CHAPTER I

INTRODUCTION

A. Background of Study

The existence of company has important role to be able to provide society's needs such as consumption needs. The company runs the business operation, and then distributes the finished goods to the customers; the customers may be distributors, wholesalers, retailers, or consumers, depending on the circumstances. Thus, it creates the position of company to be very vital in society life because the company provides anything that customer need in order to the customers do not feel difficulty to find out everything. Because of those, it encourages for the company to give much attention in keeping the business operation in order to the business activities can running well. One of way to keep the smoothness of business activities is keeping the safeguard of inventory.

Inventory safeguarding is very important thing in the company. It can be conducted by controlling the activity related to inventory. Muller (2003:1) stated that all organizations keep inventory. Inventory includes a company's raw materials; work in process, supplies used in operations, and finished goods. Some companies will also have a number of inventories where raw material, partially converted, and finished goods are held. Raw material is transferred from one stock point to another by means of an operation. An operation transforms one inventory item into another, either by changing it physically, by assembling it with others, or by moving it (as form a place to a field warehouse). If a manager controls these

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types of inventory effectively, production can be improved and protect against overloading and theft.

Raw material is one of inventory types. Raw materials inventory is so important to the production process which is one of the success key in a business operation can be determined by the amount of natural resources that company provides in the business cycle. Raw material inventory is the total amount of goods a business has on hand at a given time. It is a vital asset that keeps business can run smoothly. In manufacturing, a substantial of raw material inventory must be available to ensure production stays on time in order to it can satisfy the market demand. This is why manufacturing companies implement raw material inventory procedure to control raw material levels to where demand can still be met.

The implementation of raw material inventory procedure in a company is very important because raw material inventory as a company's good on hand, which is often a significant current asset. In many organizations, inventory is more easily accessible than cash; therefore it can become a favorite target for thieves (Horngren et al, 2006:309). The implementation of raw material inventory procedure is critical to maintain accurate, reliable numbers for operation so it is required an internal control by separating the functions in conducting the activities during procedure of raw material which it can be recorded by issuing the document. Raw material inventory procedure should be conducted by some related functions, such as purchasing function, receiving function, and storage function. Those functions have to stand alone so that there is no overlapping and avoid the fraudulence.

Internal control has an important contribution to the continuity of business, because implementing internal control help guiding the behavior of employees toward company objectives. "One of the key aspects of systems analysis, design, and implementation is a business's internal control" (Warren, Fess, and Reeve, 1996:166) so it is expected that internal control can prevent loss of resources, provide information about how business is performing, and help guide it in the planned direction. Details of a system of internal control will change according to the size and type of business. In a small business, it is possible for the manager to personally supervise the employees and to direct the affairs of the business. However, as the number of employees and the complexities of a business operation increase, it becomes more difficult for management to maintain control over all stages of operations. In growing of the company, management finds the necessary to delegate authority and to place more reliance on the accounting system in controlling operations.

An internal control on raw material inventory procedure is provided to ensure that a company has sufficient resources to meet its customers' needs without having too many goods. The company should store raw material inventory in secure spacious warehouses so that raw material inventory is not stolen or damaged. This process is affected by the company's structure, its employees, and its informational systems. Since a company's raw material inventory is directly tied to the business's ability to generate profit, the internal controls must be comprehensive and require significant thought when being designed. According to Boundless (2013:236), detail physical inventory counts

are a way of ensuring that a raw material inventory management system is accurate and as a check to provide sure goods are not being lost or stolen. A physical count of a company's entire raw material inventory is generally taken prior to the issuance of a company's balance sheet.

The importance of raw material inventory procedure has been considered by many parties, especially for Manufacturing Company that always require amount of raw materials in the production process. Also, at any point in time there may be goods at various stages of completion. Finally, certain quantities of finished goods may have to be stored until they are sold. As a company grows, not a few of raw material inventory is required so it encourages the controlling of raw material inventory in order to prevent out of stock or loss of some raw materials. One of the manufacturing companies that directly related to the raw material inventory is sugar factory. This is because commonly the sugarcane as a main raw material in this company comes from agricultural sector. Many amounts of sugarcane are required by company in order to the standard amount of sugarcane that is determined by company and management office can be achieved. The receiving of sugarcanes must be conducted by involved person to record and check off the condition of goods regarding the requirement that company provides.

PG Ngadiredjo is one of the business units of PT Perkebunan Nusantara X (Persero) in East Java is engaged in an attempt to manage the production of raw material to the main output. PG Ngadiredjo located in Desa Jambean Kras-Kediri. As one of the oldest sugar company in Indonesia, PG Ngadiredjo has been

established in 1912 by the Dutch Private Company NV HVA (Handels Verniging Amsterdam). When the milling season, PG Ngadiredjo requires many sugarcanes to run the production process in order to the company can fulfill the market demand. According to detiknews.com (2012), PG Ngadiredjo can reach 63,325 tons of sugar by the number of sugarcane used 751,527 tons per September 15, 2012 which the starting milled on May 3, 2012. The company needs a lot of sugarcane as raw material to run the production during milling season and finally it brought the PG Ngadiredjo in 2012 as the highest of *rendemen* (sugar-content) with reached 8, 69 percent in BUMN sector.

The company uses the tight procedure in supplying the raw material inventory in order to the raw material received by company has high quality in finding out a good quality for the final product (sugar). The procedure that has been applied by PG Ngadiredjo is very tight, because all of procedure in raw material supplying has been designed well which is consist of some document used have recorded all of activities that has been conducted during raw material inventory procedure and related functions that have conducted for each responsibility well. Based on the information that is provided from an employee in PG Ngadiredjo, the standard amount of sugarcane that should be supplied by company during milling season is 10.000.000 quintal. But based on the detiknews.com (2012), PG Ngadiredjo provides 751.527 tons in 2012. Thus, there is a variance that can be achieved between standard amount and real amount. In raw material inventory procedure, there is no purchasing function but the company applies a production sharing system between the company and farmers.

PG Ngadiredjo has two sources of raw material inventory, sugarcanes from PG Ngadiredjo own land and society land which is called *Tebu Sendiri (TS)* and *Tebu Rakyat (TR)*. In procedure of raw material inventory from *Tebu Sendiri (TS)* source, planting activities until felling and shipping section will be conducted and organized by related function in PG Ngadiredjo. Initially, PG Ngadiredjo will inform to management office in Surabaya by making a planning of cost estimation for every requirement that is required by company. After the requirement has been received by company from management office, it will be distributed to every region. For the sugarcanes that come from society land, PG Ngadiredjo provides two systems, credit and non credit. In *Tebu Rakyat (TR)* without provides credit system, company does not provide a loan for farmer in sugarcanes planting whereas in *Tebu Rakyat (TR)* with provides credit system, the company provides a loan for the farmer to plant the sugarcanes until felling and shipping section.

PG Ngadiredjo issues the contract number for the farmer who enrolls the land to the company. It is realized to facilitate for the PG Ngadiredjo controls the sugarcane supplying in which PG Ngadiredjo has standard amount of sugarcane that must be supplied so the existence of the contract in every land will help for the company related with the average amount of sugarcanes that will be received by company. After first procedure of raw material inventory from *TS* and *TR* has been finished, some of people from plants department who has been placed in every region will realize the duty to control and check the condition of sugarcane land in certain time. In controlling and checking the sugarcane land, the field functionary will check the sugarcanes condition and check everything that has

been conducted (i.e., hide away of stalk; peel the old leaf, etc.). After attain the age of ninth or tenth month, the quality control department will conduct the maturity analysis to check some aspect related with the condition of sugarcanes. Besides that, the measurement result will be used to decide the schedule of felling and shipping.

The schedule of felling and shipping has been made; it is a base to create the instruction letter of felling and shipping. When the felling section ends, the sugarcanes will be shipped to the company and will be checked in receiving post. After checked, the sugarcanes will be weighed in weighing post to know the amount of sugarcane that have been received and then will be delivered to production process. The implementation of raw material inventory procedure at PG Ngadiredjo is very supporting on internal control because there are many related functions that engage in this procedure from sugarcane supplying until receiving in order to find out the amount of sugarcane that is expected and accurate proof which it can be seen from the issuing of some documents that is managed by different people to control the activities during the sugarcane supplying and receiving. Based on above explanations, the researcher would like to provide a research entitled "**ANALYZING THE IMPLEMENTATION OF RAW MATERIAL INVENTORY PROCEDURE IN SUPPORTING THE EFFECTIVENESS OF INTERNAL CONTROL (Study at PG Ngadiredjo Kras - Kediri)**".

B. Problems of Study

Based on the background stated previously, the problems of this study are:

1. How is the implementation of raw material inventory procedure that has been applied by PG Ngadiredjo Kras - Kediri?

2. How is the implementation of raw material inventory procedure in supporting the effectiveness of internal control that is conducted by PG Ngadiredjo Kras - Kediri?

C. Research Objectives

Based on the problems of study, the objectives of this study are mentioned as follows:

1. Understanding, describing, and analyzing the implementation of raw material inventory procedure that has been applied by PG Ngadiredjo Kras - Kediri.

2. Understanding, analyzing, and describing the implementation of raw material inventory procedure in supporting the effectiveness of internal control that is conducted by PG Ngadiredjo Kras - Kediri.

D. Research Contributions

This study intends to have following contributions:

1. Academic

This research is purposed to give a contribution for the next researcher to give general understanding in science and knowledge especially about implementation of raw material inventory procedures.

2. Practical

This study is aimed to give a contribution for PG Ngadiredjo Kras - Kediri in the implementation of raw material inventory procedure in supporting the effectiveness of internal control.

E. **Parts of Discussion**

The arrangement of the parts of discussion meant to provide the scientific paper detailer, clearer, and understandable on how the content of the scientific paper itself. The figure of the whole basic of the undergraduate thesis content can be explained shortly into five chapters.

Chapter 1	**: Introduction**

This chapter explains about the case or the matter which become a background of study of the writer doing the research, objectives and also the contributions of the research. Besides that, the writer also serves the problems of the study to bind the focus of the research.

Chapter II : **Theoretical Framework**

This chapter contains of theoretical framework that related with the basic of problems. The theories and references will be used as analysis tool of the research problems.

Chapter III : **Research Method**

This chapter explains on how the research is conducted, as well as functioned as guidance of research and analysis.

This chapter will discuss about the type of research, research focus, research location, and source of data, data collecting technique, research instrument, and data analysis.

Chapter IV **: Result and Analysis**

This chapter contains research data and analysis result of the research method. In addition, it describes about the interpretation of the research result.

Chapter V **: Conclusion and Recommendations**

This chapter is the last part of study, which concludes the research result and provides some suggestions.