

## **Accounting and Control of Indirect Costs of Organization as a Condition of Optimizing its Financial and Economic Activities**

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**Abstract:** The study deals with one of the conditions of optimizing the financial and economic activities of the organization the management of indirect costs. At the present stage, the development of management accounting is dictated by the increased control over spending accounts, the specifics of production, the influence of size and ways of allocating indirect costs on the final results of the organization. These reasons reinforce the relevance of investigation of the questions of essence, components, features of formation, functioning, role, uses and results of the use, management of indirect costs of the organization on the basis of modern methodological approaches. Therefore, the system of allocation of indirect costs is one of the key moments of management accounting and control as impacts significantly on the effectiveness of activities of various segments of the organization. A methodological basis of the study is dialectical method, systematic approach to the analysis of facts and phenomena under consideration. The study is based on extensive use of methods of analysis, systemacy and complexity, factor analysis and also structural and functional methods, statistical analysis. The above stated methods are used in various combinations at various stages of study, depending on the goals and tasks, which undoubtedly helped to ensure the reliability and validity of the analysis and the conclusions made by the researchers. It has been reflected the structure of indirect costs in the organization, offered incremental variations of distribution of indirect expenses, singled out the scheme of indirect cost allocation which allows to identify the total cost of the products (works, services) produced in the organization and to use this information when making management decisions. The main results of investigation were presented and discussed at scientific conferences of international, national, regional levels. The methodological theses of the study are used by the researchers in the educational process, teaching economic disciplines. The recommendations formulated according to the results of the study to improve the management of indirect costs of the organization are of high practical value. The practical significance consists in the possibility of application of theoretical propositions and practical recommendations stated in the study by the legislative and executive authorities in the development and implementation of federal and regional anti-crisis programs. The conclusions obtained in the course of studying can serve as a methodological basis for creating comprehensive programs on account of indirect costs by designing a system of continuous operative controlling of the efficiency of using the available resources.

**Key words:** Control, organization, indirect costs, overhead (production) costs, manufacturing, nonmanufacturing, costs

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### **INTRODUCTION**

In a shaky economy, the effectiveness of the control and structure of indirect costs as an essential element of the cost of production of an industrial enterprise moves into the first place, in connection with continued integration into the world economy, this indicator is of paramount importance. Besides, the outline of indirect costs and the related cost of production affect the efficiency of production and economic activity, since it

reflects the competitive advantages of an economic entity in comparison with competitors. The financial results of the company, the rates of expanded reproduction, the financial state of businesses are dependent on the level of indirect costs.

The accounting and control of indirect costs and the cost of products, works and services is crucial. It allows to find out the tendencies of the development of this indicator, implementation of the plan according to its level, determine the influence of factors on its increment

and on this basis, assess the performance of the enterprise on making use of the possibilities and to establish reserves of reducing the cost of production.

**MATERIALS AND METHODS**

The methodological framework of the study consists of dialectical method, systematic approach to the analysis of facts and phenomena under consideration. The study is based on the wide use of methods of analysis and synthesis, systemacy and complexity, comparative analysis, factor analysis and statistical analysis methods, a retrospective analysis. The listed methods are used in various combinations at various stages of study, depending on the goals and tasks which will undoubtedly help ensure the reliability and validity of the analysis and the conclusions made by the researchers.

For example, labour costs being considered direct has been steadily declining since the middle of last century when they were often a big part of the cost.

Indirect substantially less costs were allotted to the finished products in proportion to the labor costs of primary production. Major portion of all costs was a variable, relatively minimal cost such as depreciation of equipment was carried out before the production stage (Drury, 1997). Automation of production, reduction of the size of inventories and continuous improvement of the technological process cause a rapid decrease in labor costs in the structure of net cost of produce, work and service. In the technological fields, the share of such costs at present does not exceed 5-10% (Horngren, 2003).

The structure and types of indirect expenses in the accounting are differentiated according to costs: overheads, general economic (Table 1).

The actual amount of expenses for the maintenance of equipment, plant and general economic expenses are

considered in the appropriate accounts of accounting or managerial accounting in the context of the established nomenclature of articles, many of which are also complex (for example, the cost of maintenance and repair of fixed assets, tests, experiments and research, factory relocation of goods, etc.). Each of the groups under consideration consists of the costs of different economic content. Differences should determine the selection and justification of the cost allocation bases and sources of compensation (Coase, 1988).

But in spite of some differences, they all have common characteristics. The common thing for indirect costs is the following:

- Both groups are made up of complex articles
- Occur mainly in production units
- Are planned and taken into account at the places of their occurring
- Are controlled by the budgetary-estimate method
- Are indirectly allocated between the types of products and finished goods and goods in process (Galbraith, 1979)

Another type of indirect costs-general business (non-manufacturing) costs. They are caused by control functions which by their nature, purpose and role differ from production functions and functions of organization of production. These costs occur within an enterprise. A distinctive feature of general economic expenses is that they do not vary with changing the volume of production (sales).

Thus, the indirect costs are understood such, the aggregate of which is difficult to attribute directly to net cost of certain types of products, works and services. The structure of indirect costs in the accounting is differentiated by overhead and general economic costs.

**Table 1: The structure of the indirect costs of organization**

	General manufacturing (production) costs	
General economic (nonmanufacturing) costs	Plant management costs	Expenditures for equipment maintenance
<b>The indirect (overhead) expenses</b>		
Administrative and management costs	Costs of production management	Amortization of equipment and vehicles
Expenses for technical management	Costs associated with the preparation and organization of production	Routine maintenance and repair of equipment
Expenses for production management	The content management apparatus manufacturing units maintaining the management apparatus by manufacturing units	Energy costs for equipment
Expenses for managing supply and procurement activities	Amortization of buildings, constructions, production equipment	Services of auxiliary processes on equipment maintenance and jobs
Managing financial and marketing activity	Maintenance of buildings, structures, equipment	Salaries and allocations to social needs of workers, maintaining equipment
Labour costs: recruitment, selection, training managers, training and refresher courses, professional development payment for services rendered by external organizations	The cost of providing normal working conditions	Expenditures on internal transportation of materials, semi-finished products
Maintenance of buildings, structures, equipment	Costs of vocational guidance and training	

At the same time, this division of the costs into manufacturing and nonmanufacturing is not always the same as division into direct and indirect costs. The urgency of studying the issues of allocation of the indirect costs at modern stage of development of a management accounting is dictated by strengthening the control over expenses, specificity of production, impact of rate and method of allocation of indirect costs to final results of activities of the organization.

**RESULTS**

The system of allotment of indirect costs is one of the key moments of the management accounting as it considerably influences the performance of organization segments. Firstly, the indirect costs are usually raised from places where they occur, that is, allocated between operating and auxiliary departments, then the expenses that are collected in auxiliary departments are reallocated to operating departments and included into net cost of cost drivers carried out in these departments (Fig. 1).

To understand the concept of allocation of indirect costs it is essential to have a clear understanding in what cost centers they are formed and what is the relationship between the cost centers. Overhead costs are collected through the following cost centers:

- Production Cost Centers (PCC): the units of mainline production and producing departments
- Service Cost Centers (SCC): auxiliary production units or auxiliary shops
- Non-production-related Cost Centers (NCC): administrative divisions of the organization as well as the whole set of non-production costs (Palamarchuk, 2009)

These divisions are designated as the cost centers, which means the presence of persons in charge being responsible for controlling costs (Apcherch, 2002).

Indirect costs can be allocated by several variants. The most common pattern of allocation of indirect costs (Fig. 2) allows to reveal the total net cost of the products manufactured at the plant and to use that information for management purposes. Step allocation of indirect costs is reflected by group expenses:

**Step 1:** Grouping of nonmanufacturing indirect costs in the context of responsibility centers (NCC).

**Step 2:** Grouping of production indirect costs in the context of PCC and creating information about costs of SCC.

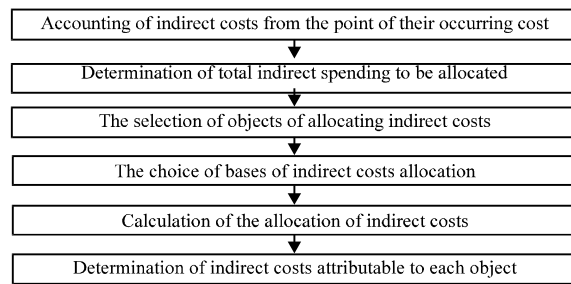


Fig. 1: The chart of allocating of indirect costs

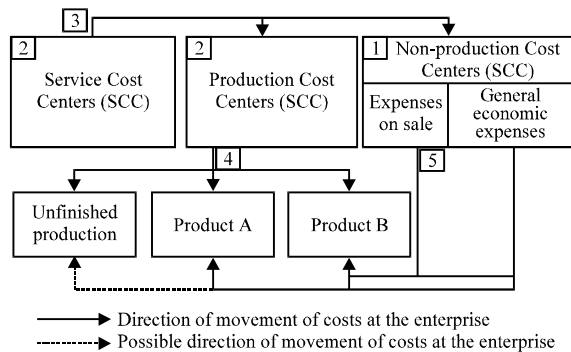


Fig. 2: The chart of allocation of indirect costs to determine the total cost of production

**Step 3:** Reallocation of costs of service cost centers between NCC, PCC and the other SCC.

**Step 4:** Allocation of indirect costs collected inside of PCC between the goods and goods in process.

**Step 5:** Deduction of non-production indirect costs (Whiteman, 2013).

The chart in Fig. 2 allows to answer the question, how much money and resources the company invests for maintaining specific divisions and for production of a specific product. All the stages of allocation of indirect expenses will be reviewed in greater detail in future studies and reflected in scientific publications.

**DISCUSSION**

Abroad, in case of expenditures grouped between the structural cost centers, great importance is attached to indirect costs. Indirect costs relate to all structural cost centers (depreciation of the building of plant, maintenance of buildings, etc.) and can be distributed between them in proportion to the selected base (Vakhrushina, 2013).

However, this allocation is not always carried out. In this case, the indirect costs in relation to divisions will be collected in the itemized context separately. Then the

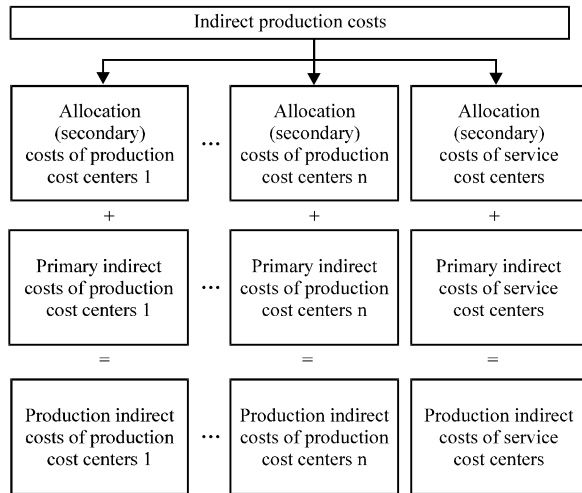


Fig. 3: Control over the allocation of indirect production costs between units

distributed costs are attached to the costs directly allocated to the cost center. At the end, the grouping of manufacturing indirect costs in the context of production and service cost centers (Fig. 3).

In some cases, there are production overhead costs that are difficult to be attributed to the cost center (PCC or SCC) directly. The costs of renting buildings, premises, where there are few shops or industries, the costs of heating and energy supply of the premises, labour expenditures can be given as an example. In the world practice of management accounting a special attention is paid to these costs. They are distributed between PCC or SCC (Scoon, 1997). For example, labour costs are allocated in proportion to the time of the operation of main workers, costs for heating, via special calculation, the cost of production procurement, proposal costs, depreciation of buildings, the area costs, etc. (Samusenko, 2010).

Thus, under conditions of unstable economy, preconditions for changes in the methods of allocation of indirect costs have reached their advanced stage: a significant variety of products. It varies in amount, cost of resources; as a result of the automation of industrial processes, a share of direct labour costs in the structure of production costs has decreased and indirect costs have increased; the resource costs being not directly related to the production of companies: logistics costs, adjustment and readjustment of the equipment costs have also increased; automation of accounting processes allowed to use more sophisticated methods of processing the primary data.

**Summary:** The control and accounting of indirect costs must be kept in a centralized automated form. For the

control and accounting of the cost of repair and maintenance of transport, the cost of communication services, mechanical material maintenance, the cost of rental property, the cost of maintaining assets of general economic purpose, it should be established the account “General expenses”. At the same time, this cost evaluation is carried out from the point of view of each organizational division.

To reflect the administrative expenses in the organization, the account “Administrative expenses” should be opened where the following items are reflected as: salaries of managerial personnel with deductions; expenses for business trips and assignments, communications; maintenance, repair and protection of nonresidential buildings; advertising expenditures; costs of fees and charges; office supplies, furniture and office equipment.

## CONCLUSION

In the current economic conditions, it becomes obvious that the indirect costs not primary ones become the most controlled items in terms of search for the reserves of savings, profit markup and revenue growth in the organization which have determined a program of production and marketing. Indirect costs are understood the totality of the costs of production which cannot (or economically unfeasible) be directly attributed to specific types of products. In home economic literature they are also referred to as overhead costs. Indirect costs are divided into two groups: general production (nonproduction) costs, general economic (non-production) costs.

Insufficient adapted to the modern conditions are the methods of accounting, control and analysis of indirect costs which adversely affects not only the current research of the enterprise but also leads to making incorrect strategic management decisions. Allocation of indirect expenses and their inclusion in the net cost of production is one of the problematic issues in accounting. Therefore, in shaky economy, the ripe have become the preconditions to change the methods of allocation of indirect costs: a significant variety of products.

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