



# Valuing Stock

- Stock must be valued in order to complete accounts
- But stocks are constantly being brought, and prices change frequently
- There are 3 accepted methods of putting a value on stocks:
  - **First In First Out (FIFO)**
    - Assumes that stocks are used in the order that they were received
    - It tends to give a higher value
  - **Last In First Out (LIFO)**
    - This method assumes that the stocks received last will be used first.
    - It tends to undervalue stocks
  - **Average Cost Method**
    - This method recalculates the average cost of stock after every delivery.
    - Each unit is then assumed to have been purchased at this average price





# Calculating The Average Cost of Stock

- In order to use the average cost method it is necessary to calculate the average cost of each unit using the following formula:

$$\text{Average Cost of Stock} = \frac{\text{Existing Stock Value} + \text{Value of Latest Purchases}}{\text{Number of Units Now In Stock}}$$

- For example:

- A firm buys 10 units at a price of £10, and then another 5 units at a price of £11
- The average cost of each unit becomes:

$$\text{Average Cost of Stock} = \frac{100 + 55}{15} = 10.33$$

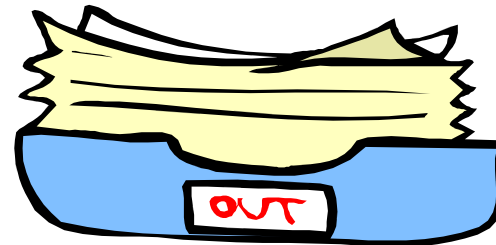
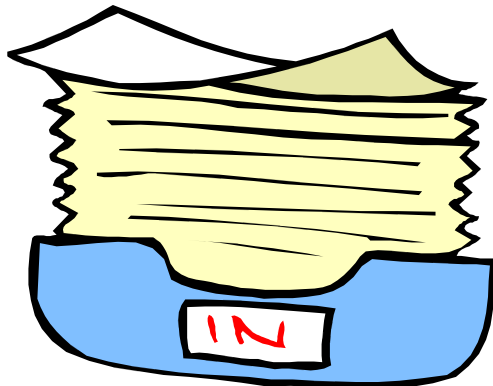
- Therefore it is assumed that each unit cost £10.33



# Comparing the 3 Methods

- In order to compare the 3 methods assume that a business makes the following transactions:

- January: Opening stock of 200 units that cost £2.00 each
- February: Purchased 50 units at a price of £3.00 each
- March: Sold 100 units
- April: Purchased 80 units at £3.50
- May: Sold 120 units





# The FIFO Method

FIFO Method				
Date	Price In	Price Out	Running Value	
Jan	Balance		200 @ £2.00 =	£400
				£400
Feb	50 @ £3.00		200 @ £2.00 =	£400
			50 @ £3.00 =	£150
				£550
Mar		100 @ £2.00	100 @ £2.00 =	£200
			50 @ £3.00 =	£150
				£350
Apr	80 @ £3.50		100 @ £2.00 =	£200
			50 @ £3.00 =	£150
			80 @ £3.50 =	£280
				£630
May		100 @ £2.00 20 @ £3.00	30 @ £3.00 =	£ 90
			80 @ £3.50 =	£280
				£370



# The LIFO Method

LIFO Method				
Date	Price In	Price Out	Running Value	
Jan	Balance		200 @ £2.00 =	£400
				£400
Feb	50 @ £3.00		200 @ £2.00 =	£400
			50 @ £3.00 =	£150
				£550
Mar		50 @ £3.00 50 @ £2.00	150 @ £2.00 =	£300
				£300
Apr	80 @ £3.50		150 @ £2.00 =	£300
			80 @ £3.50 =	£280
				£580
May		80 @ £3.50 40 @ £2.00	110 @ £2.00 =	£220
				£220



# The Average Cost Method

Average Cost Method					
Date	In	Out	Average Cost	Units	Running Value
Jan	Balance		£2.00	200	£400.00
Feb	50 @ £3.00		£2.20	250	£550.00
Mar		100	£2.20	150	£330.00
Apr	80 @ £3.50		£2.65	230	£609.50
May		120	£2.65	110	£291.50