

Good morning students.

Today I'm going to take up a session for Semester 5 Cost Accounting Major one paper. The topic for my discussion today is accounting for material losses from Unit 2. Myself, Mrs Rupali Sangodkar Assistant Professor of Commerce from Government College of Commerce and Economics, Borda.

In today's session I'm going to cover meaning and accounting for material losses, which are waste, scrap, spoilage and defectives. These are the learning outcomes which you all will be able to achieve at the end of this session.

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 example, a loss of fragile material like glass during handling or a loss of perishable material like fruits while in stores or evaporation of liquid materials while processing are all examples of material losses. In today's session we are going to discuss the forms of material losses. These are the four forms of material losses which we're going to discuss; waste, scrap, spoilage and defectives.

Beginning with the 1st that is waste. Waste is that portion of raw material which is lost in production process and has no recoverable value. So any loss of material which has no recoverable value is called as waste. A waste may be visible, or it may be invisible. Visible waste is in the form of dust or sand, or it could be invisible, such as shrinkage or evaporation of liquid materials. Waste is of two types; Normal waste and abnormal waste. Normal waste is a loss on account of inherent nature of material. It is unavoidable completely. The example is evaporation of liquid materials. Any waste, in excess of normal waste is called as abnormal waste. It arises due to abnormal factors or causes not inherent in the production. These factors are avoidable or controllable. These examples will make the concept of abnormal wastage clear. For example, if there is fire in the production department, and if materials are lost completely, it is abnormal wastage or for example if there is pilferage (theft in small quantities or of small value materials). So in all these examples, if the loss is a complete loss where there is no realisable value, then we call it as abnormal wastage.

The accounting for waste depends on whether the waste is abnormal or it is normal waste. Normal waste is treated as cost of production. So for example, if the company prepares Cost Sheet to find out cost of its production cost, normal waste will be shown

in the cost sheet whereas cost of abnormal waste cannot form a part of cost of production. So it is to be shown in costing profit and loss account.

Moving towards the second form of material loss, scrap. Scrap is incidental residue resulting out of production process or in simple words, scrap is discarded material having some values, unlike a waste scrap is always visible. The following example will make the concept clear. For example in timber industry cuttings, pieces, splits, sawdust. All these are examples of a scrap because these losses can be sold for some nominal value. Scrap is of three types; Legitimate scrap, Administrative scrap and defective scrap.

Legitimate scrap arises due to the nature of operation. For example in timber industry, cuttings of wood are examples of legitimate scrap. Administrative scrap arises due to administrative decision taken by the firm's management. For example, if the company decides to change the design of the product because of which if there is any scrap that is generated then that will be called as administrative scrap. Moving further, the third type of scrap is called as defective scrap. Defective scrap arises as a result of unavoidable circumstances. For example, if substandard raw materials are used which may generate scrap or if scrap is generated due to defective machines used.

The accounting treatment is as follows. Normal scrap is treated as cost of production where the value of scrap is negligible. That is, if the value of scrap is very less, net sale proceeds of scrap is credited to costing profit and loss account as any other income. Where the value of scrap is significant and when this scrap is not identifiable with a particular job or process, then net sales proceeds of scrap is credited to material cost or factory overheads. When scrap is identifiable with a particular job or process, net sale proceeds is created to that particular job or process. Cost of abnormal scrap like abnormal waste is charged to costing profit and loss account because it cannot form a part of cost of production.

Moving further towards the third form of material loss spoilage. Spoilage is the material damaged in the production process which cannot be rectified economically and which is to be disposed of without further processing. Spoilage is loss of not only material but also labour and overheads which are damaged in the manufacturing process. Spoilage is of two types, normal spoilage and abnormal spoilage.

Normal spoilage is the part of production process as it arises out of causes inherent in the production process. For example, in Bakery, when cookies are manufactured

because of the type of raw material and the nature of operation some cookies tend to get spoiled, so that is an example of normal spoilage. Abnormal spoilage arises due to causes which are not inherent in the production. For example, some spoilage may occur due to errors committed by the employees while they are working.

The accounting treatment depends on whether spoilage is normal spoilage or abnormal spoilage. Normal spoilage is treated as part of cost of production, whereas cost of abnormal spoilage cannot form a part of cost of production because of which it needs to be shown in costing profit and loss account.

Moving further towards the last, the fourth form of material loss, Defectives. Defectives are the products which are not according to the standards, but they can be rectified as finished product by incurring rectification costs. Defective can be treated in two ways. That is after incurring the rectification cost on the defectives. Or they can be sold as first quality products or they may be sold as seconds. Defectives are of two types, normal defectives and abnormal defectives. Normal defectives arise due to causes inherent in the production process.

For example, if fragile materials like glass are used for production, then there are chances that some products may be produced as defective products. Abnormal defectives arise due to abnormal factors. For example, if the company uses some substandard or low quality material, then some amount of defectives may arise. In case of normal defectives when they're identifiable with a particular job or process, it is charged to that particular job or process when normal defectives are not identifiable with a particular job or process, it is charged to a production overheads or general factory overheads. In case of abnormal or defectives like an abnormal wastage is charged to costing profit and loss account for the simple reason that abnormal defectives cannot form a part of cost of production.

At the end, what I would like to say is all these four forms of material losses may sometimes be used interchangeably, but each form of material loss differs from the other in terms of the nature of loss, in terms of whether they can be rectified or not, or in terms of whether they have the realisable value or not. Whatever may be the form of material loss, utmost care has to be taken in order to minimize these losses as far as possible. These are the books which I have referred for this session.

Thank you.