

## Cost Capitalization Offset

### Why was this account proposed?

Cost Capitalization Offset, was first proposed to help with the elimination problem between program agencies and the administering agency for employer contribution to employee benefits. The program agencies report their portion of the contribution in account 6400G and the administering agency records the benefit revenue in account 5400 G. However, some agencies were capitalizing their portion of employee benefit directly into Work-in-Process(WIP) or Construction-in-Progress (CIP) account. This made it difficult to match program agencies' 6400G with the administering agency's 5400G. As a result, the Issue Resolution Committee proposed account 6610 to provide agencies a mechanism to offset all direct costs in the expense accounts when those costs were capitalized subsequently to an in-progress product/job or to a completed product/job.

### What is Direct Cost?

FASAB Statement of Federal Financial Accounting Standards #4, paragraph 90 defines direct cost to be the following:

“Direct costs are costs that can be **specifically identified with an output**. All direct costs should be included in the full cost of outputs. Typical direct costs in the production of an output include:

- 1) Salaries and other benefits for employees who work directly on the output
- 2) Materials and supplies used in the work
- 3) Various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output, and
- 4) Costs of goods or services received from other segments or entities that are used to produce the output.”

### When should Cost Capitalization Offset Account be used?

All direct costs that are traditionally reported in the expense accounts and some direct material costs, that did not meet capitalization threshold, should be first reported using the 6000 series USSGL accounts. This will allow agencies to accumulate their cost information, establish audit trails, and allow a proper elimination and consolidation at the government-wide level. Agencies will offset those amounts using account 6610 when the cost is capitalized into Inventory Work-in-Process, Construction-in-Progress, Internal-Use Software In Development, or to the finished product.

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**THE ENTRIES ILLUSTRATED BELOW SHOW A MANUFACTURING ACTIVITY**

NOTE: Focus of these transactions is to illustrate the new proposed account 6610, Cost Capitalization Offset and how this account is used. For complete Inventory scenario and the calculation of imputed cost please refer to SGL case studies on Inventory and Liability - pension on the SGL web site.

DESCRIPTION	TRANSACTION	Ref
1) To record appropriation, apportionment and allotment.	<i>proprietary</i>	
	1010 FBWT 40,000	A104
	3100 Unexpended appropriation 40,000	
	<i>budgetary</i>	
	4119 Other appropriation realized 40,000	
	4450 Unapportioned authority 40,000	A118
	4450 Unapportioned authority 40,000	
	4510 Apportionments 40,000	A120
	4510 Apportionments 40,000	
	4610 Allotments - realized resources 40,000	
2) To record raw material purchased for its manufacturing activity	<i>proprietary</i>	
	1525 Inventory - Raw Materials 5,000	B302
	2110 Accounts payable 5,000	
	3100 Unexpended appropriation 5,000	B134
	5700 Appropriation used 5,000	
	<i>budgetary</i>	
	4610 Allotments - realized resources 5,000	B204
	4901 Expended authority - unpaid 5,000	B302
3) To record raw materials used to produce product A	<i>proprietary</i>	
	1526 Inventory - Work in Process 4,000	D310
	1525 Inventory - Raw Materials 4,000	
	<i>budgetary</i> None	

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<p>4a) To record incurrence of direct labor (salary of production workers - \$10,000) during the production of product A.</p>	<p><u>proprietary</u>          6100 Operating expense 10,000          2210 Accr funded payroll and benefits 10,000            3100 Unexpended appropriation 10,000          5700 Appropriation used 10,000    <u>budgetary</u>          4610 Allotments - realized resources 10,000          4901 Expended authority - unpd 10,000</p>	<p>B302            B134           B204          B302</p>
<p>4b) To capitalize payroll expense to WIP.</p>	<p><u>proprietary</u>          1526 Inventory - WIP 10,000          6610 <b>Cost Capitalization Offset</b> 10,000    <u>budgetary</u>          None</p>	<p>D604?</p>
<p>5a) To record incurrence of employee benefits such as retirement, health, life and FECA for workers during the production of Product A.</p> <p><i>For imputed cost calculation, please refer to the pension case study under Liability Standard on the SGL website. Imputed cost illustrated on this case study is not calculated. It is an arbitrary amount since our focus of this case study was to illustrate how the proposed new account 6610, <b>Cost Capitalization Offset</b> is used.</i></p>	<p><u>proprietary</u>          6400 Benefit expense 1,000          2213 Employer contrib &amp; payroll taxes pay. 1,000            6730 Imputed costs 100          5780 Imputed financing source 100            3100 Unexpended appropriation 1,000          5700 Appropriation used 1,000            6850 Employer contrib not req CY budget 500          2225 Unfunded FECA liab 500    <u>budgetary</u>          4610 Allotments - realized resources 1,000          4901 Expended authority - unpd 1,000</p>	<p>D404           D602           B134           B326           D404</p>

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<p>5b) To capitalize employee benefit cost<sup>1</sup> to, WIP. <i>There are other direct costs that are not identified in this illustration.</i></p>	<p><u>proprietary</u>  1526 Inventory - WIP 1,600  6610 <b>Cost Capitalization Offset</b> 1,600</p> <p><u>budgetary</u>  None</p>	<p>D604</p>
<p>6) To record incurrence of other factory overhead (\$2,000) such as factory rent, factory utilities, and indirect labor (\$3,000) utilized to produce product A.</p>	<p><u>proprietary</u>  6100 Op expense/Prog costs (overhead) 5,000  2110 Accounts payable 2,000  2210 Accrued funded payroll and benefits 3,000</p> <p>3100 Unexpended appropriation 5,000  5700 Appropriation used 5,000</p> <p><u>budgetary</u>  4610 Allotments - realized resources 5,000  4901 Expended authority - unpaid 5,000</p>	<p>B302</p> <p>B134</p> <p>B204 B302</p>
<p>7) To record overhead applied<sup>2</sup>, the budget rate is determined to be \$5.00/per direct labor hour. The direct labor hour was determined to be 900 hours. 900 hours * \$5.00 = \$4,500.</p>	<p><u>proprietary</u>  1526 Inventory - Work in Process 4,500  6600 Applied overhead 4,500</p> <p><u>budgetary</u>  None</p>	<p>D604</p>

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<sup>1</sup> The imputed cost was capitalized in order to comply with the “full cost” standard in FASAB Standard #4, Managerial Cost Accounting. However, issues regarding charging for costs that were never outlayed has been referred to the AAPC.

<sup>2</sup> “Overhead is applied to products because of management’s desire for a close approximation of costs of different products. If such product costs are to help management for product pricing, income determination, and inventory valuation, they must be timely as well as accurate. If the purpose were to apply all actual overhead to actual production for the year, the most accurate application of overhead could be made only at the end of the year, after actual results were determined. However, this timing would be too late. Managers want product cost information throughout the year. Therefore overhead application rates are usually computed in advance of production.” (Charles T Horngren, George Foster, Cost Accounting A Managerial Emphasis, 6th edition pg 98).

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8) To pay salary to the employees	<p><u>proprietary</u></p> <p>2210 Accrued payroll and benefits 13,000</p> <p>1010 Fund balance 13,000</p> <p><u>budgetary</u></p> <p>4901 Expended authority - unpaid 13,000</p> <p>4902 Expended authority - pd 13,000</p>	B110?
9) To reclassify fully completed goods which are ready to be sold	<p><u>proprietary</u></p> <p>1527 Inventory - Finished Goods 14,500</p> <p>1526 Inventory - Work in Process 14,500</p> <p><u>budgetary</u></p> <p>None</p>	D312
10) To liquidate liabilities for the purchase of raw materials and other overhead costs	<p><u>proprietary</u></p> <p>2110 Accounts payable 7,000</p> <p>1010 Fund balance 7,000</p> <p><u>budgetary</u></p> <p>4901 Expended authority - unpd 7,000</p> <p>4902 Expended authority - pd 7,000</p>	B110
11) To close <u>underapplied</u> overhead, which is deemed immaterial	<p><u>proprietary</u></p> <p>6600 Applied overhead 4,500</p> <p>6500 Cost of goods sold 500</p> <p>6100 Op exp/Prog costs (OH) 5,000</p> <p>[If overhead is overapplied (applied overhead is budgeted more than the actual), the adjustment will be credited to CGS]</p> <p><u>budgetary</u></p> <p>None</p>	D500

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Pre-closing Trial balance - Proprietary			Pre-closing Trial balance - Budgetary		
1010	FBWT	20,000	4119	Other appropriation realized	40,000
1525	Inventory - Raw Materials	1,000	4610	Allotments - realized resources	19,000
1526	Inventory - WIP	5,600	4901	Expended authority - unpaid	1,000
1527	Inventory - Finished Goods	14,500	4902	Expended authority - pd	20,000
2213	Employee contrib & payroll taxes pay.	1,000			
2225	Unfunded FECA liab	500			
3100	Unexpended appropriation	19,000			
5700	Appropriation used	21,000			
5780	Imputed financing source	100			
6100	Operating expense	10,000			
6400	Benefit expense	1,000			
6500	Cost of Goods Sold	500			
6610	<b>Cost Capitalization Offset</b>	11,600			
6730	Imputed costs	100			
6850	Emp contrib not req CY budget	<u>500</u>			
		53,200			53,200
<b>STATEMENT OF NET COST</b>			<b>CLOSING ENTRIES</b>		
6100	Operating expense	10,000	<b>proprietary</b>		
6400	Benefit expense	1,000	3310	Cumulative results	12,100
6500	Cost of Goods sold	500	6100	Operating expense	10,000
6610	<b>Cost Capitalization Offset</b>	(11,600)	6400	Benefit expense	1,000
6730	Imputed costs	100	6500	CGS	500
6850	Emp contrib not req CY budget	<u>500</u>	6730	Imputed costs	100
Net Cost		500	6850	Emp contrib not req CY budget	500
			6610	<b>Cost Capitalization Offset</b>	11,600
			5700	Appropriation used	21,000
			5780	Imputed financing source	100
			3310	Cumulative results	32,700
			<b>budgetary</b>		
			4610	Allotments - realized resources	19,000
			4450	Unapportioned auth	19,000
			4902	Expended authority - pd	20,000
			4201	Total actual resources	20,000
			4119	Other appropriation realized	40,000

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<u>STATEMENT OF FINANCING</u>		<u>BALANCE SHEET</u>	
1A. Obligations incurred (4901+4902)	21,000	<b>Assets</b>	
1D. Financing imputed for cost subsidies	100	1010 FBWT	20,000
2C. Costs capitalized in the B/S (1525,1526,1527)	(21,100)	1525 Inventory - Raw Materials 1,000	
4. Financing sources yet to be provided (6850)	<u>500</u>	1526 Inventory - WIP	5,600
<b>Net Cost</b>	500	1527 Inventory - Finished Goods	<u>14,500</u>
		<b>Total Assets</b>	<b>41,100</b>
		<b>Liabilities and Net position</b>	
		2213 Employee contrib & payroll taxes pay.	1,000
		2225 Unfunded FECA liab	500
		3100 Unexended appropriation	19,000
		3310 Cumulative results	<u>20,600</u>
		<b>Total liabilities and Net Position</b>	<b>41,400</b>