

**ST . MARY'S UNIVERSITY**  
**FACULTY OF BUSINESS**  
**DEPARTMENT OF ACCOUNTING**

**ASSESSMENT OF**  
**INVENTORY ACCOUNTING SYSTEM IN**  
**ST.GEORGE BEER FACTORY**

**BY**

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**JUNE 2014**

**SMU**

**ADDIS ABABA**

**OF INVENTORY ACCOUNTING SYSTEM IN  
ST.GEORGE BEER FACTORY**

**A SENENIOR ESSAY SUBMITTED TO THE  
DEPARTMENT OF ACCOUNTING  
BUSINESS FACULTY**

**ST . MARY'S UNIVERSITY  
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REQUIREMENTS FOR THE DGREE OF BACHELOR  
OF ARTS IN ACCOUNTING**

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# CHAPTER ONE

## Introduction

### 1.1 Background of the Study

The establishment of a business organization is vital to the society's welfare and the country economy as a whole. The success of an organization depends on the efficient and effective utilization of the given resource. The term Inventory is used to indicate goods held in stock for sale or materials, components and supplies to be used for production of other goods. In manufacturing sector inventories appear in different forms such as, direct material inventory, work in process inventory and finished goods inventory. (Horn gren.etal, 2011)

1. Direct material:-direct material in stock and waiting for the used in the manufacturing.
2. Work in process: - goods that are partially processed but not fully completed.
3. Finished Goods: - goods that are fully completed but not yet sold.

Inventory accounting is a big part of profit planning for manufacturing company. Material cost account for more than 40% of total costs of manufacturing companies. Inventory accounting can play a key role in inventory management, since inventory costs cover the significant portion of the company's total cost it is important for a company to manage its inventory in well organized way using the information provided by the accounting system. (Horn gren.etal, 2011)

The task of inventory accounting should be to manage the inventory effectively and maximize the value of the firm.

Inventory accounting is the process of accounting for inventory costs, physical flow of inventories from purchasing of materials to the final sales point. (Horn gren.etal, 2011)

The inventory accountant should consider costs, profit, risk factors & smooth operation of a business as a whole based on an inventory theory, procedure and policy of the business.



## **1.2 Back ground of the Organization**

In 1922 Addis Ababa was just beginning to see the first sparks of technology when St. George, the nation's first brewery was founded. The brewery was set up with modest premises to produce the country's first bottled beer. When the brewery began operation, the machineries were manually operated and not more than 200 bottles were produces daily. One could also see the challenges to popularize the product, as beer drinking was not an established habit in our country. ( St. George 80th anniversary issue, 1995 E.C)

The founder of St. George Brewery is Mussie Dawit Hailey who is a Belgian, who lately sold it to a German company. . (St. George 80th anniversary issue, 1995 E.

Eventually an Ethiopian Company took over the brewery in 1952/3. This company was said to have been organized as shareholding entity, the larger share of which was owned by Emperor Haile Sellasie. (St.George's 80th anniversary issue, 1995 E.C)

Generally, St.George Brewery could be said as having scored good result in the 1940s and 1950s. Toward the end of the 1950s the annual production of the Brewery had reached 50,000 hectoliters. According to the review made on "The Ethiopian Trade Journal" the Brewery had 53 silos, which had the capacity of 100-hectoliters each. There were about 300 employees who worked in two shifts for 24 hours. (St.George's 80th anniversary issue,1995 E.C

St. George Brewery is once again privatized. The factory is now owned by BGI, an internationally acclaimed Brewing Company that operates in many countries it has excellent reputation in producing quality beer and brought St. George to the same standard. Today, St. George is the oldest beer in Ethiopia and is certainly also the youngest with fresh dynamism. (St.George's 80th anniversary issue,1995 E.C)

### **Objective of the factory**

- To increase profit and create stable market
- Production of quality beer for the public

### **1.3 Statement of the problem**

Inventory accounting is very useful for any organization or operation especially to manufacturing and merchandising activities. It emanate b/c of its importance in production management to any business firms' b/c inventory needs a big deal of capital investment and affects delivery of goods to customer. An organization may have different types of inventories, which are produced inside the company or purchased from any other firms. As a result finance of every firm concerned with overall financial picture of the organization including fund allocated to inventories and operations of inventories to assure smooth and efficient production.

On the other hand absence of effective inventory accounting procedure or existence of poor inventory accounting, at a minimum may result in high inventory holding costs due to the absence of non compliance to the policy of re order level. High stock obsolescence and expiry due to poor warehousing and poor inspection, payment for undelivered/received inventories due to absence of clearly defined receiving and dispatching procedures, finally these all leads to loss of profit which may result in bankruptcy and close of business.

However, different functions that are found in most organization have different contradicting objectives related to inventories. Finance function prefers to keep levels of inventories low to conserve capital but operation prefers to have adequate inventories for efficient and smooth employment level. While marketing prefers high volume of inventories to enhance.

Thus, by taking the above and similar facts into consideration the research paper aims to assess whether the inventory accounting system of the St. George beer factory is producing the relevant information for Accounting system and decision making.

### **1.4 Research questions**

1. What inventory control system does the company uses?
2. Are cost flow assumption used by the company suitable?
3. How the company treats special inventory recording issues such as goods in transit, inventories in consignment and the like?

## **1.5 Objective of the Study**

This project (research) paper has the following general and specific objectives

### **1.5.1 General objective**

The general objective of the study is to assess whether or not the company under investigation is applying the proper inventory accounting system. It is to try to collect data, analyze and summarize it and report findings along with the researchers' recommendation to the company under investigation and any interested third party.

### **1.5.2 Specific objective**

The specific objectives of this study are presented as follows:

- To assess the proper treatment of special inventory recording issues to determine accurate inventory balance to be appeared in financial report.
- To study the way that the company manage its inventory costs to formulate a business strategy such as proper pricing that enables to generate sufficient profit and stay competitive.
- To assess the application of cost flow assumptions and inventory system use to record and determine inventory value and there appropriateness.

## **1.6 Significance of the study**

Inventory accounting system plays an important role in achieving organizational goal such as profitability and effective and efficient use of resources by providing accurate and timely information about inventories which covers a significant portion of company's asset.

This research work will have a significant importance to improve the efficiency of inventory accounting system of the organization such as:-

- It improves productivity and enhance just in time purchasing and manufacturing.
  - It will identify major challenges for the application of inventory accounting system and list out alternative course of actions to overcome those challenges.
  - It initiates and provides direction to conduct further research and development works.
- It help as a reference material for those who are interested to make future study.

## **1.7 Scope of the Study**

Inventory accounting is a broad concept and it is applicable in all business organizations and not for profit organizations which carry inventories for different purposes. Though efficient inventory accounting system is necessary for all organization the scope of this research is limited to assess the application of inventory accounting in St. George Brewery in Addis Ababa branch.

## **1.8 Limitation of the Study**

The study will face some constraints like:

- Lack of research experience
- Unwillingness of accountant to give information regarding to subject matter and financial statements
- It may be difficult to find the authorized person for the appropriate information

## **1.9 Research Design & Methodology**

### **1.9.1 Research Design**

In order to solve the specified problems the researchers will gather information on the current inventory costing system, period of undertaking physical inspection (checking of inventory), the base for classification and allocation of overhead costs and the current accounting treatment on different types of inventories from employees who are currently working at St. George Brewery and the accounting records kept in the company. Furthermore the study used descriptive types of research. The researcher prefer descriptive because it enables to described facts reflected by the respondents.

### **1.9.2 Population and Sampling Technique**

Out of available departments in the factory, the finance department, store department, purchasing department, were taken as the major focus of attention in the study of the total 40 employees in the department 30 employees were selected by using random sampling techniques to select sample in accounting records since the technique will give equal chance for the population elements and it avoids personal bias and sample representativeness.

### **1.9.3. Types of Data Collected and Used**

The study is conducted in St.George Beer factory in Ethiopia. The required information for conducting the study is primary and secondary

**Primary data:** - was collected using questionnaire methods from concerned employees.

**Secondary data:-** Obtained from manuals, broacher.

### **1.9.4. Method of Data Collection**

In our research we used questioner method of data collection.To follow this method of data collection, we can used proper time utilized accomplish of final research paper.

### **1.9.5. Methods of Data Analysis**

As far as data analysis is concerned, the collected data is analyzed by using a descriptive analysis method using percentage and tabulation.

## **1.10 Organization of the Paper**

The paper is organized as follows:-

The paper will contain four chapters. The first chapter considers the introduction of the study which consists of the back ground of the study, the organization profile, statement of the problem, objective of the study, significance of the study, limitation and scope of the study and methodology of the study. The second chapter will cover the literature review part, the third chapter deals with the data presentation and analysis and also the result and finding of the study will be covered. The final chapter will present the summary conclusion and recommendations.

# CHAPTER TWO

## Literature Review

### 2.1 Nature of Inventories

Inventories consist of goods held for sale to customers, partially completed goods and material and supplies to be used in production. Inventory items are acquired and sold continuously by a merchandising enterprise or acquired, placed in production, converted to finished product, and sold by a manufacturing enterprise. . (Horngren.2002)

The sale of merchandise or finished product is the primary source of revenue for most non service business enterprise. . (Horngren.2002)

In retail or merchandising operation, inventories consist principally of products purchased for resale in their existing form. A retail enterprise also may have an inventory of supplies such as wrapping paper cartons and stationery. A manufacturing enterprise has several types of inventories: material, parts, and factory supplies, goods in process; and finished goods. . (Horngren.2002)

Materials and parts are basic commodities or other products obtained directly from natural resources or acquired from other, which will be incorporated physically into the finished product, but their relation to the end product is indirect. Goods in process consist of partially completed products and include the cost of direct material, direct labor and factory overhead. Finished goods are items that are complete and ready for sale and include the same cost elements as those in goods in process. (Horngren.2002)

### 2.2 Inventory Procedures

Two methods may be employed to ascertain the inventory quantities on hand. The periodic system and the perpetual system, both systems may be employed simultaneously for various inventories, such as material, finished goods and goods in process.(Mosich, A.N.1989)

### **2.2.1 The periodic Inventory System**

Relies on a physical count of the goods on hand as base for control, management decisions and financial accounting. Although this procedure may give accurate result on a specific date, there is no continuing record of the inventory. (Mosich, A.N. 1989)

### **2.2.2 The Perpetual Inventory System**

Requires a continuous record of all receipts and withdrawals of each items of inventory. The perpetual record sometimes is kept in terms of quantities only. This procedure provides a better basis for control than is obtained under the periodic system. When the perpetual system is used, a physical count of the goods owned by the business enterprise must be made periodically to verify the accuracy of the inventories reported in the accounting records. Any discrepancies discovered must be corrected so that the perpetual inventory records are in agreement with the physical count. (Mosich, A.N.1989)

## **2.3 Types of Inventory**

**There are two types of inventory**

- Merchandising and
- Manufacturing

Manufacturing is further divided in to three more components: Raw material, work in process and finished goods.

**2.3.1 Merchandise Inventory:** if you buy items from other artists and Crafters to sell in your own gallery of shop, you will have a merchandise inventory; remember though – any items in your shop on consignment are not part of your inventory.

**2.3.2 Manufacturing Inventory:** if you make your own arts and crafts, you will have a manufacturing inventory. The term manufacturing might not seem to fit a hand craft type of business, but a quick review of the classification within the term, will make the relationship clearer.

A manufacturing inventory consists of three different parts: raw materials, work in process and finished goods using leather crafting business as my sample craft company, here are definitions and example of the three.

- A. Raw materials:** everything the crafter buys to make the product is classified as raw materials. That includes leather, dyes snaps and grommets. The raw material inventory only includes items that have not yet been put into the production process.
- B. Work in process:** this includes all the leather raw materials that are in various stages of development. For the leather crafting business, it would include leather pieces cut and in the process of being sewn together and the leather belts and purse etc. that are partially constructed.

The work in process inventory includes the cost of the labor directly doing the work and manufacturing overhead. Manufacturing overhead is costs that are indirectly related to making the product.

**Finished Goods:** items those are ready to sell. The finish the goods inventory also consists of the cost of raw material, labor and manufacturing overhead, now for the entire product. *(Source: Maire Loughran/Art leraft business guide. arts and crafts. about.com/ed/.../at/fourtypesinventory.htm)*

## 2.4 Cost and Cost Terminology

Accountants define cost as resource sacrifices or forgone to achieve a specific objective. A cost (such as direct materials or advertising) is usually measured as the monetary amount that must be paid to acquire goods or services. An actual cost is the cost incurred (a historical cost), as distinguished from a budgeted (or forecasted) cost. . (Horngren.2002)

To guide their decisions, managers want to know how much a particular thing (such as product, machine, service or process) cost. We call this “things” a cost object, which is anything for which a measurement of costs desired. . (Horngren.2002)

A costing system typically accounts for costs in two basic stages accumulation followed by assignments. Cost accumulation is the collection of cost data in same organized way by means of



an accounting system. For example, publisher that purchases paper rolls for printing magazines collects (accumulate) the costs of individual rolls brought in any one month to obtain the total monthly cost of paper. Beyond accumulating cost, managers assign costs to designated cost objects (such as the different magazines). Managers assign costs to cost object for many purposes costs assigned to department facilitate decisions about department efficiency. Costs assigned to products help in pricing decisions and in analyzing how profitable different products are. Costs assigned to customers help managers to understand the profit earned from different customers and to make decisions about how to allocate resources to support different customers. Cost assignment is a general term that encompasses both (1) tracing accumulated cost that have a direct relationship to a cost object and (2) allocating accumulated costs that have an indirect relationship to cost object. . (Horngren.2002)

## **2.5 Elements of Costs**

### **2.5.1 Direct Costs**

These are costs that are specifically traceable to or caused by a specific project or production. Two major direct costs are direct labor and direct materials. . (Horngren.2002)

#### **2.5.1.1 Direct Material Cost**

Is the cost of materials which can be identified with and allocated to, cost centers or cost units. Direct material is that material which becomes a part of the product. There are some materials which become a part of a product, but are used in comparatively small quantities and have very negligible costs. Under such circumstances, instead of making a futile effort to make an analysis of them for the purpose of a direct change, they are conveniently grouped under indirect material as part of overhead. . (Horngren.2002)

#### **2.5.1.2 Direct Labor cost (Direct Wages)**

Is the wages which can be identified with and allocated to cost centers and cost units. Payment of direct labor and in some cases payment of indirect labor fall within the definition of direct wages. Direct labor is labor expended in altering the condition, conformation or composition of the product. There are some cases where wages of indirect labor may be treated as direct wages. (Horngren.2002)

### 2.5.1.3 Indirect Cost (Overhead)

These are costs that are associated with or caused by two or more operating activities “jointly” but are not traceable to each of them individually. The nature of an indirect cost is such that it is not possible (or practical) to measure directly how much of the cost is attributable to a single operating activity. Indirect cost can be fixed or variable, depending on their behavior of the following groups of indirect items fall within the category of factory overhead. . (Horngren.2002)

**Indirect material:** in the strict sense, indirect material is the material that cannot be traced in the finished products such as consumable stores, e.g., lubricants, cotton waste, grease, oils, small tools, belt fasteners and works stationary. All indirect materials costs relating to factory become part of factory overhead. . (Horngren.2002)

**Indirect Wages:** wages that are not charged directly are indirect wages. In general, salaries or wages of the following are treated as indirect wages: foremen, supervisors, charge hands, inspectors, general labor, maintenance labor, works clerical staff, watch and ward, indirect labor in drawing and design office, internal transport, tool room and other service. . (Horngren.2002)

**Indirect Expense:** expenses (other than indirect material and labor) that are not charged directly to production are indirect expenses. . (Horngren.2002)

The following are treated as indirect factory expenses:

- Rent, rates and insurance in relation to factory.
- Depreciation, power and fuel; repair and maintenance of plants, machinery and building.
- Sundry expenses for other services including employment office, first aid, rewards for welfare, etc.

## 2.6 Purpose of Cost Allocation

Indirect costs of particular cost object are costs that are related to that cost object but cannot be traced to it in an economically feasible (cost effective) way. This costs often comprises a large percentage of the overall costs assigned to such cost objects as products, customer and distribution channels. The allocation of a particular cost need not simultaneously satisfy all for purposes. Consider the salary of an aerospace scientist in a central research department of air bus industries. This salary cost:

- May be allocated to a product as part of central research of costs to satisfy purpose 1(an economics decision such as pricing),
- May or may not be allocated to a product to satisfy purpose 2(motivation, such as reducing future R&D costs of the product),
- May or may not be allocated to a government contract to satisfy purpose 3(cost reimbursement, in which the terms of the contracts will guide the allocation decision),and

Cannot be allocated to inventory under generally accepted accounting principles (GAAP) to satisfy purpose 4 (income and asset measurements for reporting to external parties). .

(Horngren.2002)

### **Classification basis for Overhead costs**

- 1. Cause and effect.** Using this criterion, managers identify the variables that cause resources to be consumed. For example, manager may use hours of testing as the variable when allocating the costs of quality-testing area to products. Cost allocations based on the cause-and-effect criterion are likely to be the most credible to operating personnel.
- 2. Benefits received.** Using this criterion, managers identify the beneficiaries of the out puts of the cost object. The costs of the cost object are allocated among the beneficiaries in proportion to the benefits, each receives. Consider a corporate which advertising rather than an individual product, the costs of their program may be allocated on the basis of division revenues; the higher the revenues, the higher the divisions allocated cost of the advertising program. The ration able behind their allocation is that division's with higher revenues apparently benefited from the advertising more than divisions with lower revenues and therefore, ought to be allocated more of the advertising cost.
- 3. Fairness of equity.** This criterion is often cited in government for contracts when cost allocations are the basis for establishing a price satisfactory to the government and its supplier. Cost allocation here is viewed as all "reasonable" or "fair" means of establishing a selling price in the minds of the contracting parties for most allocation decisions, fairness is a difficult to achieve objective rather than an operational criterion.
- 4. Ability to bear.** This criterion advocates allocation costs in proportion to the cost object ability to bear costs allocated to it. An example in the allocation of corporate executive salaries on the basis of division operating income. The presumption is that the more profitable division has a greater ability to absorb corporate headquarters costs.

## 2.7 Cost Flow Assumptions

The term flow refers to the inflow of costs when goods are purchased or manufactured and to the out flow of costs when goods are sold. The cost remaining in inventories is the difference between the inflow and outflow of costs. During a specific accounting period, such as a year or a month identical goods may be purchased or manufactured at different costs. Accountants then face the problem of determining which costs apply to items in inventories and which apply to items that have been sold. (Mosich, A.N. 1989)

A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues. (Mosich, A.N. 1989)

Costs for inventory purpose may be determined under any one of several assumptions as to the flow of cost factors (such as first-in, first out, average and last-in, first out); the major objective in selecting a method should be to choose the one which, under the circumstance, most clearly reflects periodic income.

The assumed flow of cost to be used in the assignment of costs to inventories and to goods need not conform to the physical flow of goods. Cost flow assumptions relate to the flow of costs, rather than to the physical flow of goods. The question of which physical units of identical goods were sold and which remain in inventories is not relevant to income measurement and inventory valuation.

All method of inventory valuation are based on the cost principal, no matter which method is selected, the inventory is stated at cost. In selecting an inventory valuation method (or cost flow assumption), accountants are matching costs with revenue, and the idea choice is the method that “most clearly reflects periodic income.

The most widely used method of inventory valuations are:

1. First-in, first Out method (FIFO)
2. Last-in, first Out method (LIFO)
3. Weighted-average method
4. Specific identification method

A recent survey of 600 corporate annual reports indicates that FIFO was used by 366 companies, LIFO was used by 480 companies, average cost was used by 235 companies and

52 companies applied a variety of other method to the valuation of inventories. Obviously, many of the companies include in the survey used more than one method.

### **1. First-in, first Out method**

The first-in, first out method assumes a flow of costs based on the assumption that the oldest goods on hand are sold first. This assumption about cost flow generally conforms to reality, management usually finds it desirable to keep the oldest good moving out to customer in order to keep fresh or new goods on hand. The method is systematic and is easy to apply it adheres to the cost principle and the cost assigned to inventories likely to be in close harmony with the current prices being paid for inventory replacement.

### **2. Weighted-average method**

The weighted-average method of inventory valuation is based on the assumption that all goods are commingled and that no particular batch of goods is retained in the inventories. Thus the inventories are valued on the basis of average prices paid for the goods. Weighted according to the quantity purchased at each price. (Mosich, A.N. 1989)

This method produces a result, for both inventory valuation and income measurement that lies between the results achieved under FIFO and those achieved under LIFO. The weighted-average method does not produce an inventory value consistent with the current cost of the items in inventory, by its nature it lags behind market prices. During a period of rising prices the inventory costs tends to be below replacement costs during a period of falling prices it tends to be above replacement cost.

When the perpetual inventory system is used, the weighted-average method gives the result of a moving weighted average under the perpetual system; new weighted-average average unit costs are computed after each purchase and for their reason are known as the moving-weighted-average method. Unit sold are priced at the latest weighed average unit cost.

### **3 Specific Identification Method**

At first thought one might argue that each item of inventory should be identified with its actual cost and that the total of these among should constitute the inventory value. Although such a technique might be possible for a business enterprise handling a small number of items. For example, an automobile dealer, it becomes completely inoperable in a complex manufacturing

enterprise when the identity of the individual item is lost. Practical considerations this makes a specific identification in an appropriate in most cases.

Even when specific identifications a feasible means of valuation, it may be undesirable from a theoretical point of view. The method permits in come manipulation when there are identical items acquired at varying price. By choosing to sell the item that was acquired at a specific cost, management may cause material distortions in income.

## **2.8 Job Costing and Process-Costing Systems**

Two basic types of costing systems are used to assign costs to products of services.

### **2.8.1. Job-costing system.**

In this system, the cost object is a unit or multiple units of a distinct product of service called a job. The product or service is often a single unit. Job costing is also used to cost multiple units of a distinct product.

This method is applied where the items of prime cost are traceable to specific jobs or orders, as house-building; ship-building; engine and machinery construction and repair; constructors' work, e.g. making reinforced concert structure; garage and repair shops.

Job costing may include the following terms:-

- a) **Contract costing:** in building trade, a contract is treated as a whole job and is costed in total.
- b) **Terminal costing:** this method emphasizes the essential nature of the job costing, i.e., the cost can be properly terminated at some point and related to a particular job.
- c) **Department costing:** if the output of or service performed by a department sufficiently uniform, a cost per unit of output may be established. This departmental rate is applied to all jobs passing through that department.
- d) **Batch Costing:** a batch of similar products is regarded as one job, and the cost of this complete batch is collected. It is then used to determine the unit cost of articles produced.

## 2.8.2 Process-Costing System

In this system, the cost object is masses of identical or similar units of a product or service. In each period, process-costing systems divide the total costs of producing an identical or similar product or service by the total number of units produced to obtain a per-unit cost. This per unit cost is the average unit cost that applies to each of the identical or similar unit produced.

These two types of costing system are best considered as opposite ends of a continuum; in between, one type of system can be into the other to some degree.

Many companies have costing system that are neither pure job costing nor pure process costing but have elements of both.

In a processing-costing system, the unit cost of a product or service is obtained by assigning total costs to many identical or similar units. In a manufacturing process-costing setting each unit receives the same or similar amounts of direct material costs, direct manufacturing labor cost, and indirect manufacturing costs (manufacturing overhead). Unit costs are then computed by dividing total costs incurred by the number of units of output from the production process.

The main difference between process costing and job costing is the extent of over going used to compute unit costs of products or services. In a job-costing system, individual jobs use difference quantities of production resources; so it would be incorrect to cost each job at the same average production cost. In contrast, when identical or similar units of products or services are mass-produced, not processed as individual jobs, process costing is to calculate an average production cost for all units produced.

Process costing system reflects work organized and collects by continuous processes rather than by bathes and jobs. Process costing can be characterized as follow:

- Work is organized around process
- Costs are collected by processes. Direct materials are issued and direct labor is traced to specific process. Manufacturing overhead is assigned to a process using on overhead rate.
- The cost of goods completed and transferred from work in process to finished goods is based on equivalent “Whole” units of work performed. Total cost is divided by equivalent whole units to determine unit cost. Cost of good transferred from work in process to finished goods at the equivalent whole-unit cost.

- The cost of completed units is maintained in finished goods at the equivalent whole-unit cost until the product is sold.

## **2.9 Inventor able and Period Costs**

- The purpose of inventory accounts is to collect and store all costs that can be attached to the product—that's why they are called product costs. Then, in the period when the product is sold, total product. Cost is released against income as cost of goods sold. Then, and then, is the cost deducted from revenue. (Mosich,A.N. 1989)
- In contrast, all non-product costs are related immediately. That's because they can't be associated with specific products. Because non-product costs are realized in the time period for which they are incurred, they are commonly referred to as period cost. Period costs are never found in inventories.

### **2.9.1 Inventor able costs**

Inventor able costs are all costs of a product that are regarded as assets when they are incurred and then become costs of goods sold when the product is sold. For manufacturing sector companies, all manufacturing costs are inventor able costs. Costs of direct material issued to production from direct material inventory, direct manufacturing labor costs, and indirect manufacturing costs create new assets, beginning as work in process and becoming finished goods. Hence manufacturing costs are included in work-in process inventory and in finished goods inventory (they are "inventoried") to accumulated the costs of creating these assts. When finished goods are sold, the cost of manufacturing the goods sold is matched against the revenues from the sale. The cost of goods sold includes all manufacturing costs (direct materials, direct manufacturing labor, and indirect manufacturing costs) incurred to produce the goods sold. Finished goods may be sold during a difference accounting period than the period in which the goods were manufactured. Thus inventorying manufacturing costs during the period when they were manufactured and expensing the manufacturing costs of goods sold later when revenues are recognized achieves matching of revenues and expenses. (Mosich, A.N. 1989)

#### **2.9.1.1 Prime Costs and Conversion Costs**



Two terms used to describe costs classification in manufacturing costing system are prime costs and conversions costs. Prime costs are all direct manufacturing costs. As information gathering technology improves, companies can add more and more direct-cost categories. For example, power costs might be metered in specific areas of a plant that are dedicated totally to the manufacture of separate product. In this case, prime costs should include direct materials, direct manufacturing labor, and direct metered power (assuming there are already direct materials and direct manufacturing labor categories). Computer Software Company's often have a "purchased technology" direct manufacturing cost item. This item, which represents payments to suppliers who develop software algorithms for product, is also included in prime costs. Conversion costs are all manufacturing costs incurred to convert direct materials costs.

Some manufacturing companies use conversion costs to simplify the accounting. They have only two classifications of costs: direct material costs and conversion costs. For these companies, all conversion cost are indirect manufacturing costs. An example is costing systems in computer integrated manufacturing (CIM) plants. CIM plants have very few workers. The workers role is to monitor the manufacturing process and maintain the equipment that produces multiple products. Costing system in CIM plants do not have a direct manufacturing labor cost category because direct manufacturing labor costs are small and because it is difficult to trace these costs to products.

### **2.9.2 Period Cost**

Period costs are all costs in the income statements other than costs of goods sold. Period costs are treated as expenses of the period in which they are incurred because they are expected to benefit revenues in the current period and not expected to benefit revenues in future period (perhaps because there is not sufficient evidence to conclude that such benefit exists). Expensing these costs in the current period matches expenses to revenues. (Horngren, 2002) For manufacturing-sector companies, period costs (for example, design costs and distribution costs). For related to the cost of goods purchased for resale. Example of period costs are labor costs of sales floor personnel and marketing costs. Because there are no inventor able costs for service-sector companies, all their costs in the income statement.

### **2.9.3 Scrap Materials**

These are rejections from production process, which cannot be used anymore and are to be thrown away. Similarly, old, broken parts, rejects, cut pieces of iron sheets, angel iron, gaskets, insulation materials etc., are generated during maintenance and repair works. These materials are removed from the place of work and dumped in the scrap yard. Some of these materials are very useful for small jobs or can be reprocessed for other works.

For example, damaged tires are a good source of heat generation as they can be burnt in a furnace. Batteries, rejected or damaged, can be a useful source; its battery case can be taken out for making the re-conditioned battery. Similarly, shafts can be recovered from scrapped pumps. They are likely to be in good condition for uses in repair of other pumps are period cost.

## **2.10 Accounting for Scrap**

Scrap is material left over when making a product, it has low sales value compared with the value of the product no distinction is made between normal and abnormal scrap because no cost is attached to scrap. The only distinction made is between scrap attributable to specific job and scrap common to all jobs.

There are two aspects of accounting for scrap;

1. Planning and control, including physical tracing.
2. Inventory costing including when and how it affects operating income.

Initial entries to scrap records are commonly in physical terms. In various industries, items such as stamped out of metal sheets or edges of molded plastics parts are qualified by weighting, counting or some other expedient means. Scrap records not only help measure efficiency, but they also help keep track of scrap and so reduces the chances of theft. Scrap reports are prepared as source documents for periodic summaries of the amount of actual scrap compared with the budgeted or standard amounts. Scrap is either sold or disposed or quickly or stored for later sale, disposal or reuse a careful tracking of scrap often extends into the accounting records. (Mosich, A.N.1989)

# CHAPTER THREE

## DATA PRESENTATION, ANALYSIS AND INTERPRETATION

### 3.1 Overview

The theoretical part concerning Inventory Accounting Control System is covered in the literature review. Here in this chapter the student researcher could examine or study the inventory accounting and control system of St. George Beer Factory in relation to the factories manual as well as what is literally said. The researcher used in the research design as Descriptive research study, questionnaire and observation method for collecting primary and secondary data. In addition to this analyzed based on descriptive analysis.

The purpose of this study is to critically owner's adequate information on Inventory Accounting in case of St. George Beer Factory.

The population size is 40 and the sample size is 30 selected through random sampling 40 questionnaires were distributed across the factory, out of which 30 were completed and returned successfully; generally this section is organized in the following manner. 1<sup>st</sup> the general information about inventory accounting were presented of analyzed. 2<sup>nd</sup> data collected through questionnaire were analyzed concurrently.

### 3.2 Personal Information

#### 3.2.1 Gender

**Table 1: Show that Participants sex**

No.	Questions and answers	Participants	
		Number	Percentage (%)
1	Male	17	57 %
2	Female	13	43 %
	Total	30	100 %

**Source: Questionnaire 2014**

From the above data more than half employees of the company are males which around 57% out of total employees, which are the remaining 43% them are females.17 indicates that the organization is not giving wide opportunity for female workers as much of male workers.

### 3.2.2 Age

**Table 2: Show that Participants age**

	Questions and answers	participants	
		Number	Percentage (%)
1	<20	7	23 %
2	20-50	15	50 %
3	>51	8	27 %
	Total	30	100 %

**Source: Questionnaires 2014**

Table 2 shows that age of respondents, 23 % of the respondents are <20, 50 % of workers of the company employees are in between of 20-50 years of age indicating a better retirement of elder workers with adults substitution.27% of the respondents responded that the age line of adulthood prescription.

### 3.2.3 Education

**Table 3: Show that Participants educational background**

No	Questions and Answer	Participants	
		Number	Percentage (%)
1	Grade 10 & below	-	-
2	Diploma	19	64 %
3	Degree	10	33 %
4	Masters and above	1	3 %
	Total	30	100 %

**Source: Questionnaires 2014**

According to table 3 when we see their educational background almost 2/3 of the participants which is 64% of them are Diploma graduates showing a preferential deficiency of participants 33 % Degree graduates and 3 % Master & above respectively.

### 3.2.4 Duration in the Factory

**Table 4: Show that Participants services year**

No	Questions and answer	Participants	
		Number	Percentage (%)
1	<1 year	4	13 %
2	1-5 year	5	17 %
3	5-10 year	10	33 %
4	>10 year	11	37 %
	Total	30	100 %

**Source: Questionnaires 2014**

Table 4 shows that duration of the participants in the factory. 13 % of them stay for less than 1 year, 33% and 37% of the employees are more experienced within 5-10 years, and more than 10 years of participation in the claim of the working environment.17% portrays the fact most of the workers are adequately & properly trained, experienced & cultivated to function in an appropriate manner of firm's condition. So this is good the company workers have at least basic knowledge about the work they doing and the company its mission and plan.

### 3.3 When did the company start inventory cost control?

**Table 5: Participants response with regard to inventory cost control**

No	Questions and Answer	Participants	
		Number	Percentage
1	Since its establishment	-	-
2	In the last 5 years	7	23 %
3	In the last 10 years	14	47 %
4	In the last 20 years	6	20 %
5	I don't know	3	10 %
	Total	30	100 %

**Source: Questionnaires 2014**

As shown in table 5, we can see that from the participants response the gap of duration & time in which the company started inventory control has been in the last 10 years rating a percentage of 47% .10% of the respondents responded that the company hasn't have that much concern & sufficient to control the inventory cost in appropriate manners, the company is not with adequate knowledge how to control the inventory cost. More is plummeted from the firm to fill this gap.

### **3.4 What system is used in your company to conduct inventory**

**Table 6: Participants response with regard to conduct inventory**

No	Questions and Answers	Participants	
		Number	percentage
1	Computerized	8	27%
2	Manual	16	53%
3	Both	6	20%
	Total	30	100%

**Source: Questionnaires 2014**

The data on the table has shown 27% of respondents replied as the company used computerized inventory, 53% of the participants replied the company used manual to conduct & manage inventory counting system in its own affairs it indicates the firms uses primitive traditional time wasting techniques to manage inventory and 20% agreed on both respectively. So still the

company is not controlling its inventory cost properly. Because of this the company is better to use computerized system of inventory control as a huge & vast company.

### 3.5. Does the company have an appropriate accounting treatment?

**Table 7: Record of appropriate accounting treatment**

No	Questions and Answers	Participants	
		Number	percentage
1	Yes	23	77%
2	No	7	23%
	Total	30	100

**Source: Questionnaires 2014**

This table states that, the appropriation accounting treatment in the company, 77% of the participants are harmonious with the firm's level of an appropriate accounting treatment. On the other side 23% of the respondents are in a favorable pleasant and appearing condition for its own efficiency & competence. For the reason. It follows an appropriate accounting treatment.

### 3.6 Reason for appropriate accounting treatment

**Table 8: Participants response with a regard to accounting treatment**

No	Questions and Answers	Participants	
		Number	Percentage
1	Raw material	11	37%
2	Labor and work in process	9	30%
3	Finished goods	9	30%
4	Scrap	1	3%
	Total	30	100%

**Source: Questionnaires 2014**

As shown in table 8, from 30 participants 11 responded that 37% of the respondents responded as the company use Raw materials as mechanism, 9 responded that 30% labor and work in process, 9 responded that 30% finished goods and 3% scrap respectively. In table 8 of answer 1 the company is not working regarding raw materials which have purchased on a huge amount of

money. On the other side finished goods have not maintained as indicated and delivered to the end users. It signals the fact that the firm is in order of treating its resources and cost of manufacturing with an appropriate measure of its allocation.

### 3.7 Sustainable evaluating and monitoring system

**Table 9: Record of Sustainable evaluating and monitoring system**

No	Questions and Answers	Participants	
		Number	Percentage
1	Yes	27	90%
2	No	3	10%
3	I don't know	-	-
	Total	30	100%

**Source: Questionnaires 2014**

Tables 9 indicate that with an approved percentage of 90% of participants confirmed yes responded as the company has Sustainable evaluating and monitoring system which is 10% of them sketch's the firms preserved and secured position to monitor the inventory accounting system in a more efficient & striking manner with this .because of this the company use sustainable evaluating and monitoring system of inventory control.

### 3.8 Period of evaluation

**Table 10: Record of the period evaluation**

No	Questions and Answers	Participants	
		Number	Percentage
1	Monthly	-	-
2	Quarterly	-	-
3	Half year	5	17%
4	Yearly	25	83%
	Total	30	100%

**Source: Questionnaires 2014**



According to table 10, participants were asked whether there is appropriate accounting period of evaluation 17% of respondents replied as the company monitors its inventory half in a year and 83% on the other hand side yearly bases. As the company is vast and huge it has to conduct inventory even daily basis, but in this case inventory is conducted either half yearly or annually.

### 3.9 Method of inventor

**Table 11: Participants response with a regard to inventory method**

No	Questions and Answers	Participants	
		Number	Percentage
1	First-in, First- out (FIFO)	6	20%
2	Last-in, First- out (LIFO)	11	37%
3	Weighted-average	13	43%
4	Other	-	-
	Total	30	100%

**Source: Questionnaires 2014**

As indicate in table 11, 20% of the participants replied as the company used FIFO method, 37% on the hand side LIFO and 43% the majority of the respondents agreed with the company used weighted-average method inventor cost system. As a company it has use the above mentioned inventory methods properly. However as stated by most participants the company is using only LIFO and weighted average system.

### 3.10 Management of cost

**Table 12: Record of management of cost**

No	Questions and Answers	Participants	
		Number	Percentage
1	Through inventory cost	14	47%
2	Through income & cost accounting system	16	53%
3	Other	-	-
	Total	30	100

**Source: Questionnaires 2014**

Table 12 shows that how the company manage its cost. 47% of the respondents responded as the company manages its costs through inventory cost system on the other hand 53% which is majority of the respondents agree on the part the firm record management of cost through income & cost accounting system it portraits the firms insufficiency & in aptitude position to determine management of cost efficiently and accurately. This is due to, in case the negative perspective of raw material, labor, ending wip, and finished goods costing through income & cost accounting system. Inventory costing is more preferable compared with costing through income & cost accounting system.

### **3.11 operating of inventory accounting**

**Table 13: Participants response with regard to operating inventory accounting**

No	Questions and Answers	Participants	
		Number	Percentage
1	Yes	12	40%
2	No	18	60%
	Total	30	100%

**Source: Questionnaires 2014**

As indicated in the above table 40% of the participants replied as the company operates with inventory costing efficiently while as the remaining 60% of the respondents give clues on a fact that the firm doesn't use operating of inventory accounting on the basis of their disclaim and dis

approvals. The above figure pin points the scene of the firm not to take enough measures & efforts to take inventory accounting system to a more appropriate level, and circumstance. It has its own negative declaration impacts as the day to day operations of the firm in alliance with the inventory.

### **3.12 purpose of conducting inventory in the company**

**Table 14: Show that Participants inventory purpose**

No	Questions and Answers	Participants	
		Number	Percentage
1	To identify fast moving & slow moving items	11	37%
2	To increase productivity	7	23%
3	To comply with rules & regulation	12	40%
4	Other	-	-
	Total	30	100%

**Source: Questionnaires 2014**

According to table 14, 37% of the respondents responded as the purpose of conducting inventory is to identify fast & slow moving items, 23% and 40% of the total respondents are harmonious on a point inventory conducting and accounting system is taken with the purpose of uplifting the productivity of the firm and to comply with rules & regulations. It gives a picture for the firm's positive and appealing activity to maximize the potentials of its optimum efficiency, capability & potential to strike its operating purpose. Inventory is conducting for many reasons as mentioned earlier but still the company is expected a lot.

### **3.13 how often inventory conducted**

**Table 15: Participants response about inventory conducted**

No	Questions and Answers	Participants	
		Number	Percentage
1	Weekly	-	-
2	Monthly	-	-
3	Quarterly	5	17%
4	Half yearly	25	83%
	Total	30	100%

**Source: Questionnaires 2014**

Table 15 state that how often the company conduct inventory, from 25 Participants 83% of the respondents agree on a point the firm conducts inventory accounting semi-annually. 17% of the participants agree on the fact with a real sense the time gap in which the firm conducts inventory accounting is not too vast or narrow. It shows the firm has a well-balance time duration to provide & access the required data, concerning the durations of inventory accounting to be conducted for internal parties & external personalities in a more contextualized and organized manner.

### **3.14 appropriate base for classification and allocation of indirect cost**

**Table 16: Participants response with regard to allocation of indirect cost classification**

No	Questions and Answers	Participants	
		Number	Percentage
1	Yes	28	93%
2	No	2	7%
	Total	30	100%

**Source: Questionnaires 2014**

According to table 16, majority of the respondents which out of 28 participants more than 90% are in a claim approval for the appropriate classification and allocation of indirect cost with in inventory accounting system. Only 7% disclaimed for this approval. If the scene of the firm to be in a well position of performance for taking a due consideration for classification & allocation of indirect cost, for an optimistic achievements of its operating functions.

### 3.15 treatments of special inventory recording issues

**Table 17: show that participants record of special inventory treatment**

No	Questions and Answers	Participants	
		Number	Percentage
1	Good in transit	4	13%
2	Inventory in consignment	10	33%
3	Special sale agreements	16	54%
4	Other	-	-
	Total	30	100%

**Source: Questionnaires 2014**

As indicate in table 17,from 30 participants 4 respondents said that goods in transit 13%,from 10 of as the company treats special inventories in consignment 33% & 54% agreed with special sales agreement. Goods in transit have included in inventory because of ones they are purchased for consumption purpose, but the company is not treating them properly. On the other side consignment is also the same case. But the company stresses on special sales agreement.

## CHAPTER FOUR

### 4. SUMMARY, CONCLUSION AND RECOMMENDATION

#### 4.1 SUMMARY OF MAJOR FINDINGS

The overall objectives of this study is to address the inventory accounting and controlling systems of St.George Beer factory and to find out the problems related with inventory accounting system .

The method used to prepare this research is random sampling techniques to pick subjects from the population and used primary and secondary data obtained through questionnaire and analysis a written document from the company's manuals and report the method in analyzing and presenting data, the researchers used descriptive analysis method like percentage and tables.

- About 27% of the respondents have viewed that the company uses computerized inventory system, 53% replied manual and the remaining 20% agreed on both ideas.
- Among the respondents 77% of the participants agreed on the company have an appropriate accounting treatment, where as 23% disagreed.
- 37% of the respondents responded as the company uses raw materials as a mechanism, 30% labor and work in process, 30% finished goods and 3% of them said scrap.
- About 90% of the participants replied as the company have sustainable evaluating and monitoring system while 10% of the said no.
- 17% of the respondents responded as they evaluate inventory half in a years and 83% on the other hand yearly basis.
- Among the participants 40% of them said the company uses LIFO method of inventory, while 60% of the said weighted average.
- About 47% of the respondents responded as the company manage its costs through inventory cost, while 53% through income and cost accounting system.
- 40% of the participants replied as the company uses inventory accounting system efficiently and 60% said no.
- About 37% of the respondents responded as the purpose of conducting inventory was to identify fast moving slow moving items, 23% productivity and 40% to comply rules and regulations.

## 4.2 CONCLUSIONS

Based on the data about the current application of inventory accounting system in St. George brewery that are obtained through questionnaire and review of documents, and the analysis made on them based on the theory of inventory accounting system for manufacturing companies.

- ❖ As maintained above there are some problems in the inventory control of the factory. Lack of proper inventory control system means, cost to the company since profit is a function of cost and revenue, increasing in cost means decrease in profit and vice versa.
- ❖ According to the findings that, the factories inventory control mechanism is used more by manual systems. There for, it is not possible for proper accounting of inventory control system.
- ❖ According to the findings, the factory has well experienced accounting staffs that are worked for many years their role is limited to routine application of an already established policies and procedure. They do not participate in establishment and implementation of new policies and procedures related to inventory, this limits the efficiency of inventory accounting system of the company.
- ❖ Purchasing regarding raw materials on a huge amount of money. On the other side finished goods have not maintained as indicated and delivered to the end users. Because of this much resources and cost wasted in inventory work.
- ❖ As mentioned above period of inventory evaluation mostly done annually. But as the company is vast and huge it is impossible to ensure that appropriate inventory accounting period of evaluation.

### 4.3 RECOMMENDATIONS

Based on the data analysis and the conclusion drawn above we recommend that:

- It is better to the factory to participate accountants in establishment and implementation of new policies and procedures related to inventory, since the most accountants have many years of experience in the factory they can do well. Besides, we have to recommend the company to make further training to its various employees in order to effectively and efficiently making productive activities.
- It is better to the company to establish a separate cost accounting department that is responsible to control production costs and participate in product designing by estimating cost of each alternative product designs. Since the cost of production have a significant effect in the overall profitability by affecting the price of the product. Thu a separate cost department will help the company to manage its production costs effectively.
- In allocating power costs to departments the company have try to create a cause-effect relationship that also consider power consumed for lighting and other purposes in addition to operating production machineries and equipment's.
- In planning for purchase the company has to consider estimated amount of possible obsolescence and damages in raw material and finished to avoid cost overruns above the planned purchase to replace such obsolescence and damages.
- Most respondents mentioned that the company is using both manual and computerized system. It is better to upgrade it because it incurs a lot of costs during inventory and may not have proper records.
- Inventories are purchased in a huge amount of money so we have to control them properly, but the respondents still agreed that the company is not maintain them properly.
- As the company is huge inventory must be conducted either daily or weekly basis to control costs, but the company is not making it on this schedule so it is preferable to conduct inventory properly.
- LIFO and weighted average system is the only system used by the company. In the future the company is suggested to use all of the methods of inventory to have efficient and effective system



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# Appendix

# St.mary's University

## Department of Accounting

This questionnaire is prepared by the students of St.Mary's University, to undertake a research entitled "An assessment of Inventory Accounting System in St. George Beer Factory". The major objective of the study is to gather adequate information on inventory accounting of St.George Beer Factory.

### General Instruction

- Please complete each part of the survey with care, honesty and due attention.
- Instruction; put a tick mark (✓) in the box.
- Your cooperation has par amount important for the completion of the study.

#### 1. Personal information

- i. Gender      A/ Male            B/ Female
- ii. Age      A/ <20            B/ 20-50            C/>51
- iii. Education      A/ Grade 10 and below            B/ Diploma
- iv. How long have you stayed in the Factory?

A/ 1 year            B/ 1-5 years            C/ 5-10 years            D/>10 years     

#### 2. When did the company start inventory cost control?

A/ since its establishment            B/ in the last 5 years            C/ in the last 10 years            D/in the last 20 years            E/ I don't know     

#### 3. What system is used your company to conduct inventory?

A/ Computerized            B/Manuel            C/ both     

#### 4. Does the company have an appropriate accounting treatment?

A/ yes            B/no     

#### 5. According to question number "4" if your answer is "yes" which mechanism does the company used?

A/ raw materials            B/labor and work in process        
C/ finished goods            D/ scrap     

#### 6. Does the company have sustainable evaluating and monitoring system effectively?

A/ yes            B/no            C/ I don't know     

#### 7. According to question number "6" if your answer is "yes" how often they do?

A/ monthly            B/quarterly            C/ half year            D/ yearly     

#### 8. Which method is selected in your company?

A/ First-in, First Out (FIFO)            B/Last in, First Out (LIFO)        
C/ Weighted-average            D/ Other \_\_\_\_\_

#### 9. How does the company manage its cost?

A/ through in inventory cost            B/through income and cost accounting system        
C/ other \_\_\_\_\_

#### 10. Does inventory accounting system in the company efficiently operating?

A/ yes  B/no

11. What is the purpose of conducting inventory in your company?

A/ to identify fast moving and slow moving items  B/to increase productivity

C/ to comply with rules and regulation  D/ Other\_\_\_\_\_

12. How often inventory is conducted in your company?

A/ weekly  B/ monthly  C/quarterly  D/half a year

13. Does the company have appropriate base for classification and allocation of indirect cost?

A/ yes  B/no

14. How the company treats special inventory recording issues?

A/ goods in transit  B/inventories in consignment

C/ special sales agreements  D/ Other\_\_\_\_\_

THANK YOU!

# Declaration

We the undersigned, declare that this senior essay is our original work, prepared under the guidance of Ato Abdu Yimer. All sources of materials used to the menu script have been fully acknowledged.

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Signature: \_\_\_\_\_

Signature: \_\_\_\_\_

Signature: \_\_\_\_\_

Place of submission: \_\_\_\_\_

Place of submission: \_\_\_\_\_

Place of submission: \_\_\_\_\_

# Certification

This is to certify that kidist Belay, Haymanot Kassahun and Tamir Mekonnen. Have carried out the research work on the topic entitled “**Assessment of Inventory Accounting system in St.George Beer factory**”. The work is original in nature and suitable for submission for the reward of the BA Degree in Accounting.

Instructor Abdu Yimer

Name of Advisor

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Signature

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