

# Analysis of the Allocation of Indirect Production Costs

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## Abstract

The allocation of indirect production costs represents an important aspect in the process of calculating the cost of manufactured products, directly influencing the quality of accounting information and the substantiation of managerial decisions. The purpose of this article is to analyze the methods of allocating indirect production costs and to highlight the importance of selecting an appropriate allocation base, adapted to the specific characteristics of the entity's activity. The research examines the main allocation bases used in practice, such as direct costs, direct wages, labor hours, or other relevant indicators, as well as their impact on determining the actual cost of production. The article demonstrates that the use of an inadequate allocation base may lead to a distortion of product costs and to erroneous interpretations regarding the economic and financial performance of the entity. By applying methods of analysis, synthesis, and generalization, the study illustrates how the correct allocation of indirect production costs contributes to a faithful representation of resource consumption and enhances the relevance of accounting information. The conclusions emphasize the need to correlate the allocation base with the particularities of the production process in order to ensure a rational and equitable allocation of indirect production costs.

**Keywords:** Production Costs, Indirect production Cost, Accounting, Financial Management.

## Introduction

Production costs play a fundamental role in accounting and financial management, significantly influencing the economic decisions of domestic entities. They directly impact the final pricing of goods and services, overall business profitability, and market competitiveness. In the Republic of Moldova, the proper recognition and accounting of production costs are governed by the Tax Code and the National Accounting Standards (NSA), which are essential tools for the effective allocation and optimization of resources. A comparative analysis with Romania reveals both legislative similarities and differences, which in turn affect cost management practices [1].

Production costs encompass the total costs incurred in the creation of a product or service. From an accounting perspective, they are critical for assessing economic efficiency and formulating financial strategies. Accurate and systematic cost management enables economic entities to maintain competitiveness and ensures the efficient utilization of available resources. Within

this framework, Moldovan legislation establishes explicit rules for cost recording and reporting, thereby enhancing financial transparency and reliability.

A comparison with Romanian legislation offers an additional perspective on how production costs are treated in practice, highlighting both similarities and differences between the two accounting systems. Thus, the analysis of costs becomes an important tool for understanding how entities operate and for improving the decision-making process [2].

The research methodology applied in this paper includes the analytical method, which enabled a detailed examination of the structure, composition, and evolution of production costs within the analyzed entity; the comparative method, through which changes over time in key economic and financial indicators were highlighted, providing a perspective on the efficiency of resource management; and the synthesis method, which contributed to formulating the final conclusions based on the analyzed

information. By combining these methods, the research aimed to emphasize the way production costs are recorded, calculated, and controlled.

### Analysis of the Allocation of Indirect Production Costs

For any economic entity, monitoring and managing costs is essential for maintaining financial balance and making informed decisions on resource allocation and organization. In a business environment characterized by competitive pressures and price fluctuations, accurate cost recording and analysis become fun-

damental decision-making tools. Costs provide concrete data for pricing and product profitability, while also supporting the efficient organization of economic activities. It is important to clearly distinguish between production costs and expenses, as they have different accounting and tax treatments that directly affect the financial results of the enterprise. Production costs reflect the value of resources consumed—materials, labor, utilities, etc.—to obtain finished or semi-finished products and form the basis for key financial indicators such as unit cost, gross margin, and profitability rate [3].

**Table 1:** Accounting and Tax Distinctions between Costs and Expenses of the Entity

Production Costs	Criterion	Expenses
Production costs – resources expressed in monetary terms and consumed for the manufacture of products or the provision of services	1. Definition	Reductions of economic benefits recorded during the reporting period in the form of outflows, decreases in asset values, or increases in liabilities that lead to a decrease in equity (financial result), other than those resulting from distributions to owners
Included in the cost of goods sold and affect the taxable base at the time of revenue recognition	2. Tax treatment	Deductible from taxable income in accordance with the provisions of the Tax Code, Art. 24 para. (1), within the limit of allowable expenses
Raw materials, wages of production workers, depreciation of production equipment	3. Example	Administrative expenses, rent, interest, marketing expenses

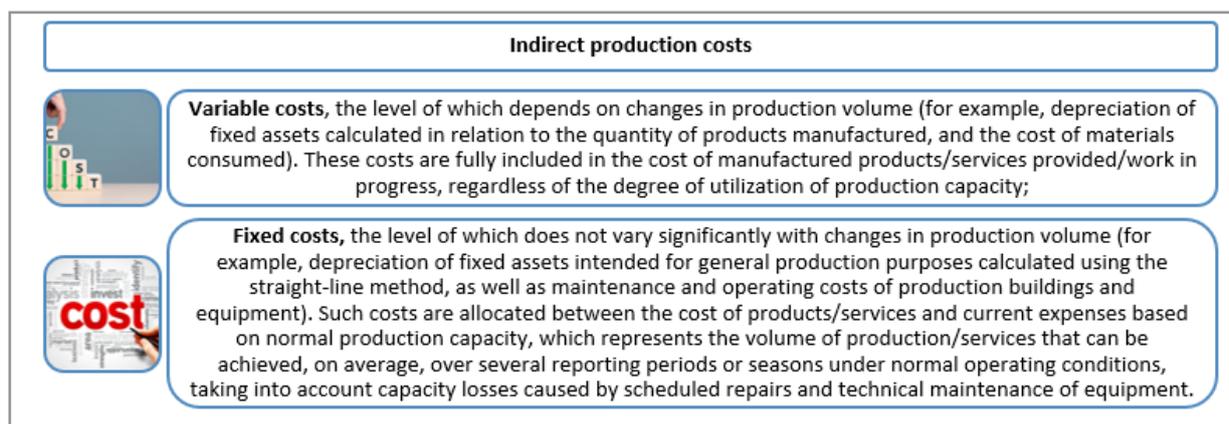
**Source:** Prepared by the author based on the Methodological Guidelines on the Accounting of Production Costs and the Calculation of Product and Service Costs, approved by MF Order no. 118/2013, and NSA “Expenses” [4].

In the process of calculating the cost of manufactured products and/or services provided, the allocation of indirect production costs (hereinafter referred to as IPC) represents an essential aspect. According to point 5 of the Methodological Guidelines approved by MF Order no. 118/2013, these costs comprise expenses related to the management and servicing of the entity’s production subdivisions.

- compliance with the fundamental principles of accounting;
- a clear separation of costs by reporting periods;
- adequate documentary support and the application of appropriate analytical and synthetic accounting records.

According to Article 30 of NSA “Inventories”, for the allocation between the cost of products/services/work in progress and current costs, indirect production costs are classified as shown in Figure no. 1:

The proper allocation of indirect production costs to the cost of manufactured products must ensure:



**Figure 1:** Allocation of Indirect Production Costs

**Source:** Prepared by the authors based on the Methodological Guidelines on the Accounting of Production Costs and the Calculation of Product and Service Costs All the entity’s documents (tax invoices, invoices, payroll calculation sheets, accounting notes, etc.) must be adjusted to allow the inclusion and separation of fixed and variable costs at the initial recording of each

transaction/operation carried out within the entity. According to Annex 6 to NSA “Particularities of Accounting in Agriculture”, the nomenclature of indirect production cost items specific to the crop production sector, linked to the core activity, is presented in Table 2.

**Table 2:** Nomenclature of Indirect Production Cost Items in Core Activities

Groups	Indirect Production Cost Items
1. Costs related to the maintenance of management personnel and other staff:	– Salaries (basic and additional) in cash and in kind, as well as mandatory state social insurance contributions for management personnel and other staff in the crop production subdivisions – agronomists, foremen, accountants, field guards, etc.  This item also includes costs related to the maintenance of communication and other technical command equipment, computing equipment used in the subdivisions, the value and depreciation of low-value and short-lived items, and other materials used by management and other personnel; as well as business travel expenses for management personnel and other staff.
2. Costs related to the maintenance of fixed assets:	– Depreciation of fixed assets intended for general use in sections and sectors (buildings, special constructions, inventory, agro-offices, seed control laboratories, agrochemical laboratories, veterinary hospitals, veterinary pharmacies, sanitary-veterinary installations); costs related to repairs according to the general rules established in NSA “Intangible and Tangible Assets”, as well as the operation and maintenance of similar fixed assets; payments for leasing (rent) of general-purpose assets of the brigade, farm, and sector, in accordance with the general rules established in NSA “Leasing Contracts”.
3. Costs related to ensuring favorable working conditions, occupational safety, and safety engineering:	– Costs related to the installation and maintenance of barriers for machines, equipment, and units; ventilation systems, signaling devices, washing stations, and showers; the value of special clothing and footwear, protective glasses and gloves, and other personal protective equipment provided to workers; costs associated with the purchase of signs and guidelines regarding occupational safety; the cost of special food provided to workers; costs related to ensuring fire safety in the subdivisions, etc.
4. Other indirect production costs:	– the value and amount of wear and tear of objects of low value and short duration; premiums for insurance of general sector, brigade and farm goods; costs related to the round-trip transport of workers to the workplace; transport of petroleum products and water for tractors, combines; costs related to carrying out non-capital actions related to combating soil erosion; depreciation of intangible assets for general purpose by the brigade (farm); costs related to the arrangement of animal cemeteries and other quarantine measures; the cost of auxiliary activities services; cash payments for innovations and proposals for technical improvement; costs related to the maintenance and operation of the means for the protection of nature, etc.

**Source:** Prepared by the authors based on NSA “Particularities of Accounting in Agriculture”

The allocation of indirect production costs is carried out based on primary accounting allocation documents, the form and content of which depend on various factors, such as the calculation method, the technological process, and management decisions and requirements [5].

According to NSA “Inventories”, these costs are allocated proportionally to:

- The basic salaries of workers involved in core and auxiliary activities,
- The total amount of direct production costs, the number of machine-hours worked, or
- The quantity of products manufactured.

The accounting for the allocation of indirect production costs is recorded as an increase in current costs, costs of core and/or auxiliary activities, and fixed assets, and as a decrease in the indirect production costs account. This allocation should be reflected in the entity’s accounting policies. Regarding the choice of allocation base, it is important to note that, according to point 4 of NSA “Accounting Policies, Changes in Accounting Estimates,

Errors, and Subsequent Events”, accounting policies must be applied consistently from one reporting period to another. Changes are allowed only if required by the regulatory framework or if they lead to more relevant and reliable information regarding the economic realities of the entity [6].

The cost structure, which is defined as expenses in Romania, includes the direct expenses related to production, namely: direct materials, energy consumed for technological purposes, direct labor, and other direct production expenses, the cost of product design, as well as the proportion of indirect production expenses that is reasonably allocated as being related to the manufacturing process [7-8].

At Farm Prod S.R.L., which is the subject of indirect production cost research, the accounting policies stipulate that the allocation of indirect production costs is carried out proportionally to the number of hectares cultivated for each crop. The results of the allocation are presented in Table 3:

**Table 3:** Allocation of Indirect Costs at Farm Prod S.R.L.

Nr.	Orchard	Surface, ha	%	Depreciation of fixed assets, MDL	Combustible, MDL	Indirect costs, MDL	Social Fund, MDL	Repair and maintenance of machinery, MDL	Salary, MDL	Day laborers’ salary, MDL	Social Fund, MDL

1.	Cherry	26,96	21,17	228248,2	69430,21	155606,93	44993,76	71038,74	196746,77	29730,86	1995,93
2.	Apri-cot	8,26	6,48	69930,64	21272,01	47674,83	13785,18	21764,84	60279,24	9108,94	611,51
3.	Peach	7,91	6,21	66967,48	20370,66	45654,71	13201,07	20842,59	57725,04	8722,97	585,6
4.	Plum	14,72	11,55	124622,16	37908,48	84960,46	24566,33	38786,74	107422,57	16232,87	1089,77
5.	Apple	54,77	42,99	463692,65	141049,42	316119,89	91406,11	144317,21	399696,61	60399,07	4054,8
6.	Grape-Vine	14,79	11,6	125214,79	38088,75	85364,49	24683,15	38971,18	107933,41	16310,07	1094,95
	Total	127,41	100	1078675,92	328119,53	3585381,31	212635,6	335721,3	929803,64	140504,78	9432,56

**Source:** Prepared by the authors based on primary data from the 1C Accounting software

According to Table 3, the total amount of indirect costs was allocated proportionally to the cultivated area of the orchards.

### Depreciation of Fixed Biological Assets

Total depreciation: 1,078,675.92 MDL

Total area: 127.41 ha

Depreciation per hectare: 1,078,675.92 MDL / 127.41 ha = 8,466.18 MDL/ha

Therefore, the costs were allocated to each orchard as follows:

Cherry: 26.96 ha × 8,466.18 MDL/ha = 228,248.21 MDL

Apricot: 8.26 ha × 8,466.18 MDL/ha = 69,930.64 MDL

Peach: 7.91 ha × 8,466.18 MDL/ha = 66,967.64 MDL

Plum: 14.72 ha × 8,466.18 MDL/ha = 124,622.16 MDL

Apple: 54.77 ha × 8,466.18 MDL/ha = 463,692.65 MDL

Grapevine: 14.79 ha × 8,466.18 MDL/ha = 125,214.79 MDL

This staged allocation of costs reflects a rigorous accounting approach, allowing for a clear distinction between cost categories, tracking their development, and ensuring precise recording of the production cost structure.

The allocation of indirect production costs is one of the most complex stages in management accounting, as it involves several factors that can affect the accuracy of the final product or service cost. The main challenges include:

Accurate identification of indirect costs. Some costs are difficult to classify clearly as direct or indirect costs, which can lead to misclassification and incorrect interpretations of the production cost structure. Choosing the appropriate allocation base. Determining the optimal criterion for cost allocation—such as labor hours, machine hours, production volume, salaries, or other bases—can be challenging, as each method affects the final product cost differently. An inappropriate choice may result in imbalances in unit cost calculation.

Equitable distribution across different products. Products consume resources differently, and applying a uniform allocation method may distort the actual cost per product, affecting pricing, profitability, and competitiveness.

Complexity of documentation and accounting records. Allocat-

ing indirect costs requires precise supporting documents and detailed analytical records. The absence of an adequate system can lead to accounting errors and difficulties in cost auditing.

Adapting to technological and production changes. Modifications in the production process, varying utilization of production capacity, or the introduction of new products may require frequent adjustments to the allocation base and recalculation of costs, increasing the risk of errors and consuming additional resources [9-11].

Therefore, the allocation of indirect production costs remains a sensitive process that requires a rigorous methodological approach, clear and up-to-date accounting policies, and continuous oversight by management to ensure the accuracy and relevance of financial information.

In order to optimize the process of allocating indirect costs, the entity may adopt the following practices:

Periodic review of allocation bases. The selected base for allocating indirect costs (labor hours, salaries, machine hours, etc.) should be reviewed annually to ensure it accurately reflects the actual resource consumption for each product or service [12].

Adoption of modern allocation methods. It is recommended to consider implementing methods such as Activity-Based Costing (ABC), which allow for a more precise allocation of indirect costs based on the actual activities consumed by products or services [13].

### Conclusion

Accurate allocation of production costs is a key factor in determining the true cost of products and services. Proper allocation of indirect costs enables the enterprise to analyze the efficiency of production processes, identify areas with high resource consumption, and make well-informed economic decisions. It also ensures transparency in accounting records, supports precise budget planning, and facilitates the determination of a competitive and justified final price. Therefore, applying an appropriate cost allocation method not only optimizes internal management but also strengthens the financial performance of the enterprise. Costs are not merely an accounting component; they serve as a fundamental decision-making indicator that guides the entity's development strategy. Continuous and in-depth analysis of

costs supports increased economic efficiency, enables adaptation to changes in the external environment, and contributes to the sustainable strengthening of operations. As part of an analysis of the way of allocation the indirect costs of production, it is proposed to move from volume-based bases (those mentioned in the accounting normative framework of the Republic of Moldova) to causality-based distribution bases, specific to the ABC (Activity-Based Costing) method, according to which costs are distributed by activities, and then allocated per product using cost generators.

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