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## THEORIES AND PRACTICES OF INVENTORIES ACCOUNTING

### An Analytical Study of Mawana Sugar Ltd and Daurala Sugar Ltd.

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#### Abstract

An Inventory Accounting augments business operation by effective flow of goods and services. It adds to profitability, competitive ability, service optimization, market diversification etc. This Article investigates the role of inventory accounting in fostering big sugar mills growth. The Research Framework and hypothesis were examined by the empirical analysis of secondary data from Daurala Sugar mill Ltd. And Mawana Sugar Mills Ltd. To promote inventory accounting integrated strategic planning encompassing logistics, promotional mix, and technological capabilities.

**Key-words :** Inventory Accounting

#### Introduction

Inventories constitute the second largest item next to fixed assets in the balance-sheet of most of the companies. In a number of case they are several times larger than the reported profits. As such a small variation in the valuation of inventories can significantly affect the profits reported. The present practices in inventories valuation give much leeway to the management for manipulating the accounts. And the multiplicity of valuation methods decreases the usefulness of financial statements to the users. In term inventories is a wild term includes under it, stocks of raw materials, semi-finished goods or partly finished goods and finished goods. "Inventory is a tangible property held for sale in the ordinary course of business, or in the process of production for such sale or for consumption in the production of goods or services per sale Including maintenance supplies and consumable other than machinery spares". According to American institute of certified public accountants Inventory design at the aggregate of items of tangible personal property which are (i)held for sale in the ordinary course of business or in the process of production for much sale are (ii)to be currently consumed in the

production of goods or services for sale. Items like jugs, tools, component material, sundry supplies etc are also often included in the meaning of the terms inventory closing inventory and opening inventory figures appear in the trading accounts of are concerned and thus are important determinants of profit of business.

### **Main Objectives and Principles of Inventory Accounting**

The main objective of in account is to fold for it is concerned with valuation of the inventory. Valuation of the inventory account is important because the funds invested by a corporate in its inventories are usually quite significant; the Inventory of our business is often a largest of its current assets. Second and at least of equal importance is a proper determination of net income of the business for the period by matching the appropriate cost( the coast of the inventory sold) against the related revenue ( the receive from sale of the inventory) in other words the matching process requires that cost been assigned to those goods which were sold during the period and to those goods which were still in and available for sale at the end of the period it should be noted that this is really a single process the procedure which are employed in the valuation of inventories also simultaneously determined the cost of the goods sold. Historical cost is the primary basis used in accounting for inventories. This cost includes not only the price of the asset itself but also any direct or indirect outlays which were made or incurred in order to bring the inventory to the firm location in the desired form and condition. For example electricity cost would be considered a part of the coast of the inventory if they were paid by the purchaser.

### **Problems of Inventory Valuation**

There are 5 main problems involved in the valuation of inventory in question from they are

1. When shall Accountants recognise on the books of account that inventory have been required?
2. At what amount shall asset recognised by valued?
3. In as much as it is impossible to keep a separate account for an inventory acquired, how should the various inventory recognised be combined or classified?
4. How were the quantities of stock arrived at
5. What was the method of valuing it

Overriding these problems is the fundamental issue of the nature of an inventory there is a need to know the characteristics that make a thing or process and inventory effect the element Review that an inventory asset is anything of value owned by end Enterprise is not particularly useful in the more advanced problem of accounting are somewhat broad view would be to consider inventory asset as two rather distinct types:

- I. General purchasing power in the form of cash and direct claims to cash.
- II. Command for specific resources embodying services that is to be used in the operations of the Enterprise.

### **Significance of the study**

Inventory cost has vital bearing in accounting and a glance through the published accounts of a couple of Companies will reveal that inventory cost amounts to about 60% to 90% of the total current assets besides there is a direct relationship of the cost to profit the two basic aspects concerning inventory are first is the size of inventory that is whether inventories are reasonable and really necessary to meet the production program and do not contain any absolutes are useless stock second is valuation or the inventory that is whether these are valued on sound Accounting Principles.

The first aspect involved inventory control implying systematic and scientific approach towards purchasing storage and uses of materials with the object of keeping them to a minimum consistent with the production requirements with the minimum cost.

The second aspect which is the main term of this topic deals with the valuation aspect by manipulating valuation of inventories the profit can be converted into losses and vice versa the correctness of this decides the true and fair value attached to inventory it can materially affect the operating results and the financial position of the concern. it is the method of pricing inventory which matters and should always be based on scientific and sound accounting Principles with a conservative approach.

### **Valuation of Inventory**

There are three main groups by the corporate sector ascertaining the value of inventory at the end of accounting period. These are

- Raw material or merchandise inventory
- Work in progress or partly finished goods
- Finished goods

### **Valuation of Raw Material of Merchandise Inventory**

Under the head merchandise inventory may be considered the Inventory of the trader who does not manufacture in the raw material accounting procedures must include:

- All acquisitions by purchase transfer duration or other means must be recorded on the date custody is obtained.
- The accounting must recognise the use application consumption through expensive for supplies and materials and disposal of property.
- Keeping of physical records of quantities of property my location including those relating to use transfer and disposal.
- Periodic confirmation of inventory by physical verification shall be made to confirm quantities weight quality and controls with differences between the records and physical verification being investigated and the various recorded in the accounts.

Three basic methods are adopted for the purpose of ascertaining the value of raw material in the corporate sectors stock at the end of the financial accounting period.

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### **(1) At Market Price or Realizable Value**

This is based on the principle that the balance sheet should always reflect a true and their positions consistent with the current trends the main difficulty in this method is how to obtain market price replacements of items lying in stock some of the practical difficulties:

- It is impossible to have the market price for each and every item some of them maybe specialised items made inside the concert or imported.
- It is very difficult to get authentic prove or written documents of the ruling market price as on the date of preparation of balance sheet.
- Market price can differ from place to place.

### **(2) At Cost or At Market Prices Whichever is lower**

This method of inventory valuation is based on the counting of conservatism under this convention of conservatism all prospective losses are taken into account while all prospective profits are left out does inventory is valued at market price if that is lower than actual cost incurred. If cost is lower than market value inventory will be valued at cost the principle of cost of market price whichever is lower suffers from following limitations:

- (i) It lacks owing to the use of cot in one period and market price in another period. This makes comparisons difficult between inventories held at different dates.
- (ii) This method is not logical as it recognizes only decreases in market prices and not increases in market prices.
- (iii) It operates against the principle of true and fair reporting of financial statements because under valuation of inventory results in understatement of income.

### **(3) At Cost or At Historical Cost**

For specific purpose as the present one closing stock of material is best valued at historical cost in fact most of concerns do follow this as actual practice irrespective of the remarks they put in the published accounts profit and loss arising out of adopting either of the methods described above cannot and should not form a part of profits or losses. The greatest advantage of this method is that prices for all items are available which is not the case in the earlier method these are also adequately supported by the documents indicating the price secondly the effort time the energy needed to obtain reliable replacement or realizable prices can be completely avoided in this method.

Even under at historical cost method and number of sub methods are available and one has to choose the suitable and appropriate method depending upon such factors as:

1. Nature of Industry.
2. Total Number of Items used.
3. Issues for use or maturates.
4. Price Fluctuations.

5. Method used for Costing.
6. Frequency of Purchases.
7. Need of the Management to reflect current market trends, in the present product cost.

### **Valuation of Work in Progress or Partly Finished Goods**

“Work in progress includes all materials which have undergone manufacturing or processing operations, but upon which further operations are necessary before the product is ready for sale”

This is always based on actual cost, since it is almost impossible to get the market price for such partially completed jobs and or processes. The actual cost of work in progress is found by adding cost of “raw material plus the labour applied to it and a proper proportionate of the direct and indirect expenses and proportionate factory overheads such as the depreciation of machinery, power, heat, light and similar items.” Material cost is calculated by pricing material requisition at actual cost prices based on any accepted principles. Similarly, actual labour cost is taken. Only factory overheads are charged at predetermined basis. Work in progress may be valued at direct cost also which means cost of direct materials, direct labour and direct expenditure. Inclusion of administrative and selling and distribution overheads is not advisable. If included, it would result in over-valuation and consequently unrealizable profit.

### **Valuation of Finished Goods**

These should be valued at Cost or Market price whichever is lower. At cost or historical cost would include direct material cost, direct labour cost direct expenses or proportionate factory overheads, but would exclude the administrative and selling & distributing overheads. The Finished Goods are meant for sale and naturally, for the purpose of evaluation, selling or marketing price or cost the lower of the two, need to be adopted as a conservative approach. In case of imported materials used for finished Goods than including those canalized through Govt. agencies, defiles of cost, insurance, freight charges (CIF value) custom duty port charges, inland freight and handling and clearing charges paid shall be recorded separately.

The methods of valuation of inventories of finished goods are the same as the methods “for valuation of inventories” of raw materials.

## **SELECTED CORPORATE SECTORS ACCOUNTING PRACTICE FOR INVENTORIES VALUATION AND ACCOUNTING**

### **M/s DAURALA SUGAR LTD:**

- Stores and spares are valued at cost or under.
  - Stock-in-trade is valued at the lower of cost and net realizable value.
  - Cost of inventories is generally ascertained on weighted average basis.
  - Finished goods and process stocks, appropriate share of labour and overheads is included. Not to be included under it administrative cost.
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- The company is maintaining proper records shoring Full particulars including details and situation of stores.
- The company has a program of physically verifying all its assets over a period of three years.
- The stock of finished goods, stores, spare parts and raw materials have been physically by the management during the period.
- The procedures of physical verification of stocks followed by the management are reasonable and adequate in relation to the size of the company and the nature of its business.
- The discrepancies noticed on verification between the physical stocks and the book records were not material and have been properly dealt with in the books of accounts.
- The valuation of stocks is fair and proper in accordance with normally accepted accounting principles and is on the same basis as in previous financial years.
- There is adequate internal control procedure commensurate with the size of the company ad nature of its business with regard to the purchase of stores, raw materials including components, equipment and others with regard to the sale of goods.
- There were no transactions of purchase of goods and materials and sales of goods, material made in pursuance of contracts or arrangements entered in the register maintained under section 301 of the Companies Act 1956 and aggregating during the year to 50000 or more in respect of each party.
- The company has a regular procedure for the determination of unserviceable or damaged stores raw materials and finished goods. Adequate provision has been made in accounts for the loss arising on the items so determined.
- Reasonable records have been maintained by the company for the sale and disposal of realizable by products and scrap.

**Inventories (as taken, valued and certified by the management)**

	(In laces)		
<b>DESCRIPTION</b>	<b>31-03-14</b>	<b>31-03-15</b>	<b>31-03-16</b>
Stores and spares (at cost or under)	893.34	1055.7 1	1010.80
Raw materials (lower of cost & net releasable value)	880.06	1964.11	528.06
Work-in-Progress ( lower of cost & net releasable value)	316.15	524.37	529.96
Finished Goods ( lower of cost & net releasable value)	5210.10	6269.10	7914.93

**Notes to the accounts:**

- The quantities have been derived from the quantitative details available in respect of stocks and production.
- As there are diverse products, it is not practicable to give figures in the same quantitative denomination in which there are normally dealt with in the market and have been converted into metric tons.
- The licensed capacity of sugar includes a letter of intent for 3500 tons crushing per day sanctioned by the Ministry of Industry, Govt. of India.

### **M/S MAWANA SUGAR LTD**

- Stores and spares are valued at cost or under.
- Loose tools are valued at cost.
- Raw materials, Components are valued at lower of cost and not realizable value.
- Work-in progress and finished goods are also valued at lower of cost and realizable value.
- Cost of inventory is generally ascertained on the "weighed average" basis. Further, in respect of the manufactured inventories i.e process stock and finished goods. And appropriate share of manufacturing expenses is included on absorption costing basis.
- Finished goods purchased for sale are valued at cost or not realizable value whichever is lower.
- The stocks of finished goods, stores spare part and raw materials have been physically verified by the management during the year. The frequency of verification is reasonable.
- None of the inventories have been revalued during last five years period.
- The discrepancies noticed on verification between the physical stocks and book records were not material and have been properly dealt with in the books of account.
- On the basis of examination of stock records, the valuation of stocks is fair and proper in accordance with normally accepted accounting principles and is on the same basis as in the previous years.
- The transactions of purchase of goods and materials and sale of goods, materials and services made in pursuance of contracts or arrangement entered in the register maintained under section 301 of the companies Act 1956 and aggregating during the years to the Rs.50,000 or more in respect of each party have been made at the prices at which are reasonable having regard to the prices at which transactions for similar goods. Material or services have been made with other parties.
- The company has a regular procedure for the determination of unserviceable or damaged stores, raw materials and finished goods. Adequate provision has been made in the accounts for the loss arising on the items so determined.

- Spare part/materials received will be inspected fully or partly before acceptance. When spare part/material are found defective rejection report will accompany the received materials. The Rejection report will detail the specific reasons to the Commercial Department, to enable them to take up with the supplier as appropriate.

Particulars	31.03.2013	31.03.2014	30.09.2015	30.09.2016
Stores and Spares	1023.75	1120.94	1043.54	1208.85
Loose tools	17.29	21.92	-	-
Stock in trade	1244.05	1603.41	1509.15	6.87
Raw material, components				
Works in progress:				
Process stocks	452.34	550.26	175.31	49.93
Constant works	469.93	432.37	5.07	-----
Finished Goods	7188.98	8682.42	9287.64	9212.31

#### Notes to the Accounts:

-Includes Oil stocks in process Rs 214.52 Lacs(Previous year Rs 173.07 Lacs)

-The amount of excise and customs duties payable of finished goods, raw materials, stores, spares and components as at March 31,2014 estimated at Rs 636.55 Lacs (Previous year Rs 715.36Lacs)shall be accounted for on the clearance of goods from the factory premises/bonded warehouse. However, non provisions of this liability will not affect the profit for the year.

-The price of levy sugar sold during the season 2002-03 by one of the units of the company is to subject of court cases. Pending decision an amount of Rs. 98.18 Lacs realized in this respect together with interest accrued of Rs 200.87 Lacs in items of court ordered is included.

The amount of excise and customs duties payable on finished goods, raw materials, stores, spares and components as at March 31, 2016 estimated at Rs 604.10 Lacs(Previous period Rs 556.04 Lacs) shall be accounted on the clearance of goods from the factory premises /bonded warehouses. However, non provision of the liability will not affect the project for the year.

-Current year's figures included figures of IHM and are, therefore not comparable with the figures of the years.

-Previous year figures have been regrouped wherever be necessary.

5% of the packages are inspected at the time of receipts before stacking. The same packages is to be checked ,weighed before inspection.

-The issues of stock shall be governed by principles of FIFO.

#### Conclusion and Recommendations

Inventories constitute the second largest item next to fixed assets in the balance sheet of the most corporate sector. Due to the absence of any statutory, requirements, flexibility in standards a non-

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enforcement of the same, numerous methods are being employed by the corporate sectors in inventory valuation, which constitutes one of the crucial items of financial and which delinquently handled and manipulate to the best advantage of the company and can harm the investing public financing institutions. There is a wide area not covered by accounting standards.

### **Recommendations**

- About the method of inventory costing, through different methods for different products.
- Provide direct costing or absorption costing may be used while determining the historical cost of manufactured inventories.
- To the extent possible, uniform accounting codes in respect of common heads of accounts, for similar producer, shall be fixed in the present computerised environment.
- Cost of conversion includes a systematic allocation of both fixed and variable production overheads that are incurred in converting materials in to finished goods.
- Inventory normally valued at lower of historical cost and net realisable value.

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