Valuation of Inventories

Different Techniques for ascertaining Cost of Inventories

Historical Cost Methods	Other Methods
1. **First–In–First–Out (FIFO)** 2. **Last–In–First–Out (LIFO)** 3. **Simple Average Cost** 4. **Weighted Average Cost (WAC)** 5. Base Stock	1. **Adjusted Selling Price or Retail Inventory Method** 2. **Standard Cost**

Notes:

Though different techniques / formula are described above, AS–2 recognises the use of First–In–First–Out (FIFO), or Weighted Average Cost (WAC) methods only.

Periodic Inventory System and Perpetual Inventory System

Inventory System refers to – (a) system of recording receipts and issues of inventory, and physical counting of actual stock available at the period end and (c) comparing physical stock as per books and records to ascertain discrepancies if any.

There are two broad Inventory Systems – (1) Periodic Inventory System, and (2) Perpetual Inventory System. The salient features / differences between these two methods are –

Particulars	Periodic Inventory System	Perpetual Inventory System
1. **Meaning**	This involves ascertaining inventory value by actual physical count. It is also called as Physical Inventory System.	This involves ascertaining inventory value by keeping uptodate records and ascertaining the value from such Books and Records.
2. **COGS**	Cost of Goods Sold (COGS) = Opening Inventory (known from Books) + Purchases during the year (known) – Closing Inventory (by **physical count**)	Cost of Goods Sold (COGS) is determined from the books, since each receipt and issue of materials is recorded on an immediate basis.
3. **COGS vs Stock**	This system determines Inventory Value, and calculates COGS as balancing figure.	This system determines COGS for every issue and determines Inventory / Stock Value as balancing figure.
4. **Treat–ment of Loss**	COGS includes loss of goods, as goods not in stock are assumed to be sold.	Closing Inventory includes loss of goods as all unsold goods are assumed to be in Inventory.
5. **Stock Taking**	Stock Verification takes place at the end of a financial period, say a year.	Stocks are verified at regular intervals in the year. Since Stock–Taking takes place regularly, it is called Continuous stock–taking.
6. **Coverage in Stock Taking**	All items of Stocks are covered in a single stretch of verification, say over two or three days.	In each verification, two or three items are covered on random basis. In the entire period, all items are covered on rotation basis.
7. **Effect on work**	Regular stores procedures like materials receipts, issues, etc. may have to be stopped to facilitate stock–taking.	There is no interference with regular work flow.
8. **Control**	Discrepancies can be known only at the end of the period. Responsibility cannot be easily fixed.	Discrepancies are ascertained immediately in order to take corrective action and avoid recurrence.
9. **Records**	Inventory Records may be updated periodically, say weekly or monthly, infact, at any time before physical verification.	Due to surprise element involved, Inventory records must be maintained up–to–date at all times. Such records are called **Perpetual Inventory Records**.
10. **Posting**	Transactions can be accumulated and posted, e.g. all receipts and issues during a week, etc. So, **Batch Posting** is possible.	Each transaction should be posted individually. **Transaction Posting** (not Batch Posting) is required.
11. **Cost**	This is simple and **less costly** method.	This is a relatively **costly** method.
12. **Interim Results**	This does not facilitate or help the quick compilation of interim or final financial results.	Provides stock figures on real–time basis. Hence final accounts and Interim Results can be prepared easily.

Verification of Stock on other than Balance Sheet date

Generally, Physical Stock Verification and Valuation is done at the end of the last day of the accounting year. Sometimes, in big organizations, it may not be possible to verify the stocks exactly on the last date of the accounting period. In such cases, stock is taken either few days earlier or later, according to the situation. The following adjustments are carried out in order to arrive at the Stock Value on the Balance Sheet date –

1. **Stock Taking after Balance Sheet date**	2. **Stock Taking before Balance Sheet date**
Value of Stocks on verification date (e.g. 6th April)	Value of Stocks on verification date (e.g. 25th March)
(+) Cost of Sales made during the interim period	(+) Purchases made during the interim period
(+) Purchase Returns during the interim period	(+) Sales Returns (at Cost Price) during the period
(–)Purchases made during the interim period	(–)Cost of Sales made during the interim period
(–) Sales Returns (at Cost Price) during the period	(–)Purchase Returns during the interim period
Value of Stocks on Balance Sheet date, i.e. 31st March	Value of Stocks on Balance Sheet date, i.e. 31st March