**INVENTORY VALUATION AND VALIDATION**

**INVENTORY [STOCK] VALUATION METHODS AND SYSTEMS**

1. **WHAT SHOULD LEARNERS EXPECT TO BE TESTED ON THIS TOPIC?** [**OBJECTIVES**]   
   • What is stock?   
   • Why stock is so important in the business?   
   • Difference between periodic and perpetual inventory systems   
   • Difference between stock valuation methods  
   • Calculating stolen units [number] and how long sell stock on hand in days.  
   • How to calculate value of closing stock using each method? (FIFO,WA,SI)  
   • Calculation of cost of sales ( using formula and using traditional method)   
   • Take into consideration the multi-questioning [ remember to practice stock ratios]  
   • Problem solving questions on stock
2. **TEACH THEM**• Stock are the items bought with an intention to re-sell them to make profit   
   • Stock are the possessions of the business, stock is a liquid investment (**current asset**)  
    since the business is expecting to make profit out of selling stock within short period of   
    time. **It has to be fully protected** [***internal controls***]   
   • Once stock is purchased and reached a receiving point in the business, it has to be  
    controlled.   
   • Introduce stock systems (one of the internal controls on stock)   
    ♥ What is a stock system? Stock system is the way that is used to control the  
    movement of stock in the business  
    ♥ How many stock systems do we have in business? We have two stock systems   
    ♥ Name them: **1)** **Perpetual inventory system**  **2) Periodic stock system**   
    ♥ Perpetual inventory system – Cost of Sales is calculated every time when stock is  
    sold   
    ♥ Periodic inventory system – Cost of Sales is calculated at the end of a period

**3. STOCK VALUATION METHODS**   
   
♥ FIFO (**F**irst **I**n **F**irst **O**ut) – closing stock is valued at the most recent cost price or old stock will be sold first and new stock will form a part of closing stock   
♥ WAM (**W**eighted **A**verage **M**ethod) – closing stock is valued at weighted cost price   
♥ Specific identification method – closing stock will be recorded at a specific price that  
 stock was originally bought (items are independent)

**4. CALCULATING MISSING UNITS**

Opening **units** + **units** purchased – **units** returned – **units** sold – closing **units** = **Missing** **units**

**5. CALCULATION OF HOW LONG (IN DAYS) IT IS EXPECTED TO SELL THE CLOSING STOCK [Using the closing stock in your calculation]:**

Units of closing stock X 365 **OR** Value of closing stock X 365

No. of units sold 1 Cost price of units sold (cost of sales) 1

**6. HOW TO CALCULATE THE VALUE OF CLOSING STOCK:**

**FIFO**

**CALCULATION OF CLOSING STOCK**

a) Update the units and cost price

b) Allocate number of units using closing units, please indicate dates [bottom up]

c) Then multiply number of units with cost price and add up

**HOW TO CALCULATE COST OF SALES USING FIFO [TRADITIONAL FORMAT]**

a) Update the units and cost price

b) Allocate number of units using units sold, please indicate dates [from top to bottom]

c) Then multiply number of units with cost price

**WEIGHTED AVERAGE METHOD**

**CALCULATION OF CLOSING STOCK**

Employ the formula: WAM = Total cost price of units available to be sold

Total number of units available to be sold

**(R)** [OB + PURCHASE – RETURNS-donations + Carriage OP]

**(UNITS)** Opening + Purchases – Returns –donated units– **Units stolen** (only if given)

= Weighted Cost P.U X Number of units at the end

= **VALUE OF CLOSING STOCK**

**HOW TO CALCULATE COST OF SALES USING WEIGHTED AVERAGE** **METHOD**

Total cost price of units available to sold – value of closing stock = **Cost of Sales**   
 [calculation depends on calculation above]

**SPECIFIC IDENTIFICATION METHOD**

**CALCULATION OF CLOSING STOCK**

***N/B: PLEASE MAKE SURE THAT YOU separate the units (ITEMS ARE INDEPENDENT)***

Units purchased – units returned to the supplier – units stolen – units sold = units unsold (left) x cost price for that item

**HOW TO CALCULATE COST OF SALES USING SPECIFIC IDENTIFICATION METHOD**

Units sold x cost price = Cost of Sales [remember that items are independent]

**7. HOW TO MASTER THE FINANCIAL INDICATORS CALCULATIONS (INTEGRATION)**

a) Know the formula [advantage]

b) Correct substitution [earn marks]

c) Complete calculation correctly

**8. PROBLEM TYPE QUESTIONS ON STOCK [LEARNERS NEED TO KNOW WHAT THEY SHOULD INVESTIGATE]**

a) **Units stolen** [opening units + units purchased –units returned – units sold – closing  
 units]

b) **Cash theft** [compare cash deposited and cash received (units sold x selling price)]

c) Look for **lower** sales

**9. FORMULA FOR COST OF SALES**

Opening stock + Purchases – Returns + Carriage on purchases – Closing stock

**10. INTERNAL CONTROL**

Division of duties – workers should check each other regularly; a senior worker must check and approve orders before stock are ordered.

Reconciliations – regular stock counts and compare with the records.

Physical controls – stock must be behind shut doors and entrance must be monitored. Security cameras can also be installed to prevent theft.