

# Direct and Indirect Costs

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# Direct and Indirect Costs

- There are three costs associated with manufacturing a product.
- In the correct order, they are:
  - Direct materials, (DM)
  - Direct labor, (DL) and
  - Factory or manufacturing overhead (FOH / MOH).

# Direct and Indirect Costs

- Direct material costs:
  - Direct costs are visible and more than immaterial.
  - Direct costs are normally items listed in the Bill of Materials (BOM).
  - The windshield of a car is a direct cost of manufacturing a car.
- Direct costs can be traced (seen) moving through production.

# Direct and Indirect Costs

- Direct labor costs are the cost of those working on the assembly, the “blood, sweat, and tears” crew.
- Direct costs can be traced (seen) moving through production.
- Supervisors, material movers, quality assurance, and the janitor, all necessary for production, are indirect labor costs.

# Direct and Indirect Costs

- Indirect costs fall into two categories. The first is immaterial costs.
  - The cost of grease on the hinge of the car door is an indirect cost. While the customer may see it, the cost of a “dab” is too low to track when cost / benefit considerations is applied.

# Direct and Indirect Costs

- Indirect costs fall into two categories. The second is costs incurred that do not go into the product.
  - The cost of setting up the machine to make a part is not part of the direct materials or direct labor, it is factory / manufacturing overhead.

# Direct and Indirect Costs

- The cost of moving materials around the production area is an indirect cost.
- The cost of the supervisor and the janitor for the production area are indirect costs.
- Indirect costs are allocated and assigned to production through drivers and rates.

# Direct and Indirect Costs

- A driver is something that can be quantified / counted.
  - ❖ The number of man-hours,
  - ❖ The number of machine-hours,
  - ❖ The number of material movements, or
  - ❖ The number of machine setups are common drivers.



# Direct and Indirect Costs

- PROJECTED or ESTIMATED indirect costs are totaled:
  - Indirect materials \$125.00
  - Supervisor wages 750.00
  - Quality control salaries 1,125.00
  - Material handling wages 650.00
  - Total projected indirect costs \$2,650.00

# Direct and Indirect Costs

- Total estimated machine hours as a driver – 175.
- The amount applied for each machine hour is:  
$$\$2,650.00 \div 175 \text{ machine hours} =$$
$$\$15.58824 \text{ per machine hour}$$
- This is an estimate rounded off to five significant digits.

# Direct and Indirect Costs

- If the production effort to produce 25 items utilized 30 machine hours then  
 $\$15.58824 \text{ per machine hour} \times 30 \text{ machine hours} =$   
 $\$467.64710 \text{ in factory / manufacturing overhead}$   
applied to the job
- The cost of this production run will be the sum of  
Direct Materials + Direct Labor + \$467.64710.

# Direct and Indirect Costs

- Since factory / manufacturing overhead is an estimate, the true cost of the production run is an estimate.
- A close and professional estimate.

# Direct and Indirect Costs

- The factory / manufacturing overhead account is credited as the Work in Process account is debited when factory / manufacturing overhead is applied or allocated to production.

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# Direct and Indirect Costs

- At the end of a fiscal period, if the factory / manufacturing overhead account has a debit balance factory / manufacturing overhead has been under applied.
- If the factory / manufacturing overhead account has a credit balance factory / manufacturing overhead has been overapplied.

# Direct and Indirect Costs

The end.