

## 4 Product Versus Period Costs

Now, another way to look at manufacturing costs is to think of them as attaching to a product. In other words, products result from the manufacturing process and “product costs” are the summation of direct materials, direct labor, and factory overhead. This is perhaps easy enough to understand. But, how are such costs handled in the accounting records?

To build your understanding of the answer to this question, think back to your prior studies about how a retailer accounts for its inventory costs. When inventory is purchased, it constitutes an asset on the balance sheet (i.e., “inventory”). This inventory remains as an asset until the goods are sold, at which point the inventory is gone, and the cost of the inventory is transferred to cost of goods sold on the income statement (to be matched with the revenue from the sale).

By analogy, a manufacturer pours money into direct materials, direct labor, and manufacturing overhead. Should this spent money be expensed on the income statement immediately? No! This collection of costs constitutes an asset on the balance sheet (“inventory”). This inventory remains as an asset until the goods are sold, at which point the inventory is gone, and the cost of the inventory is transferred to cost of goods sold on the income statement (to be matched with the revenue from the sale). There is little difference between a retailer and a manufacturer in this regard, except that the manufacturer is acquiring its inventory via a series of expenditures (for material, labor, etc.), rather than in one fell swoop. What is important to note about product costs is that they attach to inventory and are thus said to be “inventoriable” costs.

### 4.1 Period Costs

Some terms are hard to define. In one school of thought, period costs are any costs that are not product costs. But, such a definition is a stretch, because it fails to consider expenditures that will be of benefit for many years, like the cost of acquiring land, buildings, etc. It is best to relate period costs to presently incurred expenditures that relate to SG&A activities. These costs do not logically attach to inventory, and should be expensed in the period incurred.

It is fair to say that product costs are the inventoriable manufacturing costs, and period costs are the nonmanufacturing costs that should be expensed within the period incurred. This distinction is important, as it paves the way for relating to the financial statements of a product producing company. And, the relationship between these costs can vary considerably based upon the product produced. A soft drink manufacturer might spend very little on producing the product, but a lot on selling. Conversely, a steel mill may have high inventory costs, but low selling expenses. Managing a business will require you to be keenly aware of its cost structure.