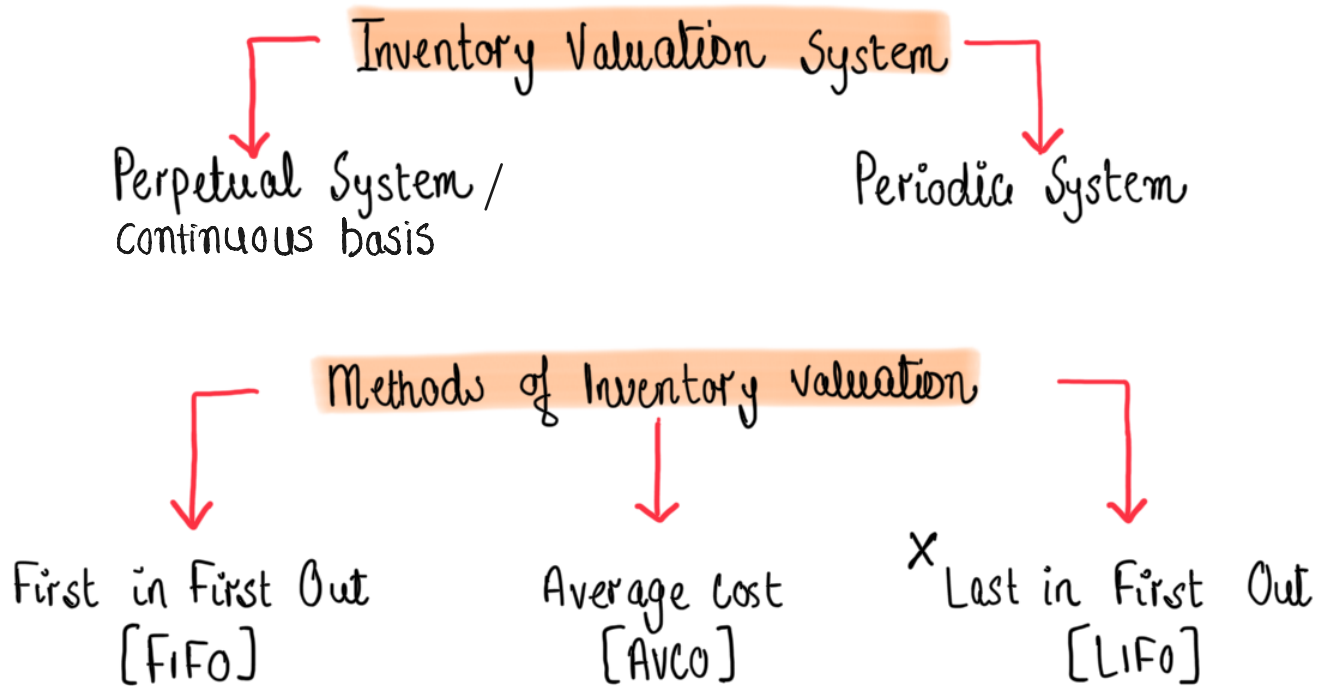


# Topic 13



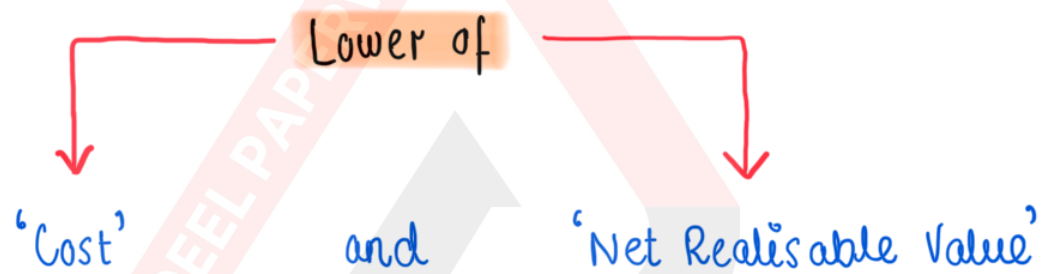
# Inventory valuation

# INVENTORY VALUATION [IAS 2]



Intro:

As per IAS 2 and prudence concept inventory is valued at:



**Cost** means the purchase price of an inventory and includes all expenses incurred in making the goods ready and available for sale.

Components to be included in cost price of inventory:

[Trading Business]

1. Amount paid to suppliers of goods, i.e.: List Price - Trade Discount
2. Carriage and transportation costs incurred in bringing the goods to the business warehouse.
3. Import duty / custom duty paid
4. freight charges.
5. Remaking or packaging costs.

All these cost are one time cost and non recurring.

[Manufacturing Business]

1. Direct material
2. Direct labour
3. Factory overheads.

Inventory: It means the leftover/unsold goods held by the business on a certain date.

Valuation: It means measurement or estimation of the worth of the inventory



## Net Realisable Value

The market value of goods.

$$\text{Net Realisable Value} = \text{Expected selling price} - \text{Expected Selling Expense.}$$

### Example # 1

The following details relating to inventory is given. Calculate the total value of inventory to be included in final accounts.

Product	A	B	C	D	E
Cost	10	15	18	26	34
Selling Price	15	18	20	22	30
Selling Expense	2	3	1	2	1
N.R.V	13	15	19	20	29
Inventory to be valued at	10	15	18	20	29

	\$
A =	10
B =	15
C =	18
D =	20
E =	<u>29</u>
	<u>92</u>

### Example # 2

At the end of financial year inventory was valued at cost of \$60,000. Later it was discovered that included in inventory valuation are 6 units which each cost \$220 and normally sells for \$350 each. They are now damaged and can only be sold for \$250 each after incurring total repair cost of \$400. Calculate the value of inventory.

### Solution

$$\text{Cost of damaged units} = \$220 \times 6 = \$1320$$

$$\begin{aligned}\text{Net Realisable Value} &= \text{Expected selling price} - \text{Expected Selling Expense.} \\ &= [\$250 \times 6] - \$400 \\ &= \$1100\end{aligned}$$

$$\begin{aligned}\text{Value of Inventory} &= 60,000 + 1,100 - 1,320 \\ &= \$59,780\end{aligned}$$

### Example #3

A business financial year ended on 31<sup>st</sup> December, 2018. The accountant was away sick and therefore inventory valuation took place on 5<sup>th</sup> January, 2019 and on that date, inventory was valued at \$62,000. Transactions from 31<sup>st</sup> Dec - 5<sup>th</sup> Jan are as follows:

	₹
1. Sales	9,900
2. Purchases	14,000
3. Sales Returns	6,600
4. Purchase Returns	5,000
5. Goods withdrawn for personal use	560

Sales and sales returns are given at selling price which is cost plus markup of 25%. Prepare a statement showing the value of inventory on 31<sup>st</sup> December, 2018.  
20% margin.

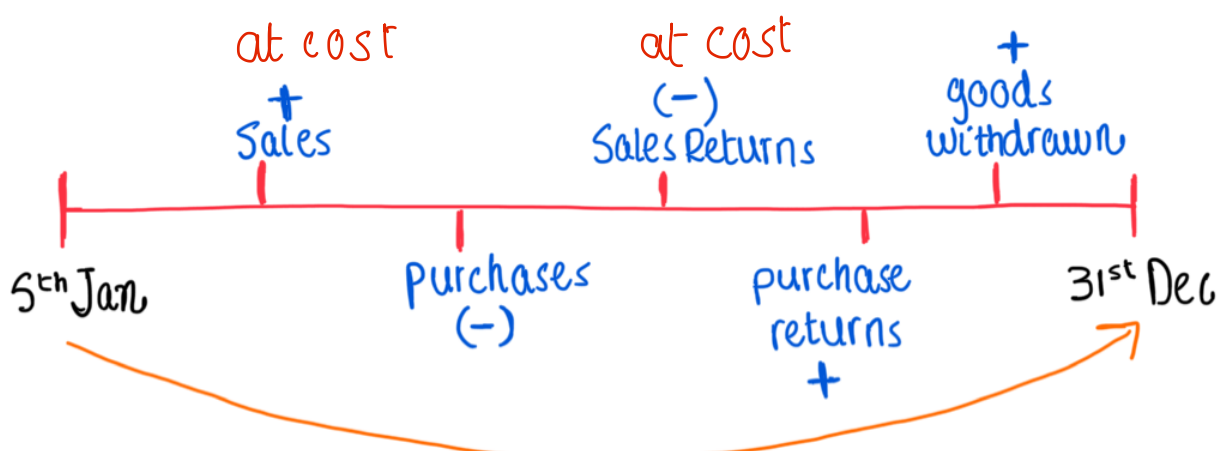
### Working

$$\frac{\text{Sales}}{125\%} = \text{cost} \rightarrow \frac{9900}{125\%} = \$7,920 \text{ value of goods sold on cost price.}$$

$$\frac{6600}{125\%} = \$5,280 \text{ sales returns on cost price.}$$

### Solution

	\$
Inventory at valuation on 5 <sup>th</sup> Jan.	62,000
+ Sales (at cost)	7,920
(-) Purchases	(14,000)
(-) Sales returns (at cost)	(5,280)
+ purchase returns	5,000
+ goods withdrawn	<u>560</u>
Inventory at valuation on 31 <sup>st</sup> Dec.	<u><u>56,200</u></u>



## Perpetual Inventory Valuation System

Under this inventory valuation system, inventory records are updated after every sale and purchase transaction, that means the inventory is updated on continuous basis.

## Periodic Inventory Valuation System

Under this system of inventory valuation, inventory is counted or valued at the end of period (e.g.: week, month, year) rather than on continuous basis.

## Methods of Inventory Valuation

As per IAS 2 inventory can be valued at under FIFO and AVCO. A business entity cannot follow LIFO method of inventory valuation.

### FIFO - First in First Out

Under this method of inventory valuation, it is assumed that inventory purchased first will be sold first and the left over inventory will always be the one purchased at the latest.

**Disadv** In times of rising prices, inventory valuation under FIFO gives a higher value of inventory leading to reduction in cost of sales and higher gross profit which leads to higher taxation.

### AVCO - Average Cost of Inventory

Under this method of inventory valuation, items are not valued at different costs rather the inventories are valued at average valuation which is calculated as follows:•

$$\text{Weightage average rate} = \frac{\text{value of opening inventory} + \text{value of purchases}}{\text{units of opening inventory} + \text{units of purchases}}$$

## Example

The following details are given relating to inventory:

✓ 1 Jan	200 units at cost @ \$5/unit	→ 200 × \$5 = \$1000	opening inventory
✓ 10 Jan	purchased 300 units @ \$7/unit	→ 300 × \$7 = \$2100	
✓ 15 Jan	sold 360 units @ \$20/unit	- Selling Price	360 × \$20 = \$7200
✓ 18 Jan	purchased 500 units @ \$10/unit	→ 500 × \$10 = \$5000	
✓ 21 Jan	sold 420 units @ \$20/unit	- Selling Price	420 × \$20 = \$8400
✓ 25 Jan	purchased 200 units @ \$13/unit	→ 200 × \$13 = \$2600	
✓ 28 Jan	sold 150 units @ \$20/unit	- Selling Price	150 × \$20 = \$3000
✓ 31 Jan	purchased 50 units @ \$15/unit	→ 50 × \$15 = \$750	
		<u>units 1050</u>	<u>purchases 10450</u>
			<u>Sales 18600</u>

\* Calculate closing inventory under FIFO and AVCO methods using both perpetual and periodic systems.

### FIFO - Perpetual



Date	Purchases		Sales/Issue		Balance		Value (\$)
	Quantity	Rate (\$)	Quantity	Rate (\$)	Quantity	Rate (\$)	
1 Jan	-	-	-	-	200	5	1000
10 Jan	300	7	-	-	200	5	1000
					300	7	3100
15 Jan	-	-	200	5	140	7	980
			160	7	140	7	980
18 Jan	500	10	-	-	140	7	980
					500	10	5980
21 Jan	-	-	140	7	220	10	2200
			280	10	220	10	2200
25 Jan	200	13	-	-	220	10	2200
					200	13	4800
28 Jan	-	-	150	10	70	10	700
					200	13	3300
31 Jan	50	15	-	-	70	10	700
					200	13	2600
					50	15	4050
							closing inv

**Note:** In inventory sheet sale and purchases will be recorded at cost price and selling price will be ignored.

## Income Statement - FIFO Perpetual

	\$	\$
Sales [ 360 + 420 + 150 = 930 units x \$20 ]		18600

### (-) Cost of Sales

opening inv. [ 200 units x \$5 ]	1000	
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+ purchases	10450	
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(-) closing inv.	(4050)	(7400)
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Gross profit		<u>11200</u>
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Note: In income statement sales will be recorded at selling price.

ADEEL PAPERWALA

# INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

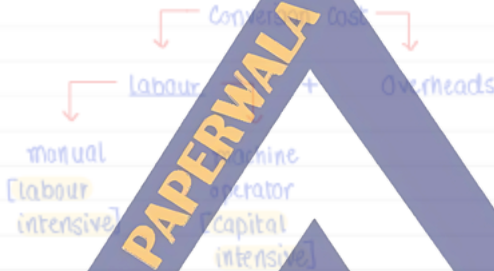
Cost/Expense: Outflow of resources.

# For full content

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Stages of Manufacturing

1. Input [raw material] → 2. Process → 3. Output [finished goods]



Labour intensive business: Business organisations dependant on manual labour rather than technology or machinery.

Capital intensive business: Business organisations which are more dependant on machines rather than manual labour.