Policy Code # A-FN-105-001/AG-001

Chapter 25 – Inventory Valuation

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APPLICATION

1. This policy applies to all Non-Public Property (NPP) entities/activities that carry inventory.
2. Entities are encouraged to use a Perpetual Inventory System when feasible for a more accurate, real-time picture of inventory and cost of goods sold (COGS). When a perpetual inventory system is not in use, NPP inventory is valued by either the Cost Multiplier or the Current Cost method and usage is determined by factors such as, the type of outlet, scale and scope of operations, degree of control desired, rate of turnover of inventory, and frequency of stocktakings.

APPROVAL

3. This policy is issued under the authority of the Chief Financial Officer (CFO).

ENQUIRIES

4. Enquiries regarding this policy should first be directed to the local NPP Accounting Office. If further guidance is required, enquiries should then be referred to the Senior Manager, Financial Policies via email to: financepolicy@cfmws.com.
5.

DEFINITIONS

6. **Current Cost Method** – an inventory valuation approach based on the most recent purchase cost of inventory items.
7. **Cost Multiplier Method** – an inventory valuation approach using predetermined cost multipliers approved by designated authorities to reflect cost factors.
8. **First-In, First-Out (FIFO)** – an inventory valuation approach that assumes the oldest items purchased are the first ones sold.
9. **Inventory Valuation** – the process of determining the cost of inventory items on hand and available for sale.
10. **Official Stocktaking** – a stocktaking conducted by independent parties who are not affiliated with the entity undergoing the stocktaking.
11. **Perpetual Inventory System** – a system that continuously updates inventory balances and cost of goods sold (COGS) as transactions occur.
12. **Purchases Not Invoiced (PNI)** – goods received but not yet invoiced by suppliers, which require temporary valuation adjustments.
13. **Weighted Average Method of Inventory Valuation** - an inventory valuation approach that assigns the same average unit cost to all units of inventory.

POLICY

14. Inventory valuation is done to ensure accurate financial reporting and effective management

control. Proper inventory valuation helps detect discrepancies and manage cost fluctuations.

15. After an official stocktaking, inventory values shall be adjusted to match the physical inventory count values, as per Chapter 26 (Stocktaking).

INVENTORY VALUATION METHODS

16. The following is a list of the methods of inventory valuation used within NPP and a brief description of each.

COST MULTIPLIER METHOD

17. Cost multipliers (CMs) are established for each department at the beginning of each fiscal year based on either the budget figures or the fiscal year end actuals from the previous year.

18. When using budget figures, CMs are determined by taking the total year budgeted figure for Cost of Goods Sold (COGS) divided by the total year budgeted Sales figure for each department.

19. For example, the Officer's mess has budgeted sales of $6,425 in department 11 (Soft Drinks) and $3,900 of COGS. The CM for this department is 0.607 (3,900/6,425 = .607), which would be rounded to 0.61.

20. Once CMs have been established for each department, they are compared to the actual Fiscal Year End (FYE) COGS percentages, for each department, from the departmental analysis report (DAR) to ensure the new CM is in line with the actual CM from the FYE. On the DAR, CMs are shown as COGS percentages. If CMs are not in line, a discussion with the entity manager shall take place to determine if the new CMs need to be amended. Once any necessary amendments have been made and all CMs are verified to be accurate, the newly established CMs are entered on the DSR template for the entity.

21. When fiscal year-end actuals are used, the amounts may be adjusted to reflect current-year cost increases by multiplying the actual amounts by the applicable increase factor.

22. On each DSR, the total sales for each department is multiplied by the CM for that department to determine the COGS.

23. CMs can remain the same for the entire fiscal year, or they can be updated to reflect actuals if an official stocktaking is conducted throughout the year. When updating the CMs, the new CMs shall be entered on the DSR template to be used going forward.

24. After an official stocktaking, the inventory records within the accounting system are updated to reflect the cost inventory value which is calculated by using the cost multiplier to convert the retail inventory counts to cost values.

PERPETUAL INVENTORY SYSTEM

25. Perpetual inventory system shall use either the weighted average method or the First-In, First-Out (FIFO) method for inventory valuation.

    Note: The Last-In, First-Out (LIFO) method is not acceptable in Canada, under the International Financial Reporting Standards (IFRS).

26. For perpetual inventory systems that use the FIFO method, all purchases, sales, and transfers are recorded in the POS system, which maintains an ongoing inventory valuation by deducting inventory at the cost associated with the earliest purchases (First-In, First-Out) for each sale and transfer.

27. At the end of each month, an inventory report is pulled from the perpetual inventory system that identifies the inventory FIFO cost for each department. Those amounts are entered on the CIW, any variances are identified and investigated as needed, and the CIW is then uploaded into the accounting system to update and align its inventory costs with the FIFO

values.

28. After an official stocktaking, the inventory records within the POS System are updated to reflect the physical count. Then, the updated inventory costs from the POS system are entered onto the CIW and uploaded into the accounting system to reflect the actual inventory value based on the stocktaking count and FIFO cost, as per Chapter 26 – Stocktaking.

29. For perpetual inventory systems that use the weighted average method, all purchases, sales, and transfers are recorded in the POS system, which maintains an ongoing inventory valuation by calculating the average cost of each unit of inventory. The weighted average is calculated by adding up all actual cost prices of inventory on hand and dividing that total by the total number of inventory items on hand.

    Note: For CANEX, the Associate Vice-President of Merchandising and the Finance Business Partner are responsible for giving specific directions on which departments are accounted for by the weighted-average method.

30. At the end of each month an inventory report is pulled from the perpetual inventory system that identifies the inventory's weighted-average cost for each department. Those amounts are entered on the CIW, any variances are identified and investigated as needed, and the CIW is then uploaded into the accounting system to update and align its inventory costs with the weighted-average values.

31. After an official stocktaking, the inventory records within the perpetual inventory system are updated to reflect the actual inventory value based on the stocktaking count and weighted-average cost. Then, the inventory costs from the perpetual inventory system are entered onto the CIW and uploaded into the accounting system to reflect the actual inventory value based on the stocktaking count and weighted-average cost, as per Chapter 26 – Stocktaking.

CURRENT COST ACCOUNTABILITY METHOD

32. NPP entities/activities with small scale retail operations (such as smaller deployed operations and/or Unit NPP Activities) may use the current cost method for inventory valuation.

33. The current cost method uses the cost as shown on the most recent vendor invoice and applies that cost to all inventory on hand/available for sale.

34. Inventory is accounted for solely at cost for this method.

35. Stocktakings are conducted at every month end and the inventory is counted by units then multiplied by the most current cost price. The closing inventory at cost figure is therefore reflective of actual current cost values in contrast to the approximate current values determined when using a cost multiplier.

36. After an official stocktaking, the inventory records within the accounting system are updated to reflect the actual inventory value based on the stocktaking count and current cost.

37. The NPP Accounting Office may need to consult the most recent invoices to confirm cost amounts if there are any material discrepancies.

SHRINKAGE

38. Periodically merchandise will deteriorate or be lost through breakage or spoilage. The Breakage/spoilage register (Annex B) is an essential internal control tool that must be maintained by Entity Staff. It provides an indicator of potential equipment and/or personnel issues and must be reviewed regularly by entity management. Material and/or recurring losses should be investigated for cause and corrective action initiated as soon as plausible.

39. In exceptional circumstances, such as a significant, identifiable loss resulting from events like a refrigeration failure, flood, fire, or major breakage, management may approve the

immediate recognition of an expense at the time the loss becomes known. Outside of these rare and material events, shrinkage is not expensed separately and is reflected in the cost of goods sold only when inventory balances are adjusted to actual amounts following an official stocktaking.

AUTHORITIES / RESPONSIBILITIES

40. Prior to conducting an official stocktaking, entity managers are required to submit all Purchases not Invoiced (PNI) to the NPP Accounting Office. The NPP Accounting Office will then adjust inventory values accordingly to ensure that all PNI are accurately reflected in the inventory records.

    Note: It is vital that PNI be accounted for Cost Multiplier Departments prior to Stocktaking or COGS will not be reliable.

41. Entity managers and the NPP Accounting Manager, or their delegate, shall review the Department Analysis Report (DAR) at minimum quarterly to confirm the COGS is in line with budgets. Any material variances should be investigated immediately and corrective action taken if/as required.

ANNEXES

Annex A - Source Documentation and Local Accounting Office Responsibilities

Annex B - Breakage/spoilage register