

THE STUDY ON INVENTORY VALUATION FOR A BUSINESS; ANALYSIS OF PRICING ISSUE OF MATERIALS FIFO&LIFO METHODS

Dr.Chitta Ranjan Mishra *

ABSTRACT

The objective of study to discuss & evaluate of the pricing issue of materials , which is choosing proper method of inventory evaluation that play an important role in evaluation of materials are issued from the stores to the jobs or work orders as per their requirement material price always changes in accordance with the market conditions. The stock of material includes the purchases made at different times at different prices. There is need to know about the price at which the material should be issued.

Keyword: Methods of pricing issue of material, Analysis of FIFO & LIFO methods, Table & figures.

* **Asst-professor of commerce, D.K.N COLLEGE (UTKAL UNIVERSITY), Eranch,
Cuttack**

1-INTRODUCTION

Pricing of material issues

Materials purchased are kept in stores and issued to different jobs or work orders. These jobs or work orders are charged with the cost of materials issued to them. This is called pricing of material issues. Prices paid for purchases made at different times may be different. While issuing these materials, it is essential to consider the price at which it should be charged to jobs or work orders. There are different methods of pricing materials issues. The selection of a proper method of pricing of material issues depends on many factors e.g.

- 1) Environment of business.
- 2) Regularity of materials purchases
- 3) Longevity of stock
- 4) Duration of inventory turnover.
- 5) Range of price fluctuations etc.

Different methods are in use concerning the pricing of materials issued from the store. The best two methods are as follows:

First-in, First-out [FIFO]

Last-in, First out [LIFO]

1.1-First-in, First-out [FIFO]

It is based on the assumption that the materials purchased and received first are issued first to the job. After the first lot of material is used for production, the next lot is taken for the supply. This assumption is made for the purpose of assigning cost of material to a job/process/product. The price of first purchase for all the issues is same until the material of first purchase is entirely issued to various jobs, cost of materials issued represents the cost of earlier purchases. Cost of closing stock shows the cost of latest purchases. It is not necessary that the physical movement of the stock be in the order of first in and first out.

1.2-Last-in, first out [LIFO]

This method is based upon the assumption that the material purchased and received last are issued first to the job. The cost of last lot of materials received is used to price the materials

issued until the stock of that lot is exhausted. This method is suitable when prices are raising because material will be issued from the latest consignment at a price which is near to current price level.

1.3-IMPORTANCE OF THE STUDY

The materials stored in the stock room are issued to various jobs or production departments against the authorized materials requisitions. The issues are recorded in the store ledger and the respective jobs or production departments are debited with the price of the material issued. As the time of purchase and the time of issue are mostly different and the market price of the materials tends to vary, the problem of pricing the materials issued necessitates certain policy formulation. It is an important consideration not only under stores management but also for costing and pricing policies. The fundamental consideration is whether to price the issues at historical price i.e. the original purchase price, at the replacement price i.e. the prevailing market price at the time of issue or at some other price.

The various methods are used for pricing the material issues which are based on different principles. The following are the important methods of pricing the material issues

If the inventory quantity increases or remains constant, FIFO income will exceed LIFO income when acquisition prices are increasing, will equal LIFO income when prices are steady, and will be less than LIFO income when prices are falling.

The reason is that LIFO never brings prior-year prices into the income statement if inventories increase or remain constant, whereas FIFO always brings these old prices into the cost of goods sold. If prices are rising, these old prices will be lower than LIFO costs; if prices are falling, the old prices will be higher than current LIFO costs.

1.4-OBJECTIVE OF THE STUDY:

- To study the meaning of material issued from the stores;
- Analyzing the most commonly used methods "FIFO" and "LIFO" used for pricing inventories

- To study the different stock levels;
- To study the methods of pricing of material issues and its solution.

2- METHODOLOGY OF THE STUDY

Research design

Research takes the theoretical study, which is obtained the necessary information of the topic of Inventory valuation through books, references. As for the reason for our choice for this research due to its importance practical life, where the first goal of the establishing of the project, whether large or small is how to select the inventory evaluation method and issuing the materials in the business.

2.1- METHODS OF PRICING ISSUE OF MATERIALS

The following points highlight the generally accepted methods of inventory pricing, each based on a different Assumption of cost flow.

(i) First-In, First-Out (FIFO):

The principle of in this method, materials received first are issued first. 'First come first serve' is the basis of issuing materials. Sometimes, all materials are tagged with their arrival date and issued in date order especially with stocks that deteriorate. Materials are issued in order in which they are received in the stores. Closing stock of materials are valued at the latest price of purchases under this method.

Advantages:

- The FIFO method is easy to understand and operate.
- It is a method as the materials purchased earlier are used in earlier jobs.
- Materials are issued at the purchases price, so cost of materials recovered.
- Fall in price in the market this methods gives better results.
- It is suitable where materials are slow moving bulky and when the cost is high.

Disadvantages: .

- In case of fluctuations in prices of materials, calculation becomes complicated.

- When prices fluctuate, there is possibility of clerical errors.
- When prices fluctuate, calculations become tedious.
- It overstates profit at the time of rising prices.
- The old materials which are returned to stores from production centre will be sending to other production units as fresh issues.

The FIFO method is suitable where:

- (i) The size and cost of raw materials units are large,
- (ii) Materials are easily identified as belonging to a particular purchased lot, and
- (iii) Not more than two or three different receipts of the materials are on hand at one time.

2.2-ANALYSIS OF FIFO AND LIFO METHOD

The Received side of the store ledger account shows the following particulars:

Jan. 1, 2015	opening Balance	1,000units @ Rs.2
Jan. 6	Received from vendor	400 units @ Rs. 2.50
Jan. 11	Received from vendor	300 units @ Rs. 2.10
Jan. 20	Received from vendor	600 units @ Rs.2.20
Jan. 26	Received from vendor	800 units @ Rs.2

Issue of materials was follows:

Jan. 5-400units; Jan. 10-800units; Jan. 16-200units ;Jan. 18-200units;Jan.27-400;
Jan. 31-500units.

Prepare the stores ledger account showing how the value of the issues would be recorded under FIFO ('First In First Out') and LIFO('Last in first out') methods.

Table-1 Store ledger Account (FIFO)

Date	Receipts			Issued			Balance		
	Quant ity (units)	Rate (Rs.)	Amount (Rs.)	Quanti ty (units)	Rate (Rs.)	Amou nt (units)	Quantit y (units)	Rate (Rs.)	Amou nt (Rs.)
Jan. 1	—	—	—	—	—	—	1,000	2	2,000
Jan.	—	—	—	400	2	800	600	2	1,200

5									
Jan.	400	2.50	1,000	—	—	—	600	2	1,200
6							400	2.50	1000
Jan.	—	—	—	600	2	1,200	200	2.50	500
10				200	2.50	500			
Jan.	300	2.10	630	—	—	—	200	2.50	500
11							300	2.10	630
Jan.	—	—	—	200	2.50	500	300	2.10	630
16									
Jan.	—	—	—	200	2.10	420	100	2.10	210
18									
Jan.	600	2.20	1,320	—	—	—	100	2.10	210
20							600	2.20	1,320
Jan.	800	2	1,600	—	—	—	100	2.10	210
26							600	2.20	1,320
							800	2	1,600
Jan.	—	—	—	100	2.10	210	300	2.20	660
27				300	2.20	660	800	2	1,600
Jan.	—	—	—	300	2.20	660	600	2	1,200
31				200	2	400			

Close stock-600 units =1200

2,3- Last-In, First-Out (LIFO):

The LIFO method of costing and inventory valuation is based on the principle that materials entering production are the most recently purchased. The method assumes that the most recent cost, generally the replacement cost is the most significant in matching cost with revenue in the income determination.

The cost of the last lot of materials received is used to price materials issued until the lot is exhausted, then the next lot pricing is used, and so on through successive lots.

Advantages of LIFO Method:

- (i) Like LIFO method, it is simple and easy to operate.
- (ii) In this method, cost of material is recovered from production because cost of material is charged to production.
- (iii) It ensures complete recovery of material cost from production.
- (iv) It is more useful during the period of rising prices.
- (v) In this method, production is charged at the recent prices because materials are issued from latest consignment.

Disadvantages of LIFO Method:

- (i) If purchases are made frequently calculations become tedious.
- (ii) Unfair comparisons of job cost when price changes too frequently.
- (iii) Stock value does not represent current market price.
- (iv) Stock taking on LIFO basis is not acceptable for income tax purposes.
- (v) It does not show the true position of stock.

Table-2 Store ledger Account (LIFO)

Date	Receipts			Issued			Balance		
	Quantity (units)	Rate (Rs.)	Amount (Rs.)	Quantity (units)	Rate (Rs.)	Amount (units)	Quantity (units)	Rate (Rs.)	Amount (Rs.)
Jan. 1	—	—	—	—	—	—	1,000	2	2,000
Jan. 5	—	—	—	400	2	800	600	2	1,200
Jan. 6	400	2.50	1,000	—	—	—	600 400	2 2.50	1,200 1000
Jan.	—	—	—	400	2.50	1,000	200	2	400

10				400	2	800			
Jan.	300	2.10	630	—	—	—	200	2	400
11							300	2.10	630
Jan.	—	—	—	200	2.10	420	200	2	400
16							100	2.10	210
Jan.	—	—	—	100	2.10	210	100	2	200
18				100	2	200			
Jan.	600	2.20	1,320	—	—	—	100	2	200
20							600	2.20	1,320
Jan.	800	2	1,600	—	—	—	100	2	200
26							600	2.20	1,320
							800	2	1,600
Jan.	—	—	—	400	2	800	100	2	200
27							600	2.20	1,320
							400	2	800
Jan.	—	—	—	400	2	800	100	2	200
31				100	2.20	220	500	2.20	1,100

QUESTION NO-2.2, CLOSEING STOCK-600 Units=1300**3-CONCLUSION:**

Lastly conclude that the case of FIFO, the materials which are received first are issued first, where as in case of LIFO, the materials which are received last are issued first.

(2) In conditions of rising prices, due to difference in values of closing stock, better profit is given by LIFO than FIFO. But the FIFO closing stock 600units Rs 1200 & in LIFO closing stock consists of 600 units at Rs1300 .In FIFO method cost of goods sold represents cost of earlier purchases and in LIFO cost of goods sold represents cost of latest purchases. it is suitable for falling price and in LIFO it is suitable for raising prices.

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