

Manufacturing Overhead

The 8th edition of our accounting textbook does not cover the topic of dealing with under- and overapplied balances in Manufacturing Overhead as well as the 7th edition did. A comparison of page 889 in the 8th edition under the caption “Year-End Balance” with the following quote from the 7th edition, especially for the portion covering “Interim Balances” parallels the presentation in class:

Interim Balances

The existence of under- or overapplied overhead at the end of a month is expected. It usually does not require corrective action by management. Monthly differences between actual and applied overhead will usually be offsetting over the course of the year.

When Monthly financial statements are prepared, under- or overapplies overhead is reported on the balance sheet. **Underapplied overhead is shown as a prepaid expense in the current assets section. Overapplied overhead is reported as unearned revenue in the current liabilities section.**

Year-End Balance

At the end of the year, all manufacturing overhead transactions are complete. There is no further opportunity for offsetting events to occur. Accordingly, any balance in Manufacturing Overhead is eliminated by an adjusting entry. Usually, under- or overapplied overhead is considered to be an **adjustment to cost of goods sold**. Thus, **underapplied overhead is debited to Cost of Goods Sold. Overapplied overhead is credited to Cost of Goods Sold.** To illustrate, assume that Wallace Manufacturing has \$2,500 credit balance in Manufacturing Overhead at December 31. The adjusting entry for the overapplied overhead is:

Dec. 31	Manufacturing Overhead	2,500	
	Cost of Goods Sold		2,500

After this entry is posted, Manufacturing Overhead will have a zero balance. in preparing an income statement for the year, the amount reported for cost of goods sold will be the account balance **after the adjustment** for either under- or overapplied overhead.¹

¹ Weygandt, Kieso, Kimmel, Accounting Principles, John Wiley & Sons, Inc., 7th edition, 2005, pp. 869-870.

The decision tree distributed in class also provides additional information similar to that contained in the 7th edition.