

# An analysis of process costing vs. job order costing



## **Introduction**

Management accounting uses several costing techniques. Costing techniques are very important to the business management because they help them make sound decisions for the company. They also help companies keep track of the costs that they incur in the production process. The techniques are mainly for internal use apart from absorption costing which is used by external users like the shareholders and the creditors. This paper analyses the process costing techniques and compares it with job order costing. It gives reasons as to why SAC Company should use job order costing rather than process costing (Bradford, 2008).

## **Process Costing**

This is a costing technique that is used in finding costs in homogenous or products that are uniform. This technique makes averages of costs for all units to make per unit costs. Work in process account is used to track the process costs. Through this system, a continuous manufacturing process is used to produce identical goods (Bradford, 2008).

## **Computation Procedures for Process Costing**

Manufacturing costs are accumulated for a period of time. It also works out the average costs of manufacturing. This being a continuous process, there is need for order (Bradford, 2008). The following are the steps that are followed in the calculation of manufacturing costs through process costing:

Units' physical flow: this is accounted for by the use of starting inventory, current or used inventory and the inventory at the end of the financial period.

Production of equivalent units: the units that are equivalent during production are found by multiplying the units that are accounted for by the completion percentage for each category of costs ('Costing.' (n. d.).

Accounted for costs: these costs are identified during each production period for each cost category. They include the inventory at the starting of the period and the inventory used in the current production period.

Per unit cost: for each equivalent unit of production, costs are calculated through the division of the costs to be accounted for by the produced equivalent units.

The allocation for each category of the costs is done for total costs that are to be accounted for. This is possible through the multiplication of the equivalent produced units and the cost per produced equivalent cost (Bradford, 2008).

## **Methodology**

Process costing follows the following method in finding the total costs used in the production process. The two main methods used in process costing are weighted averages and FIFO methods.

Weighted Average Method: The main method used is the use of weighted average to compute the costs of output. The average cost computed is comprised of the weighted average cost from both the opening inventory and the current inventory. The following steps are necessary:

There is a physical flow of units since this weighted average method doesn't separate the starting inventory from the current and the closing inventory.

This weighted average technique computes the units that are equivalent and it fails to separate the percentage of produced units in previous period from these units produced currently (' Costing.' (n. d.).

Unit costs in the starting inventory are not separated from the unit costs for inventory incurred in the current period in the calculation of costs to be accounted for.

To compute per equivalent unit cost, the total costs to be accounted for are divided by the equivalent total units of production.

In the calculation of the costs to be accounted for total equivalent units accounted for, the weighted average method doesn't separate costs of starting inventory from costs of inventory in the current period (' Costing.' (n. d.).

FIFO: this method, in computation of costs, separates costs for the current period from the costs of the starting inventory. The following steps are used:

This method separates the current inventory from the inventory of previous period in the computation of continuous flow of units (' Costing.' (n. d.).

The percentage of production units in the previous periods is separated from the percentage of units produced in the current period during the calculation of produced equivalent units.

In the identification of the costs to be accounted for, the FIFO methodology separates the opening inventory units' from the cost of eventual units that are added to the current period (' Costing.' (n. d.).

In the calculation of per equivalent unit cost, this FIFO methodology divides the current accountable for units by the current produced equivalent.

This method in the calculation of current costs that accounted for separates the costs that added to production in the current period from the costs of opening inventory.

## **Application of Process Costing**

This costing technique is appropriately used when the products of manufacture are homogenous or they are identical. This methodology is differentiated from job order costing in the cost finding process. While job order costing is best used in the finding of per unit costs, this method finds the total average costs of production over a certain period of time (Bradford, 2008).

## **Advantages of Process Costing**

This method has the following advantages;

Process costing is best used for manufacturing industries that perform general manufacturing processing.

Disadvantages of process costing

This type of costing technique is not appropriate with those organizations that have jobs and batches.

## **Job Order Costing**

This is a costing technique that accumulates costs for different types of jobs. The jobs are categorized into batches. For a batch to be considered as a

separate job it has to be differentiated. If the batches are identical then process costing will have to be used. As per customer's specifications, different individual jobs are produced.

## **Job Order Costing Procedures**

There are accumulated costs for manufacturing for each separate job. This is done by the use of different ledger accounts. The procedures to be followed are as specified below;

The process is initiated by the customer placing a sales order for the batch of products.

The sales order is translated into a production order.

This is followed by the ordering of the materials and the labor that is to be used in the production of the batch. The materials are tracked for the batch (Bradford, 2008).

The relevant manufacturing overhead for the job is done by the use of a rate that is predetermined. This is usually done per the hours of labor or per the hours that the machines work (Bradford, 2008).

The work in progress account is changed to a control account and is thus not affected by the allocated manufacturing overheads.

The spoilage that is abnormal (i. e. spoilage above the expected rates) is reclassified from the work in progress account the period costs. This makes it possible for the management to address the cost of abnormal spoilage (Bradford, 2008).

The actual amounts of labor and material incurred are used by the accountant to charge the direct labor and materials to work in progress.

The use of a job costing sheet is used to track these amounts of labor and material. This sheet is usually in a format that is computerized and each account has a subsidiary ledger (Bradford, 2008).

## **Applications of Job Order Costing**

The application of job order costing is wide and varied. It is used by many companies in tracking costs. It is mainly used by the industries that produce and sell goods in batches. Unlike companies that do general manufacturing, this technique is effective in companies that manufacture products in batches (Bradford, 2008).

## **Advantages of Job Order Costing**

This technique readily avails to the management the various costs in relation to the individual batches or jobs. Though this, an analysis can be made to show how and why the cost was incurred. The management gets to know the problems with the various allocations of costs and improve on it in future (Accountingformanagement, 2010).

Though job costing, on going results that are for each job can be yielded. The costs incurred can be added even before the job is finished. This is helpful for the company since it enables the accounting staff of the company to access costs of jobs hence monitoring them.

It enables the company to be in a position to analyze costs for longer jobs hence room for adjustment (Accountingformanagement, 2010).

## Disadvantages of job costing technique

This costing technique is not relevant in some environments like the software industry which has no direct costs but many development costs. Job order costing will not be of help recording such costs.

This costing technique has its main focus as primary products. Departments and activities are not dealt with. This is a problem because the management of a company is left with inadequate information (Accountingformanagement 2010).

## **Application of Job Order Costing to SAC**

SAC has switched the mode of manufacturing goods. It now manufactures spark plugs. The company could get various purchase orders from different organizations and companies. These are sale orders that SAC can transform into batches and start processing the plugs. These form different jobs. It will be costly for SAC to continue using process costing because costs can not be traced to different costs or batches. Therefore I highly recommend SAC to use job process costing in its cost analysis because of the new mode of manufacturing spark plugs.

## **Conclusion**

Management accounting uses various costing techniques to perform its tasks of costs analysis. Process costing and job order costing are two types of costing techniques that have a similarity that they both analyze the costs that are incurred by the organization. Though these methods can be used to analyze costs, they differ in their approach to the analysis. Process costing uses both weighted average methods while job order uses the sale orders



placed as batches or jobs for costs analysis. Also while process costing is good for companies that do general manufacturing, job costing is good for companies that manufacture based on batches.