HRM, Rajgurunagar - Commerce Department

## K.T.S.P. Mandal's Hutatma Rajguru Mahavidyalaya

Rajgurunagar-410505

Second Year B.Com

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Subject – Cost & Works Accounting – II

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Topic 1 – Material Accounting

Compiled by Prof. G.M. Dhumal

### **Material Accounting**

#### • LOCATION AND LAYOUTS OF THE STORES -

The store room is commonly described as a place for everything and everything at its place. The first part of the phrase refers to the provisions of adequate space for the materials while the latter part highlights on the scientific location and layout of the store room. The point of receiving the material and the point of use are not always the same. In between them, the materials are housed in the store room. The store room provides the space for materials. The storage space may be in the form of constructed buildings or godowns, temporary structures or even in the form of vast open yards. The size and the type of the storage space is dependent on varied factors such as number of items to be stored, quantity, characteristics of the materials to be stored, space, due consideration should also be given to the space required for the movement of material handling equipment inside the store area.

The following eight types of equipment are commonly used in storing materials:

Pallets and skids
 Open and closed shelving
 Cabinets (with or without counters)
 Bins
 Tacking boxes
 Special storage racks
 Gravity feed racks
 Outdoor platforms and racks

#### • Location of a Store:

The location of the stores is also an important consideration which has a direct bearing on the product cost. The basic principles of stores location are – straight line movement with minimum of backtracking, minimization of handling, re-handling and internal transportation costs, minimization of waste motion for personnel and reduced human hazards, efficient utilization of storage space and provision for the flexibility and expansion of the store area. The materials are stored at one central godown or in the godown located at distant places. Where the materials are stored is distantly located godowns, receiving materials from various suppliers and issuing materials to remotely located production centers. The optimum stores location is decided on the basis of clearly defined objective function with the help of quantitative techniques or through the computer programming.

The stores location will differ according to the divisibility of the total storage space, type of business activity say multi-product operations, manufacturing operations carried on at multi-plants located at distant places, type of production processes such as continuous processing, job order production, assembling etc. Fundamentally the raw materials should be stored in the vicinity of the starting point of the production operation, work in progress between first and following operation, finished inventories near the shipping area, spares, tools and stores somewhere in the central storage area.

#### • Bin Card –

A bin card is a quantitative record of receipts, issues and closing balances of items of stores. Each item is accompanied by a separate bin card. The bin card is posted as and when a transaction takes place. Only after the transaction is recorded, the items are received/issued. On receipt of materials, the quantity is entered in the bin card from the goods received note in the receipt column and the issues to various departments in the issue column. The balance quantity is calculated and recorded. The various levels indicated in a bin card enables the store-keeper to requisition materials as and when required. Sometimes quantity on order and quantity reserved is also noted separately.

Code No.	Code No. : Level of Stock						
Description:			: Maximum	: Maximum			
Unit of Quantity:			: Minimum	: Minimum			
Location Code:			:Danger	:Danger			
: Ordering							
: Ordering Qty:							
Date	Doc No	Receipts	Issues	Balance	On Order	Reserved	

#### Bin Card

#### • Stores Ledger –

The store ledger is maintained to record all receipt and issue transactions in respect of materials. The quantities and the values are entered in the receipts, issues and balance columns. Additional information regarding quantity on order and quantity reserved may be recorded. Separate sheets for each item or continuous stores ledger may be maintained. The sheets should be serially numbered to obviate the risk of removal or loss.

# Bin Card Store Ledger (a) It is a quantity record (a) It is a record of quantity and value. (b) It is kept inside the stores (b) It is kept outside the stores. (c) It is maintained by the store keeper (c) It is maintained by the store keeper

#### • Difference between Bin Card and Stores Ledger –

(d) The postings are done before the

(e) Each transaction is individually posted

#### • STORE-KEEPING –

transactions

Storekeeping is a service function. Storekeeping is the function of receiving materials, storing them and issuing these to workshops or departments.

department

(e)

(d) The postings are done after the

may

be

posted

transactions take place take place.

Transactions

periodically and in total.

The stores department is under the control of a person known as storekeeper. The storekeeper is a custodian of all the items kept in the store. The stores should be spacious, well lit and well equipped so that costs can be minimised and service can be provided effectively.

The main objectives of store-keeping are:

- (i) To protect stores against losses.
- (ii) To keep goods ready for delivery/issue.
- (iii) To provide maximum service at minimum cost.
- (iv) To avoid over-stocking and under-stocking.

(v) To facilitate perpetual inventory.

#### • FUNCTIONS OF STORE-KEEPING -

(a) Receipt of material into storage:

Materials should be received unloaded, inspected and then moved to stores. The storekeeper classifies the materials, stores it in appropriate places and records the receipts in proper books.

(b) Record keeping:

The stores records should be maintained in an efficient and orderly manner so that materials can be easily located and information can be obtained for various departments.

(c) Storage of materials:

The stores should provide maximum protection and safety and accessibility and utilize minimum space. Suitable storage device should be installed.

(d) Maintaining stores:

To keep the stores in the desired condition over a period of time depends on the nature of the material, length of time in storage, rates of deterioration. Special covering or periodic lubrication is necessary to prevent damage due to atmospheric conditions.

(e) Issuing stores:

This function should be performed most efficiently, promptly and accurately. All issues should be properly recorded. All issues should be duly authorised and procedures laid down should be duly followed.

(f) Co-ordination with materials control:

The storekeeper is partly responsible for such coordination. Much depends on the type of production, size of the company, the organisation structure, etc.

(g) Ensure that all transactions are posted in the Bin Card and that the Bin Card is up-to-date.

- (h) All items should be in its proper place.
- (i) Maintenance of stores at required levels.
- (j) Neatness in stores to facilitate physical verification.
- (k) Co-ordination and supervision of staff in the stores department.
- (1) Periodical review of various scales, measuring instruments, conversion ratios etc.

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(m) Protect stores from fire, rust, erosion, dust, theft, weather, heat, cold, moisture and deterioration etc.

#### • CLASSIFICATION AND CODIFICATION OF MATERIALS -

For facilitating identification of materials, each item of stores is given a distinct name. Similar items are divided into sub-groups and a number of sub-groups are classified under major groups. Stores are usually classified either by nature or usage of stores.

Codification is the procedure for assigning symbols for each item in accordance with a proper plan.

The advantages of codification are:

- (i) Lengthy descriptions are replaced by a simple code.
- (ii) Hence, it economises space in forms and reduces clerical work.
- (iii) Ease in identification of stores.
- (iv) It is comprehensive.
- (v) It facilitates mechanised accounting.
- (vi) Secrecy of description can be maintained.
- (vii) It ensures clarity.

#### • ISSUE OF MATERIALS –

While issuing materials, the following points should be kept in mind:

(a) Planning of material requirement:

All requirements of materials should be thoroughly planned. The bill of materials gives estimates of different items of stores required.

(b) Requisition of materials:

Based on the quantities mentioned in the bill of materials, materials are requisitioned. Materials should not be issued in excess of standards. If necessary, an additional bill of materials can be issued by competent authority.

(c) Internal audit of issues:

All issues should be audited. Any excess/shortfall in issues should be explained and accounted for.

(d) Control of wastage:

Actual wastage should not exceed the standard wastage fixed. Wastages should be examined and any variance should be reported.

(e) Issues of sundry items:

Certain stores are required in various departments. Either the requirement can be budgeted or order can be placed strictly on the basis of requirement.

#### • METHOD OF PRICING OF MATERIAL ISSUES -

#### 1. First-in First-out (FIFO) Method -

This method is based on the assumption that materials which are purchased first are issued first. It uses the price of the first batch of materials purchased for all issues until all units from this batch have been issued. In other words the materials are issued at the oldest cost price listed in the stores ledger account and thus, the materials in stock are valued at the price of the latest purchases. It should be noted that the assumption of FIFO is only for accounting purpose i.e. the physical flow of materials need not necessarily be in the order of the flow of cost, though normally materials would be expected to move out of stock on approximately a FIFO basis because oldest stocks are usually used up first.

#### Advantages:

(i) It is a good inventory management system since the oldest units are used first and inventory consists of the latest stock.

(ii) It is logical.

(iii) It is easy to understand and operate.

(iv) It facilitates inter-firm and intra-firm comparisons.

(v) Valuation of inventory and cost of finished goods is consistent and realistic.

#### **Disadvantages:**

(i) The cost of production is not linked to the current prices.

(ii) If prices are rising, production cost is understated. But if stock turnover rate is high, the inventory will reflect current prices. The effect of current market prices is not revealed in issues when prices are rising.

(iii) It does not present the true picture when many lots are purchased at different prices. The calculation become complicated.

(iv) The pricing of material returns is difficult.

(v) High inflation creates problems in replacing used materials, this aspect is not dealt with in FIFO.

(vi) Usually more than one price has to be adopted for a particular issue.

(vii) Cost comparisons between two batches of production becomes difficult when issues are priced differently.

#### 2. Last-in First out (LIFO) Method -

The principle adopted is that the materials used in production is from the latest purchase. The inventory is priced at the oldest costs. As the method applies the current cost of materials to the cost of units, it is also known as the replacement cost method. It is the most significant method in matching cost with revenue in the income determination procedure.

#### Advantages:

(i) It is simple and useful when transaction are few.

(ii) It is a good method of avoiding tax.

(iii) It is a systematic method. It matches current costs with current revenues in a better way.

(iv) It reveals real income in times of rising prices.

(v) It minimises unrealised inventory gains and losses and tends to stabilise reported operation profits especially when the industry is prone to sharp price fluctuations.

#### **Disadvantages:**

(i) When rates of material receipts are highly fluctuating, the method becomes complicated.

(ii) More than one price may have to be adopted for an issue.

(iii) Cost of different batches vary greatly, making inter-firm and intra-firm comparison difficult.

(iv) The stocks require to be adjusted during falling prices.

(v) Unless purchases and sales occur in equal quantities the current costs cannot be easily matched with current revenue.

(vi) The company can time the purchases to cause high or low costs thus changing reported income at will.

(vii) Existing profit sharing and bonus can be effected by an accounting change. Employees will have difficulty in understanding the cause for these changes.

#### 3. Simple Average Method -

The simple average is the average of prices ignoring the quantities involved. It can be used when the prices are normally stable and the stocks purchased are in equal quantities or the stock value is small. It is calculated by dividing the total rates of materials by the number of rates of prices. A new average is worked out after every receipt.

#### 4. Weighted Average Method-

In this method, the total quantities and total costs are taken into account while calculating the average price. It is calculated after every purchase by adding the quantity received to the stock in hand and the cost of this purchase to the cost of stock in hand. The total cost is divided by the total quantity to arrive at the value. This method avoids price fluctuations and reduces the number of calculations and gives an acceptable figure for stock.

#### **Advantages:**

(i) It is logical and consistent.

(ii) Changes in prices do not affect issues and inventory.

(iii) The values reflect actual costs.

#### Disadvantages

(i) It involves considerable amount of clerical work.

(ii) When prices change frequently, it is inconvenient and complex.

(iii) As it is not the actual price, it is not realistic.

#### • Use of computer in store Accounting –

Periodic vs. Perpetual Inventory Systems Quick, Accurate Counting Better Receiving and Shipping Reduced Shrinkage and Missing Inventory Better Inventory Management Real-Time Management Information

#### **Reference** -

The Institute of Company Secretaries of India (ICSI)