

**PROBLEMATIC ISSUES RELATED TO THE EVALUATION AND ACCOUNTING OF DIRECT MATERIAL COSTS**

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**Abstract**

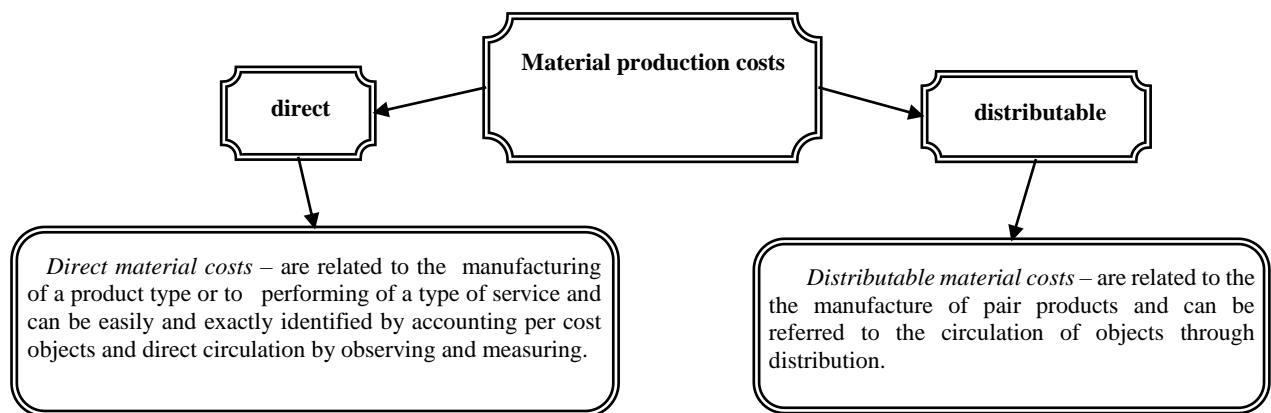
*In the the present article there are examined some problematic issues as regards the evaluation of and the accounting for direct material costs. By using research methods, such as that of analysis and deduction, there were also investigated the views of local scientists, that allowed for the formulation of stronger conclusions and recommendations on the settlement of the problem related to the evaluation and accounting of direct materials costs.*

**Key words:** *evaluation; direct materials costs; normative method; method of equivalence coefficients.*

**JEL Classification:** *M41.*

**I. INTRODUCTION**

According to point 19 of the Methodological Guidelines regarding the accounting for production costs and the calculation of products and services’ costs (hereinafter Guidelines) the classification of material production costs according to the way of their inclusion in the costs of production can be illustrated below in Figure 1:



**Figure 1 – Classification of material production costs**

Source: developed by the author based on Official Monitor of the Republic of Moldova, (2013)

According to poinr 20 of the Guidelines the direct and distributable material costs related to the manufacture of the products include the costs regarding:

- 1) raw materials and materials, which form the basis of the products or are an indispensable component in their manufacture;
- 2) ancillary articles (components) and semi-finished products subject to further assembly or processing by the entity;
- 3) production services provided by third parties (for example, for the performance of separate operations for the manufacture of products, for processing of raw materials and materials);
- 4) fuels of all kinds used for technological purposes;
- 5) energy of all kinds (for example, electricity, heat, compressed air, cold, water), used for technological purposes;
- 6) packaging and packaging materials used in production departments;

7) other direct and distributable material costs related to the manufacture of the products (Official Monitor of the Republic of Moldova, 2013)

The direct material costs are the first element that forms the actual cost of production and, as a rule, have the largest share in its composition. For this reason, it is necessary to have a correct record and a rigorous control of such elements to ensure the determination of a real production cost and to favor its reduction.

Certain requirements must be met when releasing raw materials and materials into production:

- the release is based on the set requirements regarding their volume, weight and mass;
- the release is based on the pre-established limits taking into account the progressive norms of consumption of materials and the production schedule;
- the release of the materials from the warehouse into production will be carried out by the authorized persons.

The release of materials into production does not mean their actual consumption. The *actual consumption of materials* means their actual use for the manufacture of products, the execution of works or the provision of services. In this context, we will mention that the release of materials into the department warehouses (depots) is treated as *the internal movement of materials* and not as actual consumption.

Thus, in order to correctly determine the actual cost of finished production, services rendered or works performed, there is a need to solve the problem of evaluating the material production costs.

*The goal this article* consists in the research and examination of the notional and applicative issues, related to the evaluation and accounting of material production costs according to the requirements provided in the NAS, and the objective lies in the investigation and clarification of the problem mentioned above.

Therefore, there were studied the provisions of the national accounting regulations as well as the works, research and viewpoints of local economists and scientists for the formulation of conclusions and recommendations on the issues approached.

## II. METHODOLOGY

The research method results from the analysis of the theoretical and practical materials on the problematic aspects related to the evaluation and accounting of material production costs. The theoretical foundation was based on analysis, synthesis, deduction and the inductive method used for an as much as possible clear and representative interpretation. The importance of this article's investigation consists in reaching the above-mentioned goal and objective by the examination of the provisions of the national accounting regulations as well as the works, investigations and opinions of the local authors, scientists and researchers in view of improving the accounting for direct material costs.

## III. RESULTS AND DISCUSSIONS

As a rule, the direct material costs are included directly in the cost of production, i.e. directly based on the data from the primary documents, without performing any additional calculations. However, the direct inclusion is not always possible. Thus, in some complex branches of industry several different types of products are obtained from one type of the basic materials, which leads to their distribution by the types of manufactured products.

For this purpose, different distribution methods can be used, the most common being:

- ***the normative method*** - is used in the conditions of a more or less homogeneous production, such as: the industry of machine-building, footwear and furniture production etc.;
- ***the method of equivalence coefficients*** - applies to entities where products are obtained from the same raw material and which differ in shape, size, technological and chemical properties etc.;
- ***the method of physical volume of production*** - is applied in perfectly homogeneous productions. This method uses the units of measurement in which the physical volume of production is expressed (pieces, kg, l, etc.) as the basis for allocating the costs of raw materials and basic materials;
- ***the method of relative value of sales*** - is based on the share of sales of each product in total sales. According to this method, the costs of raw materials and basic materials are distributed according to the ability of each product to generate revenue.

Next, the authors of this article will focus on the problematic issues related to the evaluation and accounting of material production costs distributed in the cost of products manufactured according to the normative method.

The essence of the method consists in the following:

- ❖ the norms of consumption of the material for each type of product are established at the beginning of the reporting period;
- ❖ the normative consumption of materials on each type of product and on the total is determined by multiplying the effective volume of production with the norms of consumption of the material;

- ❖ the distribution coefficient is calculated as the ratio between the total actual consumption of materials and the total of their normative consumption;
- ❖ the actual consumption of materials is established on each type of product made from the same material by multiplying the distribution coefficient with the normative consumption of materials (Caraman & Cușmăunsă, 2015).

Let us further follow the distribution of material costs according to the normative method through a practical example.

Let us suppose that material "X" is used to make 2 products: "A" – 2 000 units and "B" - 400 units. 7 400 kg of material X were consumed for the manufacture of these products. The consumption norm for product "A" is 2 kg/unit and for product "B" - 8 kg/unit. The price of the material is 10 lei/kg.

The distribution of the actual consumption of material "X" by product type, according to the normative method can be followed in table 1.

**Table 1. The distribution of basic material costs byproduct types according to the normative method**

Product name	Actual product volume, unit.	Unit consumption norm, kg	Normative consumption of materials, kg	Distribution coefficient	Actual material consumption, kg	Deviation, kg
<b>1</b>	<b>2</b>	<b>3</b>	<b>4 = 2 x 3</b>	<b>5 = <math>\sum 6 / \sum 4</math></b>	<b>6 = 4 x 5</b>	<b>7 = 6 - 4</b>
A	2 000	2	4 000	1,0277777	4 111,11	111,11
B	400	8	3 200		3 288,89	88,89
<b>Total</b>	-	-	<b>7 200</b>	-	<b>7 400</b>	<b>200</b>

Source: prepared by the author

At the end of the management period, usually monthly, it is necessary to draw up the Report on consumption of raw material and materials. The essence of this report consists in the the establishment of the deviations that occur between the normative consumption of raw materials and materials and and the effective consumption registered. As a result of the deviation analysis, there were found savings and surpluses regarding the consumption of materials raw and materials. The exact normative consumption can not be determined due to the complex technological process, the use of substitutable raw materials, recoverable wastes, human and technological factors, but it is a reference point for controlling and identification of the causes, that provoked these deviations, aiming to improve the management of the production process. (Cechina & Țugulschi, 2019)

According to the technological practice and rules, overconsumption and savings of raw material and materials are justified by the specialists in charge with reference to the technical documents developed by the entity. Therefore, the overconsumption of the accounting value of a material can be explained by the savings of another one and then, if such deviations do not exist, all overconsumption and savings situations have to be examined. Any unjustified savings, but which is periodically encountered can be treated as a deliberate increase of the norms and require adjustment. (Cechina & Țugulschi, 2019)

The entrance cost of product stocks does not include the losses of materials, staff costs and/or other production costs supported beyond the limits of the norms and regulations admitted.

Thus, according to the data presented in Table 1 the cost of the manufactured product "A" must include only 4 000 kg of "X" material and the cost of the manufactured product "B" must include only the amount of 3 200 kg. The overconsumption of 200 kg of "X" material shall not be included in the cost of the manufactured products, but passed on to other operational costs.

Once the amount of material actually consumed has been determined, it will acquire a value expression for its reflection in the corresponding accounts. For this purpose, one of the methods for evaluating the outflows provided in the NAS „Stocks” can be used: the identification method, the weighted average cost FIFO or LIFO.

The actual consumption of materials established on the basis of special consumption documents is reflected in the accountancy through the compilation of the accounting formula:

Debit account 811 „Basic activities”, product "A" – 40 000 lei (4 000 kg x 10 lei / kg)

Debit account 811 „Basic activities”, product "B" – 32 000 lei (3 200 kg x 10 lei / kg)

Credit account 211 „Materials” – 72 000 lei

On the basis of the Accounting Note, the overconsumption of material "X" in the amount of 2 000 lei (200 kg x 10 lei / kg) is reflected in the accountancy by setting the accounting formula:

Debit account 714 „Other operational activity expenses” - 2 000 lei

Credit account 211 „Materials” – 2 000 lei.

It is allowed the deduction of ordinary and required expenses, paid or borne by the taxpayer during the fiscal period, exclusively in entrepreneurial activities. Consequently, the expenses in the amount of 2 000 lei are not allowed to deduction for fiscal purposes 400 lei (2 000 lei x 20%), drawing up the accounting formula:

Debit account 714 „Other operational activity expenses” - 400 lei

Credit account 534 „Debts to the budget” - 400 lei

#### IV. CONCLUSIONS

We should mention that each entity will choose its own distribution method, based on the specificity of the manufacturing process and the production structure. However, regardless of the method chosen, it must be stipulated in the entity's accounting policies.

It is certain that according to the principle of prudence, the material losses supported beyond the limits of the norms and regulations admitted are not included in the entrance cost of the production stocks. This overconsumption of raw materials must be passed on to other operational costs.

Therefore, the method of evaluation and accounting of material production costs according to the normative method described above, will allow the correct determination of the actual cost of the manufactured products.

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