

Quadrant II – Notes

Paper Code: COD102

Module Name: Accounting for Material losses

MATERIAL LOSSES IN COST ACCOUNTING

Losses of material during handling, storage or manufacturing are called as material losses in cost accounting. Material Losses also arise due to the nature and type of material.

For e.g. Fragile material like Glass while handling, liquid materials like chemicals or perishable materials like fruits in a food processing industry, evaporation of liquid materials like chemicals, shrinkage of materials etc.

FORMS OF MATERIAL LOSSES

1. WASTE

Waste is that portion of basic raw material which is lost in production processes and has no recoverable value. i.e. you cannot recover any value by sale of that loss.

Waste may be:

- a) Visible which can be seen e.g., ash, sand, dust, etc.
- b) Invisible which is disappearance of a portion of a raw material e.g., shrinkage, evaporation, etc.

Types of Waste

i. Normal Waste

It is the loss which is unavoidable on account of inherent nature of material.

E.g. Liquid materials lose their weight due to evaporation

E.g. Materials like Coal which are wasted due to loading unloading

ii. Abnormal Waste

It arises due to abnormal factors or causes not inherent in the production or any waste in excess of normal waste is called as abnormal waste. These factors are avoidable or controllable.

E.g., fire, Pilferage, careless in handling, defective storage etc.

ACCOUNTING TREATMENT OF WASTE:

Case	Accounting treatment
Cost of Normal Waste	It is distributed over balance of material. It is treated as cost of production.
Cost of Abnormal waste	It is charged to Costing Profit and loss account. It is not a part of cost of production.

2. SCRAP

Scrap is the incidental residue resulting out of manufacturing process. Scrap is discarded material having some values. Scrap is always visible

Types of scrap:

- i. Legitimate scrap:
Arises due to the nature of operation like turning, boring, punching etc.
- ii. Administrative scrap:
Arises due to administrative decisions taken by the firm's management such as change in the method of production, change in design.
- iii. Defective scrap:
This type of scrap is not planned. It results from avoidable circumstances. Arises because of use of inferior quality/sub-standard raw materials of material or bad workmanship or defective machines.

ACCOUNTING TREATMENT OF SCRAP:

Case	Accounting treatment
A) Where the value of scrap is negligible	It is treated as cost of production. Net sale proceeds of scrap is credited to Costing Profit and Loss account
Where the value of scrap is significant	Net sale proceeds of the scrap are transferred to material cost or factory overheads.
1) When scrap is not identifiable with a particular job or process	
2) When scrap is identifiable with a particular job or process	Net sale proceeds are credited to that particular Job or process.
3) Cost of Abnormal Scrap	It is charged to Costing Profit and Loss account.

3. SPOILAGE

Spoilage is the material damaged in the manufacturing process which cannot be rectified economically and which is to be disposed off without further processing. Spoilage is loss of not only material but also labour and overheads which are damaged in manufacturing process.

Spoilage may be of two types:

- i. Normal Spoilage
It is the part of production process as it arises out of causes inherent in the production process.
For e.g. Spoilage due to usage of perishable products

ii. Abnormal Spoilage

It arises due to causes which are not inherent in production.

For e.g. Spoilage due to errors.

ACCOUNTING TREATMENT OF SPOILAGE:

Case	Accounting treatment
Cost of Normal Spoilage	It is treated as part of cost of production. The cost of such spoilage is borne by good production units.
Cost of Abnormal Spoilage	It is not a part of cost of production. It is charged to Costing Profit and loss account.

4. DEFECTIVES:

Defectives are the products which are not according to the standards but they can be rectified as a finished product by incurring rectification (rework) cost. Defectives are generally treated in two ways:

a) First Quality:

They are brought up to the standard by incurring further costs on additional material and labor wherever possible.

b) Seconds:

They are sold as inferior products (seconds) at lower prices

Type of defectives:

i. Normal defectives

Arise due to common causes inherent in the production process.

ii. Abnormal defectives

Arises due to the abnormal factors.

ACCOUNTING TREATMENT OF DEFECTIVES:

Case	Accounting treatment
A) In case of Normal defectives 1) When defectives are identifiable with a particular job or process	It is charged to that particular Job or process.
2) When defectives are not identifiable with a particular job or process	It is charged to production overheads/general factory overhead
B) In case of Abnormal Defectives	It is charged to Costing Profit and loss account.