For the purchase of consumption materials are: 1.

For accounting purpose, purchasing of capital equipment is considered as a fixed asset, to be capitalised and depreciated over the period of economic life of the equipment. The purchase of capital equipment is usually differentiated both in procedures and policies from the purchase of consumption materials mainly because of the nature of large investment over a long duration. Purchase of Capital Equipment Vs Purchase of Production Materials & Supplies: The purchase of capital equipment usually occurs once in ten or fifteen years and the significant differences in the purchase of major equipments from the purchase of consumption materials are: 1. Nature and size of expenditure 2. Lead time requirement 3.

Availability of sources 4. Non recurring purchases 5. Size of the expenditure 6. Extent of negotiation.

1.

Nature and size of expenditure:

An expenditure of company funds for capital equipment is an ‘ investment’. If purchased wisely and operated efficiently, capital equipments generate profits for its owner. Because it exerts a direct influence on the costs of production, the selection of major capital equipment is a matter of significant concern to top management. Although capital equipment prices cover a wide range, the purchase of most major equipments involves the expenditure of the substantial sum of money. The purchase price for a piece of equipment, however, is frequently over-shadowed in importance by other elements of cost. Since, a machine is often used for ten years or more, total cost of operation and maintenance during its life time may far exceed its initial cost.

Hence, the ultimate (or total life) cost of a machine, relative to its productivity, is the cost factor of primary importance.

Estimating operating and maintenance costs which will be incurred in future years is not easy. Frequently these costs vary from year to year. Consequently, discussions involving the choice among several alternative machines often centre on the probable accuracy of specific cost estimates. The timing of many capital purchases often presents a paradoxical situation. Typically, the general supply capabilities of capital investment manufacturers do not adjust quickly to changes in levels of demand. Thus, because capital equipment purchases are made infrequently and can often be postponed, manufacturers of industrial capital goods frequently find themselves in a ‘ feast or famine’ type of business. When a purchaser’s business is good, he needs additional production equipment to satisfy his customers burgeoning demands.

But because other purchasers are in the same situation, he also finds capital equipment prices rising in a market of short supply. Conversely, when his business is poor and he does not need additional production equipment, capital equipment is in plentiful supply, often at reduced prices.

2. Lead time requirement:

A unique feature in the purchase of capital equipment is the lead time required for its supply. Though very few types of equipment are standardised, most of the major equipments are custom built and require sufficient lead time for the suppliers to fabricate or manufacture and deliver.

3. Availability of sources:

Since many of the requirements of major equipment are specific and typical for different types of industries, the number of suppliers available is also very few and the organisation has to decide carefully a number of factors.

4. Non recurring purchases:

The purchase of a particular piece of capital equipment typically occurs only once every five to twenty years. For example, one buyer recently purchased a unique high-temperature electric furnace for use in his company's research and development laboratory.

Since, the furnace is used only periodically for experimental work, it is very likely that another purchase of this kind of equipment will not be made for the next twenty years. On the other hand, a few industrial operations require the use of many identical machines in the production process. For example, in petroleum and chemical processing plants, the product is transported by pipe line throughout most of the production operation. This requires dozens, at times hundreds of similar pumps which vary only in size and minor details of construction.

To keep capital expenditures at a fairly uniform level from year to year and to minimise maintenance costs, pumps are often replaced on a continuing basis rather than all at once. Although it is relatively uncommon, this type of capital equipment purchase assumes some of the characteristics of conventional production purchasing. A unique feature of many capital equipment purchases is the lead time requirement. While some types of capital equipments are standard off – the shelf products, most are not. Much production machinery and prime moving equipments are built (at least in part) to operate under specific conditions peculiar to each purchaser’s operation. Consequently, manufacturing lead time is usually a matter of months or years.

The production of a large steam turbine, for example, may require negotiating and expediting work substantially different from that normally required in production purchasing.

5. Size of the expenditure:

This is the major consideration as the organisation would have to invest large amount over a long duration. Moreover, the equipment directly influences the manufacturing operations of the organisation. It is natural that the purchasing of major equipment is a matter of significant concern to the top management.

6. Extent of negotiation:

Purchase of major equipment is a result of careful negotiations and analysis of various alternatives available to an organisation. The number of contacts and discussions with the vendors will be much greater compared to those for the purchase of consumption materials.