

Unit-2

Material Cost

Materials:

In cost accounting, material is defined as the part of inventory. Basically, material and raw material are used for same purpose. This is main part of total cost of production. It can reduce or increase according to the fluctuation in production. So, this is very flexible and controllable source of production. For making furniture, wood is the material. 60% to 70% proportion in the total cost of production will be material cost. So, it is very necessary for producing any new product. Its cost will reflect the profit of company directly. This input can be stored and transported from one place to another.

Meaning:

Material means any commodity or substance which is processed in a factory in order to be converted into finished product.

Classification of material:

- Raw material- The basic material supplied in crude form to be used for production
- Components- Finished part made out of raw material which are assembled to make finished products
- Tools- appliances used in manufacturing operations
- Spare parts- used for maintenance of plant, machinery etc
- Consumable stores- items used for smooth running of machines like lubricants, oil, cotton wastes, rags etc.

Material Cost:

The cost of material used at the basic input in a process of production of any good is known as the material cost. Material cost is bifurcated as direct material cost and indirect material cost.

Importance of material cost:

- **Conciliation For Proper Quality with Price of Material:** If company buys high quality material, its price will be high. If company buys low quality material, its price will less. Company has to compromise quality with price of material. Quality will not less than minimum standard. At that level, company has to pay price of material.

- **Purchase at Competitive Price:** If company is selling the products in competitive market, its price must be same with other competitors. It will be only possible, if company will buy products at competitive price. For buying competitive price, company has to check past records of purchased material and compare prices with other competitors
- **Continue Supply of Material:** It is main objective and feature of material that for continue operating of machinery, it is very necessary that we should have to continue supply of raw material for production. Without, this our fixed cost will be increased. That is not good. So, it is needed that store keeper must record when he issues the goods to production department. He also alerts to purchase department for new buying of material.
- **Equilibrium in the Stock of Material:** Over-stocking and under-stocking both are harmful for concern. Equilibrium in stock of material means optimum stocking of materials. It can be only possible, if company records and control the stock and use different techniques for measuring level of stock.
- **To Reduce the Wastage and Losses:** To reduce normal and abnormal wastage and losses of material in production should be also the aim of material record and control.

Types of materials:

Materials may be classified into two categories direct and indirect materials.

1.Direct Material:

Those materials, which are easily and unambiguously acknowledged in relation to a specific product, process or job are called direct materials. Following examples in this regard would make the concept of direct material clearer.

i) Primary Packaging Materials

a) Bag for cement.

b) Plastic packing for milk, ghee and oil.

c) Can for tinned food and drink.

d) Bottles for water, wine and whisky.

e) Card board box for drinks like Frooti, real juice.

f) Tin packing for ghee and oil.

ii) Basic Raw Materials -

a) Bricks and cement in building construction.

b) Gold and silver in jewellery.

c) Paper in books.

d) Milk and cream in ice cream.

e) Cloth in garments.

f) Timber in furniture.

2. Indirect Material:

Those materials, which are not easy to be acknowledged in relation to a specific product, process or job are called indirect materials. Following examples would make the concept of indirect material clearer :

a) Materials having in significant monetary value e.g. nails used in furniture, thread used in stitching garments etc.

b) Materials which are used by Service Department e.g. power house, boiler house etc.

c) Items which are useful in the maintenance of various types of Machines e.g. lubricant oil/grease, cotton waste and other consumables etc.

Material Control:

Material control, is the system that ensure, the provision of the required quantity of material of the required quality at the required time with the minimum amount of capital tied up.

Inventory Control technique of inventory control:

Inventory control uses different techniques and methods.

- Fixation of stock levels
- Economic order quantity(EOQ)
- ABC Technique
- Just in time inventory
- Bin card
- Stores ledger

Procurement:

Procurement refers to the activities required to obtain goods and services from suppliers. It is needed to ensure that purchases are made at reasonable prices and from reputable suppliers. The most effective procurement process focuses on obtaining those goods and services that are in short supply, or which present opportunities for significant cost reductions.

Procedure for procurement of materials:

The standard procurement steps are:

1. **Purchase Requisition:** Purchases of materials are initiated through purchase requisitions. It is a formal request by the head of the department or other authorities to the purchase manager to purchase the specified materials.

Such requisitions are received from certain authorised persons as follows:

XYZ Co. Ltd.
PURCHASE REQUISITION

Department..... No.....
To be delivered at..... Date.....
.....

Please Purchase the items listed below :

<i>Items No.</i>	<i>Quality</i>	<i>Description and Code No.</i>	<i>Purpose</i>

For the use of purchase department only
Purchase Order No..... Requisition by.....
Delivery date..... Approved by.....

2. **Selection of Suppliers:** When the purchasing department receives a duly authorised purchase requisition, a source of supply has to be selected. The purchase department generally maintains a list of suppliers for each type of material and selects a particular supplier after inviting tenders.

The important rule is to buy the best quality materials at the lowest possible price after giving due consideration to delivery dates and other terms of purchases. Purchase should be made from dependable

sources of supply and ethical standards in dealing with suppliers should be maintained.

3. **Purchase order and Follow up:** When the supplier has been selected, the most common procedure is the preparation of a purchase order. The purchase order is the form used by purchasing department authorising the suppliers to supply the specified materials at a price and terms stated therein.

A purchase order should be carefully prepared as it forms a basis of legal contract between the parties concerned. For this reason, authority to sign purchase orders should also be restricted to selected responsible officials.

Large companies generally prepare five copies of the purchase order. The original is sent to the supplier. Second copy is retained by the purchase department for its own file and reference. Third copy is sent to the receiving department as advance intimation to expect the materials.

Fourth copy is sent to the cost accounting department for entry in the ordered column of the stores ledger account. Last copy is sent to the department requisitioning the material as an intimation of the order and expected date of receipt of materials.

XYZ Co. Ltd.
PURCHASE REQUISITION

Department..... No.....
To be delivered at..... Date.....
.....

Please Purchase the items listed below :

<i>Items No.</i>	<i>Quality</i>	<i>Description and Code No.</i>	<i>Purpose</i>

For the use of purchase department only
Purchase Order No.....
Delivery date.....

Requisition by.....
Approved by.....

4. **Receipt of materials:** All incoming material should be received by the receiving department. This department performs the functions of unpacking the goods received and verify their quantities and conditions. The quantity is checked against the purchase order copy and the supplier's advice note which is normally received along with the goods.

Goods received note serves the following purposes:

1. It informs the store keeper or other requisitioner of the receipt of materials.
2. It notifies the accounting department that the materials have been received and that a voucher can be prepared.
3. When it includes columns of cost, it can serve as a source of entry in the stores ledger. Original copy of this goods received note is sent to the purchase department to be marked completed. Second copy is sent to the store keeper. Third copy is sent to the accounting department for entry in the stores ledger and last copy is retained by the receiving department for its own file.

FORMAT OF GOODS RECEIVED NOTE

ABC Ltd.

Supplier.....

No.....

.....

Date.....

Advice Note No.....

Purchase Order No.....

<i>Quantity</i>	<i>Description</i>	<i>No. of Packages</i>	<i>Gross Weight</i>

Inspection Report

<i>Quantity Passed</i>	<i>Quantity Rejected</i>	<i>Reason for Rejection</i>	<i>Received by</i>
Inspected by.....		Date.....	

5. **Inspection and Testing of Materials:** Goods received should be inspected for quantity to ensure that they comply with specifications stated on the purchase order. Where technical or laboratory inspection is necessary, the goods are passed to laboratory which will provide a report on the quality of goods.

An inspection report is prepared to show the results of the inspection. This report is either prepared separately or incorporated in the goods received note. In either case, the report is forwarded to the purchasing department.

6. **Return of Rejected Materials:** Where materials received are damaged or are not in accordance with the specifications, these are usually returned to the supplier along with a debit note, informing him that his account has been debited with the value of materials concerned. When such a claim is accepted by the supplier, he signifies his acceptance by the issue of a credit note. The rejected materials may be returned to the supplier immediately or they may be held pending his instructions.

The debit note may be prepared by the purchase department on the basis of the inspection report. Original copy is sent to the supplier one copy is sent to accounts department for adjustment entry and one copy is retained for purchase department file.

**FORMAT OF DEBIT NOTE
ABC CO. Ltd.**

To (supplier)

No.
Date

We are debiting your account with the value of undermentioned materials for the reasons stated. Meanwhile, we wait for your instructions.

<i>Quantity</i>	<i>Description</i>	<i>Rate</i>	<i>Amount</i>

Reasons.....
.....

Date received
.....

Purchase Order No.....
Supplier's Invoice No.....

Goods received Note No.....
.....
Signature

7. **Passing Invoices for Payment:** When the invoices are received by the purchasing department, the process of assembling the business paper concerned with each purchase and preparation of vouchers begins. Invoices are numbered serially and entered in the invoice register.

Documentation involved in materials accounting:

- **Stores ledger:** Stores department will maintain a record called 'stores ledger' in which a separate folio is kept for each individual item of stock. It records not only the quantity details of stock movements but also record the rates and values of stock movements.
With the information available in the store's ledger, it is easier to ascertain the value of any stock item at any point of time. The minimum, maximum and reorder levels of stock are also mentioned for taking action to replenish the stock position.
- **Bin card:** A 'bin card' indicates the level of each particular item of stock at any point of time. It is attached to the concerned bin, rack or place where the raw material is stored. It records all the receipts of a particular item of materials and its issues. It gives all the basic information relating to physical movements. It is record of receipts, issues and balance of the quantity of an item of stock handled by a store.
- **Material return note:** If Materials received from the stores are not of suitable quality or if there is surplus material remaining with the department, they are returned to stores with a note called 'material return note' evidencing return of material from department to stores.
- **Material Transfer Note:** If materials are transferred from one department or job to another within the organization, then material transfer note should be raised. It is a record of the transfer of materials between stores, cost centres or cost units showing all data for making necessary accounting entries.
- **Stores requisition Note:** It is also called as 'materials requisition note'. When production or other departments requires material from the stores it raises a requisition, which is an order on the stores for the material required for execution of the work order. This note is signed by the department in-charge of the concerned department. It is documents which authorize the issue of a specified quantity of materials.
- **Goods Received Note(GRN):** Once the inspection is completed, GRN is prepared by the stores department, and copies of GRN is sent to the

purchasing department, costing department, accounts department and production department, which initiated purchase requisition.

- **Material Inspection Note:** when materials are delivered, a supplier's carrier will usually provide a document called 'delivery note' or 'delivery advice' to confirm the details of materials delivered. When materials are unloaded, the warehouse staff check the material unloaded with the delivery note. Then the warehouse staff prepares a materials receipt note, a copy of which is given to the supplier's carrier as a proof of delivery.

After receiving the materials the Inspection Department thoroughly inspects whether the quality of material is in accordance with the purchase order and the quality of material received and it prepares a note called 'material inspection note', copies of which are sent the supplier and stores department.

- **Purchase order:** If the purchase requisition received by the purchasing department is an order then it will call tenders or quotations from suppliers of materials. It will send enquiries to prospective suppliers giving details of requirement and requesting details of available materials, prices, terms and delivery etc. Quotation will then be compared and will place order with those suppliers who will provide necessary goods at competitive prices.
- **Bill of materials:** Bill of materials is a comprehensive list of materials, with specifications, material codes and quantity of each material required for a particular job, process or production unit. It will also include the details of substitute materials. It is prepared by the engineering or planning department for submission of quotation and after the receipt of work order. It is a method of documenting materials required for execution of the specified job work.
- **Purchase requisition:** Purchase requisition is an instruction to a buying office to purchase goods or services . It states their quantity and description and elicits a purchase order.

The manager in-charge of purchase department should obtain requisition from the stores in-charge, departmental head or similar person requiring goods before placing orders on suppliers. If the present stock run down to the reorder level, then the stores department send a purchase requisition to purchase department, authorizing the department to order further stock.

Material Storage:

After the purchase, receipt and inspection of materials, the next most important step in the process of material control is concerned with the storage of materials which is termed as 'storekeeping'. Storekeeping is that aspect of material control which is concerned with the physical storage of goods. For carrying the task of storekeeping, a separate stores department under the charge of a storekeeper is set up. The storekeeper should have the technical knowledge and experience in stores routine and the ability of organising various activities relating to the storage of goods, An efficient system of storekeeping should:

- 1) Ensure uninterrupted supply of materials and stores without delay to various production and service departments of the organisation.
- 2) Prevent overstocking and under stocking of materials.
- 3) Minimise the cost of storage.
- 4) Prevent all kinds of stores from theft, deterioration, evaporation and pilferage.
- 5) Ensure an effective utilisation of available storage space and workers engaged in the process of storekeeping.
- 6) Develop a system of providing necessary information about the material items in the stores as and when required.

Duties of store Keeper:

The following duties are performed by the stores department:

- 1) Receipt of material from the goods receiving department and ensuring that every Item of stores received by a storekeeper is duly supported by a indent, a purchase order, an inspection note and a goods received note.
- 2) Issue purchase requisition to the purchase department when the stock of material reaches the re-order level.
- 3) Maintain proper record of receipt, issue and balance of all items of materials, and check the bin card balances with the physical quantities in the bins.

4) Placing and arranging materials received at proper and appropriate places and adhering to the golden principle of storekeeping, i.e., a-place for everything and everything in its place.

5) Issue stores, against proper authorisation, in right quantity of right specification, and at the right time.

6) Minimising the storage handling and maintaining costs.

7) Ensuring that the stocks neither exceed the maximum level nor go below the minimum level at any point of time.

8) Preventing the entry of unauthorised persons into the stores.

9) Co-ordination and supervision of staff in the stores department.

10) Carrying out a regular review of the items of stores in hand for locating slow moving and non-moving items so that the necessary steps may be taken for their disposal before they become obsolete.
