

K.T.S.P. Mandal's  
**Hutatma Rajguru Mahavidyalaya**  
Rajgurunagar – 410505

S.Y.B.Com  
(CBCS 2019 Pattern)

**I<sup>st</sup> – Semester**

**Subject – Cost & Works Accounting - I**

**Prof. G.M. Dhumal**  
(Head, Department of Commerce)  
[ganeshakole@gmail.com](mailto:ganeshakole@gmail.com)

***Topic 3 – Purchase  
Procedure***

- **Material cost -**

The term material refers to all commodities consumed in the process of manufacturing. According to CIMA of the UK, material cost is “the cost of commodities supplied to an undertaking”.

Material represents an important asset and is the largest single item of cost in almost every manufacturing business. The important role played by this element in the total cost structure can be realised by the fact that usually more than 50% of the total product cost is material.

**Classification of materials -**

Materials may be classified as follows:

**Direct materials -**

Direct material cost is that which can be conveniently identified with and allocated to cost units. Direct materials generally become a part of the finished product. for example cotton used in textile mill is a direct material, Timber used in furniture, Steel used in making machines etc.

**Indirect materials -**

These are those materials which cannot be conveniently identified with individual cost units. These are minor in importance, such as 1) small and relatively inexpensive items which may become a part of finished product. E.g. Pins, screws, nuts and bolts, thread etc. and 2) those items which do not physically become a part of the finished products, e.g. coal, lubricating oil and Grease, Sandpaper used in polishing, soap etc.

**Supplies -**

Supplies are indirect materials used in production which do not become part of the finished product. oil and grease used in keeping machines in running condition, soaps and towels used by workmen, Sandpaper used in polishing etc. are examples of supplies

**Finished or component parts -**

In assembly type production, like refrigerator, radio, TV, car etc. Component parts may be purchased or produced within the organisation. For example Tyres and tubes in car manufacturing, picture tube in TV manufacturing are component parts.

**Stores -**

the term stores is a very wide a term and include raw materials, component parts, tools, maintenance materials, consumable stores, work in progress, finished goods and pattern etc.

**Inventory -**

The term inventory covers stock of raw materials, work in progress and finish stock

- **Material Control –**

**Significance -**

No cost accounting system can become effective without proper and efficient control of materials. This is so because quite often materials are the largest single element of cost and as such an efficient system of material control leads to a significant economy in the total cost of production.

**Meaning and definition -**

Material control is defined as “safeguarding of company's property in the form of materials buy a proper system of recording and also to maintain them at the optimum level considering operating requirements and financial resources of the business”. this wide definition embraces control over purchases, storage and consumption of materials and determining optimum level for each item of inventory. The system of control should be comprehensive enough to cover the flow of materials starting from the point when someone make a request for the purchase up to the stage when materials are consumed and their costs compiled and assembled in cost sheets.

**Objectives of material control -****1. No under-stocking -**

Under-stocking leads to material running out of stock at some time or the other. Shortages of materials may arise at the time when they are urgently needed and production then be delayed. Delay or stoppage in production due to non-availability of materials is very costly as it may result in the loss of profits. Material control system ensures that there is no shortage of materials.

**2. No overstocking -**

Investment in materials must be kept as low as possible, considering the production requirements and the financial resources of the business. Overstocking of materials

unnecessarily locks up capital and causes high storage costs, thus, adversely affecting the profits.

**3. Minimum wastage**

Proper storage conditions must be provided to different types of materials. Losses of materials may occur due to deterioration, obsolescence, theft, evaporation etc. All efforts should be made to keep these losses at the minimum.

**4. Economy in purchasing -**

The purchasing of materials is highly specialised function. By purchasing materials at the most favourable prices, the efficient purchaser is able to make a valuable contribution to the success of a business.

**5. Proper quality of materials -**

By purchasing materials, due consideration should also be given to the quality. It is no use purchasing materials of inferior quality or of very superior quality. For each type of product there is a particular quality of materials which is needed and that quality alone should be purchased.

**6. Information about materials -**

Not only that materials should be available as and when required, but also there should be a system to give complete and up to date accounting information about the availability of materials. Sometimes inadequate information about the availability of materials may cause new purchases to be made of materials already in stock.

**7. Material reports to management -**

The material control system should be so designed so as to serve the purpose of accurate and up to date reports to management about purchase, consumption and stock of materials.

**Essential requirements for principles of material control -**

Ideally, the material control must ensure that the following requirements are fully met:

1. There should be proper coordination and cooperation between various departments dealing in materials; viz., purchasing department, stores department, receiving and inspecting, department accounting department etc.
2. There should be Central purchasing department under the control of a competent expert Purchase Manager
3. There should be proper classification and codification of materials

4. Material requirements should be properly planned
5. The perpetual inventory system should be operated so that up-to-date information is available about the quantity of material in stock
6. Adequate records should be introduced to control materials during production and the quantities manufactured of for stock
7. The storage of all materials should be well planned subject to adequate safeguards and supervision
8. The various stock levels like minimum, maximum etc. should be fixed for each item of material
9. Purchase of materials should be controlled through budgets
10. An efficient system of internal audit and internal check should be operated so that all transactions involving materials are checked by reliable and independent persons
11. There should be regular reporting to management regarding purchases, issues and stock of materials. Special reports should be prepared for obsolete items, spoilage, returns to suppliers etc.

- **Need and Importance of Material Control –**

1. For keeping the stock of raw materials within limits in the stores i.e., to avoid overstocking and under-stocking of raw materials, materials control is significant.
2. It ensures proper storage of materials. For the proper preservation and safety of materials, adequate storage facilities are to be provided. With the help of proper storing of materials, quantity of materials as and when required can be issued to various jobs.
3. For knowing proper cost of production, control over materials is indispensable.
4. Certain techniques and methods are developed under the system of materials control thereby ensuring optimum utilisation of materials.
5. In order to undertake continuous checking of materials, the necessity of a proper system of materials control cannot be ignored.
6. A well-managed system of materials control ensures the availability of different kinds of materials without delay.

- **Functions of Purchase Department –**

**1. Procuring Raw Materials and Other Resources -**

One role of the purchasing department is to procure all necessary materials needed for production or daily operation of the company or government organization. For a manufacturing company, this might include raw materials such as iron, steel, aluminum or plastics, but it also might include tools, machinery, delivery trucks or even the office supplies needed for the secretaries and sales team.

**2. Achieving the Best Possible Price –**

A purchasing department also is charged with continuously evaluating whether it is receiving these materials at the best possible price in order to maximize profitability. This can be challenging for a small business that may purchase in lesser quantities than a larger vendor and which thus may not receive the same type of bulk discounts. A purchasing department in a small business needs to shop around to find the best vendors at the most reasonable prices for the company's particular size orders.

**3. Paperwork and Accounting –**

Purchasing departments handle all of the paperwork involved with purchasing and delivery of supplies and materials. Purchasing ensures timely delivery of materials from vendors generates and tracks purchase orders and works alongside the receiving department and the accounts payable department to ensure that promised deliveries were received in full and are being paid for on time. In a small business, this means working closely with the accounting department to ensure that there is sufficient capital to buy the items purchased and that cash is flowing smoothly and all payments are made on time.

**4. Compliance with Business Protocols –**

The purchasing department also must ensure that it is complying with all company policies. For example, in a small business, individual staff members may communicate with the purchasing department about purchasing needs for things such as office supplies or computers. Before making a purchase, the purchasing department must ensure that it heeds the proper protocols for purchase and budget approval and must ensure that any items are purchased in accordance with the overall purchasing policy of the organization

**5. Preparation of Purchase Budget.****6. Helping the Engineering Department in developing standards for materials.****7. Fixing quality or grades of materials.**

8. Prepare and maintain list of suppliers for long period at agreed price.
9. Preparing manual of sources of supply.
10. Receiving purchase requisitions from various departments of an organization.
11. Receiving quotations or tenders on the basis of purchase requisition.
12. Selection of suppliers on the basis of tenders or quotations.
13. Placing of orders with selected suppliers.
14. Follow up actions for timely purchase.
15. Checking the materials as per the invoice and purchase order with reference to quality and quantity of materials.
16. Making arrangement for return of materials received in excess or materials not received as per specification.
17. Receiving note from the suppliers for excess supply or short supply of materials.
18. Making recommendation for settlement of account along with invoice to the Accounts Department.
19. Making market research for availing the best advantage on purchase.

- **Purchase Procedure -**

The procedure of purchasing materials varies from one business to another, depending upon its size, conditions and ideas. Assuming a central Processing department, important steps in purchasing of materials given below may be taken as typical.

1. **purchase requisition-**

Purchasing starts when someone in the organisation decides that a particular material is needed. A form known as purchase requisition is commonly used as a formal request to the purchasing department for the purchase of a material. Purchase requisition may be received from:

- a) Storekeeper, for all items in regular use when these reach reorder level

b) Departmental head, who may require materials in the course of the running of the department

c) Plant engineer, for special maintenance material and capital expenditure

Purchase requisition should be received only from certain authorised persons in the organisation. Everybody cannot be allowed to requisition purchases.

## **2. Selection of suppliers -**

The purchase department analyses each of the Purchase requisitions received before making arrangements for the purchase. It usually maintains a suitable record of the different sources of supply and of various quotations. Various sources are examined for the purpose of securing the best quality materials at the lowest possible price. Due consideration is also given to factors like terms of payment, dates of delivery and reliability of various suppliers in the past. Tenders may also be invited for this purpose.

## **3. Purchase order -**

The purchasing department should place purchase orders with those suppliers who will provide the necessary goods at competitive rates. Purchase order is a written authorisation to the supplier to supply the specified materials at a price and terms mentioned therein. As a purchase order forms the basis of a legal contract between the parties concerned, the authority to sign purchase orders should be restricted to a selected responsible officer.

## **4. Receipt of materials -**

In large concerns, there is generally a separate receiving department. All incoming materials are received by the receiving department. This department unpacks the goods and verifies their quantities and condition. The quantity is checked against the copy of the purchase order and the supplier's advice note, which is normally sent along with the goods. Thereafter a goods received note is prepared.

Goods received note is generally prepared in triplicate and send as follows:

- a. first copy to purchasing department
- b. second copy accompanying the goods to the department or stores to which goods are sent
- c. third copy retained in receiving department

## **5. Inspection of materials -**

Large manufacturing companies may also have separate inspection and testing departments to test the quality of materials purchased. Samples may be subjected to laboratory tests before the goods are finally approved. The results of the tests are intimated to



the authorities by means of testing reports. Necessary columns are also provided in the goods received note about the goods passed and rejected on the basis of tests conducted.

#### **6. Returns to supplier -**

Where goods received are not of the type ordered or are damaged or are not satisfactory, these may be returned to the supplier immediately. It is usual to forward a debit note to the supplier. If the supplier accepts the claim, he signifies his acceptance by the issue of a credit note.

#### **7. Approval of invoices and payment -**

The supplier's invoice should be checked before payment is made. When the invoice is being vouched, the various departments like copies of purchase requisition, purchase order, goods received note, and Inspection Report should be checked against each other to ensure that the quantity, price, packing and discounts have been charged correctly. All calculations on the invoice should also be checked for mathematical literacy. If everything on the invoice is found to be correct, a voucher authorising payment is prepared and payment made accordingly.

#### **❖ Purchase Documentation –**

##### **a) Bills of Materials –**

Whenever a new work is to be taken up, drawing office in consultation with the planning department prepares a complete list of raw materials, spares, components parts, consumable stores, etc. required for the completion of the work. This statement is called Bill of Material. If the materials listed in the Bill of materials is not available in the store in adequate quantity, the store-keeper will prepare the purchase requisition. The Bill of Materials is prepared usually in quadruplicate – one each to stores department, production department, accounts department and drawing office's file.

##### **b) Purchase Requisition –**

Request for purchase of materials is termed as "Purchase Requisition". A form known as purchase requisition is commonly used as a formal request to the purchasing department for the purchase of material. On the basis of the stock levels and or Bills of Material, the store-keeper prepares the Purchase Requisition in triplicate – original sent to the purchase department, duplicate to the production control department and the third copy to be retained in the stores department itself for its reference.

**c) Request for Quotation –**

After receiving purchase requisition, purchase department moves to invite quotations from likely suppliers intimating them about the time and date upto which their offers are acceptable.

**d) Schedule of Quotations –**

After expiry of the last date, the quotations are opened and a comparative statement of different quotations are summarised in brief and tabulated in this statement known as “schedule of quotations”.

**e) Purchase Order –**

After selecting the supplier, the purchase manager prepares a purchase order which is the evidence of the contract between the purchaser and his supplier. Purchase order generally includes the description of the product, quantities to be order, rate, amount and delivery terms. Five copies of the purchase order will be prepared – one each to the supplier, store-keeper, receiving and inspection department, accounts department and to the file of the purchase department itself. After the placement of order, it is necessary for the purchase department to follow-up deliveries so as to ensure the receipt of materials at-least on time and to avoid stock-out situation.

**f) Material Received Note –**

The receiving clerk enters particulars of goods in a material received note. This note is sometimes prepared by the storekeeper. This note specifies the quantities ordered, quantities received and differences if any.

**g) Material Inspection Report –**

After receipt of material, it is the responsibility of the inspection department to check whether it is according to the order or not. Sometimes, laboratory testing is necessary. Material inspection report shows the quantities ordered, quantity received and inspected, whether quantities passed or rejected and reason for rejection etc.

**h) Material Debit Note –**

On the basis of the goods received note and the goods inspection report, the purchase department will initiate steps for the discrepancies in the material received. In case the invoice sent by the supplier includes the cost for materials not received, then the purchase department will issue a note called Material Debit Note to the supplier and the accounting department will be informed to make the payment only for the actual quantity of raw materials received.

In the same way, when excess quantity of materials than ordered is received, the same may be retained if required for the production of goods and services. In this case, a Material Credit Note is to be issued by the purchase department to the supplier marking a copy to the accounts department for making payment even for the excess quantity of material received.

**i) Invoice –**

An invoice denotes the bill sent by the supplier stating therein the details of material supplied and the amount payable to him by the purchasing company. Invoice includes the description of the goods, quantity, rate and total amount payable etc.

**Reference –**

1. Himalaya Publication – M.N. Arora
2. Nirali Publication