

Inventory valuation



Inventory Valuation Palermo Wine Company The Chief Financial Officer 1st June The Auditors Dear Sirs, Re: Inventory Valuation This letter serves to justify the position of Palermo Wine Company to maintain the value of its inventory in its account at 31st May 2010. On that date, approximately one third (1/3rd) of the company's inventory, which consisted of 2, 100 cases of Red Wines from Bordeaux, with an average cost of \$120 per case had a market value of \$146, down from the previous price of \$220. Since that time the replacement cost of wine has fallen to \$80 per case. According to generally accepted accounting principles (GAAPs) there are three acceptable methods of valuation. These include average cost (AVCO) and First-in-first-out (FIFO) and last-in-first-out (LIFO). However, International Accounting Standards (IAS) 2 does not permit the use of LIFO (BPP 2009, p. 205). The method that we have adopted is AVCO. GAAPs and IAS 2 also require that inventory be valued at the lower-of-cost-and-market value (LCM) (Hoyle and Skender 2010). This means that if the market value had fallen below cost after the year end then the inventory would require an adjustment to market value. We therefore need to compare our valuation at 31st May 2010 which is \$120 with the current market price of \$146. Since Palermo's valuation is lower than the market value, we will maintain our current valuation of \$120 per case. As soon as we start paying \$80 per case, the average cost will decline as long as cost prices remain that way. This however, will not apply to 31st May 2010. Furthermore, if later on, we see a reduction in market value below our current average cost of \$120, we will have no other choice but to reduce our valuation to market value and to write off as an expense. Otherwise, our valuation as it stands currently is in keeping with GAAPs and IASs. Sincerely, Chief Financial Officer References BPP.

(2009). F7 Financial Reporting. 3rd Ed. London: BPP Learning Media. Hoyle, J.

B and Skender, C. J (2010) Financial Accounting. Available at: [http://www.](http://www.flatworldknowledge.com/printed-book/90996)

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