CHAPTER LEARNING OBJECTIVES:

MAJOR:
- Identify and explain the components of a product cost.
- Explain and calculate total cost and per unit cost.
- Calculation of and use the Predetermined Factory Overhead Rate.
- Explain the disposition of over or under-applied FOH (factory overhead).
- Preparation of journal entries, especially those that are unique to this subject.

MINOR:
- Impact of applying overhead at capacity versus estimated activity - Appendix 3A.

NOT IMPORTANT:
- Layout (how they look) of forms.

* WHEN PREPARING HOMEWORK PROBLEMS THAT REQUIRE JOURNAL ENTRIES, USE BOTH GENERAL JOURNAL ENTRIES AND T ACCOUNT ENTRIES THROUGHOUT THE SEMESTER!

ABSORPTION (FULL) COSTING is a method that considers all traditional product costs (DM, DL, VFOH & FFOH) as part of the cost of the product. This is what we are studying and what we previously studied in financial accounting when discussing inventory. Absorption (Full) Costing is also GAAP. Remember, accounting is man-made; therefore, all the rules and concepts are made up (defined) by man. In a future chapter we will use a slightly different definition for a product cost.

UNIT COST data, i.e., *Average Cost* of products, is needed for such tasks as:
- valuing inventories
- product costing
- make/buy decisions
- add/drop decisions

Two costing approaches of accumulating and transferring costs:
- PROCESS COSTING is used for continuous processing of an identical product.
- JOB ORDER COSTING is used for batch processing of small groups of similar products or one-of-a-kind products. E.g., accounting services, limited number of typewriters, a lunch order, or house construction.

FOH is APPLIED (Estimated) based upon a predetermined FOH RATE, which is determined by using some COMMON ACTIVITY BASE, such as DLH or MH or Material Cost. FOH is applied because of the immediate need for unit cost data by management. A COST DRIVER would be better than a common activity base because of the causal (cause and effect) relationship.

\[
\text{ESTIMATED FOH COST FOR YEAR} = \frac{\text{PREDETERMINED FOH RATE}}{\text{ESTIMATED TOTAL ACTIVITY BASE FOR THE YEAR}}
\]

Total FOH RATE is equal to VFOH rate plus the FFOH rate.

JOB COST SHEET is subsidiary ledger (detail) to the WIP control account. **Know what information is contained on the JCS!**

JOURNAL ENTRIES and FLOW OF COSTS

DISPOSITION OF OVER/UNDER APPLIED FOH at yearend:
- Close to COGS when amount is immaterial or don’t want to follow accounting theory.
- Allocate to WIP, FG & COGS when amount is material or want to follow accounting theory.

MULTIPLE Predetermined FOH Rates (separate departmental rates) are necessary when activities in the various departments are significantly different from one another.