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| **Client name:** Cosmopolitan Industries Pvt. Ltd. (CIPL) | | |
| **Accounting period:** 01 July 2021 to 30 June 2022 | | |
| **Prepared by:** |  | **Date:** |
| **Reviewed by:** |  | **Date:** |
| **Final Reviewed by:** |  | **Date:** |
| **Subject:** |  |  |

**Objective:** The objective of this memo is to document process of calculating closing raw material inventory valuation rate

**Process performed:** Following process is noted from the discussion with Mr. Khayer Uddin, Deputy General Manager-Finance & Accounts, Epic BD.

**Overall process related to COGS:**

In CIPL the COGS consist of the following subheads:

1. **Production material consumed**
2. **Direct Cost**
3. **Factory Overhead**

Each of the subheads process is described in below:

1. **Production material consumed:**

Production material consumed consist more than 70% of the COGS cost. The production material consumed are generally consist of the following:

1. **Production material consumed-Fabrics and Trims**
2. **Production material consumed-Other (Packing Materials, chemical and spare parts)**
3. **Production material consumed-Inward cost**

Each one is described in below:

1. **Production material consumed-Fabrics and Trims**

Production material consumed-Fabrics and Trims generally consist more that 90% of the total production material consumed. There are generally two material comes under this head.

* Fabric
* Trims

For both Fabrics and Trims Consumption comes from the following calculation:

|  |  |  |
| --- | --- | --- |
| **Cal.** | **Component in the calculation** | **Break up of component** |
|  | Opening stocks-Fabrics and Trims | * Opening Raw material * Opening WIP * Opening Finished goods |
| **Add:** | Purchase during the year-Fabrics and Trims | Fabrics and Trims purchased during the year **(Described in details in Point numer-1)** |
| **Less:** | Closing stock-Fabrics and Trims | * Closing Raw material **Details are** * Closing WIP **given in** * Closing Finish goods **Point number-2** |
| **=** | Production material consumed-Fabrics and Trims | Charged as expense as COGS in Profit and Loss statement |

For recording the data regarding the above components, three separate software is maintained.

1. For Raw material-Fabrics and Trims: **OMS-V2**
2. For Work in Process (WIP)- Pcs of garment: **PCS-V2**
3. For Finished Goods -Pcs of garment: **FGMS**
4. **Raw material-Fabrics and Trims: OMS-V2**

OMS-V2 is the separate software maintains only to record Raw material for Fabrics and Trims. The software is used for:

* **Opening:** Getting the opening value of stock of Raw material-Fabrics and Trims
* **Purchase:** Recording the purchase of the Raw Material-Fabrics and Trims
* **Issue:** Recording the issue of the Raw material-Fabrics and Trims during the year
* **Closing:** Getting the closing number of stock of raw material

Process and recording of purchased of raw material and process of closing stock count and valuation is separately discussed in **points number 1 & 2** respectively in below.

1. **Work in Process (WIP)-Fabrics and Trims: PCS-V2**

PCS-V2 is a separate software maintains only for Work in Process of the Fabrics and Trims. It is used for the following purposes.

* **Opening:** Getting the opening value of WIP-Fabrics and Trims
* **Addition:** Recording the addition of the WIP-Fabrics and Trims
* **Issue:** Recording the issue of the WIP-Fabrics and Trims during the year
* **Closing:** Getting the closing number of WIP

The issue from OMS-V2 is automatically booked as addition in the PCS-V2. The valuation method of closing WIP is described in detail in **point number 2**

1. **Finish Goods-Fabrics and Trims: FGIMS**

FGIMS is the separate software maintains for Finish goods-Fabrics and Trims.

It is used for the following purposes.

* **Opening:** Getting the opening value of FG-Fabrics and Trims
* **Addition:** Recording the addition of the FG-Fabrics and Trims
* **Issue:** Recording the issue of the FG-Fabrics and Trims during the year
* **Closing:** Getting the closing number of FG

The issue from PCS-V2 is automatically booked as addition in the FGIMS. The valuation of closing FG is described in detail in **point number 2.**

The interconnectivity between the three software is given below:

|  |  |  |
| --- | --- | --- |
| **OMS-V2 (Raw Material)** | **PCS-V2(WIP)** | **FGIMS(FG)** |
| Recording of Issue | Addition in WIP |  |
|  | Recording of WIP Issue | Addition in FG |

1. **Production material consumed-Other**

Production material others consist of the following consumables:

* Chemicals
* Packing material
* Spare parts
* Others

For production material consumption-other, same calculation is used for getting the COGS amount as like Fabrics and Trims:

|  |  |  |
| --- | --- | --- |
| **Cal.** | **Component in the calculation** | **Break up of component** |
|  | Opening Stock-Others | * Opening Raw material * Opening WIP * Opening Finish goods |
| Add: | Purchase during the year-Others | Purchased during the **(Described in details in Point numer-1)** |
| Less: | Closing stock-Others | * Closing Raw material **Described** * Closing WIP **details in** * Closing Finish goods **Point number-2** |
| = | Production material consumed-Other | Charged as expense as COGS in Profit and Loss statement |

No separate software is maintain for Production material consumption-Other. It is integrated with SAP. Purchase, Issue entries are given directly in SAP.

1. **Production material consumed-Inward cost**

The production material consumed-Inward cost generally consist of the following items:

* C&F Charge
* Loading and Unloading cost
* Insurance Cost
* Bank Charge
* Interest paid on Import
* Air freight
* Sea freight
* Others

The charging of these expenditures are directly posted to SAP as expense.

**Point-1: Purchase of Raw Materials (All consumables):**

**Purchase process:** There are generally two way the purchases are made:

* Purchase by Import
* Local purchase.

**Purchase by Import:**

**Purchase by Import:**

Most of the raw material purchased by CIPL is from import. There is an authorized list of vendors from which the purchase is made. Sometimes customer of the specific contract demands a particular vendor for purchasing raw materials for that specific contract. For cases like this, customer’s preference is given the priority. The process of purchase is listed in details below:

* Hong Kong (HK) Merchant, based on the required number of raw materials needed raise a purchase requisition (PR).
* After the approval, HK sourcing team selects the supplier from the authorized list and communicate with the supplier through pro-forma invoice including the availability of the material to be delivered, time of delivery, quality needed, price of the material etc. Most of this communication happens through mail.
* After all this agreed with the supplier, a Purchase Order (PO) is raised for the purchase.
* The commercial officer/executive opens Letter of Credit (L/C) against this purchase order.
* The product is received at plant and warehouse team prepare the GRN accordingly.

**Local purchase:**

CIPL purchase raw materials from local vendors/suppliers in some cases. The purchase team purchases from listed vendors/suppliers or quotations based for purchasing raw materials. For quotations based systems performed following process:

* The factory head, mentioning the required amount of raw materials needed raise a purchase requisition (PR). That purchase requisition is then sent to the central purchase team for checking.
* The central purchase team verifies the PR and sent the PR to Head of central purchase team for approval.
* Finance head approved the PO and dispatched to vendor on electronic medium. Minimum Three Quotation collects where authorized vendor is not available.
* Central purchase team selects the supplier from the quotation based on the availability of the material to be delivered, time of delivery, quality needed, price of the material etc. through comparative statement for purchasing raw materials which checked by Purchased head and approved by Plant CFO;
* Central purchase team prepares the PO based on PR and verified by Head of department.
* Good is received and GRN is prepared

**Recording of Purchase:**

* Each purchase of raw material is recorded at cost.
* When the Good Receive Note (GRN) is prepared by the Factory, a purchase entry is posted including quantity and value in the OMS-V2 System (For Fabrics and Trims), then in the SAP, the payable entry is posted mentioning only the value for Fabrics and Trims. For other Consumable raw material purchase, a direct entry is posted in the SAP.
* The payable entry posted is this:

Purchase of Raw material----DR.

Accounts Payable-Credit------------CR.

* Treasury executes the payment to the vendor and payment entry posted in the systems is:

Accounts Payable/ Respective vendor A/C.........… Dr.

Bank A/C...........… Cr.

**Point-2: Closing inventory valuation**

1. **For Raw material**
2. **For WIP**
3. **For Finish goods**
4. **Raw material:**

* For Fabrics and Trims
* For Others

**Raw material-For Fabrics and Trims:**

* Closing inventory number is extracted from the OMS-V2 system at the closing day of the year (30 June 20XX).
* Physical stock count is conducted in regular interval to ensure the quantity
* The closing raw material is valued at Cost (**Weighted Average Rate)** or NRV whichever is lower.

**Raw material-Others:**

* Closing inventory number is extracted from the SAP at the closing day of the year (30 June 20XX).
* Physical stock count is conducted in regular interval to ensure the quantity;
* The closing raw material is valued at **Weighted Average Rate**.

1. **Work in process (WIP):**
2. For Pcs of garment

For Pcs of garment closing work in process data is extracted from PCS-V2.

The process is described as below:

* For each sales contract received, EPIC opens a separate file. On that file below details regarding the sales are listed:
* Total sales contract quantity and value
* Total raw materials cost for the contract
* Total conversion cost for the contract (Probable)
* Whole of the WIP is segregated by individual sales files at the closing day. They identify which sales contract remained in the WIP. What portion of the sales contract remained in the WIP
* When it comes to the closing WIP valuation of the inventory. EPIC uses the below formula:

**WIP Closing valuation:** Raw material cost for the portion of the sales contract remained in WIP + 50% of the conversion cost\* identified for the sales contract. Or NRV whichever is lower.

**\*Here by Conversion cost**= All the cost related to the production of individual sales contract except raw material cost. (Client will provide detail calculation)

**As an Example:** If we take the below data as example:

One sales contract=10,000 USD for 100 Jeans

Raw material cost for the contract=50,00 USD

Conversion cost=3,000 USD

Let’s suppose, 70 Jeans of that sales contract remained in the WIP, 30 jeans is not yet went into the conversion stage or production is finished. Which means that 70% of that sales contract remained in the WIP

WIP Valuation of that sales contract at closing day will be:

=70% of {5000 USD + (50% of 3000)}

=70% of {5000 USD+ 1500 USD}

=70% of 6,000 USD

= 4200 USD/60 USD per pcs

1. **For Finished goods (FG)**

For all finished goods below process is performed:

* Finish goods closing report is extracted from FGIMS software.
* Each finish goods is identified with the its sales contract
* Sales contract value is identified
* **95%** of the sales contract value is recognised as closing FG valuation.

1. **Direct Cost**

Direct cost generally consist of the following significant items:

* Workers’ wages
* Workers bonus
* Overtime
* Local conveyance
* Fabric shading
* Washing
* Other benefits to workers
* Each worker has a separate bank account, the wages is paid directly to the bank through salary sheet.
* Expenditure is booked in SAP directly.

The whole Salary and wages process is elaborately discussed in Process Note-EPIC-PN-01

1. **Factory Overhead**

For CIPL there is two factory:

* Factory numbe-1: Adamjee EPZ, Narayangonj
* Factory number-2: Dhaka EPZ, Savar

Factory overhead generally consist of the following significant items:

* Repair and maintenance
* Factory rent
* Gas, Electricity and Water
* Depreciation (Building, plant and Machinery)
* Other related cost to factory

Depreciation is charged at straight-line method. Depreciation of factory building and plant and machineries are allocated to Factory overhead.

**Stock Count:**

Physical stock is counted on monthly basis by central finance team to ensure the quantity and report is generated accordingly. Mr. H. M Zahidul Islam, Manager- F&A, counts and check the stock. Mr. Khayer Uddin, DGM, reviews and approves the report**.**

**What could go wrong? :**

1. Inventory may be incorrectly shown due to use of incorrect inventory quantity and rate at year end inventory valuation;
2. Inventory may be recorded in the books of accounts which does not exist in reality;
3. Production material consumed may not be recorded fully or may be recorded over than actual;
4. Factory overhead reported in the financial statement may not be recorded as per actual expense and maybe misallocated.

**Controls applied:**

1. Inventory should be valued at lower of cost and NRV based on the system generated report quantity confirmed on the physical count at the year end. That report is checked and approved by Warehouse Manager. Any adjustment in the accounting record needed is posted based on that report;
2. Physical stock is counted on monthly basis by central finance team to ensure the quantity and report is generated accordingly. Mr. H. M Zahidul Islam, Manager- F&A, counts and check the stock. Mr. Khayer Uddin, DGM, reviews and approves the report.
3. For Production materials consumed-Material cost and Inward Cost, Each raw material purchased and consumed is based on sales contract. Raw materials are purchased based on the requirements of raw materials mentioned in the sales contract. Separate inventory system is maintained to record purchase and consumption of raw materials. After checking PO, invoice, delivery challan a GRN is prepared and that GRN is approved by the Plant finance head. After receiving the approved GRN for raw material purchase, the purchase entry is posted in the system. Purchase voucher is reviewed by Finance Manager and approved by Finance Head/ CFO;
4. Factory-in-charge authorizes, approves and ensures proper allocation of factory overhead and verifies if it is charged at actual.

----------------------------------------------------------END of WP--------------------------------------------------------