FACULTY OF COMMERCE AND MANAGEMENT

COURSE: MBA III SEM..

SUBJECT: WORKING CAPITAL MANAGEMENT

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LECTURE: 30

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LECTURE-30

Other Methods of Valuation of Inventory:

– Other than those based on Historical Cost:

Some of the important methods of valuation of inventory (other than those based on historical cost) are noted below:

(a) Standard Cost Method;

(b) Inflated Cost Method,

(c) Reverse Cost Method;

(d) Replacement Cost Method, and

(e) Realisable Market Value Method.

(a) Standard Cost:

Under this method, closing inventories are valued at pre-fixed standard rates. This method is found suitable where the manufacturing units are engaged in production on a large scale. But this method cannot reveal the true value of inventory when production is completed after passing through several processes or where manufactured products are of different varieties.

At the same time, if there is a slight error in fixing the single standard rate the same will affect the measure of all items of inventory.

Illustration 6:

Follow Standard Price/Cost Method assuming that the Standard price is fixed at Rs. 5.5 per unit.

Solution:

Store Ledger Account
Standard Price Method

Name of Material –
Specification –
Code No –
Unite of Measurement —

Bill No –
Location –

Folio No -
Maximum level –
Minimum level –
Re-ordinaring level –

	Receipts				Issues				Balance			
Date	G.R. No.	Quantity	Rate	Amount	S.R. No	Quantity	Rate	Amount	Quality	Rate	Amount	Rem-arks
1992				Rs.				Rs.			Rs.	
Jan. 1.									1,000	5	5,000	
3.		200	5,5	1,100					1,200	—	6,100	
9.						1,000	5.5	5,500	200	—	600	
15.		1,400	6	8,400					1,600	—	9,000	
17.						1,000	5.5	5,500	600	—	3,500	
21.		800	6.5	5,200					1,400	—	8,700	
23.						1,000	5.5	5,500	400		3,200	

(b) Inflated Cost Method:

Under this method, closing inventories are valued at a cost per unit which is higher than the actual cost per unit to provide for the normal loss due to certain inherent in them, e.g., loss due to evaporation, shrinkage etc.

(c) Reserve Cost Method:

Under this method, inventories are valued at an estimated cost which is determined by deducting an amount equivalent to the normal profit margin and the estimated cost of disposal from the current selling prices. This method is also referred to as 'Adjusted Selling Price'.

(d) Replacement Cost Method:

Under this method, each closing item of inventory is valued at cost which is to be incurred for purchasing/procuring the said item from the open market on the date of valuation, i.e., they are valued at the replacement cost as on that date. This cost of replacement should be determined in relation to the current market price of similar items.

(e) Realisable Market Value:

Under this method, each closing item of inventory is valued at its estimated net realisable value. The net realisable value, i.e., prospective selling price less all prospective costs to be incurred in conditioning and selling the goods, may be adopted suitably for the purpose of valuation.