

**S.A JAIPURIA COLLEGE (MORNING)**

**SEM II- COST AND MANAGEMENT ACCOUNTING -1**

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**PRICING OF ISSUES OF MATERIALS**

Materials which are issued against stores requisition, before such issues are to be entered in the stores ledger & a job or a service are charged, are required to be priced by the cost department. For pricing the issues, there are different methods:

**1. Cost Methods:** It means charging materials at their cost of purchase.

**(A) Specific Cost Method:**

Under this method, materials purchased for a specific job are issued at individual purchase price. This method can be applied if materials purchased under different lots and their respective purchase price can be identified separately.

**Advantages:**

- a. Appropriate material cost which is chargeable to a job or service is given by the method.
- b. In job costing, where purchases of non-standard materials are made, this method is suitable, as in separate lots the materials are kept & then issued.

**Disadvantages:**

- c. The identification of the material of a particular purchase & its corresponding cost when the purchases are numerous is difficult under this method.

**B. First-in-First out (FIFO) Method:**

Under this method, assumption is made, for the purpose of pricing the issues, that the materials which are received first shall be issued first & at the corresponding costs the charges are made. In other words, in the order of receipts, the issues take place. Here the identity of the material is immaterial. However, as per assumption, in FIFO, the earlier purchases shall be exhausted earlier & the stock will represent later purchases. Thus, in a condition of falling prices, the production will consume higher costs & the replacement cost will be lower. In the condition of rising prices, the opposite shall happen.

### **Advantages**

- a. At cost, the materials shall be charged. Thus, between the total cost & the total charges, no difference will be there.
- b. Better result is provided by the method, in the conditions of falling prices.
- c. With the market price, more or less the value of closing stock will correspond.
- d. In both theory & practice, the method is simple.

### **Disadvantages:**

- a. The cost of production does not represent the current market price.
- b. In the conditions of rising prices, it is proved by the method that the production will consume lower costs & the closing stock will represent higher costs. Thus more money will involve in replacement of stock.
- C. On the basis of stock available, at different rates, two jobs may be charged. So the comparison of costs will give misleading results.

### **C .Last-in-First out (LIFO) Method:**

This method is similar to FIFO, with the exception that under this method, assumption is made, for the purpose of pricing the issues, that the materials which are received last shall be issued first. Here also the identity of the material is not required. However, for the purpose of pricing, the assumption is that, the latest purchases are issued first. Under this method, in the conditions of rising prices, the charge to production will be more or less at current market price while the earlier low prices will be represented by the stock.

### **Advantages:**

- a. Cost of production is charged at current market prices.
- b. It reveals real profits in time of rising prices.
- c. The earlier low prices will be represented by the closing stock & hence, in financial accounting, no unrealised profit will be there.
- d. Determination of income by matching current costs with current revenues becomes accurate.
- e. Both in theory & practice, the method is simple.

**Disadvantages:**

- a. Closing stock value fails to represent current costs because materials consumption is valued at the more recent prices.
- b. When rates of material receipts are highly fluctuating, this method becomes complicated.
- c. If the price level is falling, this method should not be applied.

**D .Base Stock Method:**

Under this method a fixed minimum stock of materials is always carried at original cost. The excess stock is issued in accordance with one of the two methods, (i.e. FIFO or LIFO). The minimum stock which is always maintained is known as base stock.

**2. AVERAGE COST PRICE METHOD****Simple Average Method :**

Under this method materials are issued at the average price of materials on hand on the date of issue. The simple average price is calculated dividing the total of all rates of material in hand by the number of rates. The lot which is exhausted, based on FIFO method is excluded in computing the average.

Rate of Issue = Total of Different Rates /No. of Rates

This method is useful when the materials are received in uniform quantities and purchase prices are normally stable.

**Advantages :**

- i) This method is easy to operate.
- ii) It gives reasonably accurate results if prices are stable

**Disadvantage :**

- i) Materials are not priced at actual costs.
- ii) It does not take into account the quantity of materials purchased.
- iii) Verification of closing stock becomes difficult.
- iv) When price and quantity of different lots are widely fluctuates, this method gives incorrect result

### **Weighted Average Method :**

This method gives due importance to quantity of material in stock. Under this method issue price of material is calculated by dividing the value of materials in stock by the quantities of material in stock

Rate of Issue = Value of material in stock/ quantities of material in stock

Weighted average rate is calculated each time when a fresh lot is received. It remains the same till the next lot is received. Thus issue price are calculated at the time of receipt of material and not all the times of issue of material

This method is useful, where the purchase price and quantities of material are widely different.

### **Advantages :**

- i) Easy to calculate and operate.
- ii) Closing stock value is acceptable
- iii) When prices fluctuate considerably, it smooths out the fluctuations.
- iv) This method is more logical than the simple average method.

### **Disadvantage :**

- i) The issues are not priced at current market price.
- ii) Issue price of materials does not represent actual cost price and therefore a profit or loss may arise.
- iii) It involves considerable amount of clerical work.