

ANNUAL STOCK VALUATION- BIG BUSINESSES

Definitions

A "Big Business" for tax purposes is one or an associated group with a turnover of more than \$3 million per year.

Associated person rules apply. This means, for example, a person having an interest in two companies must add the turnovers to see whether the total is still less than \$3million. A company is associated when this person owns 50% or more of the shares.

Trading Stock?

In general it is anything bought for resale. It includes work in progress and the yet unprocessed raw materials. For example, to a cardboard box maker the partly complete boxes are stock and subject to these rules. Stock purchased but not yet delivered forms part of your year end stock, and must be included in your stock take. However the value of such stock, not paid for by year end, should be included in the amount owing in your accounts payable (Sundry Creditors).

These rules do not apply to:

- Livestock except when used in dealing operations.
- Nursery Plants (Special rules apply and new ones apply to the 2002 year)
- Consumable aids like lubrication oil.
- Spare parts unless they are your trading stock
- Land (including crops in the ground)

The following expenses are either not stock or do not form part of trading stock:

- Stationery
- Wrapping paper
- General administration
- Marketing costs
- Distribution costs

Ways to Value stock

- **Discounted selling price**
- **Cost**

- **Market Selling Price**
- **Replacement**

Stock is to be valued using Generally Accepted Accounting Principles and valuations must comply with the financial reporting standard (FRS 4), with the exception, that tax law permits cost to be used even though market selling price may be lower than cost. FRS 4 requires you to use the lower.

- If by using FRS4 it is materially different to cost then you must use cost.
- You may, however, value different stock lines using different bases. Some stock can be valued at selling price and other at cost.
- Shares may only be valued at cost.
- You must keep a record of your valuation methods and how you have applied them as well as your records of stock take. Records are to be kept for seven years.

1. Discounted Selling Price

- It is Possible to value your stock at adjusted retail price. If you do this though, you must be a retailer to have adopted the method for financial reporting purposes.
- You are expected to divide your stock into departments having similar profit margins.
- Determine the profit margin for each department. If selling price of some stock has been reduced, reduce the profit margin when valuing stock.
- Discount the selling price of the stock of each department to bring it back to cost.
- You must recalculate the normal gross profit margin each year.
- For purposes of calculating gross profit include all costs listed in the notes below for valuing at cost (EE10{4})

2. Cost

Comply with FRS4 and be consistent with valuation-comply with FRS1. Manufacturers using standard costs must include an adjustment for variances between actual and standard. The variances are to be spread over cost of trading stock sold during the year and closing stock.

Identified Stock

Use actual cost and value using FIFO or Weighted Average Value.

Unidentified Stock

Cost includes:

- Purchase price of materials after deducting any annual or trade discounts.

- Any gains or losses in foreign exchange
- Inwards Freight and similar

Cost of Conversion:

- Direct Labour and associated charges
- Subcontractors
- Direct and indirect costs of manufacture
- Consumables used in the process of manufacture

Design

- Depreciation of factory buildings and plant or rental payments
- Repairs and maintenance of plant
- Factory Management
- Any other costs relating to manufacture
- Inwards Freight
- Any other direct cost

3. Market Selling Price

This option is only permitted where it is lower than cost. However, when cost is higher than selling price, cost may only be used for tax purposes.

Selling price is only permitted provided you have reasonable evidence to support your valuation. There must be an objective basis for valuing at selling price.

You may deduct the following from the selling price you would normally expect to receive:

- Estimated cost of completion and these selling costs;
- Transport
- Insurance
- Sales Commissions
- Sales discounts

Net realisable value is not an acceptable way to value stock.

4. Replacement

- To use this option you must use it in your financial statements.
- First choice is the amount you would have to pay to replace the item of stock at balance date excluding GST.

Should this not be available take the last purchase price.

WARNING: The information supplied here is simplified and condensed. It is only a guide and should not be relied upon as a substitute for professional advice.