

ORGANIZING COST AND RESULT ACCOUNTING USING THE DIRECT COSTING SYSTEM

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Annotation: This article examines direct costs and variable indirect expenses involved in calculating product cost, as well as key issues in improving cost accounting in enterprises.

Keywords: cost, accounting, International Financial Reporting Standards (IFRS), financial stability, direct costing, goods sold during the reporting period.

Direct Costing is a cost accounting system based on dividing a company's total costs into fixed costs (which do not depend on the amount of production per unit of time) and variable costs, which change in direct proportion to the quantity of products produced. Only the latter group—direct costs and variable indirect expenses—are included in the cost calculation of products. This applies both to the valuation of semi-finished and finished goods when preparing the final annual balance sheet and to the assessment of costs related to goods sold during the reporting period. In direct costing, fixed costs are recorded in the profit and loss account.

The introduction of direct costing has solved two key problems:

1. Eliminating the effect of production volume changes on the unit cost of manufactured products.
2. Determining the product selection for production based on the portion of fixed costs it covers rather than the difference between price and full cost.

The direct costing technique is adapted to specific economic conditions, such as slowing economic growth and underutilization of production factors. In such situations, enterprise managers focus more on controlling variable costs than fixed ones since fixed costs remain at a relatively low and stable level and increase only with production expansion. The growth period of fixed costs is longer than economic upturns, making variable cost analysis more relevant during economic crises.

To address such problems, simple direct costing is used, based only on operating (overhead) costs. In this system, only variable costs are allocated to finished products, while fixed costs are entirely charged to the results of the reporting period in which they occurred. The company's total revenue from product sales is reduced by variable production and sales costs, yielding an intermediate result known as the **contribution margin**.

Using contribution margin allows for the expansion of traditional management decision-making tools. Simple direct costing serves as the initial and classical form of the system, where fixed costs are accounted for as a single, undivided block. In a single-step cost accounting system, all fixed costs combined in one block are deducted from the total contribution margin of the reporting period.

Principles of Simple Direct Costing:

- Costs are classified into fixed and variable based on production volume.
- The cost of manufactured and sold products is calculated only based on variable (operating) costs.

- The difference between variable cost and selling price is compared, known as the variable cost margin.
- Fixed costs are covered by various contribution margins to determine the financial performance and profitability of enterprises.

Simple direct costing is suitable for enterprises with low production volumes and a limited range of products.

Advanced Direct Costing:

Advanced direct costing retains all the advantages of simple direct costing while addressing its limitations by considering the specific nature of fixed costs linked to certain products. In multi-step fixed cost allocation, instead of distributing fixed costs among individual cost carriers, they are allocated across a general product category, cost centers, or business divisions.

In modern management accounting, fixed costs are categorized as follows:

1. **Fixed product costs** – directly related to the total volume of a specific product produced over a given period (e.g., development costs or maintenance costs for specialized equipment).
2. **Fixed product group costs** – incurred for multiple similar products within the same group but not allocated to individual items (e.g., capital costs for machinery used in producing a group of products or research costs for product group development).
3. **Fixed cost center expenses** – not allocated among individual product groups but directly assigned to cost centers.
4. **Fixed divisional expenses** – arise due to the existence of multiple cost centers within a division or the division itself and are covered by the total contribution margin of all products produced by that division.
5. **Enterprise-wide fixed expenses** – costs that cannot be assigned to specific cost objects, such as general corporate management expenses.

Advanced direct costing differentiates not only variable but also fixed costs, determining contribution margins by product type, production location, and sales region.

Key Features of Advanced Direct Costing:

- Introduction of specific direct fixed costs to regulate production volume, cost calculation, and pricing.
- Calculation of contribution margins by external segments outside the enterprise, incorporating marketing principles into management accounting.
- A hierarchical (multi-step) cost calculation system using variable cost data and specific direct fixed costs.

This method ensures continuous focus on the final business outcome—profitability—by determining contribution margin at the enterprise level and for individual products, services, and market segments.

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