Theory Q&A

Chp2 Material Cost

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Chp2. Material Costing

Theory Notes

Past Year Exam Questions PYQs

PYQ – 2024 May – Q6 b

(b) Distinguish between Waste and Scrap. Discuss the treatment of normal and abnormal scrap in Cost Accounts.

(b) Difference between Waste and Scrap

Waste	Scrap
1. The portion of raw material which is lost during storage/ production and discarded.	1. The output which is discarded and disposed off without further treatment.
2. It is connected with raw material or inputs to the production process.	2. It is the loss connected with the output
3. Waste of materials may be visible or invisible.	3. Scraps are generally identifiable and has physical substance.
4. Generally, waste has no recoverable value.	4. Scraps are termed as by-products and has small recoverable value.

PYQ – 2024 May – Q6 b

Treatment of Scrap

Normal- The cost of scrap is borne by good units and income arises on account of realisable value is deducted from the cost.

Abnormal- The scrap account should be charged with full cost. The credit is given to the job or process concerned. The profit or loss in the scrap account, on realisation, will be transferred to the Costing Profit and Loss Account.

PYQ – 2023 Nov – Q6 b

(b) State with reasons whether the following independent statements are ***true or false:***

(i) Under LIFO method, in the period of falling prices, lower income is reported and income-tax liability is reduced.

(ii) Under VED analysis, inventories are classified on the basis of cost of individual items.

(iii) Material requisition note is prepared by the store keeper.

(iv) Simple average pricing method is suitable when quantity purchased under each lot is different and prices fluctuate considerably.

(v) Bin card and stores ledger are maintained by the purchasing department. ***(5 Marks)***

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(b)

Statement No.	True/False	Reason
(i)	False	Under LIFO method, in case of falling prices profit tends to rise due to lower material cost, thus income tax liability is increased.
(ii)	False	Under VED Analysis, inventories are classified on the basis of its criticality for the production function and final product.
(iii)	False	Material Requisition Note is prepared by the production or other consuming department. It is a voucher used to get material issued from store.
(iv)	False	Simple average pricing method is suitable when the materials are received in uniform lots of similar quantity, and prices do not fluctuate considerably.
(v)	False	Bin card is maintained by the storekeeper in the store. While Stores ledger is maintained in cost accounting department.

PYQ – 2022 Nov – Q6 a

(a) *Which system of inventory management is known as 'Demand pull' or 'Pull through' system of production? Explain. Also, specify the two principles on which this system is based.*

(a) **Just in Time (JIT) Inventory Management is also known as 'Demand pull' or 'Pull through' system of production.** In this system, production process actually starts after the order for the products is received. Based on the demand, production process starts and the requirement for raw materials is sent to the purchase department for purchase.

It is a system of inventory management with an approach to have a zero inventories in stores. According to this approach material should only be purchased when it is actually required for production.

JIT is based on two principles

(i) Produce goods only when it is required and

(ii) the products should be delivered to customers at the time only when they want.

PYQ – 2022 May – Q6 b

(b) *Write down the treatment of following items associated with purchase of materials.*

(i) *Cash discount*

(ii) *IGST*

(iii) *Demurrage*

(iv) *Shortage*

(v) *Basic Custom Duty*

PYQ – 2022 May – Q6 b

(b) Treatment of items associated with purchase of materials is tabulated as below

S. No.	Items	Treatment
(i)	**Cash Discount**	Cash discount **is not deducted** from the purchase price. It is treated as interest and finance charges. It is ignored.
(ii)	**Integrated Goods and Service Tax (IGST)**	Integrated Goods and Service Tax (IGST) is paid on inter-state supply of goods and provision of services and collected from the buyers. It **is excluded from the cost of purchase if credit for the same is available**. Unless mentioned specifically it should not form part of cost of purchase.
(iii)	**Demurrage**	Demurrage is a penalty imposed by the transporter for delay in uploading or offloading of materials. It is an **abnormal cost and not included with cost of purchase**

PYQ – 2022 May – Q6 b

(iv)	**Shortage**	Shortage in materials are treated as follows: **Shortage due to normal reasons: Good units absorb the cost of shortage due to normal reasons.** Losses due to breaking of bulk, evaporation, or due to any unavoidable conditions etc. are the reasons of normal loss. **Shortage due to abnormal reasons:** Shortage arises due to abnormal reasons such as material mishandling, pilferage, or due to any avoidable reasons are not absorbed by the good units. Losses due to abnormal reasons **are debited to costing profit and loss account**.
(v)	**Basic Custom Duty**	Basic Custom duty is paid on import of goods from outside India. It **is added** with the purchase cost.

PYQ – 2021 Dec – Q4 c

(c) *What is Bill of Material? Describe the uses of Bill of Material in following departments:*

(i) *Purchases Department*

(ii) *Production Department*

(iii) *Stores Department*

(iv) *Cost/Accounting Department* ***(5 Marks)***

PYQ – 2021 Dec – Q4 c

(c) **Bill of Material:** It is a detailed list specifying the standard quantities and qualities of materials and components required for producing a product or carrying out of any job.

Uses of Bill of Material in different department:

Purchase Department	Production Department	Stores Department	Cost/ Accounting Department
Materials are procured (purchased) on the basis of specifications mentioned in it.	Production is planned according to the nature, volume of the materials required to be used. Accordingly, material requisition lists are prepared.	It is used as a reference document while issuing materials to the requisitioning department.	It is used to estimate cost and profit. Any purchase, issue and usage are compared/ verified against this document.

PYQ – 2021 Jul – Q6 e

(e) *Write a short note on VED analysis of Inventory Control.*

(e) **Vital, Essential and Desirable (VED):** Under this system of inventory analysis, **inventories are classified on the basis of its criticality for the production function and final product**. Generally, this classification is done for spare parts which are used for production.

(i) **Vital-** Items are classified as vital when its **unavailability can interrupt the production process and cause a production loss.** Items under **this category are strictly controlled by setting re-order level.**

(ii) **Essential-** Items under this category are essential but not vital. **The unavailability may cause sub standardisation and loss of efficiency in production process.** Items under this category are reviewed periodically and get the second priority.

(iii) **Desirable-** Items under this category are optional in nature; **unavailability does not cause any production or efficiency loss.**

PYQ – 2021 Jan – Q6 a

(a) *State how the following items are treated in arriving at the value of cost of material purchased:*

(i) *Detention Charges/Fines*

(ii) *Demurrage*

(iii) *Cost of Returnable containers*

(iv) *Central Goods and Service Tax (CGST)*

(v) *Shortage due to abnormal reasons.*

PYQ – 2021 Jan – Q6 a

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(a) Treatment of items in arriving at the value of cost of material Purchased

S. No.	Items	Treatment
(i)	**Detention charges/ Fine**	Detention charges/ fines imposed for non-compliance of rule or law by any statutory authority. It is an abnormal cost and **not included** with cost of purchase.
(ii)	**Demurrage**	Demurrage is a penalty imposed by the transporter for delay in uploading or offloading of materials. It is an abnormal cost and **not included** with cost of purchase.
(iii)	**Cost of returnable containers**	Treatment of cost of returnable containers are as follows: Returnable Containers: If the containers are returned and their costs are refunded, then cost of containers should not be considered in the cost of purchase. If the amount of refund on returning the container is less than the amount paid, then, only the short fall is added with the cost of purchase.

PYQ – 2021 Jan – Q6 a

(iv)	**Central Goods and Service Tax (CGST)**	Central Goods and Service Tax (CGST) is paid on manufacture and supply of goods and collected from the buyer. It **is excluded** from the cost of purchase if the input credit is available for the same. Unless mentioned specifically CGST is not added with the cost of purchase.
(v)	**Shortage due to abnormal reasons**	Shortage arises due to abnormal reasons such as material mishandling, pilferage, or due to any avoidable reasons are not absorbed by the good units. Losses due to abnormal reasons are debited to costing profit and loss account.

PYQ – 2019 Nov – Q6 c

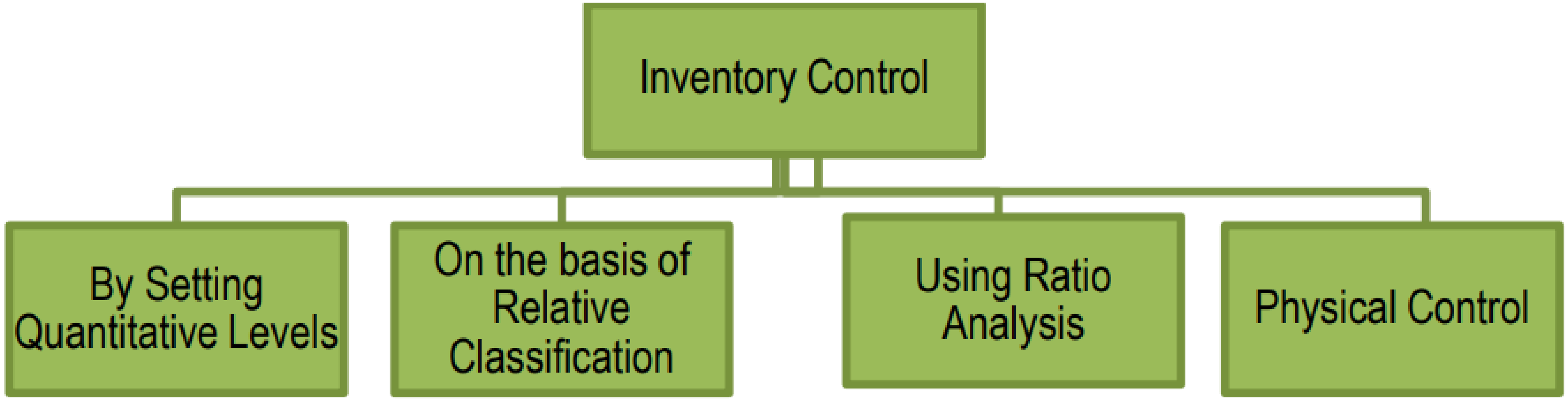
(c) Define Inventory Control and give its objectives.

List down the basis to be adopted for Inventory Control.

(c) **Inventory Control:** The Chartered Institute of Management Accountants (CIMA) **defines** Inventory Control as "The function of ensuring that sufficient goods are retained in stock to meet all requirements without carrying unnecessarily large stocks."

The **objective** of inventory control is to make a balance between sufficient stock and over-stock. The stock maintained should be sufficient to meet the production requirements so that uninterrupted production flow can be maintained. Insufficient stock not only pause the production but also cause a loss of revenue and goodwill. On the other hand, Inventory requires some funds for purchase, storage, maintenance of materials with a risk of obsolescence, pilferage etc. A trade-off between Stock-out and Over-stocking is required. The management may employ various methods of Inventory control to have a balance. Management may adopt the following **basis** for Inventory control:

PYQ – 2019 Nov – Q6 c



PYQ – 2018 Nov – Q6 b

(b) Explain obsolescence and circumstances under which materials become obsolete. State the steps to be taken for its treatment.

(b) Obsolescence: Obsolescence is defined as "the loss in the intrinsic value of an asset due to its supersession".

Materials may become obsolete under any of the following **circumstances:**

(i) where it is a spare part, or a component of a machinery used in manufacture and that machinery becomes obsolete;

(ii) where it is used in the manufacture of a product which has become obsolete;

(iii) where the material itself is replaced by another material due to either improved quality or fall in price.

Treatment: In all three cases, the value of the obsolete material held in stock is a total loss and immediate steps **should be taken to dispose it off** at the best available price. The loss arising out of obsolete materials on **abnormal loss does not form part of the cost** of manufacture.

PYQ – 2018 May – Q6 b

(b) Explain 'Just In Time' (JIT) approach of inventory management.

(b) Just in Time (JIT) Inventory Management

JIT is a system of inventory management with an approach to have a zero inventories in stores. According to this approach material should only be purchased when it is actually required for production.

JIT is based on two principles

(i) Produce goods only when it is required and

(ii) the products should be delivered to customers at the time only when they want.

It is also known as 'Demand pull' or 'Pull through' system of production. In this system, production process actually starts after the order for the products is received. Based on the demand, production process starts and the requirement for raw materials is sent to the purchase department for purchase. This can be understood with the help of the following diagram:

Demand for final product → Production starts to process the demad for product → Materail Requirement is sent to Purchase department → Order for raw materials sent to supplier → Supplier sent the material for production

PYQ – 2018 May – Q6 e (ii) – 2 marks

(e) Explain:

(i) Opportunity Cost

(ii) FIFO and LIFO method of stores issue.

(ii) **First-in First-out (FIFO) method:** It is a method of pricing the issues of materials, in the order in which they are purchased. In other words, the materials are issued in the order in which they arrive in the store or the items longest in stock are issued first. Thus each issue of material only recovers the purchase price which does not reflect the current market price. This method is considered suitable in times of falling price because the material cost charged to production will be high while the replacement cost of materials will be low.

Last-in-First-out (LIFO) method: It is a method of pricing the issues of materials. This method is based on the assumption that the items of the last batch (lot) purchased are the first to be issued. Therefore, under this method the prices of the last batch (lot) are used for pricing the issues, until it is exhausted, and so on. If however, the quantity of issue is more than the quantity of the latest lot than earlier (lot) and its price will also be taken into consideration. During inflationary period or period of rising prices, the use of LIFO would help to ensure that the cost of production determined on the above basis is approximately the current one.