

# PRODUCT COST AND PERIOD COST

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## Product cost

Product cost refers to the costs used to create a product, generally refers to the financial costs incurred in the creation of a particular product.

These costs include direct labour, direct materials, consumable production supplies, and factory overhead.

The cost of a product on a unit basis is typically derived by compiling the costs associated with a batch of units that were produced as a group, and dividing by the number of units manufactured. The calculation is:

$$\begin{aligned} & (\text{Total direct labour} + \text{Total direct materials} + \text{Consumable supplies} + \text{Total} \\ & \text{allocated overhead}) / \text{Total number of units} \\ & = \text{Product unit cost} \end{aligned}$$

Contd....

Accountants prepare product costs to serve two purposes:  
**Decision making** by managers, and **external reporting**.

- Decision making product costs approximate the marginal costs economists discuss, i.e., the unit costs includes the amount that total company costs increase when an additional unit is produced.
- Product costs for **external reporting** in contrast include a portion of company costs that do not vary with units produced. These product costs include material costs, labour costs, and overhead costs.

# Estimating Material Cost for Products

If a company has a reliable **bill of materials** , the accountant can simply take the total material cost from it as an estimate of product cost. The following example illustrates a bill of materials for a paint sprayer. As this example shows, the bill of materials lists all the materials and purchased components that make up the product, their quantities, and the unit cost for each one. The summation of the material cost for each piece gives the total material cost for the finished product. Accountants usually refer to this cost as the **unit variable cost**.

The accountant will estimate the unit production cost for the paint sprayer at \$310 because this equals the materials cost for the product.

## Bill of Materials for a Paint Sprayer

description	quantity	Unit cost	Extended cost
Head casting	1	\$54.23	54.23
Block casting	1	81.25	81.25
Head bolts	6	0.12	0.72
Head gasket	1	0.15	0.15
Bushings	4	0.85	3.40
Piston casting	1	35	35
Piston connection assy	1	5.14	5.14
Crankshaft	1	45.32	45.32
Base casting	1	24.13	24.13
Gaskets	5	0.08	0.40
Check valve assembly	1	5.64	5.64
Total			

<b>Output valve assembly</b>	<b>1</b>	<b>15.14</b>	<b>15.14</b>
Hose--18 inches	1	1.25	1.25
Hose--five feet	1	3.24	3.24
Metal frame	1	1.13	1.13
Wheels	2	1.85	3.70
Mounting platform	1	3.25	3.25
Label set	1	12.45	12.45
Packing materials	1	0.76	0.75
Packing box	1	1.26	1.26

Total material cost

\$310

## Developing a Unit Cost for External Reporting

- **Labour Cost**- Assume an accountant wants to develop a unit cost for external reporting for the paint sprayer illustrated above. First, the accountant must estimate the amount of labour cost for the product. A **product routing** shows every step a product goes through in the manufacturing process, and these routings usually include labour times for each step. So the accountant can use these labour times from the routing to estimate the labour time required to make the product.
- **Overhead cost** - Overhead cost consists of numerous types of expenses ranging from depreciation and taxes to various kinds of supplies. Because it is such a miscellaneous collection of costs, accountants spread this total lump of costs across products made to assign a portion of overhead costs to each unit produced.

## PERIOD COST

A period cost is any cost that cannot be capitalized into prepaid expenses, inventory, or fixed assets. A period cost is more closely associated with the passage of time than with a transactional event. Since a period cost is essentially always charged to expense at once, it may more appropriately be called a period expense.

A period cost is charged to expense in the period incurred. This type of cost is not included within the cost of goods sold on the income statement. Instead, it is typically included within the selling and administrative expenses section of the income statement.



Examples of period costs are:

- Selling expenses
- Advertising expenses
- Travel and entertainment expenses
- Commissions
- Depreciation expense
- General and administrative expenses
- Executive and administrative salaries and benefits
- Office rent

## Difference between period and product cost

Product cost	Period cost
products costs are only incurred if products are acquired or produced	period costs are associated with the passage of time i.e., a business that has no production or inventory purchasing activities will incur no product costs, but will still incur period costs.
It comprises of manufacturing or production cost	Non-manufacturing cost, i.e. office & administration, selling & distribution, etc.
Cost of raw material, production overheads, depreciation on machinery, wages to labour	Salary, rent, audit fees, depreciation on office assets etc
It is variable cost	It is fixed cost

# References

- <http://www.investopedia.com/ask/answers/102714/what-are-differences-between-period-costs-and-product-costs.asp>
- <https://www.accountingcoach.com/blog/product-cost-period-cost>
- <http://www.accountingtools.com/questions-and-answers/the-difference-between-product-costs-and-period-costs.html>



*Thank*  
**YOU**