Absorption vs. Variable (Direct) Costing Master Cheat Sheet

Fixed Overhead Capitalization, Net Operating Income Reconciliation & US GAAP vs. Internal Reporting

1. PRODUCT COST CLASSIFICATION MATRIX

Cost Component	Absorption Costing (Full Costing / US GAAP)	Variable Costing (Direct Costing / Internal)
Direct Materials (DM)	Product Cost (inventoriable on Balance Sheet)	Product Cost (inventoriable on Balance Sheet)
Direct Labor (DL)	Product Cost (inventoriable on Balance Sheet)	Product Cost (inventoriable on Balance Sheet)
Variable MOH (VMOH)	Product Cost (inventoriable on Balance Sheet)	Product Cost (inventoriable on Balance Sheet)
Fixed MOH (FMOH)	**PRODUCT COST**: Capitalized into ending inventory asset until units are sold.	**PERIOD EXPENSE**: Expensed 100% immediately in period incurred (like SG&A).
Selling & Admin (SG&A)	Period Expense (deducted after Gross Profit)	Period Expense (split into variable and fixed)

2. OPERATING INCOME RECONCILIATION EQUATION

Production vs. Sales Volume	Income Comparison	Explanation & Mathematical Reconciliation Formula
Production = Sales **(Δ Inventory = 0)**	**Absorption Income = Variable Income**	All FMOH produced in period is expensed in COGS under both methods.
Production > Sales **(Inventory Increases)**	**Absorption Income > Variable Income**	Part of FMOH is trapped in unsold ending inventory asset on Balance Sheet. **Absorption Income = Variable Income + (ΔUnits in Inv × FMOH/unit)**
Production < Sales **(Inventory Decreases)**	**Absorption Income < Variable Income**	Prior period FMOH released from beginning inventory into current COGS. **Absorption Income = Variable Income - (ΔUnits Liquidated × FMOH/unit)**