Lesson Description

In this lesson we:

- Explain different methods of stock valuation
- Complete calculations for stock valuation

Challenge Question

Name three methods of stock valuation?

Summary

STOCK SYSTEMS

- Remember that there are two stock systems generally in use – the periodic system and the perpetual system
- You will need to know both of these systems as they can appear in questions on financial statements.
- The perpetual system is the system you have been using since Grade 10, where you record the cost of sales after every sale
- The periodic system works out the cost of sales at the end of every period (that is why it is called periodic) using a formula.

Advantages of the perpetual stock system

- You always know exactly how much stock you should have on hand
- Stock losses are easier to detect in the perpetual system than in the periodic system
- It is more accurate and realistic as cost of sales are recorded every single day

Advantage of the periodic stock system

- It is much cheaper and easier to implement than the perpetual system – you don’t need barcode scanners and you don’t need to record cost of sales after every sale

METHODS OF DETERMINING STOCK VALUE

When adopting a method to determine the cost price of the stock still on hand, the wisest choice would be that method which can facilitate the most realistic determination of profits for any specific business.

The four methods most generally used to determine cost price of stock on hand at the end of the financial period are:

- Specific identification method
- Weighted average method
- First-in-first-out method (FIFO)
SPECIFIC IDENTIFICATION METHOD

In addition to the FIFO and Weighted Average methods of valuing stock, CAPS stipulates the specific identification method. This should not create any problems for learners as it is a method that would have been utilised at Grade 8-10 levels where the specific cost price of an article is provided either in Rand terms or in code form.

WEIGHTED AVERAGE

The weighted average method does not take quantities into account but average price into account. With the receipt of goods the average cost of each item is recalculated or calculated at the end of the financial year.

FIFO

Sale of goods is based on First in, first out basis, i.e. goods bought first are the first to be issued for sale.

Test Yourself

1. The perpetual inventory system uses the following account:
   A. Purchases
   B. Opening stock
   c. Cost of sales
   D. Closing stock

2. The periodic system makes use of the following account:
   A. Purchases
   B. Trading stock
   C. Cost of sales
   D. None of the above

3. The following is not a stock validation method:
   A. Weighted Average
   B. FIFO
   C. Specific identification
   D. Perpetual

4. The higher the closing stock, will result in a ..........gross profit
   A. Higher
   B. Lower
   C. Same
   D. None of the above

5. The stock validation method can be changed:
   A. At any time
   B. Written permission granted by SARS
   C. To manipulate profits
   D. To impress a prospective buyer
   E.
**Improve your Skills**

You are provided with information in respect of Magic Soccer Balls Shop for the year ended 28 February 2009. The business is owned by Peter Pule.

The business uses the perpetual inventory system and the FIFO method of valuing stock.

**REQUIRED:**

1.1 Explain the meaning of the term ‘FIFO’.

1.2 The selling price of soccer balls was kept constant throughout the year. Calculate the selling price per soccer ball.

1.3 The owner, Peter Pule, is aware that some soccer balls were stolen from the storeroom in April 2008. No entry has been made.
   - Calculate the number of balls that are missing.
   - What entry would you make in the books to record this?

1.4 Value the stock on hand at the year-end according to the FIFO method.

1.5 Calculate following:
   - Cost of sales
   - Gross profit for the year.

1.6 Peter is not sure when to place his next order of soccer balls.
   - How long can he expect the closing stock to last? Provide figures or a calculation to support your answer.
   - What advice will you offer Peter about his purchases of stock? Provide two points.

**INFORMATION:**

Accounting records relating to the soccer balls:

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<tr>
<th>Details</th>
<th>Date</th>
<th>No. of balls</th>
<th>Unit price</th>
<th>Total</th>
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<td>Opening stock</td>
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<td>750</td>
<td>R110</td>
<td>R 82 500</td>
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<tr>
<td>Purchases</td>
<td></td>
<td>2 480</td>
<td></td>
<td>R 340 800</td>
</tr>
<tr>
<td>20 May 2008</td>
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<td>800</td>
<td>R150</td>
<td>R 120 000</td>
</tr>
<tr>
<td>25 October 2008</td>
<td></td>
<td>1 200</td>
<td>R120</td>
<td>R 144 000</td>
</tr>
<tr>
<td>16 December 2008</td>
<td></td>
<td>480</td>
<td>R160</td>
<td>R 76 800</td>
</tr>
<tr>
<td>Closing stock</td>
<td>28 February 2009</td>
<td>1 100</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Sales</td>
<td>1 March 2008 to</td>
<td>2 100</td>
<td>?</td>
<td>R 430 500</td>
</tr>
<tr>
<td></td>
<td>28 February 2009</td>
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