INVENTORY CONTROL

**Meaning:**
The term ‘Inventory’ means materials. Inventory includes stock of raw material, work-in-progress, finished goods, components and supplies.

**Definition:**
Gordon Carson defines the term Inventory as follows:

“The process whereby the investment in materials and parts carried in stock is regulated within pre-determined limits set in accordance with inventory policy established by the management”

**Classification of Inventories:**
Inventories are broadly classified as follows:

1] Productive Inventories such as raw materials, spare parts, components etc, which are used in production process.

2] Non-Productive inventories such as office stores, machine spare parts, scrap, lubrication oil etc.

3] In-Process material such as semi-finished goods lying at different stages of production process.

4] Finished goods such as products ready for sale.

5] Scrap, Obsolete Materials are also sometimes considered at a form of Inventory.

**Purpose of Scientific Inventory Control:**

1] To fix the limit within which the inventories are to be held;

2] To lay down the inventory policy;

3] To set the investment pattern keeping in view the individual and collective requirements.

4] To examine the working of inventory policy;

5] To avoid abnormal wastage by exercising direct control;

6] To provide efficient warehousing facilities.
**Principles of Effective Inventory Control:**

1] Forecasting the sales correctly.  
2] Forecasting the production schedules properly.  
3] Forecasting the sales and production for efficient purchasing and investing in material.  
5] Organizing a proper system of reporting to management regarding materials, purchase, storage, utilization, return, spoilage, defection, obsolete stock and inventory balances.

**Techniques of Inventory Control:**

For effective and efficient control of inventory, generally the following methods and techniques are employed:

1] Determination of Economic Order Quantity,  
2] Fixation of Stock Levels,  
3] ABC Analysis,  
4] Two Bin System,  
5] Perpetual Inventory System,  
6] Review of Slow, Fast and non-moving material,  
7] Use of control ratios,  
8] Physical verification of Inventory,  
9] Use of Material Budgeting,  
10] Establishing an Effective Purchase Procedure.

**Valuation of Inventory:**

The methods of inventory valuation are of great importance to management for determining the amount of firm’s investment in inventory. For the purpose of valuation, inventory can be divided into three categories:

1] Raw Materials and Stores
2] Work-in-Progress
3] Finished Goods

**Principal Bases of Inventory Valuation:**

1] Actual Cost:

The actual cost of raw materials, work in progress and finished stock is the most logical method of valuing inventory. Cost Accounting Rules also provide that inventory should be valued ‘at cost’.

2] Lower of the Cost or Market Price:

Under this method, the inventory is valued at lower of the cost of market price. Market price may be lower than in the circumstances such as price levels are declining and inventories are becoming obsolete because of technological and other changes.

3] Replacement Cost Method:

Under this method, the inventories are valued at price that would have to be paid for those items on prices that are rising. Similarly, this method reflects losses during the accounting period, when prices are going down.

**Valuation of Materials:**

Cost Accounting Record Rules provide that raw material, stores and spare parts would always be valued at cost.

**Valuation of Work-In–Progress:**

The value of work in progress will include cost of raw materials consumed, the productive wages and a percentage to cover factory expenses. The most important point in valuation of work in progress is the stage of its completion. It is not desirable to add any percentage in respect of establishment and administration expenses for the purpose of valuation of work-in-progress. Therefore, cost of production for Work-in-Progress shall be as per the cost statement after giving due consideration to the stage of completion.

**Valuation of Finished Goods:**

The finished goods would normally be valued at total or full cost of production. As selling and distribution overheads pertain only to the selling and distribution of goods sold, these are not included in the cost for the purpose of determining the cost of finished goods.
**Reporting to Management:**

For proper results, performance in the field of Inventory Control should be properly reported to management. The reporting should include following details:

- A calendar of returns showing various reports and schedules.
- Number of purchase orders placed during the period.
- Details for foreign and local orders.
- Number of purchase requisitions, orders placed and requisitions pending.
- Savings materializes by purchasing at price below market price.
- Loss due to wastage, spoilage and obsolescence.
- Cost of placing orders, cost of running the department etc.