

## FIXED EXPENSES UNALLOCATED TO THE PRODUCTION COST

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**Abstract:** The article is about costs and the correct calculation of the production cost. The paper presents the result of a fieldwork research realized in some small and medium-sized enterprises, with regard to the cost calculation and the allocation of the cost to expenses. The studies have revealed that only some companies calculate correctly the costs, according to the importance to fixed expenses unallocated to the production cost. Cost information are very important for the cost management of the companies and also for audit work.

The research method adopted in order to gather data concerning the accomplishing the administration accountancy within small and medium-sized enterprises in Maramures county was the survey based on a questionnaire. 392 small and medium-sized enterprises in Maramures county and Salaj county were questioned.

After assessing the gathered data the following conclusions were drawn: out of the 392 small and medium-sized enterprises only 10.26% calculate correctly the production cost, according to the importance to fixed expenses unallocated to the production cost.

### 1. COST STRUCTURE

Within managerial accounting, in view to calculate product costs, the realized works and the services accomplished exploitation expenses are used, financial expenses (except for expenses linked to interest for contracted loans, for enterprises with a long production cycle) are not taken into account, and nor are extraordinary expenses. These expenses (financial and extraordinary) are labeled unincorporable expenses.

In view to determine unitary costs in order that goods, works, services could be valued and recognized in financial accountancy and that selling prices could be established and verified, and that cost and efficiency analysis could be established, within managerial accounting cost are classified as follows [7]:

1. acquisition costs;
2. production costs;
3. processing costs;
4. period expenses;

**The acquisition cost** of goods comprises the buying price, import and other tax (except those the enterprise can reimburse from the fiscal authorities), transport, handling and other expenses which can be directly attributed to the acquisition of the respective goods. Commercial discounts and other similar elements are not included in the acquisition cost.

**The production cost** comprises production related costs, namely:

- direct materials;
- direct manual labour;
- energy consumed for technological reasons;
- other direct production expenses;
- the indirect production expenses quota allotted rationally as being linked to product fabrication;

**The processing cost** comprises manual labour and other expenses related to the directly hired personnel to provide services (including the personnel in charge with surveillance), as well as the corresponding indirect costs (overhead charges).

**Other expenses** which can be included in some specific conditions in product, works or service cost are:

- debit costs which can be included in product, works, service cost only in as far as they can be directly linked to acquisition, construction or production of an asset with a long fabrication period, according to accounting regulations. Debit costs comprise interest and other expenses supported by the juristic person, linked to fund borrowing. An asset with a long fabrication period is one which necessarily requires a substantial period of time to be ready to use as pre-established or ready to sell.
- General administration expenses can be included in the cost of goods in as far as they represent expenses supported to bring the product to the form and the place where they are at present and their taking into account is justified under some specific exploitation conditions.

Period expenses are those expenses represented by the consummation of goods and services pertaining to the current period, which cannot be identified on the established calculation objects, as they do not effectively take part in stock gathering, being necessary for the realization of the activity in its entirety. In product, works and service cost the following elements, which are acknowledged as period expenses for a specific period of time must not be introduced:

- Material loss, manual labour or other production costs above the normal limit;
- Depositing costs, except when these costs are necessary in the production process, prior to passing to a new fabrication step;
- General administration expenses (overhead expenses) which do not participate in bringing the stock to the form and place they occupy at present;
- Marketing expenses;
- Fixed expenses ( fixed overhead charges) non-allotted to the cost, namely sub-activity cost [4];

In order to calculate the product, works, service and period costs, the expenses registered in financial accounting are grouped in managerial accounting according to their nature as follows:

- a) direct expenses;
- b) indirect expenses;
- c) marketing expenses;
- d) general administration expenses;

The production cost has as its components direct expenses and a quota of indirect production costs (fixed and variable), effectuated during the production process.

The calculation of the unitary cost is realized with the aid of the **structure on expenses per calculation item**, thus:

**a) direct expenses:**

- raw materials and direct materials;
- direct wages and wages-connected contributions (insurance and social security, special funds) ;
- energy consumed for technological purposes;
- other direct expenses;

**b) indirect production expenses cheltuieli indirecte de producție** (expenses common to the unit):

- expenses for equipment maintenance and functioning (CIFU) ;
- general expenses of the unit (CGS) ;

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**c) production cost costul de producție (a+b)**

**d) marketing expenses**

**e) general administration expenses**

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**Complete cost (c+d+e)**

Direct expenses are those expenses which are identified on a given calculation item (product, service, works, command, stage, activity, function, profit centre, expense centre, etc.) from the moment of their realization and as thus are directly included in the cost of the respective calculation items.

Indirect expenses are those expenses which cannot be identified and directly attributed on a given calculation item, but concern the entire production process in a unit or the enterprise in its entirety.

Indirect expenses comprise:

- Fixed production expenses ( fixed overhead charges), formed by indirect production costs, which remain comparatively constant irrespective of production volume, such as: the amortization of costs for tools and equipment, unit and equipment maintenance, as well as expenses linked to unit administration and management;
- Variable production expenses (variable overhead charges), consisting of indirect production expenses which are modified as reported to the production volume, such as indirect expenses with material usage and the workforce [1];

The allotment of fixed expenses (fixed overhead charges) on costs is made taking into account the normal production capacity of the enterprise.

The normal production capacity represents the estimated production to be obtained, on average, along a number of periods, under normal conditions, taking into account also the loss in capacity resulted from the planned equipment maintenance.

## 2. SUB-ACTIVITY COST

The fixed overhead charge unallocated to the production cost (as it is called in Order no.1826/2003) or the fixed expenses which are not included in the cost and are recognized as period expenses (expense in the profit and loss account), are called sub-activity cost (Cs).

The calculation formula of the sub-activity cost is:

$$Cs = \text{Fixed expenses} \times [1 - Nr/Nn]$$

Where:

Cs = sub-activity cost;

Nr = real level of enterprise activity;

Nn = normal level of enterprise activity;

The real level of enterprise activity is represented by the production obtained, and the normal level of activity is represented by the normal production capacity.

According IAS 2 *Stocks*, in the stock costs one includes [5]:

- Costs linked to acquisition, such as acquisition price and import taxes;
- Processing-linked costs;
- Direct manual labour;
- Costs linked to production overhead charges, including the variable production overhead charge and the fixed production overhead charge, allocated to the normal production capacity;
- Other costs such as planning and debit ones [3];

### Example

A commercial enterprise realizes in May 1,000 items of the product *a*, and in June 960 items. The unitary variable production cost is 50 Lei/item, the fixed monthly expenses are 12, 000 Lei, and the normal production capacity of the enterprise is of 1,000 items a month. Calculate the unitary cost for product *a* for each of the two accounting periods mentioned in the chart.

Explications	May	June
Obtained quantity (items)	1000	960
Variable production expenses	50,000	48,000
Fixed production expenses	12,000	11,520
Total production cost	62,000	59,520
Unitary production cost	62	62

$$Cs(\text{June}) = 12,000 \times [1 - 960/1000] = 480$$

Fixed production expenses (fixed overhead charges) for June = 12, 000 - 480 = 11,520

If the sub-activity cost hadn't been calculated, the unitary cost for product *a*, in May would have been 62.5 Lei - a cost unjustifiably charged with extra expenses [2].

### 3. CONCLUSIONS

The paper presents the result of a fieldwork research realized in some small and medium-sized enterprises, with regard to the cost calculation and the allocation of the cost to expenses. The studies have revealed that only some companies calculate the costs correctly, according to the importance of fixed expenses unallocated to the production cost. IAS 2 Inventories prescribe that the cost of inventories comprise: purchase costs, costs of conversion - direct labor and production overheads, including variable overheads and fixed overheads allocated at normal production capacity - and other costs, such as design and borrowing costs.

In 2007 we have conducted a research on putting into practice the sub-activity cost on a sample formed of 392 small and medium-sized enterprises from Maramures County

and Salaj County. This study wanted to answer the question: Do small and medium-sized enterprises from Maramures and Salaj, use the sub-activity cost when they calculate the production cost?

The research method used was market inquiry, realized with a specific research instrument: the questionnaire.

After the prelevation and analysis of the information gathered it resulted the fact that out of 392 small and medium-sized enterprises questioned in Maramures and Salaj, only 10.26% calculated sub-activity costs and influenced the production cost in accordance.

Although the notion of sub-activity cost isn't new, as it appears in the Regulations concerning the enforcement of Accountancy Law no.82/1991 (Chapter II The organization of patrimony accountancy), few commercial enterprises calculate sub-activity costs and influence their unitary cost using it. Taking into account the fact that the calculation method of the sub-activity cost is not extremely complex, it would be recommended for commercial enterprises to take it into account when calculating the costs of the products they realize, especially keeping in mind the fact that by using the sub-activity cost one obtains a real production cost.

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