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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: MBA III SEM..

SUBJECT: WORKING CAPITAL MANAGEMENT

SUBJECT CODE: MBAFM02

LECTURE: 29

NAME OF FACULTY: DR. PALASH BAIRAGI

LECTURE-29

<p style="text-align:center"><mark>**Weighted Average Method**</mark>:</p>

Under this method, rate of average cost is calculated by taking into consideration both the prices and quantities acquired at such prices, i.e., the total value of materials in stock at the time of issue is divided by the total quantity of materials in stock in order to find out the weighted average rate.

It is superior than the ordinary Simple Average Method since it takes into account both the prices and the quantities. This method proves very useful where there is a heavy fluctuation in the prices of inventories as it tends to smooth out fluctuations in prices by taking the average cost of different lots acquired at different time. But, under this method, cost of goods sold does not represent the actual cost.

Illustration:

In a factory, stores are issued and accounted for on Weighted Average Method. If the stock of a particular material on 1st Jan. 1992 is 1,000 units valued at Rs. 5 per unit and the particulars of purchases and issues during the month of Jan. 1992 are as follows, prepare a statement showing how the value of issues should be arrived at:

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Dates
Jan.3.   Purchases        200 units   at Rs. 5.50
    9.   Issues         1,000 units
   15.   Purchases      1,400 units   at Rs. 6.00
   17.   Issues         1,000 units
   21.   Purchases        800 units   at Rs. 6.50
   23.   Issues         1,000 units
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Solution:

<p style="text-align:center">**Stores Ledge Account**
Weighted Average Method</p>

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Name of Material –                                      Folio No -
Specification –                                         Maximum level –
Code No –                        Bill No –              Minimum level –
Unite of Measurement —           Location –             Re-ordinaring level –
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	Receipts				Issues				Balance			
Date	G.R. No.	Quantity	Rate	Amount	S.R. No	Quantity	Rate	Amount	Quality	Rate	Amount	Rem-arks
1992				Rs.				Rs.			Rs.	
Jan. 1.									1,000	5	5,000	
.3.		200	5,5	1,100					1,200	5.08	6,100	
9.						1,000	5.08	5,080	200	5.08	1,020	
15.		1,400	6	8,400					1,600	5.89	9,420*	
17.						1,000	5.89	5,890	600	5.89	3,530	
21.		800	6.5	5,200					1,400	6.24	8,730	
23.						1,000	6.24	6,240	400	6.24	2,490	

*Notes : Due to fractions.

Base Stock Method:

Under this method, it is assumed that every firm has to maintain a certain minimum amount of inventory (in the form of raw materials, work-in-progress and finished goods) throughout the year. The same will have to be maintained for meeting emergency needs, such as, undue delay in supply of raw materials, excessive consumption etc.

This minimum level of inventory goes by the name of Base Stock or Safety Stock. 'Base-Stock' serves as the signal below which the inventory level of a firm is never allowed to fall. (Therefore, inventory, to the extent of 'Base Stock', though basically a class falls within the category of current assets, assumes, for all practical purposes, the character of fixed assets)

Generally, there may not be any wide variation between the volume of closing and opening inventory unless there is a remarkable change in the scale of operation and other factors. This 'Base Stock' level is usually created out of the first lot of the materials purchased or goods manufactured at beginning of the period and as such, it is valued at the cost price of the first lot.

Therefore, under this method, closing inventories are generally taken to be equal to the 'Base-stock' level and hence they are valued at the values allotted to the respective 'Base-stock'. However, if there is any excess (over base stock level), the same should be valued either on the basis of FIFO or LIFO methods.

It should be remembered that this method is generally used with FIFO or LIFO method. There is, however, difference of opinion among the accountants as to the principles to be followed for valuation of inventories when this method is adopted.

For example, Finney and Miller suggest that 'Base Stock' may be valued at lowest cost experienced and valuation of closing inventory, (when it goes below base stock) should be made by deducting the value of the deficient quantity calculated at the current cost from the value of the normal quantity of base stock calculated at the base price.

Further, Yourston, Smyth and Brown suggest that 'the difference between the replacement price and the fixed price of the basic stock is deducted from the total value of the stock on hand computed at the base price'.

This method usually is operated either in conjunction with FIFO or LIFO method. It may be observed that the objective of pricing inventories on the basis of this method is to apply the current prices to issue. So, this objective will be fulfilled only when LIFO method is adopted as a method of combination'.

Illustration:

In a factory, stores are issued and accounted for on Base Stock Method. If the stock of a particular material on 1st Jan. 1992 is 1,000 units valued at Rs. 5 per unit and the particulars of purchases and issues during the month of Jan. 1992 are as follows, prepare a statement showing how the value of issues should be arrived at:

Solution:

Stores Ledger Account
Base Stock Method

Name of Material –
Specification –
Code No –
Unite of Measurement —

Bill No –
Location –

Folio No -
Maximum level –
Minimum level –
Re-ordinaring level –

Date	G.R. No.	Quantity	Rate	Amount	S.R. No.	Quantity	Rate	Amount	Quality	Rate	Amount	Rema rks
		Receipts				Issues			Balance			
1992				Rs.				Rs.			Rs.	
Jan. 1.									1,000	5	5,000	
3.		200	5,5	1,100					100*	5	500	
									900	5	4,500	
									200	5.5	1,100	
9.						900	5	4,500	100	5	500	
						100	5.5	550	100	5.5	550	
15.		1,400	6	8,400					100	5	500	
									100	5.5	550	
									1,400	6	8,400	
17.						100	5.5	550	100	5	500	
						900	6	5,400	500	6	3,000	
21.		800	6.5	5,200								
									100	·5	500	
									500	6	3,000	
									800	6.5	5,200	
23.						500	6	3,000	100	5	500	
						500	6.5	3,250	300	6.5	1,950	

* 10% of 1,000 = 100 unit are considered as Base-stock.

(e) Specific Identification Cost/Unit Cost or Actual Cost:

This method of valuation is adopted where each item of inventories and its actual cost is identifiable. It attributes certain specific costs to the identified items of inventory where each such item and its cost are identifiable. That is, this method of valuation can easily be applied where the closing inventory items can correctly be identified with specific lots.

But this method suffers from the following limitations:

(i) Where there is bulk quantities of inventories, partly finished goods or finished goods, and where individual units of inventories lose their identity.

(ii) Where there are innumerable units of inventories, keeping records for each of them becomes expensive as well as time consuming.