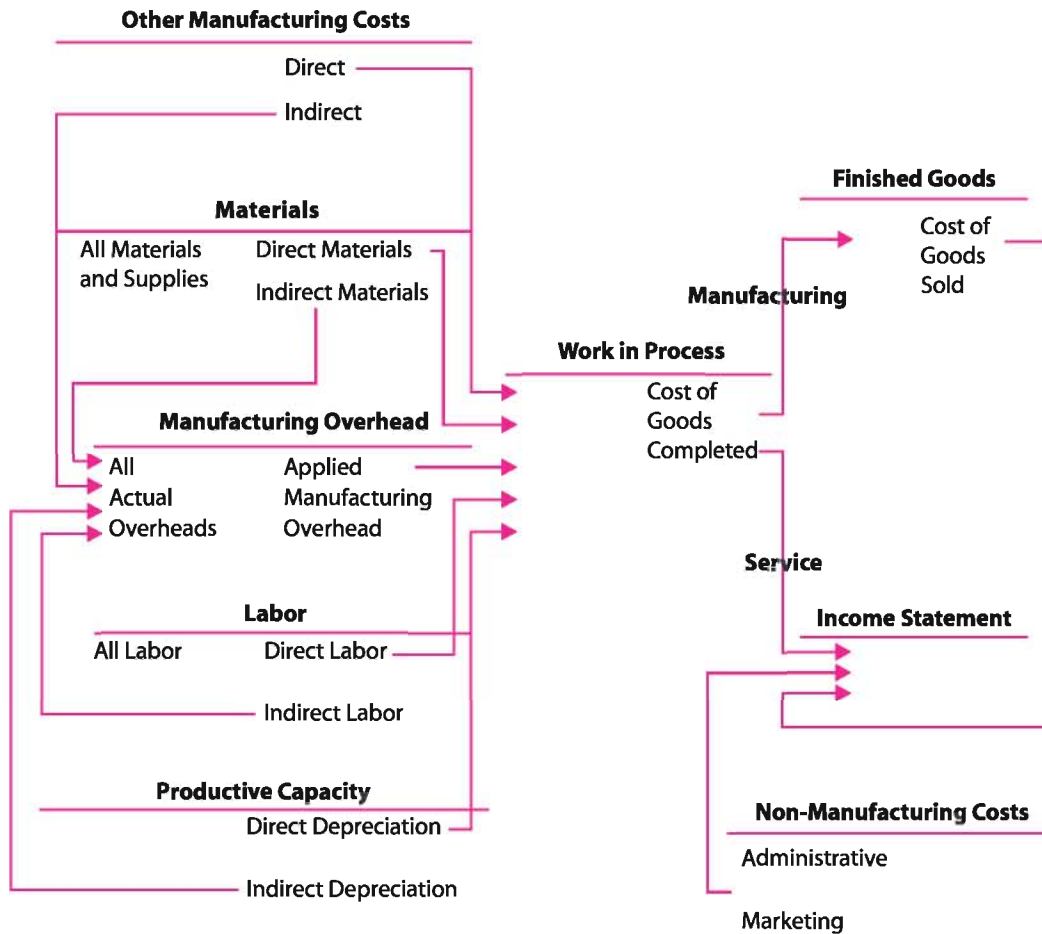
Appendix 7B

The Flow of Documents in a Job Order Costing System



Appendix 7C

Cost Flow in a Job Costing Environment



Appendix 7D

An example of Job Order Costing - Journal Entries, Ledger Accounts and Income Statement

Eureka Denim is a manufacturing industry that uses job order costing system. On January 1, the beginning of its fiscal year, the company's inventory balances were as follows:

Raw materials	TK. 20,000
Work in process	TK. 15,000
Finished Goods	TK. 30,000

The company applies overhead cost to jobs on the basis of machine-hours worked. For the

current year, the company estimated that it would work for 75,000 machine-hours and incur TK. 450,000 in manufacturing overhead cost. The following transactions were recorded for the year:

1. Raw materials were purchased on account, TK. 410,000.
2. Raw materials were requisitioned for use in production, TK. 380,000 (TK. 360,000 direct materials and TK. 20,000 indirect materials).
3. The following costs were incurred for employee services: direct labor, TK. 75,000; indirect labor, TK. 110,000; sales commission, TK. 90,000; and administrative salaries, TK. 200,000.
4. Sales travel costs were TK. 17,000.
5. Utility costs in the factory were TK. 43,000.
6. Advertising costs were TK. 180,000.
7. Depreciation recorded for the year was TK. 350,000 (80% relates to factory operations, and 20% relates to selling and administrative activities).
8. Insurance expired during the year, TK. 10,000 (70% relates to factory operations and 30% relates to selling and administrative activities).
9. Manufacturing overhead was applied to production. Due to greater than expected demand for its products, the company worked 80,000 machine-hours during the year.
10. Goods costing TK. 900,000 to manufacture according to their job cost sheets were completed during the year.
11. Goods were sold on account to customers during the year at a total selling price of TK. 1,500,000. The goods cost TK. 870,000 to manufacture according to their job cost sheets.

Required:

1. Prepare journal entries to record the above transactions.
2. Post the entries in (1) above to T-accounts (don't forget to enter the beginning balances in the inventory accounts).
3. Is manufacturing overhead under-applied or over-applied for the year? Prepare journal entry to close any balance in the manufacturing overhead account to cost of goods sold (COGS). Do not allocate the balance between ending inventories and cost of goods sold (COGS).
4. Prepare a statement of comprehensive income for the year.

Solution:

1. Journal Entries

Eureka Denim General Journal		
	Debit (TK.)	Credit (TK.)
1 Raw materials	410,000	
Accounts payable		410,000
2 Work in process	360,000	
Manufacturing overhead	20,000	
Raw materials		380,000
3 Work in process	75,000	
Manufacturing overhead	110,000	
Sales commission expense	90,000	
Administrative salaries expense	200,000	
Salaries and wages payable		475,000
4 Sales travel expense	17,000	
Accounts payable		17,000
5 Manufacturing overhead	43,000	
Accounts payable		43,000
6 Advertising expense	180,000	
Accounts payable		180,000
7 Manufacturing overhead	280,000	
Depreciation expense	70,000	
Accumulated depreciation		350,000
8 Manufacturing overhead	7,000	
Insurance expense	3,000	
Prepaid insurance		10,000
9 Work in process*	480,000	
Manufacturing overhead		480,000
10 Finished Goods	900,000	
Work in process		900,000
11 Accounts Receivable	1,500,000	
Sales		1,500,000
Cost of goods sold	870,000	
Finished goods		870,000

*The predetermined overhead rate for the year would be computed as follows:

Predetermined overhead rate = Estimated total manufacturing overhead cost / Estimated total units in the allocation base

$$= \text{TK. } 450,000 / 75,000 \text{ machine-hours}$$

$$= \text{TK. } 6 \text{ per machine-hour}$$

Based on the 80,000 machine-hours actually worked during the year, the company would have applied TK. 480,000 in overhead cost to production: 80,000 machine-hours X TK. 6 per machine-hour = TK. 480,000.

2. Ledger Accounts

Accounts Receivable		Raw Materials		Work in Process	
(11) 1,500,000		Bal. 20,000	(2) 380,000	Bal. 20,000	(10) 900,000
		(1) 410,000		(2) 360,000	
		Bal. 50,000		(3) 75,000	
				(9) 480,000	
				Bal. 35,000	
Finished Goods		Prepaid Insurance		Accumulated Depreciation	
Bal. 30,000	(11) 870,000		(8) 10,000		(7) 350,000
(10) 900,000					
Accounts Payable		Salaries and Wages Payable		Manufacturing Overhead	
	(1) 410,000		(3) 475,000	(2) 20,000	(9) 480,000
	(4) 17,000			(3) 110,000	
	(5) 43,000			(5) 43,000	
	(6) 180,000			(7) 280,000	
				(8) 7,000	
				460,000	480,000
					Bal. 20,000
Sales		Cost of goods sold		Insurance Expense	
	(11) 1,500,000	(11) 870,000		(8) 3,000	
Sales Commissions Expenses		Administrative Salary Expense		Sales Travel Expense	
(3) 90,000		(3) 200,000		(4) 17,000	
Advertising expense		Depreciation Expenses			
(6) 180,000		(7) 70,000			

3. Under- or Over-applied manufacturing overhead

Manufacturing overhead is over-applied for the year. The entry to close it out to cost of goods sold is as follows:

Manufacturing overhead	20,000
Cost of goods sold	20,000

4. Statement of Comprehensive Income

EUREKA DENIM		
Statement of Comprehensive Income		
For the Year Ended December 31, YYYY		
Sales		TK. 1,500,000
Less: Cost of goods sold (TK. 870,000 - TK. 20,000 over applied O/H)		<u>850,000</u>
Gross margin		650,000
Less: Selling and administrative expenses		
Commission expense	90,000	
Administrative salaries expense	200,000	
Sales travel expense	17,000	
Advertising expense	180,000	
Depreciation expense	70,000	
Insurance expense	<u>3,000</u>	<u>560,000</u>
Net operating income		<u>TK. 90,000</u>

Appendix 7E

Specimen Formats

Materials Requisition Form

Materials Requisition Number :		Date:/...../.....	
Job Number to be Charged :			
Department (give ✓) : Cutting / Mixing / Finishing			
Description	Quantity	Unit Cost	Total Cost
1.			
2.			
3.			
4.			
5.			
6.			
Total:			
Total (in words):		Authorized Signature	

Time Ticket

Time Ticket No :		Date :/...../.....			
Employee :		Station :			
Started	Ended	Time Completed	Rate (TK.)	Amount (TK.)	Job Number
9:00	12:00	3:00	15.00	45.00	105
12:30	2:00	1:50	15.00	22.50	202
3:00	5:00	2:00	15.00	30.00	Cleaning

Job Cost Sheet

Job Number :		Date Initiated :/...../.....					
Department :		Date Completed :					
Item :		Units Completed :					
Direct Materials		Direct Labor		Manufacturing Overhead			
Req. No.	Amount (TK.)	Ticket	Hours	Amount (TK.)	Hours	Rate (TK.)	Amount (TK.)
Cost Summary				Units Shipped			
Direct Materials		TK.		Date		Number	
Direct Labor		TK.					
Manufacturing Overhead		TK.					
Total Cost		TK.					
Unit Product Cost		TK.					