

## Chapter 2

# How Is Job Costing Used to Track Production Costs?

*Chapter summary:* This chapter introduces students to job costing and how product costs are assigned to jobs

*Class action item:* Have the students read the opening vignette at the beginning of chapter 2 for Custom Furniture Company.

*Discussion Question:* Ask the class to identify the issues presented by the owner of Custom Furniture Company.

After studying Chapter 2, students should be able to:

- Distinguish between job costing and process costing.
- Understand how direct materials and direct labor costs are assigned to jobs.
- Understand how manufacturing overhead costs are assigned to jobs.
- Apply job costing methods to service organizations.
- Use a job costing system to track costs and evaluate profitability for each job.

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### 1. Differentiating Job Costing from Process Costing

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- Distinguish between job costing and process costing.

#### Section Outline

- This segment focuses on the differences between job costing and process costing systems.
- Job costing systems record revenues and costs for unique products; ones that can be easily distinguished from other products.
- Process costing systems record revenues and costs for batches of identical units of product.
- Table 2.1 and Figure 2.1 provide examples that will help students understand the difference between products leading to the use of job costing versus process costing.

#### Class Activity

Allow approximately 5 minutes to work Review Problem 2.1 with the class. This review problem presents several real companies and asks students to identify which type of costing system, job or process, would be appropriate for each company presented.

### **In-Class and Homework Suggestions**

- Question: 1
- Brief Exercises: 15, 16, 17

### **Key Terms**

- Job
- Job costing system
- Process costing system

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## **2. How a Job Costing System Works**

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- Understand how direct materials and direct labor costs are assigned to jobs.

### **Section Outline**

- This segment focuses on how to track product costs using a job costing system. Students must have a basic understanding of how to use debits and credits to record transactions before proceeding with this segment.
- The following documents are used to track product costs for each job:
  - Materials requisition form: Tracks materials taken out of raw materials inventory and placed in production, and identifies the job in which the materials will be used.
  - Timesheet: Tracks the hours that workers spend on each job.
  - Job cost sheet: Tracks all product cost information for each job. Costs come from the material requisition forms and timesheets. Job cost sheets serve as a subsidiary ledger for the Work in Process Inventory account.
- Figures 2.2, 2.3, 2.4, and 2.5 show in detail how the documents described above are used to track product costs for each job.

### **Class Activity**

- Allow approximately 15 minutes to work Review Problem 2.2 with the class. This review problem requires students to record journal entries for product cost transactions.

### **In-Class and Homework Suggestions**

- Questions: 2, 3, 4

### Key Terms

- Materials requisition form
- Job cost sheet
- Timesheet

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### 3. Assigning Manufacturing Overhead Costs to Jobs

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- Understand how manufacturing overhead costs are assigned to jobs.

### Section Outline

- This segment focuses on how manufacturing overhead can be allocated to jobs using a predetermined overhead rate. Actual overhead information is not available until the end of the period, so most managers use a normal costing system to apply overhead based on estimates. The predetermined overhead rate is calculated as follows:

$$\text{Predetermined overhead rate} = \frac{\text{Estimated overhead costs}}{\text{Estimated activity in allocation base}}$$

- A Manufacturing Overhead account is used to track actual overhead costs (debits) and applied overhead (credits). This account is typically closed to Cost of Goods Sold at the end of the period.
- Figure 2.6 shows how manufacturing overhead is recorded on a job cost sheet.

### Class Activity

Allow approximately 20 minutes to work Review Problem 2.3 with the class. This review problem requires students to calculate a predetermined overhead rate, and to record journal entries related to manufacturing overhead.

### In-Class and Homework Suggestions

- Questions: 5, 6, 7, 8, 9, 10, 11
- Brief Exercise: 18, 19
- Exercises: 22 (set A), 23 (set A), 24 (set A), 27 (set B), 28 (set B), 29 (set B)
- Problems: 32, 33, 38, 39
- Skill-Building Cases: 41
- Comprehensive Cases: 43, 44

**Key Terms**

- Allocation base
- Predetermined overhead rate
- Overhead applied
- Cost driver
- Normal costing
- Clearing account
- Underapplied overhead
- Overapplied overhead

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**4. Job Costing in Service Organizations**

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- Apply job costing methods to service organizations.

**Section Outline**

- This segment focuses on how to use a job costing system in a service organization setting.
- Job costing systems in service organizations are similar to those used by manufacturing companies.
- Service organizations use fewer materials than manufacturing organizations, the account names they use are slightly different, and they often track costs by customer rather than by product. Table 2.2 provides examples of how account names can differ from a manufacturing organization to a service organization.

**Class Activity**

Allow approximately 5 minutes to work Review Problem 2.4 with the class. This review problem requires students to describe the similarities and differences in how services companies and manufacturing companies account for product costs.

**In-Class and Homework Suggestions**

- Question: 12, 13
- Brief Exercise: 20

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## 5. Chapter Wrap-Up: Summary of Cost Flows at Custom Furniture Company

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- Use a job costing system to track costs and evaluate profitability for each job.

### Section Outline

- This segment focuses on how to use a job costing system to evaluate profitability of individual jobs.
- In addition to tracking product costs related to each job, job costing systems can also track revenue and resulting profit for each job.
- A job costing system can be used to identify areas of concern by comparing the cost estimate before starting the job with information on the completed job cost sheet. This type of analysis often leads to changes in the production process and revised estimates for future jobs.
- Figures 2.7, 2.8, and 2.9, tie the examples in the chapter together for Custom Furniture Company, and lead to a discussion about job profitability. Figure 2.10, and the related narrative at Custom Furniture Company, provides an example of how profitability can be measured for individual jobs.

### Class Activity

Allow approximately 30 minutes to work Review Problem 2.5 with the class. This review problem requires students to calculate production costs for individual jobs, make journal entries related to product costs, and to assess profitability of individual jobs.

### In-Class and Homework Suggestions

- Question: 14
- Brief Exercise: 21
- Exercises: 25 (set A), 26 (set A), 30 (set B), 31 (set B)
- Problems: 34, 35, 36, 37
- Skill-Building Cases: 40, 42