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

Chapter 25: Inventory Valuation

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INTRODUCTION

1. There are various methods used to value inventory. Which method is used depends on several factors including degree of control desired, rate of turnover of inventory, frequency of stocktakings, and whether the inventory is counted at cost or retail. Methods may vary depending on the type of outlet, and may also vary within an outlet depending on the type of merchandise. In the case of CANEX outlets, methods may vary depending on the department. When Base Fund operates an activity which is normally a CANEX operation (eg. Retail Store), CANEX inventory procedures will apply unless indicated otherwise.

INVENTORY VALUATION METHODS

2. The following is a list of the methods of inventory valuation used within NPF and a brief description of each type. Included at the end of the description is a list of outlets and departments to which the method applies.

RETAIL ACCOUNTABILITY

3. This method permits determination of the approximate value of the closing inventory without a physical count and without researching source documents for the costs of the items. Inventory is maintained at retail. Stocktakings occur at different frequencies depending on the outlet or department and the inventory is counted at retail. A cost multiplier is used to determine the closing inventory at cost.

4. Retail accountability is used for the following outlets and departments:

    a. Bar Operations in messes, Base Fund subsidiaries, restaurants, and Food Services D/51;

    b. Retail Stores;

    c. ExpressMarts;

    d. The following Combination Stores: ExpressMart with Gas Bar: all departments other than D/40 and D/46; Retail Store and ExpressMart: all departments; and Retail Store and Supermarket: D/2 to D/16 inclusive, D/20 and D/21 and D/22;

    e. Gas Bars: all departments except D/40 and D46;

    f. Vending; and

    g. Special Services depending on the type of inventory.

5. The retail accountability method is used widely throughout NPF. Because the inventory is maintained at retail, the use of the Retail Accountability Report (RAR) is an integral part of this method. For further information on this method and the RAR, see paras 13 to 26 below.

COST ACCOUNTABILITY (CURRENT COST)

6. Inventory is not maintained at retail for this method and thus, there is no RAR. Instead, stocktakings occur every month and the inventory is counted by units and multiplied by the most current cost price. The closing inventory at cost figures are therefore actual rather than

determined through the use of a cost multiplier.

7. Cost Accountability (current cost) is used for the following outlets and departments:

   a. Supermarkets: D/19, D/21, D/31, D/33, D/34 and D/35;

   b. Gas Bars: D/40, and D/46;

   c. Food Services: D/50; and

   d. Special Services depending on the type of inventory.

8. For departments D/31, D/33, D/34, and D/35, the stock that has been priced at retail (ie. processed and located on the display shelves) should be counted at retail and costed using the following average national cost multipliers: D/31-0.75, D/31-0.80, D/34-0.65, and D/35-0.60.

COST ACCOUNTABILITY (COST MULTIPLIER)

9. Inventory is not maintained at retail for this method and thus, there is no RAR. Stocktakings occur at different frequencies depending on the outlet but are not conducted every month. The inventory is counted at retail rather than at cost, and the closing inventory is valued at cost using a cost multiplier that is determined by calculation after the inventory is taken. During those months when there is no stocktaking, the closing inventory at cost is determined by using an estimated cost multiplier.

10. Cost Accountability (cost multiplier) is used for the following outlets and departments:

    a. Supermarkets: all departments other than those listed at para 7(a) above; and

    b. Combination Stores: (combined Retail Store and Supermarket only) D/1, D/30, D/32, and D/36.

COST ACCOUNTABILITY (WAREHOUSES)

11. Inventory is not maintained at retail for this method and thus, there is no RAR. Stocktakings occur at different frequencies depending on the outlet but are not conducted every month. The inventory is counted by units and multiplied by the original cost price. A cost multiplier is determined by using accumulated Cost of Goods Sold (COGS) and Sales figures, and is for use during those months when no stocktaking occurs.

12. This method is applicable to warehouses only.

RETAIL ACCOUNTABILITY AND THE RETAIL ACCOUNTABILITY REPORT (RAR)

13. The Retail Accountability System requires that transactions moving products into or out of inventory be recorded at the retail value. Note that the retail value excludes any GST and PST which may be included in the selling price.

14. Retail accountability permits determination of the approximate value of the closing inventory without a physical count and without research into source documents for the items' cost. Under this system, different methods such as the Average Cost Method or the Lower of Average Cost and Market Method can be used with different results. The Lower of Average Cost and Market method is the one advocated by the Retail Council of Canada and is now in use for all NPF operations. Under this method, markdowns are fully accounted for in the month in which they have been taken. It assumes most of the markdowns apply to goods sold and therefore that few of those goods are part of the ending inventory.

15. It is important to note that no matter what method (Average Cost method or Lower of Average Cost and Market method) is used the total gross profit in the long term will be the same. However, the Lower of Average Cost and Market method applies more closely to the CANEX marketing situation as well as to the other NPF operations. The main advantages

are, firstly, that the impact of markdowns on the gross profit is known in the month they occur and are not carried forward and, secondly, the simplicity of application and ease of understanding for managers.

16. The system has a disadvantage in that valuations are estimates based on the average relationship between the cost and selling price of purchases moving into inventory. The system assumes that the markup on actual sales is the same as the average markup on purchases. In most cases this assumption is valid; however, when large variances occur in either the markup percentages or the departmental sales mix, the cost as calculated under this method will often be substantially different than the actual cost. By departmentalizing inventories and sales into categories which carry similar markups, the discrepancies between calculated cost and "real" cost are minimized. Therefore, those operations which have not been departmentalized should be examined and, where economically feasible, departmentalization introduced.

NOTES:

a. Markdowns represent downward changes in retail value of merchandise and may consist of promotional, regular or special markdowns.

b. Markups represent upward changes in the regular retail value of merchandise. Markups shall only apply on items ticketed at the regular selling price and shall not be used to raise prices on items which have been the subject of previous markdowns.

17. The RAR is initiated, completed, and maintained by the operating outlet.

18. The report is prepared and submitted to the NPFAO weekly for all outlets controlled at retail except for the retail stores set out in Chapter 42 which shall submit them at least twice weekly. Reports will also be completed and submitted to the NPFAO at the close of business each month and when stocktakings are conducted.

19. Although there are several different forms used by the operating outlets (mainly due to number of departments required), to calculate and maintain the RARs the same basic format as shown at Annex A applies to all of them. The procedure to prepare this report is as follows:

a. Column 1. Enter the opening inventory figure at retail brought forward from the previous report;

b. Column 2. Enter the purchases at retail for the period from the Invoice Register;

c. Column 3. Enter the transfers at retail for the period from the Transfer Register;

d. Column 4. Enter the total retail value of all markups attached to the report for the period;

e. Column 5. Enter the total retail value of NPFAO Correction Notices (Annex B) processed since the last RAR in accordance with paragraph 23;

f. Column 6. Enter the amount at retail calculated as a stocktaking shortage or overage as a result of a supervised stocktaking. This entry is made to bring the report into balance with the actual physical stocktaking;

g. Column 7. Enter the sales at retail for the period from the DSRs;

h. Column 8. Enter the total retail value of all markdowns attached to the report for the period; and

i. Column 10. Add or subtract (as applicable) the totals of columns 2 to 8 from the opening inventory in column 1 which will give the closing inventory value at retail which is entered in column 10.

NOTE: All items to be deducted from Column 1 shall be circled to avoid confusion in the totalling of columns.

20. For all items except sales entered on the RAR, the supporting documents such as Invoice Registers, RPCs, etc, must be attached to the report when submitted to the NPFAO. The

DSRs are submitted to the NPFAO for all outlets on a daily basis separate from the RAR.

21. The RAR is prepared in duplicate with the original being forwarded to the NPFAO and the duplicate copy maintained by the outlet.

ACTION BY THE NPFAO

22. On receipt of the RAR, the NPFAO shall:

    a. Verify the accuracy of the figures entered on the RAR from the attached reports and ensure that all the required documents are submitted with the reports; and.

    b. Check additions and extensions of the RAR, attached reports (Invoice Register, etc) and the individual documents (suppliers' invoices, etc) listed and attached to the reports.

    NOTE: 100 % verification of source documents is desirable, however, depending upon the number of transactions and the availability of accounting staff, the BCompt may authorize random sampling techniques in lieu of a 100 % check of all supporting documents.

23. After the verification detailed in paragraph 22, the NPFAO shall:

    a. Process the suppliers' invoices, PO and credit notes attached to the Invoice Register in accordance with Chapter 19;

    b. Process the merchandise transfers attached to the Transfer Register in accordance with Chapter 22;

    c. Process the RPCs attached to the RAR in accordance with Chapter 23; and

    d. Process the NPFAO Correction Notices attached to the RAR by checking off their numerical sequence and taking hastening action on any correction notice that is outstanding more than five working days. At month end any significant ($) correction notice shall be actioned by the outlet manager in order not to distort the monthly calculation of gross profits.

NPFAO CORRECTION NOTICES

24. In order that the RAR may be used as the operating personnel's control over their accountability for the retail inventory, whenever errors are found by the NPFAO, they shall not change the report at that time but shall notify the outlet manager through the use of the serially numbered NPFAO Correction Notice (Annex B). When applicable the NPFAO shall identify the Department(s) concerned on the Correction Notice.

25. The NPFAO will serially number the NPFAO Correction Notice (CF 1335) and control the issue and usage of the form as detailed in paragraph 23d.

26. The entity manager, upon receipt of the NPFAO Correction Notice, will review the errors noted and, if in agreement with the changes required, take the following action based on the source of the original document being corrected:

    a. Invoice Register. If the error is either in the retail or cost value of a suppliers invoice or an adding/extension error on the Invoice Register submitted, then the NPFAO Correction Notice shall be processed through the subsequent Invoice Register as shown on Annex A to Chapter 21;

    b. Transfer Register. If the error is either in the retail or cost value of a requisition or an adding/extension error on the Transfer Register submitted, then the NPFAO Correction Notice shall be processed through the subsequent Transfer Register in the same manner as outlined for the Invoice Register in paragraph 26a;

    c. Sales. If the error is on the DSRs, then the NPFAO Correction Notice shall be processed as a separate item (separate from current DSR totals) in column 5 with an applicable adjustment to column 9 of the subsequent RAR;

d. RPCs. If the error is on the RPC Summary or on individual RPCs (where the base processes them individually), the NPFAO Correction Notice shall be processed as a separate item in column 4 or column 8 of the subsequent RAR; and

e. RAR. If the discrepancy originates from arithmetic errors on the RAR itself, then the NPFAO Correction Notice shall be processed in column 5 of the subsequent RAR.

NOTE

It is important that all NPFAO Correction Notices are processed as set out in paragraph 24 in order that the manager can use the accumulated monthly figures from the RAR to verify the accuracy of entries (invoice purchases and transfers at cost) and calculations (retail gross profit calculations) prepared by the NPFAO.

CALCULATION OF CLOSING INVENTORY

27. The NPFAO calculates closing inventories by department. Appendix 1 to Annex C provides details on how to complete the Closing Inventory Worksheet (CIW) for each type of inventory valuation method described above. The calculation of the closing inventory is necessary to determine the cost of goods sold and therefore, the gross profit.

28. CIWs are to be prepared, for each department where an inventory exists, and attached to the Income Statement of the outlet. Exceptions to this requirement must be approved by DNPFS.

Annex A - Retail Accountability Report

Appendix 1, Annex C - Closing Inventory Worksheet