CHAPTER INVENTORIES (TOPPERS INSTITUTE KANPUR)

CHAPTER OVERVIEW

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1. Inventories - Basics - AS 2

1.1 Inventories - Definition

Inventories are Assets -

Nature of Inventory	Description
1. Held for sale in the ordinary course of business, or	**Finished Goods** - including trading merchandise, software, land or other property held for resale,
2, In the process of production for such sale, or	**Work in Progress.**
3, In the form of materials or supplies to be consumed in the production process or in the rendering of services.	**Raw Materials** - including Maintenance Supplies, Consumables & Loose Tools used in production process.

Note: Inventory does **not** include Machinery Spares - (a) which can be used only in connection with an item of Fixed Asset, and (b) whose use is expected to be irregular. Such Machinery Spares are generally accounted for as Fixed Assets.

Scope: At Foundation Level, the scope of discussion is limited to valuation of -(a) **Raw Materials** of **Manufacturing Entities,** and (b) **Finished Goods** of **Trading Entities.**

1.2 Significance of Inventory Valuation

Inventory Valuation is important / significant due to the following reasons -

Purpose	Explanation
1. To ascertain the **true income earned** by the entity during the accounting period.	See separate Note below this Table.

2. To determine the **true financial position** of the entity as on the Balance Sheet date.	Inventory is classified as "Current Assets". Balance Sheet will disclose the correct financial position, only if Inventory is properly valued.
3. To analyse the **liquidity** of the enterprise. **(Note:** Liquidity = Ability to meet short-term commitments)	Liquidity is analysed in terms of **Net Working Capital** (Current Assets Less Current Liabilities), and **Current Ratio** (Current Assets divided by Current Liabilities). Inventory forms an important part of Current Assets.
4. To ensure **compliance with disclosure requirements** under Accounting Standard - 2, and applicable Statutes like Companies Act.	• As per AS-2, the Financial Statements should disclose - (a) the **accounting policies** adopted in measuring inventories, including the cost formula used, and (b) the **total carrying amount** of inventories and its classification appropriate to the Enterprise.
Purpose	**Explanation**
	• As per Companies Act, details of quantities of each class of goods along with the method of valuation of Raw Material, WIP and Finished Goods should be disclosed in the Financial Statements.

Note:Effect of wrong valuation of inventory on Profits and Balance Sheet position

Situation	Effect on Profit	Effect on Balance Sheet	Effect on Liquidity
Closing Inventory is overstated	Overstated	Higher Current Assets	High
Closing Inventory is understated	Understated	Lower Current Assets	Low
Opening Inventory is overstated	Understated	-	-
Opening Inventory is understated	Overstated	-	-

1.3 Measurement or Valuation of Inventory

Principle; Inventories should be valued at - (a) Cost, or (b) Net Realisable Value, **whichever is lower.**

1.4 Components of Cost

Meaning of Cost: The Cost of Inventories shall comprise **all -**

Costs of **Purchase**	+	Costs of **Conversion**	+	**Other Costs** incurred in bringing the inventories to their present location and condition.

1. Cost of Purchase is determined as under -

Particulars		**Amount**
Purchase Price including duties and taxes (excluding tax refunds / credits)		xxxx
Add: Freight Inwards	××X	
Other Expenditure directly attributable to the purchase (See Note)	XXX	xxxx
Less: Trade Discounts, Rebates, Duty Drawbacks and other similar items		(XXX)

Costs of Purchase		XXXX

Note: Examples of expenditure directly attributable for purchases are - (a) Cost of Containers, (b) Transit Insurance, (c) Buying Commission where purchase of raw material is possible only through buying agents.

2. Costs of Conversion includes -

Type of Cost	Costs directly related to the units of production.	Variable Production Overheads	Fixed Production Overheads
Description / Example	e.g. Direct Labour, i.e. cost of workers who are directly associated in production process.	Indirect Costs which vary directly or nearly directly, with the volume of output, e.g. Indirect Materials, Indirect Labour.	Indirect Costs which remain relatively constant regardless of the level of output, e.g. Factory Rent, Salary, etc.

3. Other Costs are included in the cost of inventories only to the extent they are incurred in bringing the inventories to their present location and condition.

Items includible as "Other Costs"	**Items excludible from "Other Costs"**
•Costs of designing products for specific customers. •Non-Production Overheads incurred for bringing inventories to their present location.	•Interest and other Borrowing Costs. •Overheads incurred after inventories are brought to their present location and condition.

1.5 Exclusions from Cost

The following costs are **excluded** in determining the Cost of Inventories -

Nature of Costs	**Explanation / Exception**
1. Abnormal Costs of wasted materials, labour or other production costs.	**Reason:** Inefficiency does not make a product more valuable by means of higher cost, hence excluded.

Nature of Costs	**Explanation / Exception**
2. Storage Costs.	**Exception:** They are includible when Storage Costs are necessary in the production process, prior to a further production stage.
3. Administrative Overheads which do not contribute to bringing the inventories to their present location and condition.	**Exception:** They are includible when such costs contribute to bringing the inventories to their present location and condition.
4. Selling and Distribution Costs.	**Reason:** These are incurred after bringing the inventories to their present location and condition and hence excluded.

1.6 Net Realisable Value (NRV)

	Particulars	**Amount**
	Estimated Selling Price in the ordinary course of business	xxxx
Less:	Estimated Cost of Completion XXX Estimated Costs necessary to make the sale XXX	(XXX)

Net Realisable Value (NRV)	**xxxx**

Example: Material X can be re-sold in the market at Rs. 50 per unit. Presently, 500 units are in stock and Rs. 750 will be incurred to put them in saleable condition. The NRV will be Rs. 24,250 (Rs. 50 × 500 - Rs. 750).

Basis of Valuation of Inventories: Inventories are usually written down to Net Realisable Value on an item-by-item basis. They **should not** be valued at Net Realisable Value on -

1. **Wholistic basis,** i.e. all items of inventory taken together, and

2. **Classification basis,** e.g. all Finished Goods, or all inventories in a particular business segment.

Exceptions: In special circumstances, it may be appropriate to group similar or related items, viz.

1. Inventory items relating to the same product line that have similar purposes or end uses,

2. Produced and marketed in the same geographical area, and

3. Cannot be practicably evaluated separately from other items in the product line.

Illustration I:

Sumukha Ltd deals in 3 products A, B & C, which are neither similar nor interchangeable. At the end of a financial year, the Historical Cost and NRV of items of Closing Stock are given below. Determine the value of Closing Stock.

Items	Historical Cost (in Rs. Lakhs)	Net Realisable Value (in Rs. Lakhs)
A	40	28
B	32	32
C	16	24

Inventories are to be valued at the lower of cost and Net Realisable Value (NRV). Inventories are usually written down to NRV on **an item-by-item basis.** The Value of Closing Stocks is determined as under -

Stock Item	Historical Cost	NRV	Valuation = Least of Cost or NRV
A	Rs. 40 Lakhs	Rs. 28 Lakhs	Rs. 28 Lakhs
B	Rs. 32 Lakhs	Rs. 32 Lakhs	Rs. 32 Lakhs
C	Rs. 16 Lakhs	Rs. 24 Lakhs	Rs. 16 Lakhs
Total			**Rs. 76 Lakhs**

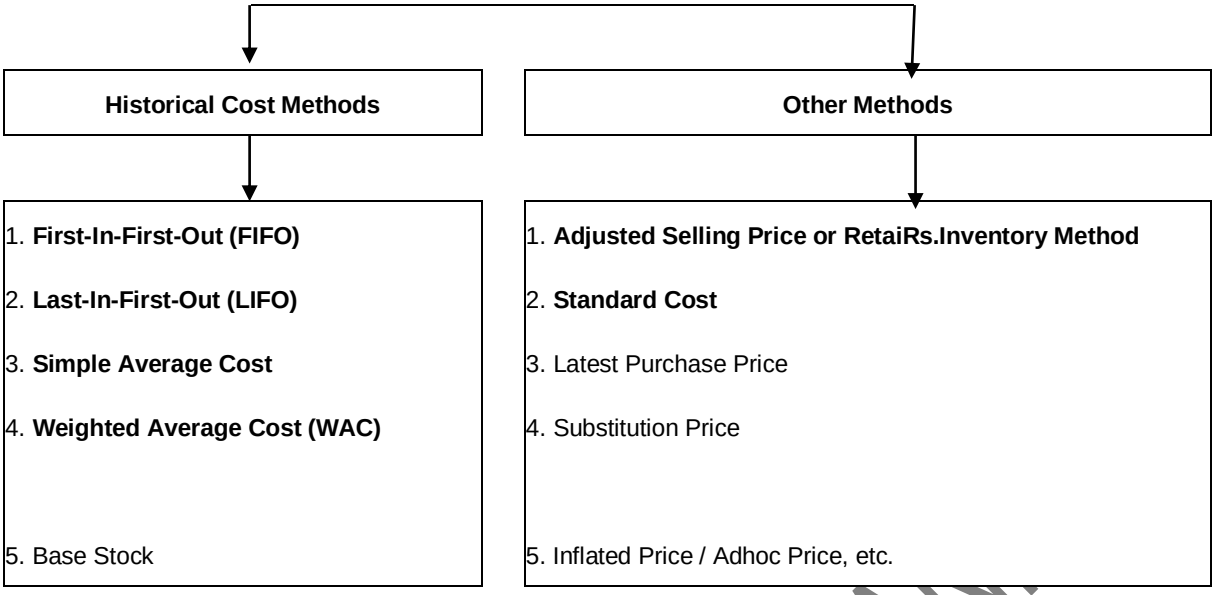
2. Techniques / Formula for Inventory Valuation

2.1 Cost Formulas

Cost should be ascertained in the following manner -

Item	Method
• For items that are not ordinarily interchangeable, and • For goods or services produced & segregated for specific projects.	Specific Identification of Cost Method.
• For other items (See **Notes** below the diagram.)	Refer **Diagram** below.

Different Techniques for ascertaining Cost of Inventories



Notes:

(a) Items marked in **bold letters** above are included in CA Foundation Syllabus. The other methods are discussed only in the next level CA Inter.

(b) Each of the above methods is discussed in separate questions below.

(c) 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.

2.2 Specific Identification of Cost

1. **Meaning**	(a) Specific Identification of Cost means that specific costs are attributed to specific or identified items of inventory. (b) This **applies** for items that are segregated or identified for a specific project, regardless of whether they have been purchased or produced. (c) When there are large numbers of items of inventory, which are ordinarily interchangeable, specific identification of costs should **not** be applied.
2. **Merits**	(a) Cost of materials issued for production / specific jobs represent actual and correct costs. (b) This method is best suited for non-standard and specific products.
3. **Demerits**	This method is difficult to operate when purchases and issues are numerous.
4. **Example**	AB Ltd is engaged in construction of high rise buildings. The cost of lifts / elevators (one or two units in each building complex) is ascertained by specific identification of costs. On the other hand, Steel and Cement being regularly used (high quantity inventory item) can be measured by FIFO or WAC Method.

2.3 First-In-First-Out Method (FIFO)

1. **Meaning**	(a) FIFO is a method of pricing the issues of materials, in the order in which they are purchased. So, the earliest prices at which materials were received are exhausted first before subsequent prices are taken up. (b) Hence, Closing Stock will be valued at the prices relating to the latest consignments.
2. **Merits**	(a) It is simple to understand and easy to operate. (b) In the case of falling prices, the use of this method gives better results.

	(c) Closing Stock of material will be represented very closely at current market price.
3. **Demerits**	This method may lead to clerical errors, when the prices fluctuate frequently.
4. **Impact**	Cost of Goods Sold (COGS) will consist of the Oldest Prices, while Closing Stock will be valued at most recent price.

2.4 Last-In-First-Out (LIFO)

1. **Meaning**	(a) It is a method of pricing the issues of materials, in the **reverse order** in which they are purchased. So, Closing Stock will be generally valued at the earliest prices. (b) The prices of the most recently received consignments, i.e. immediately last available consignment, are exhausted first before previous consignment prices are taken up.
2. **Merits**	(a) Cost of materials issued will reflect the current market price approximately. This enables the matching of cost of production with current sales revenues. (b) Use of LIFO method during the period of rising prices does not reflect undue high profit in the income statement.
	(c) In the case of falling prices, profit tends to rise due to lower material cost, yet the finished products appear to be more competitive and are at market price. (d) In the long run, the use of LIFO helps to iron out the fluctuations in profits. (e) During inflation, LIFO will tend to show the correct profit.
3. **Demerits**	(a) Calculation becomes complicated and cumbersome when frequent purchases are made at highly fluctuating rates. (b) In time of falling prices, there will be need for writing off stock value considerably to stick to the principle of stock valuation, i.e. Cost or Market Price whichever is lower. (c) This method is not acceptable under Accounting Standards or to Income Tax Authorities.
4. **Impact**	COGS will consist of Recent Prices, while Closing Stock will be valued at Older Prices.

Illustration 2: FIFO and LIFO Methods

Following information regarding Product K is provided by Ratnavel Ltd for the fortnight of April.

Stock	on 1st April	100 units at Rs. 5 p.u.			
Purchases	5th April	300 units at Rs. 6 p.u.	Sales	6th April	250 units
	8"* April	500 units at Rs. 7 p.u.		10th April	400 units
	12th April	600 units at Rs. 8 p.u.		14th April	500 units

Calculate using FIFO & LIFO methods - (a) cost of goods sold during the period, (b) value of stock of materials on 15th April.

Solution: 1. Stock Ledger under FIFO Method

Date	Particulars	Receipts			Issues			Balance		
		Quantity	Rate	Value	Quantity	Rate	Value	Quantity	Rate	Value

1	Opg.balance	-	-	-	-	-	-	100	5	500
5	Receipt	300	6	1,800	-	-	-	100	5	500
								300	6	1,800
6	Sales	-	-	-	100	5	500			
					150	6	900	150	6	900
8	Receipt	500	7	3,500	-	-	-	150	6	900
I								500	7	3,500
10	Sales	-	-	-	150	6	900			
					250	7	1,750	250	7	1,750
12	Receipt	600	8	4,800	-	-	-	250	7	1,750
								600	8	4,800
14	Sales	-	-	-	250	7	1,750			
					250	8	2,000	**350**	**8**	**2,800**
	Total	**1,400**		**10,100**	**1,150**		**7,800**	**350**	**8**	**2,800**

Cost of Goods Sold = Opening Stock + Purchases - Closing Stock = 500 + 10,100 - 2,800 = Rs. **7,800.**

2. Priced Stores Ledger under LIFO Method

Date	Particulars	Receipts			Issues			Balance		
		Quantity	Rate	Value	Quantity	Rate	Value	Quantity	Rate	Value
1	Opg.balance	-	-	-	-	-	-	100	5	500
5	Receipt	300	6	1,800	-	-	-	100	5	500
								300	6	1,800
6	Sales	-	-	-	250	6	1,500	100	5	500
								50	6	300
8	Receipt	500	7	3,500	-	-	-	100	5	500
								50	6	300
								500	7	3,500
10	Sales	-	-	-	400	7	2,800	100	5	500
								50	6	300

								100	7	700
12	Receipt	600	8	4,800	-	-	-	100	5	500
								50	6	300
								100	7	700
								600	8	4,800
14	Sales	-	-	-	500	8	4,000	100	5	500
								50	6	300
								100	7	700
								100	8	800
	Total	**1,400**		**10,100**	**1,150**		**8,300**	**350**		**2,300**

Cost of Goods Sold = Opening Stock + Purchases - Closing Stock = 500 + 10,100 - 2,300 = Rs. **8,300.**

2.5 Simple Average Price Method

1. **Meaning**	Closing Stock is valued at Average Price, which is calculated by dividing the total of all units rate by the number of unit rates. **Simple Avg Price** = **Total of Unit Prices of each purchase ÷ Total No. of purchases** **Example:** If there were three consignments with prices of Rs. 20, Rs. 27 and Rs. 22, the Simple Average Price would be Rs. (20 + 27 + 22) ÷ 3 = Rs. 23
2. **Merits**	(a) Useful when materials are received in uniform lots of similar quantity. (b) Useful when purchase prices do not fluctuate considerably. (c) Simple to understand and easy to operate.
3. **Demerits**	(a) Materials Issue Cost does not represent actual cost price. Since the materials are issued at a price obtained by averaging cost prices, a profit or loss may arise from such type of pricing. (b) This method will give incorrect results, if the prices of material fluctuate frequently. (c) The price determination is unscientific, since there is averaging of prices without considering quantity.

2.6 Weighted Average Price Method

1. **Meaning**	Weighted Average Price Method gives due weightage to quantities purchased and the purchase price to determine the issue price. Closing Stock is valued at Weighted Average Cost, calculated as under - **Total Cost of Goods received ÷ Total Quantity purchased**
2. **Merits**	(a) It smoothens the price fluctuations, if any, due to material purchases. (b) Issue prices need not be calculated for each issue unless new lot of materials is received.
3. **Demerits**	(a) Material Cost does not represent actual cost price and so, there is a profit or loss. (b) It may be difficult to compute since every new lot received would require re-computation of

	issue prices.

Illustration 3: Simple Average and Weighted Average Cost Method

A Company has the following record of purchases -

Date	December 4	December 10	December 11	December 19	December 28
Quantity (units)	900	400	300	200	800
Price p.u. (Rs.)	50	55	55	60	47.50

Sales were made as under:

Date	December 5	December 12	December 29
Quantity (Units)	600	400	600

Compute the value of Closing Inventory under - (a) Simple Average Cost, (b) Weighted Average Cost.

Solution: Method 1: Computation of Inventory Value without Daily Stock Ledger

1. Purchase Quantity during the period = 900 + 400 + 300 + 200 + 800	2,600 units
2. Sale Quantity during the period = 600 + 400 + 600	1,600 units
3. Quantity of Closing Inventory at the end of the period (1-2)	1,000 units
4. Simple Average Cost = Total of Unit Prices of each purchase ÷ Total No. of purchases = (50 + 55 + 55 + 60 + 47.50) ÷ 5 =	Rs. 53.50 p.u
5. So, Value of Closing Inventory under Simple Average Cost Method = (3×4)	Rs. 53,500
6. Weighted Average Cost= Total Cost of Goods received ÷ Total Quantity purchased $= \frac{[(900 \times 50) + (400 \times 55) + (300 \times 55) + (200 \times 60) + (800 \times 47.50)]}{(900 + 400 + 300 + 200 + 800)}$ = 1,33,500 ÷ 2,600 units =	Rs. 51.35 p.u
7. So, Value of Closing Inventory under Weighted Average Cost Method = (3×6)	Rs. 51,350

Method 2: Computation of Inventory Value under WAC Method when Daily Stock Ledger is prepared

Note: When Daily Stock Ledger is maintained, recording receipts / issues daily, a new average rate would be calculated on receiving every fresh consignment. The Stock Ledger is shown below -

Stock Ledger under WAC Method

Date	Particulars	Receipts			Issues			Balance		
		Quantity	Rate	Value	Quantity	Rate	Value	Quantity	Rate	Value
4	Receipt	900	50.00	45,000				900	50.00	45,000
5	Sale				600	50.00	30,000	300	50.00	15,000
10	Receipt	400	55.00	22,000				700	52.86	37,000

11	Receipt	300	55.00	16,500				1,000	53.50	53,500
12	Sale				400	53.50	21,400	600	53.50	32,100
19	Receipt	200	60.00	12,000				800	55.13	44,100
28	Receipt	800	47.50	38,000				1,600	51.31	82,100
29	Sale				600	51.31	30,788	**1,000**	**51.31**	**51,312**

Note: Weighted Average Cost (i.e. Rate) is computed as Total Value divided by Total Quantity.

2.7 Retail Method

1. **Applicability:** This method is applicable in the following situations -

(a) Retail Trade, (c) Inventories of large numbers of rapidly changing items, and

(b) Similar profit margins, (d) Impracticable to use other costing methods.

2. Retail Method may be used for **convenience** if the results approximate the actual cost.

3. **Measurement:** Cost of Inventory = Sales Value of Inventory Less **Appropriate** Gross Margin Percentage.

Note: Adjusted GP Percentage is used for inventories marked down to below its Original Selling Price.

An average percentage for each Retail Department is often used.

Note: In making calculations relating to Profit as a % on Cost and % on Selling Prices, the student should bear following relationships.

Cost	+	**Profit =**	**Sales**	**So, the relationship to be remembered is -**
100%	+	50%	150%	(50 ÷100) = 1/2nd on Cost = 1/3rd on Sales = (50 ÷150)
100%	+	33%	133%	(33 ÷100) = 1/3rd on Cost = 1/4th on Sales = (33 ÷133)
100%	+	25%	125%	(25 ÷100) = 1/4th on Cost = 1/5* on Sales = (25 ÷125)
100%	+	20%	120%	(20 ÷100) = 1/5th on Cost = 1/6th on Sales = (20 ÷120)

Illustration 4: Adjusted Selling Price or Retail Inventory Method

Shri Thangavel sells goods at 20% GP on Cost. He provides the following data. Find out the value of Closing Inventory.

• Opening Inventory at Market Prices = Rs. 1,20,000 (Cost = ?)

• Sales made during the period = Rs. 38,40,000

• Purchases during the period (at Cost) = Rs. 34,00,000.

Solution:

• Since GP = 20% on Cost = 1/5th on Cost, it is equal to 1/6th on Selling Price.

• So, Cost of Sales = Sales **less** GP at 1/6th thereon = Rs. 38,40,000 - 1/6th = Rs. 32,00,000.

• Similarly, Cost of Opening Inventory = Rs. 1,20,000 **less** GP at 1/6th thereon = Rs. 1,00,000

• Also, Cost of Sales = Opening Inventory + Purchases - Closing Inventory.

• From this equation, we get Closing Inventory = Opening Inventory + Purchases - Cost of Sales.

• So, Closing Inventory = 1,00,000 + 34,00,000 - 32,00,000 = Rs. **3,00,000.**

Illustration 5: Adjusted Selling Price or Retail Inventory Method

Shri Singaravelan commenced retail business during the year, and provides the following data for the year -

• Sales during the year = Rs. 85,00,000

• Closing Inventory at Market Prices = Rs. 13,50,000

• Purchases during the period = Rs. 78,80,000.

Find out the value of Closing Inventory.

Solution:

Sales during the year	85,00,000
Add: Closing Inventory at Market Prices	13,50,000
Total of above	98,50,000
Less: Cost of Purchase during the year	78,80,000
Gross Profit	19,70,000
Gross Profit Margin as a % of Sales = 19,70,000 ÷ 98,50,000	**20%**
So, Value of Closing Inventory = Market Price Less 20% GP	13,50,000 - 20% = **10,80,000**

Illustration 6: Adjusted Selling Price or Retail Inventory Method Shri Swaminathan operates a retail business. For a financial year, the following data is given -

Particulars	At Retail Price	At Cost
Value of Opening inventory	Rs. 80,000	Rs. 60,000
Value of Purchases	Rs. 1,40,000	Rs. 1,20,000

Calculate the cost of Closing Stocks, if the Sales made during the period is Rs. 2,00,000. **Solution:**

1. Value of Closing Inventory at Retail Prices	= Opening Stock + Purchases - Sales = Rs. 80,000 + Rs. 1,40,000 -Rs. 2,00,000 = **Rs. 20,000.**
2. Average Percentage of Cost to Retail Prices	= Total Average Cost 4 Total Average Retail Value = (Rs. 60,000 + Rs. 1,20,000) ÷ (Rs. 80,000 + Rs. 1,40,000) = **81.82%.** So, GP Margin = 100% - 81.82% = **18.18%.**
3. Value of Closing Inventory at Cost Prices	= Retail Values **Less** Margin of 18.18% = Rs. 20,000 - 18.18% thereon = Rs. **16,364.**

2.8 Standard Cost Method

1. Features:

(a) Under this method, Materials are priced at a Pre-determined Rate or Standard Price irrespective of the actual purchase cost of the materials.

(b) Standard Cost is usually determined considering factors like - (i) Current prices, (ii) Anticipated market trends, and (iii) Discount available and Transport Charges, etc.

2. **Advantages:**

(a) Simplifies the task of valuing issues of materials. (c) Facilitates the control of Material Cost, and the task of

(b) Reduces clerical work. judging the efficiency of the Purchase Department.

3. **Disadvantages:**

(a) Standard Price does not reflect the Market Price, and thus results in a profit or loss.

(b) Fixing Standard Price becomes difficult when prices fluctuate frequently.

3. Inventory Systems

3.1 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. Treatment 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.

3.2 Physical Stock vs Book Stock

Wherever required, the following adjustments are carried out in respect of value of Physical Stock, to arrive at the Value of Inventory as per the Balance Sheet -

	Value of **Physical Stocks** on the Closing Date	XXX
Add	Goods in Transit, i.e. goods in respect of which the Firm has the title and ownership, but lying with the Transporter / Carrier, pending delivery.	XXX
Add	Goods held by Other Entities on our behalf (e.g. Our Stock held by Agent, Sub-Contractor, Job Worker, etc.) Goods sent on approval for which confirmation not received from Customer.	XXX
Add		
Less	Any goods sold in respect of title has been transferred to the Buyer, but delivery pending at Buyer's request.	XXX
Less	Goods held by us on behalf of Other Entities (e.g. As Agent, as Sub-Contractor, as Job Worker, etc.)	XXX
Less	Adjustments required to mark-down defectives / obsolete items, etc. to their NRV, if any.	XXX
	Value of Stocks as per Balance Sheet	

Illustration 7: Physical Stock vs Balance Sheet Value

Subramanya Ltd provides the following information. Find the Value of Inventory for Balance Sheet purposes.

Value of Stocks as per Physical Verification on 31st March = Rs. 28,00,000. The following items are to be considered.

• Goods held by Sub-Contractors and Job Workers of Aruna Ltd, for which Confirmation Certificates have been received = Rs. 8,30,000

• Goods sold to Harini Ltd, a customer, who has requested for despatch only on 7th April, included in above physical stock = Rs. **10,00,000.**

• Goods held by Aruna Ltd on behalf of Padmini Ltd (Consignor) = Rs. 2,50,000

• Goods sold on approval to Sankari Ltd Rs. 7,00,000 for which confirmation not yet received in respect of Rs. 2,00,000.

• Goods purchased under Firm Contracts, still in transit at year-end = Rs. 3,50,000.

Solution:

	Value of **Physical Stocks** on 31st March	Rs. 28,00,000
Add	Goods in Transit	Rs. 3,50,000
	Goods held by Other Entities (e.g. Stock held by Sub-Contractor, Job Workers) Goods	Rs. 8,30,000

Add	sent on approval & confirmation not received from Customer Sankari Ltd	Rs. 2,00,000
Add		
Less	Goods sold but delivery pending at Buyer's request (Harini Ltd)	Rs. 10,00,000
Less	Goods held by us on behalf of Other Entities (e.g. in our capacity as Consignee Agent)	Rs. 2,50,000
	Value of Stocks as per Balance Sheet	**Rs. 29,30,000**

3.3 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

Illustration 8: Stock Taking at a later date

Shanmuga Bros could organize their stock-taking only on 12th April, even though their financial year ended on 31st March. The following data is provided for the period 1st April to 12th April -

Sales during the period (at an average Gross Profit of 25% on Cost)	10,00,000
Purchases during the period (including Cash Purchases Rs. 3,80,000)	7,80,000
Purchase Returns (only out of Credit Purchases)	80,000
Sales Returns by Customers (at Market Prices)	1,00,000

Value of Physical Stock as per Stock-taking was Rs. 30,00,000. What would be value of Inventory for B/s purposes?

Solution: GP = 25% on Cost = 1/4th on Cost = 1/5th on Sales Value = 20% on Sales

	Value of **Physical Stocks** on 12th April	Rs. 30,00,000
Add	Cost of Sales made during the interim period (Rs. 10,00,000 less 20% thereon)	Rs. 8,00,000
Add	Purchase Returns during the interim period	Rs. 80,000
Less	Purchases made during the interim period	Rs. 7,80,000
Less	Sales Returns (at Cost Price) during the period (Rs. 1,00,000 less 20% thereon)	Rs. 80,000
	Value of Stocks as per Balance Sheet	**Rs. 30,20,000**