

**Chapter 4 Part 2****Actual Costing System  
for allocating indirect costs**

Choose a cost allocation base (cost driver)

Actual indirect cost rate =

$\frac{\text{Actual costs in indirect cost pool}}{\text{Actual total quantity of cost allocation base}}$

In Actual costing, indirect costs of a cost object

= actual indirect cost rate  
x actual quantity of cost allocation base for the cost object

**Longer Time Period Used to Compute  
Indirect-Cost Rates**

The numerator reason  
(indirect costs):

The shorter the period, the greater the influence of seasonal patterns on the level of costs.

The denominator reason  
(quantity of the allocation base):

The need to spread monthly fixed indirect costs over fluctuating levels of output.

**Source Documents****Job Cost Record**

- records and accumulates all the costs assigned to a specific job - is the record for product costing.

**Materials Requisition Record**

- is the form used to charge job cost records for the cost of direct materials used on specific jobs.

**Labor Time Record**

- is used to charge job cost records and for labor time used on specific jobs.

It shows the time each employee spent on individual jobs.

**Normal Costing Systems  
for allocating indirect costs**

Choose a cost allocation base (cost driver)

Budgeted indirect cost rate =

$\frac{\text{Budgeted costs in indirect cost pool}}{\text{Budgeted total quantity of cost allocation base}}$

In Normal costing, indirect costs of a cost object

= Budgeted indirect cost rate  
x actual quantity of cost allocation base for the cost object

**Budgeted Indirect Costs**

- Budgeted indirect-cost rates can be assigned to individual jobs on an ongoing and timely basis.
- However, budgeted rates are based on estimates made up to 12 months before actual costs are incurred.
- Adjustments may need to be made by year end.

**Under / Over Allocation**

- Underallocated indirect costs occur when the allocated amount of indirect costs in an accounting period is less than the actual amount incurred.
- Overallocated indirect costs occur when the allocated amount of indirect costs is greater than the actual amount incurred.

**Underallocated or underabsorbed costs**

Underallocated indirect costs  
= Indirect costs incurred - Indirect costs allocated

Underallocated indirect costs  
same as underapplied indirect costs  
same as underabsorbed indirect costs

Similar terms for overallocated indirect costs

**End-Of-Period Adjustments****Reasons for the underallocated amount:**

Numerator reason (indirect costs)

Denominator reason (quantity of allocation base)

**Approaches to disposing** underallocated or overallocated overhead:

- 1 Adjusted allocation rate approach
- 2 Proration approaches
- 3 Immediate write-off to Cost of Goods Sold approach

**Adjusted Allocation Rate Approach**

- restates all entries in the general and subsidiary ledgers by using actual cost rates rather than budgeted cost rates.
- Actual indirect-cost rate is computed at the end of the year.
- Every job to which indirect costs were allocated during the year has its amount recomputed.
- Leads to Actual Costing

**Proration Approach**

- Proration is the spreading of under- or overallocated overhead among ending work in process, finished goods, and cost of goods sold.
- Basis to prorate under- or overallocated overhead:
  - A Total manufacturing overhead allocated before proration
  - B Ending balances of Work-in-Process, Finished Goods, and Cost of Goods Sold - NO (old inventories allocated new amounts)