

Factory / Manufacturing Overhead

Accounting presentation created by
Rex A Schildhouse
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www.schildhouse.com



Factory / Manufacturing Overhead

- Within the production effort there are three costs (in proper order):
- Direct materials – do not send a workman earning wages to a workbench with nothing for him to do.
- Direct labor – the blood, sweat, and tears guys of the production line. If they are not converting the product, they are not direct labor.

Factory / Manufacturing Overhead

- Factory / manufacturing overhead are indirect costs. Costs incurred and necessary to make the product but not visible in the product or material in nature.
- Factory / manufacturing overhead is applied to the production effort by a rate through the use of drivers.

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- Indirect materials has two basic examples.
 - The grease on the door hinge of a car is a “dab.” Its amount is not consistent and its cost is immaterial. The cost of the barrel of grease is allocated to production through factory / manufacturing overhead rather than a value added to each unit produced.

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- The grease applied to a machine to keep it running.
- This grease does not become part of the product at all.
- However, without proper lubrication the machines do not work properly for long.

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- Indirect labor has several aspects.
- The first is the material handler and quality assurance team. They handle the product but do not produce any product. Therefore they are indirect labor.
- The second is the janitor. The janitor does not touch the production system or the materials. However, without clean restrooms and facilities, the production effort so stops.

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- Supervisors on the production line are also indirect labor. They do not touch the material or the product. They maintain the level of production and solve problems as they arise.

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- Other indirect costs include those such as:
 - Insurance on the production portion of the facility,
 - Taxes on the production portion of the facility,
 - Utility costs on the production portion of the facility,

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- Other indirect costs include those such as:
 - Depreciation is an indirect cost and has become a major value within factory / manufacturing overhead as production facilities have added significant amounts of machinery and automation, and
 - Repair and maintenance costs.

Factory / Manufacturing Overhead

- With factory / manufacturing overhead, you sum the estimated indirect factory / manufacturing overhead costs.
- Then you determine the estimated number of drivers such as machine hours, direct labor hours, or machine setups.
- Then divide the estimated indirect factory / manufacturing overhead costs by the estimated number of drivers.
- The result is your rate.

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- As production proceeds you record the number of driver events,
- Multiply the driver events by the estimated driver rate to get the amount of factory / manufacturing overhead applied to production.

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- 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

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- 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.

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- If the production effort to produce 25 items utilized 30 machine hours then
 $\$15.58824 \text{ per machine hour} \times 30 \text{ machine hours}$
 $=$
 $\$467.64710$ 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.

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

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- 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.

Factory / Manufacturing Overhead

- 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.

Factory / Manufacturing Overhead

The end.