

METHODS OF PRICING MATERIALS ISSUES

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METHODS OF PRICING MATERIALS ISSUES

- ▶ When materials are issued to production department, a difficulty arises regarding the price at which materials issued are to be charged. The same type of material may have been purchased in different lots at different times at several different prices. This means that actual cost can take on several different values and same method of pricing the issue of materials must be selected.
- ▶ There are numerous methods of pricing issues. They may be classified as follows:

METHODS OF PRICING MATERIALS ISSUES

1) COST PRICE METHODS

- a) First – In – First – Out (FIFO)
- b) Last – In – First – Out (LIFO)
- c) Specific Price
- d) Base Stock
- e) Highest – In – First – Out (HIFO)

2) AVERAGE PRICE METHODS

- a) Simple Average
- b) Weighted Average
- c) Periodic Simple Average
- d) Periodic Weighted Average

3) NOTIONAL PRICE METHODS

- a) Standard Price Method
- b) Market Price Method
- c) Inflated Price Method

1)COST PRICE METHODS

It is widely adopted method of pricing of materials. It takes the actual cost of the materials for its valuation. The Actual cost is the cost at which the material is originally purchased.

a)FIRST-IN-FIRST-OUT METHOD (FIFO): Under this method, the materials received first are issued first. So the price paid for the earliest lot of materials in hand is taken as the basis of charging out the materials issued.

b)LAST-IN-FIRST-OUT METHOD (LIFO): Under this method, the material received in last is issued first. The price of the latest consignment is taken as base for pricing of materials. This method requires the maintenance of record of quantity and value of every receipt of material.

c)SPECIFIC PRICE: Specified Price (Identifiable) Method: Sometimes materials are purchased to be utilized in a particular job or issues can be identified with a particular receipt. In these cases, the actual purchase price can be charged. This method can be adopted when prices are stable or when the materials are covered by price control orders. This method has limited application only.

d)BASE STOCK: In almost all concerns, a minimum quantity of stock is always kept in store. A fixed minimum stock of the material is always maintained and is known as “safety or base stock”.

e)HIGHEST-IN-FIRST-OUT METHOD (HIFO): Under this method, the materials in hand purchased at the highest price are deemed to be issued first.

2)AVERAGE PRICE METHODS

This method operates on the basis of calculation of averages. Under this method, the materials in hand are so intermingled that the issues of materials are priced at average cost price of materials in hand; a new average is calculated whenever a fresh purchase is made.

To calculate the average, various methods are adopted:

a)SIMPLE AVERAGE PRICE: Simple average price is the price calculated by dividing the total of purchase price of materials in hand on the date of issue by the number of prices.

b)WEIGHTED AVERAGE PRICE: It is the price which is calculated by dividing the cost of materials in stock from which materials to be priced could be drawn, by the total quantity of materials in the stock.

c) PERIODIC SIMPLE AVERAGE PRICE: This method is also known as End of Period method and End of Month method. Under this method, valuation of material issued is based on the simple average of all prices of materials purchased during a specific period of time, say a month.

d) PERIODIC WEIGHTED AVERAGE PRICE: It is calculated by dividing the total cost of materials purchased by the total quantity purchased. The weighted average price is calculated at the end of the year.

3) NOTIONAL PRICE METHODS

Notional value (also known as notional amount or notional principal amount) is the face value on which the calculations of payments on a financial instrument (e.g., swap) are determined. In other words, the notional amount indicates how much money is controlled by a position on a particular financial instrument.

a) STANDARD PRICE METHOD: Under this method, a standard or a fixed price is used for pricing the issues. A standard price is fixed after considering all factors affecting the price such as market conditions, quality to be purchased and future trend of the prices.

b)MARKET PRICE METHOD: Market price method takes the prevailing market price as a base for valuation of materials to be issued. This method follows the principle of valuation of stock at latest price.

c)INFLATED PRICE METHOD: This method is used when the materials are subject to normal wastage which is unavoidable. In order to recover the loss arising due to normal wastage, the material issues are priced at the higher rate known as inflated price.

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