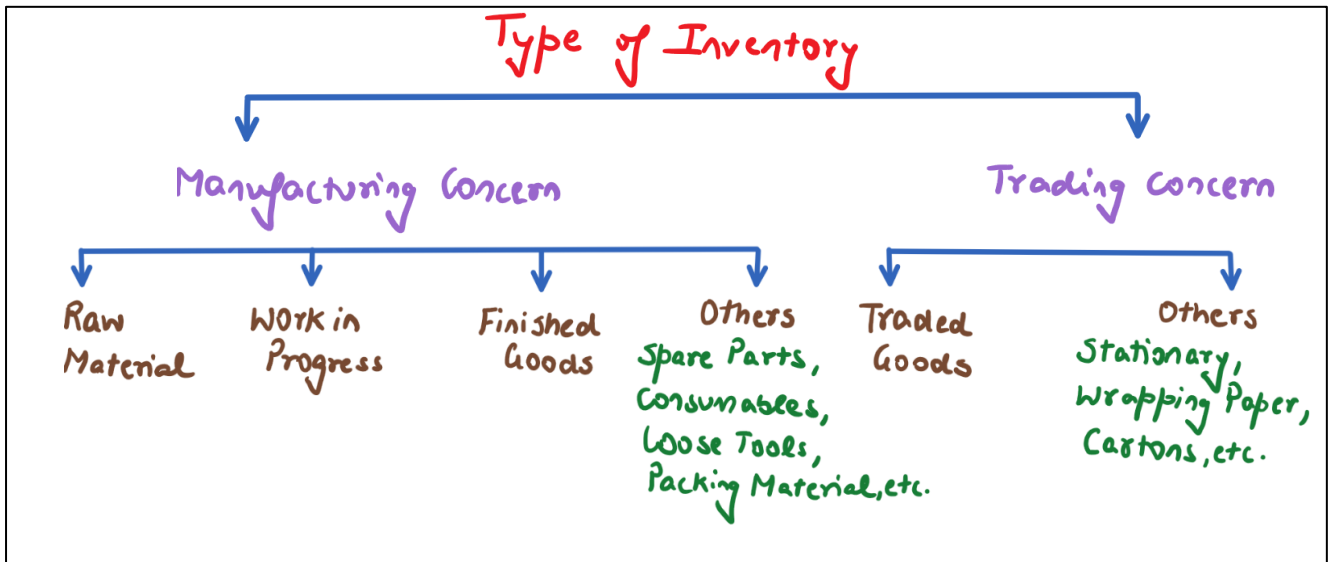


# INVENTORIES

*"Education is not preparation for life, It is Life itself"*

## DEFINITION

Nature of Inventory	Description
Held for sale in the ordinary course of business, or	Finished goods
In the process of production for such sale, or	Work in progress
In the form of materials or supplies to be consumed in production process or in the rendering of services	Raw Material - incl. consumables & Loose Tools used in production process



## SIGNIFICANCE OF INVENTORY VALUATION

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

Purpose	Explanation
To ascertain the true income earned by the entity during the accounting period.	See <i>separate note</i> below this table
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.
To analyze the liquidity of the enterprise. (Note: Liquidity = Ability to meet short-term commitment)	Liquidity is analyzed in the 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
To ensure compliance with disclosure requirements	As per AS-2, the financial Statements should disclose- (a) the accounting policies adopted in measuring inventories,

under AS- 2, and applicable Statutes like Companies Act, 2013	including the cost formula used and (b) the total carrying amount of inventories and its classification appropriate to the enterprise. Schedule III to the Companies Act, 2013, requires valuation of each class of goods i.e. Raw material, WIP and finished goods under broad head to be disclosed in the financial statements.
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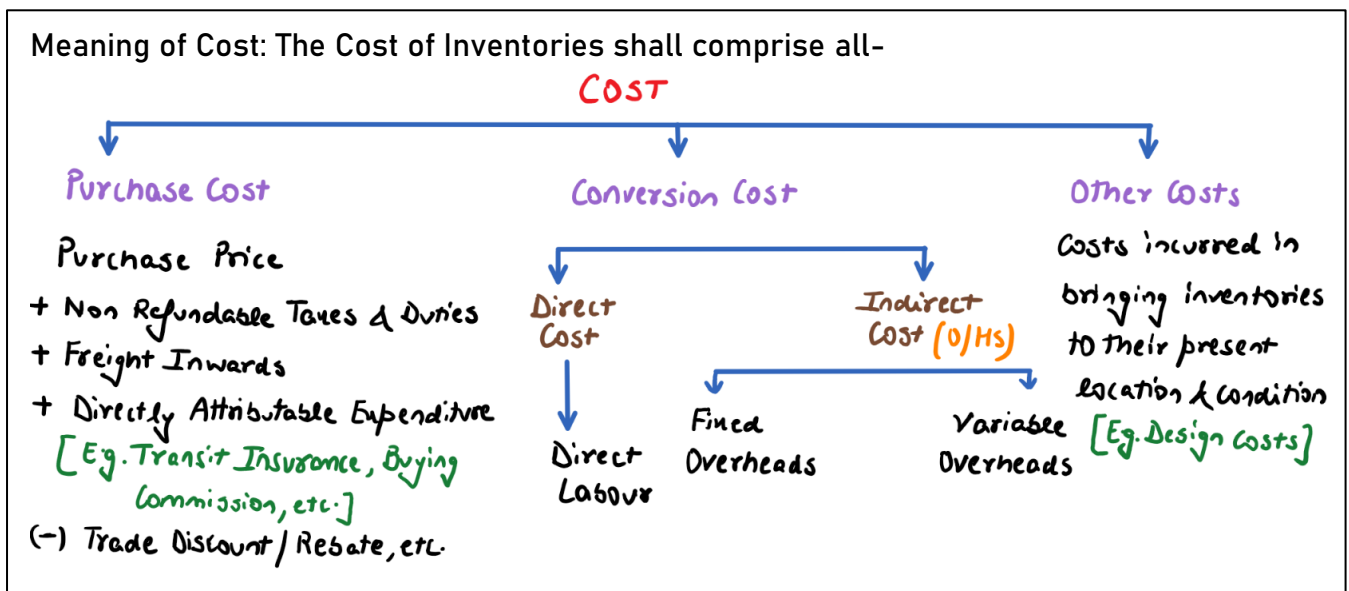
Note: Effect of wrong valuation of inventory on Profits and Balance Sheet position

Situation	Effect on Profit	Effect on Balance sheet	Effect on liquidity
Closing stock overstated	Overstated	Higher Current Assets	High
Closing stock understated	Understated	Lower Current Assets	Low
Opening stock overstated	Understated	-	-
Opening stock understated	Overstated	-	-

### MEASUREMENT OR VALUATION OF INVENTORY

Inventories should be valued at – (a) Cost, or (b) Net Realizable Value, whichever is **lower**. This principle is governed by 'Principle of Conservative Accounting' under which any expenses or losses from transactions entered or event occurred are to be recognized immediately, however, any gains or profits are recognized until its becomes due or are actually realized.

### COMPONENTS OF COST



Cost of Purchase is determined as under-

Particulars	Amount
Purchase price including duties and taxes (excluding tax refunds/credits)	XXX
Add: Freight Inwards	XXX
Add: Other Expenditure directly attributable to the purchase (See Note)	XXX
Less: Trade Discounts and Rebates	(XXX)
<b>Costs of Purchase</b>	<b>XXX</b>

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

### Costs of Conversion includes

Types of Cost	Cost 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 with 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.

### Other Costs

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"
<ul style="list-style-type: none"> <li>Costs of designing products for specific customers</li> <li>Non-production Overheads incurred for bringing inventories to their present location</li> </ul>	<ul style="list-style-type: none"> <li>Interest and other Borrowing Costs.</li> <li>Overheads incurred after inventories are brought to their present location and condition</li> </ul>

## EXCLUSIONS FROM COST

- ❖ Abnormal amount of wasted materials, labour or other production cost
- ❖ Storage cost unless those are necessary in the production process prior to a further production stage.
- ❖ Administrative overheads that do not contribute to bringing the inventories to their present location and condition
- ❖ Selling and distribution cost

## NET REALIZABLE VALUE

Estimated Selling Price	XX
Less: Estimated selling expenses	(XX)
Less: Estimated cost of completion	(XX)
NRV	XX

- Inventories are usually written down to Net Realizable value on an item-by-item basis (individual basis) & not on global basis
- In case of firm/committed contract of sale, NRV shall be calculated at the contract price.

**Example (ICAI Study Material)**

Surekha Ltd deals in 3 products P, Q & R neither similar nor interchangeable. At the end of year, the Historical Cost and NRV of items of closing stock are given below. Determine the value of closing stock.

Items	Historical Cost (in Lakhs)	Net Realizable Value (in Lakhs)
P	38	42
Q	29	29
R	17	14

**Example**

Closing Stock: 3,000 units. Cost per Unit 40. Selling Price per Unit 45.  
There is firm contract for 1,000 units @ 37 per unit.

## INVENTORY SYSTEMS

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 system, - (1) Periodic Inventory System, and (2) Perpetual Inventory System. The salient features/ difference between these two methods are-

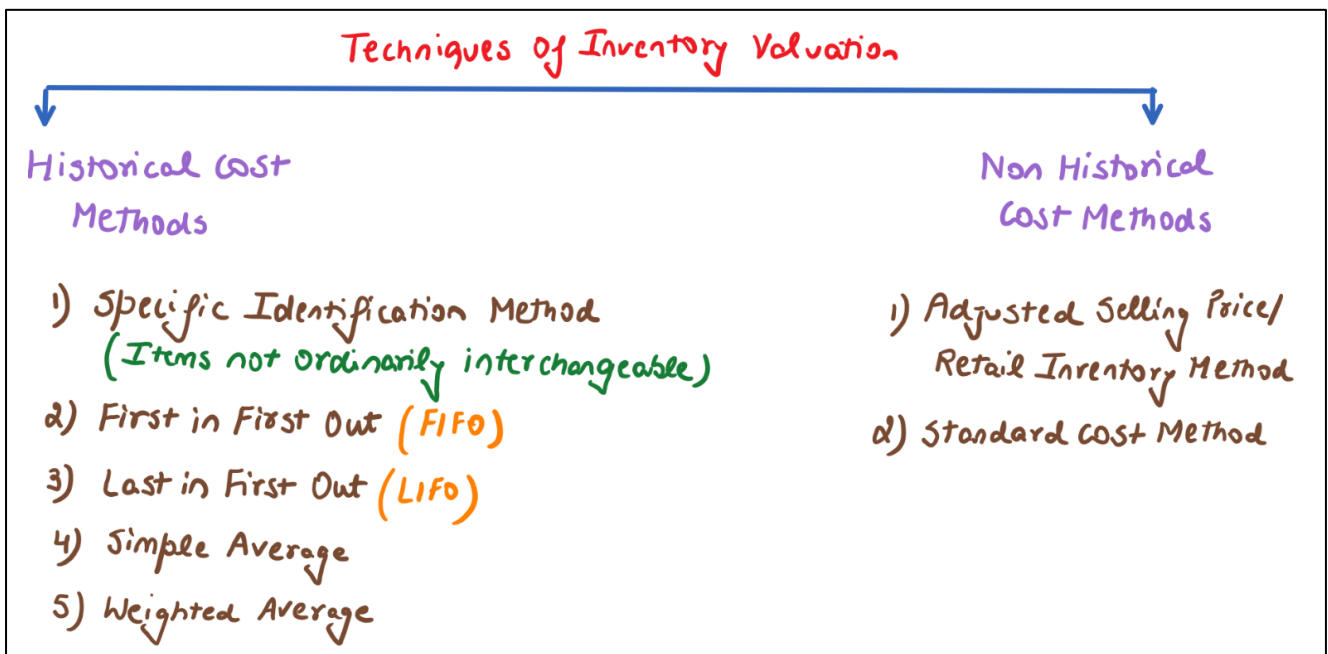
Particulars	Periodic Inventory System	Perpetual Inventory System
1. Meaning	This involves ascertaining inventory value by actual physical count. It is also called as Physical Inventory System	This involves ascertaining inventory value by keeping upto date records & finding the value from such Books and Records
2. COGS	Cost of Goods Sold (COGS) = Opening Inventory (Known) + Purchases during 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 v/s Stock	This system determines Inventory Value, and calculates COGS as balancing figure	This system determines COGS for every issue & determines Inventory 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 include 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, therefore also called as Continuous stock taking
6. Coverage in stock taking	All items of stock 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 entire period, all items are covered on rotation basis.
7. Effect on Work	Requires closure of business for counting of inventory	Inventory can be determined without affecting the business operations
8. Control	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
9. Cost	This is simple and less costly method.	This is a relatively costly method

Note:-

Periodic inventory system is used by small enterprises where is easy to control physical inventory. This system is not considered suitable for medium or larger enterprises which generally use Perpetual Inventory system.

**TECHNIQUES / FORMULA FOR INVENTORY VALUATION**



**SPECIFIC IDENTIFICATION OF COST**

Meaning	<ul style="list-style-type: none"> <li>❖ Specific Identification of Cost means that specific costs are attributed to specific or identified items of inventory.</li> <li>❖ This applies for items that are segregated or identified for a specific project.</li> <li>❖ When there are large numbers of items of inventory, which are ordinarily interchangeable, specific identification of costs should not be applied.</li> </ul>
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**FIRST-IN-FIRST-OUT (FIFO)**

Meaning	<ul style="list-style-type: none"> <li>❖ FIFO is a method of pricing the issues of materials, in the order in which they are purchased. The earliest prices at which materials were received are exhausted first before subsequent prices are taken up.</li> <li>❖ Hence, closing stock will be valued at the price relating to the latest consignments</li> </ul>
Merits	<ul style="list-style-type: none"> <li>(a) It is simple to understand and easy to operate</li> <li>(b) Closing stock of material will be represented very closely at current market price.</li> </ul>
Demerits	This method may lead to clerical errors, when the prices fluctuate frequently.
Impact	Cost of Goods sold (COGS) will consist of the Oldest Prices, while closing stock will be valued at most recent price.

**LAST-IN-FIRST-OUT (LIFO)**

Meaning	<ul style="list-style-type: none"> <li>❖ It is a method of pricing the issues of materials, in the reverse order in which they are purchased. Closing stock will be generally valued at earliest prices.</li> <li>❖ The prices of the most recently received consignment i.e., immediately last available consignment are exhausted first before previous consignment prices are taken up.</li> </ul>
Merits	<ul style="list-style-type: none"> <li>a. Cost of materials issued will reflect the current market price approximately. This enables the matching of cost of production with current sale revenue.</li> <li>b. Use of LIFO method during the period of rising prices does not reflect undue high profit in the income statement.</li> </ul>
Demerits	<ul style="list-style-type: none"> <li>a. Calculation becomes complicated and cumbersome when frequent purchases are made at highly fluctuating rates.</li> <li>b. This method is not acceptable under Accounting Standards or to Income Tax Authorities</li> </ul>
Impact	COGS will consist of Recent Prices, while Closing stock will be valued at Older Prices.

**SIMPLE AVERAGE PRICE**

Meaning	<p>Closing stock is valued at Average Price. This method is generally followed by the entities using periodic inventory method.</p> <p>Simple Avg Price = <math>\frac{\text{Total of Unit Prices of each purchase}}{\text{Total no. of purchases}}</math></p> <p>Example: If there were three consignments with prices of ₹ 20, ₹ 27 and ₹ 22, the Simple Average Price would be <math>(₹ 20 + 27 + 22) \div 3 = ₹ 23</math></p>
Merits	<ul style="list-style-type: none"> <li>(a) Useful when materials are received in uniform lots of similar quantity.</li> <li>(b) Useful when purchased prices do not fluctuate considerably.</li> <li>(c) Simple to understand and easy to operate.</li> </ul>

Demerits	<p>(a) Materials Issue Cost does not represent actual cost price. Since the material are issued at a price obtained by averaging cost prices</p> <p>(b) This method will give incorrect results, if the prices of materials fluctuate frequently.</p> <p>(c) The price determination is unscientific, since there is averaging of prices without considering quantity.</p>
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**WEIGHTED AVERAGE PRICE**

Meaning	<p>Weighted Average Price Method gives due weightage to quantities purchased and the purchase price to determine the issue price.</p> <p>Closing stock is valued at Weighted Average Cost, calculated as under-  <math>\text{Total Cost of Goods received} \div \text{Total Quantity purchased}</math></p>
Merits	<p>(a) It smoothens the price fluctuations, if any, due to material purchases</p> <p>(b) Issue prices need not be calculated for each issue unless new lot of material is received</p>
Demerits	<p>(a) It may be difficult to compute since every new lot received would require recomputation of issue prices.</p>

**ADJUSTED SELLING PRICE / RETAIL METHOD**

1. Applicability: This method is applicable in the following situations
  - (a) Retail trade
  - (b) Similar profit margins
  - (c) Inventories of large numbers of rapidly changing items,
  - (d) Impracticable to use other costing methods
2. Retail Method may be used for convenience if the results approximate the actual cost.
3. Measurement:  $\text{Cost of Inventory} = \text{Sales Value of Inventory Less Appropriate Gross Margin\%}$   
 Note: Adjusted GP Percentage is used for inventories marked down to below its Original Selling Price. An average percentage for each Retail Departments is often used.

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

**STANDARD COST METHOD**

This method is used when there is frequent change in the price per unit of the goods and goods are purchased frequently by the business e.g. crude oil. Based on the experience a standard cost is determined on the basis of frequent changes in prices and inventory is valued on that price per unit.

### PHYSICAL STOCK v/s 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.)	XXX
Add	Goods sent on approval for which confirmation not received from customer.	XXX
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	XXX

### 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-

Stock Taking after Balance Sheet date	
Value of Stocks on verification date (e.g. 6 <sup>th</sup> April)	XXX
(+) Cost of Sales made during the interim period	XXX
(+) Purchase Returns during the interim period	XXX
(-) Purchases made during the interim period	(XXX)
(-) Sales Return (at cost price) during the period	(XXX)
Value of Stocks on B/S date i.e., 31 <sup>st</sup> March	XXX

Stock Taking before Balance Sheet date	
Value of Stocks on verification date (e.g. 25 <sup>th</sup> March)	XXX
(+) Purchases made during the interim period	XXX
(+) Sales Return (at Cost price) during the period	XXX
(-) Cost of Sales made during the interim period	(XXX)
(-) Purchase Return during the interim period	(XXX)
Value of Stocks on B/S date i.e., 31 <sup>st</sup> March	XXX

## ASSIGNMENT QUESTIONS

### Question 1 \_\_\_\_\_ Pg no. \_\_\_\_\_

A manufacturer has following record of purchases of material which he uses while manufacturing TV set

Date	Quantity (units)	Price per unit
Dec. 5	900	50
Dec. 11	600	55
Dec. 26	300	60
Dec. 29	800	71
	2,600	

1,600 units were issued during the month of December as follows:

Record of issues

Date	Quantity (units)
Dec. 6	500
Dec. 21	600
Dec. 30	500
	1,600

Find out value of inventory by following methods:

- 1) FIFO Method
- 2) LIFO Method
- 3) Weighted Average Cost Method
- 4) Simple Average Method

Also find inventory value if computed by Periodic inventory system.

### Question 2 \_\_\_\_\_ Pg no. \_\_\_\_\_

Information has been given relating to petrol pump for the month of October 2023:

Sales	9,45,000
Administrative Cost	25,000

Inventory

Opening (1/10)	1,00,000 litres @ ₹ 3/litre
Purchases	
1/10	2,00,000 litres @ ₹ 2.85/litre
31/10	1,00,000 litres @ ₹ 3.03/litre
Closing	1,30,000 litres

Compute Closing Inventory, Cost of Goods Sold, Gross Profit and Net Profit as per FIFO, LIFO & Weighted average methods.

### Question 3 *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

From the following information, calculate the non-historical cost of closing inventories using adjusted selling price method:

Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening inventory	Nil
Closing inventory at selling price	50,000

**Question 4** *(ICAI Study Material)* Pg no. \_\_\_\_\_

M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2023:

Goods received from suppliers (subject to trade discount and taxes)	15,75,500
Trade discount 3% and GST 11%	
Packaging and transportation charges	87,500
Sales during the year	22,45,500
Sales price of closing inventories	2,35,000

Find out the non-historical cost of inventories using adjusted selling price method.

**Question 5** Pg no. \_\_\_\_\_

Y sells goods at a Gross Profit of 20% on Cost. He provides following data during a period-

- Opening Inventory at Market Price = ₹ 1,20,000 (Cost = ?)
- Sales made during the period = ₹ 38,40,000
- Purchases during the period (at cost) = ₹ 34,00,000

Find out the value of Closing Inventory

**Question 6** *(ICAI Study Material)* Pg no. \_\_\_\_\_

From the following particulars ascertain the value of Inventories as on 31st March, 2023:

Inventory as on 1.4.2022	1,42,500
Purchases	7,62,500
Manufacturing Expenses	1,50,000
Selling Expenses	60,500
Administrative Expenses	30,000
Financial Charges	21,500
Sales	12,45,000

At the time of valuing inventory as on 31st March, 2022, a sum of ₹ 17,500 was written off on a particular item, which was originally purchased for ₹ 50,000 and was sold during the year for ₹ 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales.

**Question 7** Pg no. \_\_\_\_\_

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

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

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

**Question 8** *(ICAI SM)/(RTP May 2018)/(Nov 2019)/(May 2021)/(Nov 2023) (Similar)* Pg no. \_\_\_\_\_

Inventory taking for the year ended 31<sup>st</sup> March, 2023 was completed by 10<sup>th</sup> April, 2023, the valuation of which showed a stock figure of ₹ 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales

for the next year were made for ₹ 68,750, profit margin being 33.33% on cost. Purchases for the next year included in the inventory amounted to ₹ 90,000 at cost less trade discount 10%. During this period, goods were added to inventory of the mark up price of ₹ 3,000 in respect of sales returns.

After inventory taking it was found that there were certain very old slow moving items costing ₹ 11,250 which should be taken at ₹ 5,250 to ensure disposal to an interested customer. Due to heavy floods, certain goods costing ₹ 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be ₹ 12,500 on 31st March, 2023.

Calculate the value of inventory for inclusion in the final accounts for the year ended 31st March, 2023.

**Question 9** *(ICAI Study Material)* Pg no. \_\_\_\_\_

X who was closing his books on 31.3.2023 failed to take the actual stock which he did only on 9th April, 2023, when it was ascertained by him to be worth ₹ 2,50,000.

It was found that sales are entered in the sales book on the same day of dispatch and return inwards in the returns book as and when the goods are received back. Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31.3.2023 and 9.4.2023 as per the sales day book are ₹ 17,200. Purchases between 31.3.2023 and 9.4.2023 as per purchases day book are ₹ 1,200, out of these goods amounting to ₹ 500 were not received until after the stock was taken.

Goods invoiced during the month of March, 2023 but goods received only on 4th April, 2023 amounted to ₹ 1,000. Rate of gross profit is 33-1/3% on cost.

Ascertain the value of physical stock as on 31.3.2023.

**Question 10** *(ICAI Study Material)* Pg no. \_\_\_\_\_

The Profit and loss account of Hanuman showed a net profit of ₹ 6,00,000, after considering the closing stock of ₹ 3,75,000 on 31st March, 2023. Subsequently the following information was obtained from scrutiny of the books:

- Purchases for the year included ₹ 15,000 paid for new electric fittings for the shop.
- Hanuman gave away goods valued at ₹ 40,000 as free samples for which no entry was made in the books of accounts.
- Invoices for goods amounting to ₹ 2,50,000 have been entered on 27th March, 2023, but the goods were not included in stock.
- In March, 2023 goods of ₹ 2,00,000 sold and delivered were taken in the sales for April, 2023.
- Goods costing ₹ 75,000 were sent on sale or return in March, 2023 at a margin of profit of 33-1/3% on cost. Though approval was given in April, 2023 these were taken as sales for March, 2023.

Calculate value of stock on 31st March, 2023 and the adjusted net profit for the year ended on that date.

**Question 11** *(ICAI SM)/(RTP May 2019)/(Nov 2020)/(May 2022)/(Nov 2022) (Similar)* Pg no. \_\_\_\_\_

A trader prepares his account on 31<sup>st</sup> March each year. Due to some avoidable reasons, no stocktaking could be possible till 15<sup>th</sup> April 2023. On which date total cost of goods in his godown came to ₹ 50,000.

The following facts were established between 31<sup>st</sup> March and 15<sup>th</sup> April 2023.

- Sales ₹ 41,000 (including cash sales ₹ 10,000)
- Purchase ₹ 5,034 (including cash purchase ₹ 1,990)
- Sales Return ₹ 1,000

- d) On 15<sup>th</sup> March goods of the sale value of ₹ 10,000 were sent on sale or return basis to customer, the period of approval being four weeks. He returned 40% of the goods on 10<sup>th</sup> April approving the rest. The customer was billed on 16<sup>th</sup> April.
- e) The trader had also received goods costing ₹ 8,000 in March, for sale on consignment basis, 20% of the goods had been sold by 31<sup>st</sup> March, and another 50% by 15<sup>th</sup> April. These sales are not included in above sales.
- Goods are sold by the trader at a profit of 20% on sales.  
You are required to ascertain the value of inventory as on 31<sup>st</sup> March 2023.

**Question 12** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

- Physical verification of stock in a business was done on 23<sup>rd</sup> June, 2023. The value of the stock was ₹ 48,00,000. The following transactions took place between 23<sup>rd</sup> June to 30<sup>th</sup> June, 2023:
- Out of the goods sent on consignment, goods at cost worth ₹ 2,40,000 were unsold.
  - Purchases of ₹ 4,00,000 were made out of which goods worth ₹ 1,60,000 were delivered on 5<sup>th</sup> July, 2023.
  - Sales were ₹ 13,60,000, which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 30<sup>th</sup> June 2023.
  - Goods are sold at cost plus 25%. However, goods costing ₹ 2,40,000 had been sold for ₹ 1,20,000.
- Determine the value of stock on 30th June, 2023.

**Question 13** *(CA Foundation May 2019) (5 Marks) / (RTP May 2023) (Similar)* \_\_\_\_\_ Pg no. \_\_\_\_\_

- Raj Ltd. prepared their accounts financial year ended on 31st March 2023. Due to unavoidable circumstances actual stock has been taken on 10th April 2023, when it was ascertained at ₹ 1,25,000. It has been found that;
- Sales are entered in the Sales Book on the day of dispatch and return inwards in the Returns Inward Book on the day of the goods received back.
  - Purchases are entered in the Purchase Book on the day the Invoices are received.
  - Sales between 1st April 2023 to 9th April 2023 amounting to ₹ 20,000 as per Sales Day Book.
  - Free samples for business promotion issued during 1st April 2023 to 9th April 2023 amounting to ₹ 4,000 at cost.
  - Purchases during 1st April 2023 to 9th April 2023 amounting to ₹ 10,000 but goods amounts to ₹ 2,000 not received till the date of stock taking.
  - Invoices for goods purchased amounting to ₹ 20,000 were entered on 28th March 2023 but the goods were not included in stock.
- Rate of Gross Profit is 25% on cost. Ascertain the value of Stock as on 31st March 2023.

**Question 14** *(RTP Nov 2018) / (RTP May 2020) / (RTP Nov 2021) (Similar)* \_\_\_\_\_ Pg no. \_\_\_\_\_

- Sky Ltd. keeps no stock records but a physical inventory of stock is made at the end of each quarter and the valuation is taken at cost. The company's year ends on 31st March, 2023 and their accounts have been prepared to that date. The stock valuation taken on 31st March, 2023 was however, misleading and you have been advised to value the closing stocks as on 31st March, 2023 with the stock figure as on 31st December, 2022 and some other information is available to you:
- The cost of stock on 31st December, 2022 as shown by the inventory sheet was ₹ 80,000.
  - On 31st December, stock sheet showed the following discrepancies:
    - A page total of ₹ 5,000 had been carried to summary sheet as ₹ 6,000.
    - The total of a page had been undercast by ₹ 200.

- (iii) Invoice of purchases entered in the Purchase Book during the quarter from January to March, 2023 totalled ₹ 70,000. Out of this ₹ 3,000 related to goods received prior to 31st December, 2022. Invoices entered in April 2023 relating to goods received in March, 2023 totalled ₹ 4,000.
- (iv) Sales invoiced to customers totalled ₹ 90,000 from January to March, 2023. Of this ₹ 5,000 related to goods dispatched before 31st December, 2022. Goods dispatched to customers before 31st March, 2023 but invoiced in April, 2023 totalled ₹ 4,000.
- (v) During the final quarter, credit notes at invoiced value of ₹ 1,000 had been issued to customers in respect of goods returned during that period. The gross margin earned by the company is 25% of cost.

You are required to prepare a statement showing the amount of stock at cost as on 31st March, 2023.

**PRACTICE QUESTIONS****MULTIPLE CHOICE QUESTIONS**

- 1) The amount of purchase if  
Cost of goods sold is ₹ 80,700  
Opening Inventory ₹ 5,800  
Closing Inventory ₹ 6,000
  - (a) ₹ 80,500
  - (b) ₹ 74,900
  - (c) ₹ 80,900
  
- 2) Average Inventory = ₹ 12,000. Closing Inventory is ₹ 3,000 more than opening Inventory. The value of closing Inventory = \_\_\_\_\_.
  - (a) ₹ 12,000
  - (b) ₹ 24,000
  - (c) ₹ 13,500
  
- 3) While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by ₹ 50,000. As a result
  - (a) Previous year's profit is overstated and current year's profit is also overstated
  - (b) Previous year's profit is overstated and current year's profit is understated
  - (c) Previous year's profit is understated and current year's profit is also understated
  
- 4) Consider the following for Q Co. for the year 2022-23:

Cost of goods available for sale	₹ 1,00,000
Total sales	₹ 80,000
Opening inventory of goods	₹ 20,000
Gross profit margin on sales	25%

Closing inventory of goods for the year 2022-23 as
  - (a) ₹ 80,000
  - (b) ₹ 60,000
  - (c) ₹ 40,000
  
- 5) If the profit is 25% of the cost price then it is
  - (a) 25% of the sales price
  - (b) 33% of the sales price
  - (c) 20% of the sales price
  
- 6) Goods purchased ₹ 1,00,000. Sales ₹ 90,000. Margin 20% on cost. Closing Inventory = ?
  - (a) ₹ 20,000
  - (b) ₹ 10,000
  - (c) ₹ 25,000
  
- 7) A company is following weighted average cost method for valuing its inventory. The details of its purchase and issue of raw-materials during the week are as follows:

1.12.2023	Opening Inventory 50 units value ₹ 2,200.
2.12.2023	Purchased 100 units @ ₹47.

4.12.2023 Issued 50 units.

5.12.2023 Purchased 200 units @ ₹ 48.

The value of inventory at the end of the week and the unit weighted average costs is

(a) ₹ 14,200 – ₹ 47.33

(b) ₹ 14,300 – ₹ 47.67

(c) ₹ 14,000 – ₹ 46.66

- 8) The cost of sales is equal to
- Opening stock plus purchases
  - Purchases minus Closing stock
  - Opening stock plus purchases minus closing stock
- 9) Inventory is disclosed in financial statements under:
- Fixed Assets
  - Current Assets
  - Current Liabilities
- 10) Accounting Standards do not permit following method of inventory valuation
- FIFO
  - Average cost
  - LIFO
- 11) Which inventory costing formula calculates value of closing inventory considering that inventory most recently purchased has not been sold?
- FIFO
  - LIFO
  - Weighted average cost
- 12) Valuing inventory at cost or net realisable value is based on which principle
- Consistency
  - Conservatism
  - Going concern
- 13) Under inflationary trend, which of the methods will show highest value of inventory?
- FIFO
  - Weighted average
  - LIFO
- 14) Which of the following methods does not consider historical cost of inventory?
- Weighted average
  - FIFO
  - Retail price method

### ANSWERS MCQs

- |        |        |         |         |         |         |         |
|--------|--------|---------|---------|---------|---------|---------|
| 1. (c) | 2. (c) | 3. (b)  | 4. (c)  | 5. (c)  | 6. (c)  | 7. (a)  |
| 8. (c) | 9. (b) | 10. (c) | 11. (a) | 12. (b) | 13. (a) | 14. (c) |

## TRUE / FALSE

State with reasons whether the following statement is true or false:

- 1) Inventories are stocks of goods and materials that are maintained for mainly the purpose of revenue generation.
- 2) A building is considered inventory in a construction business.
- 3) Inventory is valued as carrying cost less percentage decreases.
- 4) Management has daily information about the quantity and valuation of closing stock under Physical Inventory System.
- 5) Periodic Inventory System is more suitable for small enterprises.
- 6) When closing inventory is overstated, net income for the accounting period will be understated.
- 7)  $\text{Closing inventory} = \text{Opening inventory} + \text{Purchases} + \text{Direct expenses} + \text{Cost of goods sold}$ .
- 8) Cost of inventories should comprise all cost of purchase.
- 9) Costs of conversion of inventories include costs directly related to the units of production. They include allocation of fixed overheads only.
- 10) Abnormal amounts of wasted materials, labour or other production overheads expenses are included in the costs of inventories.
- 11) Perpetual system requires closure of business for counting of inventory.
- 12) Periodic inventory system is a method of ascertaining inventory by taking an actual physical count. *(Dec 2022)*
- 13) The value of closing inventory under average method is realistic as compare to LIFO.
- 14) The value of stock is shown on the assets side of the balance-sheet as fixed assets.
- 15) Under inflationary conditions, FIFO will not show lowest value of cost of goods sold.
- 16) Under LIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.
- 17) Valuation of inventory at cost or net realizable value whichever is less, is based on principle of Conservatism. *(Nov 2019)*
- 18) Finished goods are normally valued at cost or market price, whichever is higher.
- 19) Warehouse rent paid for storage of finished inventory should be included in the cost of finished inventory. *(July 2021)*
- 20) Loss of stock is said to be abnormal loss when such loss is due to inherent characteristics of the commodities.
- 21) The proprietor of a shop feels that he has made a loss due to closing stock being zero.
- 22) Finished goods are normally valued at cost or market price, whichever is lower.
- 23) Damaged inventory should be valued at cost or market price; whichever is lower.
- 24) The inventory under AS-2 is valued on the basis of cost price or current replacement cost, whichever is less.

### Solution

- 1) True: Inventories refers to stocks of goods and materials that are maintained in business for revenue generation.
- 2) True: For a construction business a building under construction will be inventory. The building is being built in the normal course of business and will eventually be sold as well as inventory.
- 3) False: Inventory is valued at lower of cost or net realizable value.
- 4) False: Under Perpetual Inventory System management have daily information of closing stock.

- 5) True: A periodic inventory system is suitable to small and micro enterprises, where physical counting of inventory is not a tedious process.
- 6) False: When closing inventory is overstated, net income for the accounting period will be overstated.
- 7) False: Closing stock = Cost of goods sold - (Opening inventory + Purchases + Direct expenses).
- 8) False: Cost of inventories should comprise all cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- 9) False: Costs of conversion of inventories include costs directly related to the units of production. They also include a systematic allocation of fixed and variable overheads.
- 10) False: Abnormal amounts of wasted materials, labour or other production overheads expenses are generally not included in the costs of inventories.
- 11) False: Periodic system requires closure of business for counting of inventory.
- 12) True: Under Periodic inventory system actual physical count of inventory is taken of all the inventory on hand at a particular date.
- 13) True: Value of Closing stock as per average method is more realistic than LIFO.
- 14) False: The value of stock is shown on the assets side of the balance-sheet as current assets as it is realisable within 12 months.
- 15) False: Under inflationary conditions, LIFO and weighted average will not show lowest value of cost of goods sold.
- 16) False: Under FIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.
- 17) True: The conservatism concept states that one shall not account for anticipated profits but shall provide all prospective losses. Valuing inventory at cost or net realisable value whichever is less, therefore is based on principle of Conservatism.
- 18) False: Finished goods are normally valued at cost or NRV, whichever is lower
- 19) False: Warehousing costs related to finished goods are expensed when incurred and are not included in inventory costs unless storage is incurred for getting the inventory ready for sale i.e. until and unless storage is required as a part of process of production of inventory like in case of wine
- 20) False: Loss of stock is normal loss when the loss is attributable to the inherent features of the goods. The abnormal loss is usually caused by fire, theft abnormal spoilage etc.
- 21) False: Since the closing stock does not determine the profit directly but the operational efficiency and other factors determine it.
- 22) True: Finished goods are normally valued at cost or NRV, whichever is lower, as also adopted by AS-2.
- 23) True: As per AS-2, the inventory should be valued at cost or market price, whichever is less.
- 24) False: As per AS-2 inventory is valued at lower of cost or net realisable value.

## HOMEWORK QUESTIONS

### Question 1 \_\_\_\_\_ Pg no. \_\_\_\_\_

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31<sup>st</sup> March 2023, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	Historical cost	Net realizable value
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock for the year ending 31<sup>st</sup> March, 2023 as per AS 2.

### Question 2 *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

The following are the details of a spare part of Sriram mills:

Date	Quantity (units)	Price per unit
1-1-2023	Opening Inventory	Nil
1-1-2023	Purchases	100 units @ ₹ 30 per unit
15-1-2023	Issued for consumption	50 units
1-2-2023	Purchases	200 units @ ₹ 40 per unit
15-2-2023	Issued for consumption	100 units
20-2-2023	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2023 if the company follows

- a) First in first out basis
- b) Weighted Average basis

### Question 3 *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets

Date	Quantity (units)	Price per unit
Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55
Dec. 19	200	60
Dec. 28	800	47
	2,600	

Record of issues

Date	Quantity (units)
Dec. 5	500
Dec. 20	600
Dec. 29	500
	1,600

Find out value of inventory by following methods:

- 1) FIFO Method
- 2) LIFO Method
- 3) Simple Average Method
- 4) Weighted Average Cost Method

Also find inventory value if computed by Periodic inventory system.

**Question 4** \_\_\_\_\_ Pg no. \_\_\_\_\_

A Company has the following record of purchases-

Date	December 4	December 10	December 24
Quantity (units)	900	700	600
Price p.u. (₹)	50	55	60

Sales were made as under:

Date	December 5	December 12	December 29
Quantity (Units)	600	500	600

Compute the value of Closing Inventory under -

- FIFO,
- LIFO
- Simple Average Cost,
- Weighted Average Cost.

**Question 5** *(CA Foundation Dec 2021) (4 Marks)* \_\_\_\_\_ Pg no. \_\_\_\_\_

The following are the details of a spare part of an Oil Mill:

Date	Quantity (units)	Price per unit
1-1-2023	Opening Inventory	Nil
1-1-2023	Purchases	10 units @ ₹ 300 per unit
15-1-2023	Issued for consumption	5 units
1-2-2023	Purchases	20 units @ ₹ 400 per unit
15-2-2023	Issued for consumption	10 units
20-2-2023	Issued for consumption	10 units

Find out the value of Inventory as on 31-3-2023 if the company follows Weighted Average Method.

**Question 6** \_\_\_\_\_ Pg no. \_\_\_\_\_

Suraj Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:

Opening Inventory ₹ 50,000; Purchases ₹ 3,60,000; Purchase Returns ₹ 10,000; Freight Inwards ₹ 10,000; Gross Sales ₹ 4,50,000; Sales Returns ₹ 11,250; Carriage Outwards ₹ 5,000. Compute the estimated cost of the inventory on the closing date.

**Question 7** *(CA Foundation July 2021) (5 Marks)* \_\_\_\_\_ Pg no. \_\_\_\_\_

From the following information, calculate the historical cost of closing inventories using adjusted selling price method:

Purchase during the year	5,00,000
Sales during the year	7,50,000
Opening inventory	Nil
Closing inventory at selling price	1,00,000

**Question 8** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

From the following information, ascertain the value of stock as on 31.3.2023:

Value of stock on 1.4.2022	7,00,000
Purchases during the period from 1.4.2022 to 31.3.2023	34,60,000

Manufacturing expenses during the above period	7,00,000
Sales during the same period	52,20,000

At the time of valuing stock on 31.3.2022 a sum of ₹ 60,000 was written off a particular item which was originally purchased for ₹ 2,00,000 and was sold for ₹ 1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

**Question 9** *(CA Foundation Jan 2021) (5 Marks)* Pg no. \_\_\_\_\_

From the following particulars ascertain the value of Inventories as on 31st March, 2023:

Inventory as on 1.4.2022	3,50,000
Purchases	12,00,000
Sales	18,50,000
Manufacturing Expenses	1,00,000
Selling & Distribution Expenses	50,000
Administrative Expenses	80,000

At the time of valuing inventory as on 31st March, 2022, a sum of ₹ 20,000 was written off on a particular item which was originally purchased for ₹ 55,000 and was sold during the year for ₹ 50,000. Except the above mentioned transaction, gross profit earned during the year was 20% on sales.

**Question 10** *(CA Foundation June 2022) (5 Marks)* Pg no. \_\_\_\_\_

Zed Enterprises furnishes the following information for the year ended 31st March, 2023.

Particulars	Amount (₹)
Value of Stock as on 1st April, 2022	28,00,000
Purchases during the year	1,38,40,000
Manufacturing Expenses during the year	28,00,000
Sales during the year	2,08,80,000

The following further information is also provided:

- At the time of valuing stock on 31st March, 2022 a sum of ₹ 2,40,000 was written off for a particular item which was originally purchased for ₹ 8,00,000. This item was sold during the year ended 31st March, 2023 for ₹ 6,40,000.
- Except for the above transaction, the rate of gross profit during the year was 1/3rd on cost. Ascertain the value of Stock as on 31st March, 2023.

**Question 11** Pg no. \_\_\_\_\_

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no inventory taking could be possible till 15th April, 2023 on which date the total cost of goods in his godown came to ₹ 5,00,000. The following facts were established between 31st March & 15th April, 2023

- Sales ₹ 4,10,000 (including cash sales ₹ 1,00,000)
- Purchases ₹ 50,340 (including cash purchases ₹ 19,900)
- Sales Return ₹ 10,000.

Goods are sold by the trader at a profit of 20% on sales.

You are required to ascertain the value of inventory as on 31st March, 2023.

**Question 12** *(CA Foundation June 2023) (5 Marks)* Pg no. \_\_\_\_\_

The Profit and Loss account of Ram showed a net profit of ₹ 5,75,000 after considering the closing stock of ₹ 2,55,000 on 31st March 2023. Subsequently the following information was obtained from scrutiny of the books.

- a. Purchases for the year included ₹ 10,500 paid for electrical fittings of the shop.
- b. Ram gave goods worth of ₹ 25,000 as free samples for which no entry was made.
- c. Invoices for goods amounting to ₹ 1,85,000 have been entered on 29th March 2023 but were not included in the stock.
- d. Sales amounting to ₹ 2,05,000 were dispatched on 27th March but were included in sales of April, 2023.
- e. Goods costing ₹ 55,000 were sent on sale or return basis in March, 2023 at a margin of profit of 33½ % on cost. Approval was given in April, 2023 but these were considered as sales in March, 2023.

Calculate. the value of stock as on 31st March, 2023 and the adjusted net profit for the year ended on that date.

**Question 13** *(CA Foundation Nov 2020) (10 Marks)* \_\_\_\_\_ Pg no. \_\_\_\_\_

Physical verification of stock in a business was done on 23rd February, 2020. The value of the stock was ₹ 28,00,000. The following transactions took place from 23rd February to 29th February, 2020 :

- (1) Out of the goods sent on consignment, goods at cost worth ₹ 2,30,000 were unsold.
- (2) Purchases of ₹ 3,00,000 were made out of which goods worth ₹ 1,20,000 were delivered on 5th March, 2020.
- (3) Sales were ₹ 13,60,000 which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 29th February, 2020, but no information is available regarding the remaining goods.
- (4) Goods are sold at cost plus 25%. However goods costing ₹ 2,40,000 had been sold for ₹ 1,50,000.

Determine the value of stock on 29th February, 2020.

**Question 14** *(CA Foundation Nov 2019) (5 Marks)* \_\_\_\_\_ Pg no. \_\_\_\_\_

Distinguish between Periodic Inventory System and Perpetual Inventory System.

**Question 15** \_\_\_\_\_ Pg no. \_\_\_\_\_

Explain the Periodic Inventory system and its limitations.