Importance of classifying period cost and product cost

Finance

The product costs of a manufacturer are the costs of direct labor, direct materials, and overhead cost that are used in the manufacturing. On the other hand, product costs are not associated with the process of manufacturing necessarily. Period cost may not be particularly assigned to the cost of inventory and products. This cost is often associated with the costs of general administration and the business selling function. The period costs are normally reported in form of expenditures in the period of accounting in which they match the best with revenues, in the period of accounting and when they expire. In addition to general administrative and selling expenses, most of the interest expenses are categorized as period expense. Mr. Smith's classification of these costs therefore would increase the reported earnings of the period. The classification of the period cost and product cost is hence important since the classification will ensure that the net income is properly measured during the time period in which they best match. Classifying period cost and product cost will also ensure that Mr. Smith reports the proper inventory cost appearing on the balance sheet. It is also important to classify these costs since the two costs cling on the units of the manufactured or purchased products. This will increase the reported period earnings because if any unit of a product will not be sold, the product cost will appear as a current asset on the balance sheet since it will be reported as an inventory. The classification will also ensure that the product cost will be reported as the expense of the cost of sold goods on the income statement for the period in which the product units were sold. In addition, classifying period costs will ensure that the expenses incurred id sales and salaries of the general administration are only featured during the exact period in which those salaries were paid to the employees. This will increase the reported earnings of the company.

The actions of Mr. Smith to postpone expenditures to the new year such as cancelling or postponing supplier orders, delaying maintenance already planned, and cutting down on the travels and adverts of the end year is ethical enough since it was in the best interest of the company to report an increase in the end year earnings. By ordering reclassification of both the period and product costs, Mr. Smith significantly increased the reported earnings since every particular period cost was to be reported in the financial year in which it relates to. On the other hand, cutting down on end year travel and advert costs is also ethical since there are not much sales expected during this time when the financial year is ending as the company is considering drawing a new budget as well as procuring new suppliers. Therefore even cancelling orders already made was valid and ethical.

The actions of Mr. Smith relates to the IMA Statement of Ethical Professional Practice in that the actions are in accordance to the stipulated principles of IMA. Some of the principles exhibited by Mr. Smith through his actions include: objectivity, Responsibility, fairness, and honesty with the company stakeholders. IMA dictates that members act within the mentioned principles and encourage the rest to adhere to such principles. The actions also relates to the IMA Statement of Ethical Professional Practice in that Mr. Smith exhibited standards such as competence in his decisions, confidentiality, integrity, and credibility. For example, he was firm in his orders and showed objectivity and integrity in reporting the actual facts and occurrence within the company in case actions are not taken

Bibliography

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