Ivory Company Uses A Job-order Costing System. What Year-end Journal Entry Could Ivory Make To Dispose

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Understanding the accounting procedures for cost management and disposal at the end of the fiscal year is vital for manufacturing firms like Ivory Company. Specifically, when Ivory employs a job-order costing system, it needs to appropriately close out the costs associated with completed jobs and dispose of any under- or over-applied overheads via journal entries. This article explores the intricacies of Ivory's job-order costing system, the process of year-end cost disposal, and provides a detailed example of the journal entry Ivory might make to properly close out its accounts.

Introduction to Job-Order Costing and Its Relevance to Ivory Company

What is Job-Order Costing?

Job-order costing is a costing method used by companies that produce customized or distinct products. In this system, costs are accumulated separately for each specific job, allowing for detailed tracking of direct materials, direct labor, and manufacturing overhead associated with individual orders.

Why Ivory Company Uses Job-Order Costing

Ivory Company, a manufacturer specializing in bespoke furniture or customized products, benefits from a job-order costing system because it:

- Tracks costs accurately per project
- Determines profitability per job
- Facilitates precise billing and cost control
- Ensures better management of production resources

Understanding Overhead Application and Its Impact on Costing

Manufacturing Overhead in Ivory's System

Overhead includes indirect costs such as factory rent, utilities, depreciation, and supervisory salaries. Ivory applies overhead to jobs based on a predetermined overhead rate, often calculated as a percentage of direct labor costs or direct labor hours.

Over- or Under-applied Overhead

At the end of the accounting period, the applied overhead may not match the actual overhead incurred:

- Over-applied overhead: Applied overhead exceeds actual costs
- Under-applied overhead: Actual overhead exceeds applied costs

Adjustments are necessary to reconcile these differences and ensure accurate financial statements.

Year-End Procedures for Disposing Over- or Under-applied Overhead

Reasons for Disposing Overhead Variances

Disposing of these variances is crucial for:

- Accurate cost of goods sold (COGS)
- Precise net income reporting
- Maintaining reliable management reports

Common Methods of Disposal

There are generally three methods to dispose of overhead variances:

1. Proration Method: Distribute the variance proportionally to work-in-process (WIP), finished goods, and COGS.
2. Charge to Cost of Goods Sold: Directly adjust COGS by the variance.
3. Write-off to Manufacturing Overhead: Adjust the manufacturing overhead account directly, usually for immaterial amounts.

Ivory Company typically employs the proration method to allocate variances appropriately across inventory accounts.

Sample Year-End Journal Entry for Ivory Company

Scenario Assumptions

Suppose Ivory Company incurred actual manufacturing overhead of $150,000 during the year, but applied overhead based on estimates was $140,000, resulting in a $10,000 over-applied overhead.

Step 1: Calculate the over-applied overhead:

- Over-applied overhead = Applied overhead − Actual overhead = $140,000 − $150,000 = -$10,000

Step 2: Decide on the disposal method

- Using proration, the $10,000 over-applied overhead is allocated among WIP, Finished Goods, and COGS based on their respective balances.

Step 3: Prepare the journal entry

If Ivory chooses to charge the over-applied overhead directly to Cost of Goods Sold, the journal entry would be:

```plaintext
Debit: Manufacturing Overhead Control $10,000
Credit: Cost of Goods Sold $10,000
```

However, if Ivory prefers proration, the journal entry would involve distributing the variance proportionally among inventory accounts.

Proration Method: Detailed Example

Suppose the balances are:

- WIP Inventory: $70,000
- Finished Goods Inventory: $50,000
- COGS (before adjustment): $300,000

Total: $420,000

The percentage of total inventory for each is:

- WIP: ($70,000 / $420,000) ≈ 16.67%
- Finished Goods: ($50,000 / $420,000) ≈ 11.90%
- COGS: ($300,000 / $420,000) ≈ 71.43%

Applying these percentages to the $10,000 over-applied overhead:

- WIP: $10,000 × 16.67% ≈ $1,667
- Finished Goods: $10,000 × 11.90% ≈ $1,190
- COGS: $10,000 × 71.43% ≈ $7,143

The journal entry would be:

```plaintext
Debit: WIP Inventory $1,667
Debit: Finished Goods Inventory $1,190
Credit: Cost of Goods Sold $7,143
Credit: Manufacturing Overhead Control $10,000
```

This entry reduces the over-applied overhead and allocates the adjustment across inventory accounts proportionally to their balances.

Additional Considerations for Ivory Company

Documentation and Record-Keeping

It is critical for Ivory to maintain detailed records of:

- Actual overhead costs incurred
- Applied overhead rates

- Inventory balances
- Variance calculations

This documentation ensures transparency and facilitates audit processes.

Impact on Financial Statements

Proper disposal of overhead variances affects:

- The accuracy of the income statement, especially COGS and net income
- The valuation of inventory on the balance sheet
- The overall financial health and decision-making

Conclusion: Ensuring Accurate Year-End Closure

For Ivory Company, employing a job-order costing system provides detailed insights into the costs associated with each custom project. At year-end, it is essential to close out any over- or under-applied overheads through appropriate journal entries. Whether Ivory chooses to directly charge COGS or allocate via proration, the goal remains to reflect the true cost of operations accurately. Properly recorded journal entries not only ensure compliance with accounting standards but also support effective management and strategic planning.

By understanding and applying these procedures, Ivory can maintain precise financial records, improve cost control, and enhance profitability analysis. As a best practice, companies should review overhead application policies regularly and update them to reflect current operational realities, ensuring ongoing accuracy in financial reporting.

Frequently Asked Questions

What is the purpose of a year-end journal entry in a job-order costing system?

The year-end journal entry is made to transfer the cost of unfinished jobs from work-in-process to finished goods or to allocate overhead costs, ensuring accurate financial statements.

How does Ivory Company typically dispose of underapplied manufacturing overhead at year-end?

Ivory Company would debit Cost of Goods Sold and credit Manufacturing Overhead to close out underapplied overhead, adjusting expenses accordingly.

What journal entry is made if Ivory Company has overapplied manufacturing overhead at year-end?

Ivory would debit Manufacturing Overhead and credit Cost of Goods Sold to dispose of the overapplied overhead, reducing expenses on the income statement.

Can Ivory Company dispose of job costs through a general journal entry at year-end?

Yes, Ivory can make journal entries to transfer or adjust job costs, including closing out over- or underapplied overhead, or transferring costs to finished goods or cost of goods sold.

What is the typical journal entry for disposing of work-in-process inventory at year-end?

The entry involves debiting Finished Goods Inventory and crediting Work-in-Process Inventory to transfer completed jobs to finished goods.

How does Ivory Company ensure accurate year-end disposal of costs in a job-order costing system?

Ivory reviews all job cost records, calculates over- or underapplied overhead, and makes appropriate journal entries to reflect the true costs in financial statements.

What impact does the year-end disposal journal entry have on Ivory’s financial statements?

It adjusts expenses and inventory values, ensuring the financial statements accurately reflect the company’s costs and profitability for the period.

Are there specific considerations Ivory should keep in mind when making year-end disposals of costs?

Yes, Ivory should consider the accuracy of overhead application, completeness of job cost records, and compliance with accounting standards to ensure correct disposal.

What is a common mistake companies like Ivory make during year-end disposal of job costs?

A common mistake is failing to adjust for over- or underapplied overhead, leading to distorted profit figures and inaccurate inventory valuation.

Additional Resources

Job-order Costing System

Introduction

In the world of manufacturing and production, accurately tracking costs is essential for maintaining profitability and ensuring sound financial management. Among the various costing methods available, job-order costing stands out for its precision in assigning costs to specific jobs or orders, especially when products are custom or produced in batches. Ivory Company's adoption of a job-order costing system offers a clear view of costs associated with individual jobs, facilitating better pricing, cost control, and financial reporting.

One critical aspect of managing a job-order costing system involves the proper disposal of manufacturing costs at the end of the accounting period. This process culminates in year-end journal entries that transfer accumulated costs from work-in-progress and finished goods inventories to cost of goods sold or other relevant accounts. For Ivory Company, understanding what entries are necessary to dispose of these costs is vital for accurate financial statements and operational insights.

In this article, we will explore the fundamentals of Ivory Company's use of a job-order costing system, examine the typical year-end journal entries necessary for cost disposal, and analyze the implications of these entries for financial reporting.

Understanding Job-Order Costing in Ivory Company

What Is Job-Order Costing?

Job-order costing is a cost accumulation system that assigns manufacturing costs—direct materials, direct labor, and manufacturing overhead—to specific jobs or orders. This system is particularly suitable for companies like Ivory Company, which may produce customized products or batch items with distinct specifications.

Key features of job-order costing include:

- Job Cost Sheets: Each job has a dedicated record that accumulates direct costs.
- Cost Accumulation: Direct materials and direct labor are traced directly to jobs, while manufacturing overhead is allocated using predetermined overhead rates.
- Cost Tracking: Costs are accumulated until the job is completed, after which they are transferred to finished goods inventory.

How Ivory Implements Job-Order Costing

For Ivory Company, the process involves:

- Recording Direct Materials: When raw materials are issued to a job, the cost is debited to work-in-progress (WIP) inventory and credited to Raw Materials Inventory.
- Recording Direct Labor: Labor costs are traced to jobs based on time tickets, increasing WIP inventory.
- Applying Manufacturing Overhead: Overhead costs are allocated to jobs using a predetermined rate, often based on direct labor hours or machine hours.

Cost Flow in Ivory Company

The typical flow of costs is as follows:

1. Raw Materials Inventory □ Work-in-Progress Inventory (when materials are issued).
2. WIP Inventory □ Finished Goods Inventory (upon job completion).
3. Finished Goods Inventory □ Cost of Goods Sold (when goods are sold).

Year-End Cost Disposal: The Critical Journal Entry

Importance of Year-End Adjustments

At the end of the fiscal year, Ivory Company must close out the costs accumulated during the period. This involves transferring the costs from WIP and Finished Goods to the Cost of Goods Sold (COGS) account to reflect expenses associated with sales accurately. These journal entries are vital for compliance with accounting standards and for presenting a true picture of profitability.

Typical Year-End Journal Entry

The general journal entry Ivory Company could make to dispose of the manufacturing costs is as follows:

```plaintext
Debit: Cost of Goods Sold
Credit: Finished Goods Inventory
```

This entry accomplishes the transfer of costs from finished goods inventory to COGS, aligning expenses with revenues in the income statement.

Detailed Breakdown of the Year-End Journal Entry

1. Determining the Total Cost of Goods Sold

Before making the journal entry, Ivory must calculate the total cost of goods sold, which includes:

- The cost of beginning inventory (if any)
- Plus: Cost of goods manufactured during the period
- Less: Ending inventory of finished goods

Example Calculation:

Suppose Ivory Company has:

- Beginning Finished Goods Inventory: $150,000
- Cost of Goods Manufactured: $500,000
- Ending Finished Goods Inventory: $120,000

The COGS calculation:

```plaintext
COGS = Beginning Finished Goods Inventory + Cost of Goods Manufactured - Ending Finished Goods Inventory
COGS = $150,000 + $500,000 - $120,000 = $530,000
```

2. Making the Journal Entry

The entry to dispose of costs would be:

```plaintext
Debit: Cost of Goods Sold $530,000
Credit: Finished Goods Inventory $530,000
```

This reduces the finished goods inventory to reflect the goods sold and recognizes the expense on the income statement.

Additional Considerations in the Year-End Disposal

Adjustments for Work-in-Progress Inventory

If some jobs are incomplete at year-end, Ivory must also make adjustments related to WIP inventory:

```plaintext
Debit: Work-in-Progress Inventory (for incomplete jobs)
Credit: Factory Overhead / Direct Materials / Direct Labor (as applicable)
```

However, the primary focus at year-end is on transferring finished goods costs to COGS.

Overhead Variance Adjustments

Since manufacturing overhead is allocated based on estimated rates, actual costs may differ from allocated amounts. Ivory may need to adjust for over- or under-applied overhead:

```plaintext
Debit: Manufacturing Overhead (if under-applied)
Credit: Cost of Goods Sold (if under-applied)
```

or vice versa, depending on the variance.

Implications for Financial Reporting

Proper disposal of costs ensures that Ivory’s financial statements accurately reflect the company’s profitability. Overstating inventory or COGS can distort margins, leading to inaccurate assessments by management and stakeholders.

Key implications include:

- Profitability Metrics: Accurate COGS ensures correct gross profit figures.
- Inventory Valuation: Properly adjusted inventory balances reflect true asset values.
- Tax Compliance: Correct expense recognition aligns with tax reporting requirements.
- Operational Insights: Variance analysis helps identify inefficiencies or cost control issues.

Conclusion

For Ivory Company, the use of a job-order costing system offers detailed insight into production costs and enhances managerial control. The year-end journal entry to dispose of manufacturing costs—primarily transferring finished goods costs to the cost of goods sold—is a critical step in closing the books and preparing accurate financial statements.

By understanding the process thoroughly—from calculating the total cost of goods sold to making precise journal entries—Ivory ensures transparency, compliance, and strategic clarity. Proper cost disposal not only reflects the true economic performance of the company but also empowers management to make informed decisions about pricing, production, and future investments.

In summary, Ivory's meticulous approach to job-order costing and year-end adjustments exemplifies best practices in manufacturing accounting, setting a standard for precision and accountability in the industry.

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