

Adding Labor to a Bill of Materials

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Adding labor costs to your bill of materials will provide a more complete cost for the items you produce which in turns enables you to make better pricing decisions.

Which costs should be included?

Accounting principals dictate that you can 'capitalize' costs associated with producing product. Such cost would include direct cost such as materials, sub-contractors and direct labor as well as indirect costs such as overhead.

Capitalized cost are not recognized as an expense rather they are added to the inventory asset account and then rolled into cost of goods sold when the product is actual sold.

Including Labor Cost in your bill of materials.

- Create a service type Item called Labor.
- Enter a cost, the cost should estimate the hourly wages and benefits. Or you can estimate the cost per unit.
- Select any income account
- For the expense account, create a new account called 'Salaries Applied to Finished Goods'
- Include the labor component in bill of materials as appropriate.
- When you finish production, the labor cost will be deducted from Salaries Applied to Finished Goods expense and included in the cost of your finished product.
- On a regular basis compare the Salaries Applied to Finished Goods to the Salaries expense account. In a perfect world these two accounts should be exactly the same but they probably never will.
 - If the Salaries account is greater than the Salaries Applied to Finished Goods this means that either a) you have processed payroll but have not yet finished product or b) the Cost amount on the item is too low.
 - If the Salaries account is less than the Salaries Applied to Finished Goods this means that either a) you have finished product but have not yet processed payroll or b) the 'Cost' amount on the item is too high.

You can repeat the above with different item names and costs.