

FINANCIAL ACCOUNTING (LECTURE-16)

COST OF GOODS SOLD STATEMENT

In manufacturing concern, separate books are maintained to keep the record of every single work done in manufacturing process to ascertain the cost incurred in producing goods. This record gives information about total cost incurred on manufacturing process, per unit cost of goods manufactured. When goods are prepared, these are sold to the customers of the business and goods unsold are taken into stock. At the end of the financial year, manufacturing concern prepares which gives the brief summary of the whole process.

This statement shows the value of raw material consumed, amount spent on labour and other factory expenses, finished goods produced and goods unsold (in stock). Such statement is called the **cost of goods sold statement**. Manufacturing concerns, while presenting financial statements, also present cost of goods sold statement.

Standard format of cost of goods sold statement is given below:

Raw Material:	O/S Raw Material + Purchases + Cost Incurred to Purchase RM - C/S Raw Material Cost of Material Consumed
Conversion Cost:	+ Labour + Factory Overheads Total Factory Cost
Work in Process	+ O/S of WIP - C/S of WIP Cost of Goods Manufactured
Finished Goods	+ O/S of Finished Goods - C/S of Finished Goods Cost of Good Sold

Cost of material consumed – is the cost of material used for consumption. This head shows the raw material left unused from the previous year(opening stock), raw material purchased in the current year, expenses incurred on bringing the purchased material into the business premises and raw material that is not used in the current year(closing stock).

Over Heads –a classification, which includes all manufacturing costs, other than the costs of material and labour. Examples are factory utilities, supervisor salaries, equipment repairs etc.

Total factory cost – is the cost of material consumed plus labour and over heads. In other words it is the total cost incurred in the factory.

Cost of goods manufactured – is total factory cost plus opening stock of work in process less closing stock of work in process.

Cost of goods sold – is the cost of goods manufactured plus opening stock of finished goods less closing stock of finished goods.

FINANCIAL ACCOUNTING (LECTURE-16)

Stock card has two parts.

- Receipt side
- Issue side

Both sides have similar columns that include:

- Nature of item to be kept in stock
- Quantity of items
- Rate at which it was purchased
- Total value of items

Receipt side is used record data of items coming in the stock and issue side is used to record information of goods issued for manufacturing process.

VALUATION OF STOCK

Any manufacturing organization purchases different material through out the year. The prices of purchases may be different due to inflationary conditions of the economy. The question is, what item should be issued first & what item should be issued later for manufacturing. For this purpose, the organization has to make a policy for issue of stock. All the issues for manufacturing and valuation of stock are recorded according to the policy of the organization. Mostly these three methods are used for the valuation of stock:

- First in first out (FIFO)
- Last in first out (LIFO)
- Weighted average

FIRST IN FIRST OUT (FIFO)

The FIFO method is based on the assumption that the first merchandise purchased is the first merchandised issued. The FIFO uses actual purchase cost. Thus, if merchandise has been purchased at several different costs, the inventory (stock) will have several different cost prices. The cost of goods sold for a given sales transaction may involve several different cost prices.

CHARACTERISTICS

- This is the widely used method for determining values of cost of goods sold and closing stock.
- In the FIFO method oldest available purchase costs are transferred to cost of goods sold. That means the cost of goods sold has a lower value and the profitability of the organization becomes higher.
- As the current stock is valued at recent most prices, the current assets of the company have the latest assessed values.

LAST IN FIRST OUT (LIFO)

As the name suggests, the LIFO method is based on the assumption that the recently purchased merchandise is issued first. The LIFO uses actual purchase cost. Thus, if merchandise has been purchased at several different costs, the inventory (stock) will have

FINANCIAL ACCOUNTING (LECTURE-16)

several different cost prices. The cost of goods sold for a given sales transaction may involve several different cost prices.

CHARACTERISTICS

- This is the alternatively used method for determining values of cost of goods sold and closing stock.
- In the LIFO method recent available purchase costs are transferred to cost of goods sold. That means the cost of goods sold has a higher value and the profitability of the organization becomes lower.
- As the current stock is valued at oldest prices, the current assets of the company have the oldest assessed values.

WEIGHTED AVERAGE METHOD

When the weighted average method is in use, the average cost of all units in inventory is computed after every purchase. This average cost is computed by dividing the total cost of goods available for sale by the number of units in inventory. Under the average cost assumption, all items in inventory are assigned the same per unit cost. Hence, it does not matter which units are sold; the cost of goods sold is always based on the current average unit cost.

CHARACTERISTICS

- Under the average cost assumption, all items in inventory are assigned the same per unit cost (the average cost). Hence it does not matter which units are sold first. The cost of goods sold is always on the current average unit cost.
- Since all inventories are assigned the same cost, this method does not make any effect on the profitability and does not increase/decrease any asset in the financial statements.
- This is the alternatively used method for determining values of cost of goods sold and closing stock.

ILLUSTRATION

Hamid & company is a manufacturing concern. Following is the receipts & issues record for the month of May, 2002

Date	Receipts	Issues
May 7	200 units @ Rs. 50/unit	
May 9		60 units
May 13	150 units @ Rs. 75/unit	
May 18	100 units @ Rs. 60/unit	
May 22		150 units
May 24		100 units
May 27	100 units @ Rs. 50/unit	
May 30		200 units

Calculate the value of closing stock by

- FIFO Method
- Average Method

FINANCIAL ACCOUNTING (LECTURE-16)

SOLUTION

Valuation of stock by FIFO method

Date	Receipts	Issues	Value of Stock	Total Amount	Remaining No. of units	Net Balance
May 7	200 units @ Rs. 50/unit		$200 \times 50 = 10,000$	10,000	200	10,000
May 9		60 units @ Rs. 50/unit	$60 \times 50 = 3,000$	(3,000)	140	7,000
May 13	150 units @ Rs. 75/unit		$75 \times 150 = 11,250$	11,250	290	18,250
May 18	100 units @ Rs. 60/unit		$60 \times 100 = 6,000$	6,000	390	24,250
May 22		140 units @ Rs. 50/unit 10 units @ Rs. 75/unit	$50 \times 140 = 7,000$ $10 \times 75 = 750$	(7,750)	240	16,500
May 24		100 units @ Rs. 75/unit	$75 \times 100 = 7,500$	(7,500)	140	9,000
May 27	100 units @ Rs. 50/unit		$50 \times 100 = 5,000$	5,000	240	14,000
May 30		40 units @ Rs. 75/unit 100 units @ Rs. 60/unit 60 units @ Rs. 50/unit	$75 \times 40 = 3,000$ $60 \times 100 = 6,000$ $50 \times 60 = 3,000$	(12,000)	40	2,000

FINANCIAL ACCOUNTING (LECTURE-16)

Valuation of stock by weighted average method:

Date	Receipts	Issues	Value of Stock	Total Amount(Rs.)	Total Units	Average Cost(Rs.)/unit	Net Balance (Rs.)
May 7	200 units @ Rs. 50/unit		200*50 = 10,000	10,000	200	50	10,000
May 9		60 units	60*50 = 3,000	(3,000)	140		7,000
May 13	150 units @ Rs. 75/unit		150*75 = 11,250	7,000+11250 = 18250	140+150 = 290	18250/290 = 62.9	18,250
May 18	100 units @ Rs. 60/unit		100*60 = 6,000	18250+6000 = 24250	290+100 = 390	24250/390 = 62.2	24,250
May 22		150 units	150*62.2 = 9330	(9,330)	390-150 = 240		14,920
May 24		100 units	100*62.2 = 6220	(6,220)	240-100 = 140		8,700
May 27	100 units @ Rs. 50/unit		100*50 = 5,000	8,700+5,000 = 13,700	140+100 = 240	13700/240 = 57.1	13,700
May 30		200 units	200*57.1 = 11420	(11,420)	240-200 = 40		2,280

LIFO METHOD WILL BE DISCUSSED AT SOME LATER STAGE