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# The Practical Application of the Theory of Accounting for Supplies

By PERCY W. POGSON

He would be a hardy adventurer who attempted to add to the already complete writings on the theory of accounting for what are known in manufacture as supplies or stores, and I hasten to disclaim any such intention.

I would like, however, to discuss the practical application and use of that theoretical knowledge for, to my mind, the question of the proper handling of supplies is one of the important issues before the practising accountant of today. He often finds a perplexing indifference on the part of company officials in this particular which, it is my impression, arises and exists through the tendency to consider supplies once purchased as material objects which have lost their money identity and, until issued for use in manufacture, having no further direct connection with the financial or accounting system. Here is lack of coördination in accounting. If there is to be genuine coöperation between the supply department and the general accounting office those concerned must at all times regard the item of supplies as something representing actual value, and everyone, from the chief clerk in the general office to the warehouse force and supply department manager, must think in terms of money value—not material things. Every amount charged to the supply department should be accounted for, not approximately, but accurately and to the last cent, so that the stock of supplies in the warehouses expressed in terms of money value at all times equals the exact amount shown by the controlling supply accounts in the general books.

This is not impossible, and in fact it is not even difficult. The plan today is working successfully to my own knowledge. The reason exact balancing of perpetual inventories is usually considered difficult or next to impossible is that it has seldom been done in the past.

What is the usual practice? Generally, to take physical inventories once or twice each year, whether or not cards and so-called perpetual inventories have been kept; to list the various articles

on sheets; to price, extend, foot, check and re-check; to arrive at a total and finally to make an adjusting entry, arbitrarily changing the controlling accounts to equal the totals shown by the physical inventories.

Can such physical inventories be correct? Almost without exception, no. To take a physical inventory of any magnitude by count, weight or measurement, and to price and extend it and have it correct would be a fortuity. The time consumed in taking a large supply inventory will run into weeks or even months. The stock is moving continuously during the stock-taking. Generally a large part of the inventorying is done by extra men employed for that purpose who, as a rule, are unfamiliar with the stock descriptions, classifications, standards of measurement, units, etc. Incidentally, the cost of taking such an inventory is no insignificant item.

In keeping proper records of accounts receivable one or more controlling accounts are kept in the general books, supported by an unlimited number of individual accounts in separate ledgers. No accountant would think of balancing the controlling accounts with the totals of the individual ledgers, say once or twice a year, by forcing them and writing off the difference to profit and loss. Yet this is what is generally done with supplies after taking a physical inventory.

In well regulated offices, accounts receivable are balanced exactly with the controlling accounts at least once a month; cash is balanced daily. Is there, as a matter of fact, any real difference between the importance of cash which usually is largely in the form of bank balances—or accounts receivable, the next conversion of which is to cash—or supplies, which finally will be converted, through manufacture and sale, into accounts receivable and cash? All of these are items represented by money on hand due to the company, or paid out for a tangible article, and they should be accounted for scrupulously.

Can supplies be balanced exactly each month, as are accounts receivable? My experience is that they can, but there must be coöperation and coördination between the various departments concerned, combined with a perpetual inventory dealing with money values.

As to a plan of working, I can give only a very general outline in the space at my disposal. Fundamentally, the plan involves

nothing more than the use of any good perpetual inventory system carried to its logical conclusion. No definite plan covering statements and forms suitable to any and all concerns could be recommended or devised. My experience is that, based upon certain set principles of control, the supporting system must be built up gradually, depending upon the particular operating conditions environing an enterprise. Broadly, the plan involves:

- Purchasing records
- Receiving records and stock cards
- Disbursing records and requisitions
- Records of adjustments and corrections
- Inventory records

The purchasing records may be disposed of by stating that they must of necessity include books, documents and files necessary for reference purposes.

The receiving records are of major importance. A columnar record must be kept which shows reference to the purchase order, the date of receipt of the goods, the description and amount of the purchase, the discount if applied against supply stock, the net amount, cost of freights, handling, commissions, etc., and the net total, which total must represent the total net cost of the particular article put in stock.

There must also be shown in the receiving record a description of the number, weight or measurement of the article received, together with the unit used in keeping track of the stock, and a column for card numbers. Finally, there should be a space where a stamp can be used to show the date upon which the stock received was entered on the individual stock cards in the supply department office.

When the article is entered on the stock card the number of the card should be entered in the column provided for that purpose. Care must be taken that no item is stamped in the receiving record as a debit to a card unless the entry is actually made on the card. At the end of the month the total of the total net money column in the receiving record should exactly equal the aggregate amounts charged on the individual cards during the month, and that charged to supply account in the controlling accounts in the general office records. The totals shown in the receiving record should be distributed in an auxiliary record to the general stock classifications and the general classifications can

be further distributed in auxiliary records to such sub-classifications as may be desired.

As to the cards to be kept in the supply department office, almost any standard form can be used, providing the card shows quantity, unit price and amount in debit, credit and balance.

In order to facilitate the constant checking and correcting of actual physical inventories with the quantities and amounts shown by the cards, it is a good plan, where feasible, to keep another set of cards in the warehouse showing quantity only, debit, credit and net. Where these auxiliary "quantity only" cards are kept it is possible for the warehousemen to constantly check the warehouse cards against the actual stocks during their spare time. When this is done a stamp may be used which shows the date they are checked and corrected. At the end of each day, corrected quantity cards with memoranda of corrections should be turned in to the warehouse office for comparison and correction of the quantity money cards.

In order to keep a correct perpetual inventory it is necessary to work almost constantly on a comparison of the cards with the stock. Stocks containing articles such as small tools and electrical supplies, etc., which might possibly be pilfered or used without requisition, should be gone over and compared with the cards, say once a month. Other fast moving stocks, say at least once in three months. Slow moving stocks or large articles, say two or three times a year. And stocks of any kind when entered on a replacement memorandum for reordering.

If any differences are developed they must be run down immediately, but in practice there should be no differences, for everyone should bear in mind that this is not supplies they are handling but money, which has been charged to the department and which must be accounted for in full. However, it sometimes develops that during a rush or emergency, or on night shifts, some particular article is required immediately to keep a machine or plant in operation, and it may be taken from outside stock without filing a requisition. The constant checking of the inventories will disclose any such discrepancy before the circumstances have been forgotten and generally, instead of having a shortage to write off to profit and loss, it develops that the necessary adjustment can be made by charging some department with the cost of a definite article used in operations.

All differences which cannot be charged definitely to any department should be listed on an adjustment sheet and an effort should be made at once to find out what has become of articles short. Often it will be found that where an article is short, some similar article, or the same article in a different size, is over. In this case there is no shortage, but immediately an adjustment should be made to take up any price difference.

As the various small adjustments and corrections are entered on the adjustment sheet in the supply department office, the individual items and corrections must be applied at once to the cards representing these items. At the end of the month the adjustment sheet should go to the general office with all necessary explanations on each item, and after authorization, the net of the adjustments should be charged or credited to the supply department through the controlling account and an account on the general books called Supplies "Over and Short."

In disbursing supplies, on no account may any article be released from stock without a requisition from some official or department head with authority to sign an order. Requisitions as filled should be numbered by a duplicating stamp commencing a fresh series of numbers each day, the duplicate numbers being stamped on a daily issue sheet, the latter showing briefly requisition number, ordering name, description and quantity. This sheet is used as a check against the possibility of loss of any requisition after it has once been filled at the warehouse.

Requisitions should show the signature of the official ordering, the account number to which chargeable, the article required and the quantity, for what purpose ordered, to whom delivered and by whom the order was delivered. Space should be left on the requisition blank to be filled in in the warehouse, showing stock number and quantity delivered, and in the warehouse office showing quantity, price and money value.

All requisitions should go to the warehouse office daily to be posted in a columnar record showing the various charge account numbers and total, this record to fit into the financial divisions and cost divisions of the general accounts. The requisitions should then be posted to the stock classifications and sub-classifications to correspond with the classifications kept as part of the receiving records.

The daily totals by charge accounts and classifications should be summarized daily to group results for the month, and monthly for the year. Requisitions should be posted to warehouse quantity cards and to the warehouse office quantity, price and amount cards, and filed for ready reference. At the end of the month the total for the month of the total column in the disbursing record, supported by a summary of the division of disbursements for cost and financial purposes, should go to the general office, and the controlling supply account in the general books be relieved of the value of the total supplies disbursed for the month.

As an aid in keeping track of stock and in order to lessen the chance of error upon the part of new employes and those unfamiliar with all of the various articles, it is a good plan to have every article in stock carry or be represented by a stock number, and every card a corresponding stock number. The stock number should appear on the bins, compartments or shelf divisions, as the case may be. On large articles in outside or yard stock the numbers may be lettered on with paint.

Reference should be made to this number wherever possible on requisition blanks, posting records, etc., as this tends to eliminate the chance of error and assists in the correction of errors should they occur.

In my opinion, it is better to use an average unit price in crediting the cards for articles issued instead of the plan sometimes used of first in first out, and when goods are received at a price at variance with the old stock on hand, the unit price on the card should be immediately corrected to the average.

Cards must be compared with actual stock at reasonable periods as outlined; and corrections should be made on the cards immediately any discrepancy is discovered.

The net of all corrections should be taken up through the controlling accounts by entry supported by all necessary data, at the end of each month. Inasmuch as, under this plan, all cards are at all times represented by actual physical stock on hand, an accurate inventory may quickly be determined at any time by totaling the cards. If the clerical and accounting work has been done correctly, the total of the cards will, at the end of any month, equal the totals of the controlling accounts. Under this plan a semi-annual or annual physical inventory is not necessary, as the controlling accounts represent the true value of the physical stock of supplies.

Groups of card numbers and corresponding stock numbers should represent classifications and sub-divisions of stock, and interesting comparisons of the various classes of stock may readily be furnished of inventories, purchases, disbursements and turn-overs, if an accurate working basis is once arrived at.

After the various stocks have been segregated into classifications, further divisions should be made into fast moving, slow moving, surplus and obsolete stock and when the surplus and obsolete stock have been determined, colored cards, or some such distinguishing method of identification, may be used to call attention to these items, and from these records lists of surplus and obsolete stock may be sent out if desired, offering the excess stock for sale.

Once the excess stock is reduced, if the plan of ordering based only on actual requirements is followed, there should be no further accumulation, except of small amounts from time to time as certain operations or types of machines are abandoned. If this does happen, then the supplies affected should immediately be thrown to the obsolete stock division and steps taken to realize on this obsolete stock in some manner and at some price. In any event, the obsolete material should be moved out of active stock and carried at salvage or nominal value, depending upon the possibilities of disposal.

An important help in the accounting for, as well as the successful handling of, a supply stock is the arrangement of the stock itself. It must be kept in perfect order and so arranged that comparison may be made with the cards with little effort and time. This calls for considerable ingenuity and skill in stock arrangement, classification and indexing, and necessarily one of the chief elements leading to success is a really good supply manager. No real results can be obtained and the plan as a whole carried to a successful conclusion if those in charge of supplies are not really interested in their work and coöperating to the fullest extent with the accounting department.

The success of an enterprise depends to a large degree upon continuous operations, therefore a stock must at all times be carried which will obviate the possibility of a shutdown through lack of supplies. For this reason, without accurate consumption records the tendency is to overstock. Proper consumption records not only guard against the possibility of a shortage, but at all



times indicate to those interested the actual necessary stock which will give adequate protection against shortages and at the same time keep the supplies reduced to a safe operating minimum.

A record of previous years' operations on each stock should be kept in a columnar book by years, showing units used, noting any abnormal conditions arising through extra material used on special work, etc. From this record should be established a fair minimum and maximum quantity necessary for a given period, and from these results there should be determined a safe minimum and sufficient maximum stock to carry, dependent upon the proximity to markets from which supplies may be obtained. Minimum and maximum requirements should be marked on each supply stock card, and when issues reduce that particular stock to or below the minimum stock necessary, the card should immediately be compared with the actual remaining stock on hand and a replacement memorandum turned in to the supply department office, showing that the stock has been checked with the card and the amount of stock on hand, and indicating the necessary further amount required to properly restock. The replacement memorandum should at once go to those in charge of orders for purchase.

Where there is a lack of proper supply records relating to minimum and maximum requirements, and where no perpetual inventories are kept, there is generally waste and unnecessary expense—waste through the gradual accumulation of obsolete stock which must eventually be written off as a loss—loss through inventory shortages arising from pilfering or misplacement of small articles—inaccurate costs of manufacturing through direct charges to profit and loss at the end of a period represented by supplies used in operations and actually applicable to costs, but through error not charged direct to costs at the time of issue—interest charges or the equivalent on working capital tied up in excess supply stocks—expense of continued handling and re-handling excess stock and insurance and taxes on the value thereof—cost of unnecessary warehouse space, etc.—expense of taking the semi-annual or annual physical inventory.

The plan of an extra set of quantity stock cards used in the warehouse, as outlined in this article, might not be good for all companies. With a comparatively small stock the warehousemen are able to keep the stock in order and the cards checked up at

such times as they are not filling requisitions. In the case of a much larger stock it might be better to appoint a supply auditor, part of whose duties would be, with such assistants as might be necessary, to keep the stock in order and the quantity money cards in the supply department office checked up with the actual stocks on hand. Even if this latter plan were used, I think it a good idea to have some sort of quantity card record at each bin, or source of distribution, as the cards tend to remind the warehousemen of the conditions of the various stocks.

The plan of actually balancing the cards against the controlling accounts may be successfully applied to almost any business. A wholesale house I happen to know of, with four distributing warehouses in different localities, carries approximately 3,000 articles in each stock. The 12,000 cards representing these articles are kept at the main office. A stock auditor checks each item in each stock monthly and the results are at once forwarded to the general office for comparison with the cards. The differences are practically nil, for the stocks are assumed to represent money values for which the warehouse managers are held responsible. Two clerks do all the posting and work in relation to the keeping of the cards and supporting records, and balance the cards monthly. The system has been in use for three years and the cards have balanced exactly to the controlling accounts at the end of each month during that period.

The inventory and receiving and disbursing records of this company are in such shape that it is possible to purchase for the future with little danger of overstocking, and each month any stock which does not appear to be moving right is drawn off and listed and such instructions are sent to the salesmen as will tend to immediately move the stock.

At the beginning of each six months' period, a ratio of gross profit and desired turnover is established and the company is able to take full financial advantage of its perfect inventory records.

In the foregoing I have purposely kept away from the technical phases of my subject. Practising accountants of today thoroughly understand the working elements involved in any inventory system, although it is my belief that most of us are not nearly so well fitted to devise the detailed operating part of a system as are those who actually work on or are in charge of it.

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It is not my idea to advocate any particular system but rather to point out one of the apparent weak phases in accounting in modern business—the laxity in methods of handling supplies and materials.

It appears to me that in this matter of supplies there is a chance for real constructive work upon the part of accountants—not so much in the preparation of the forms and the working out of the technical details of supply systems as in originating and advocating constructive ideas and working gradually and persistently towards gathering up the loose ends and making a compact whole so that the clerical work is proven and true results obtained.