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IGCSE Accounting Stock Control and NRV

1 Harrington provided the following information.

		$
At 1 January 2014	Inventory – raw materials	5 600
	– work in progress	1 900
	– finished goods	4 600
For the year ended 31 December 2014	Purchases of raw materials	71 100
	Raw materials returned	1 000
	Raw materials taken for own use	2 000
	Carriage on raw materials	2 100
	Carriage outwards	4 050
	Direct labour	52 550
	Depreciation of machinery	4 400
	Depreciation of office equipment	3 200
	Discount allowed	3 050
	Discount received	1 010
	Salesman's salary	19 840
	Administration costs	20 070
	Factory rent	20 000
	Office rent	10 000
At 31 December 2014	Inventory – raw materials	4 200
	– work in progress	1 800
	– finished goods	5 500

REQUIRED

(a) Complete the following table. Indicate with a tick ( ) which costs from this data appear in the overheads section of the manufacturing account and which appear in the income statement. One cost has been shown as an example.

Cost	Overheads section of the manufacturing account	Income statement
Office rent		

Answer:

Cost	Overhead section of the manufacturing account	Income statement
Office rent		
Factory rent	✓	
Carriage outwards		✓
Depreciation of machinery	✓	
Depreciation of office equipment		✓
Discount allowed		✓
Salesman's salary		✓
Administration costs		✓

(b) Prepare an extract from Harrington's manufacturing account for the year ended 31 December 2014 showing the prime cost.

Harrington
Manufacturing Account (extract) for the year ended 31 December 2014

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Answer:

Harrington
Manufacturing Account (extract) for the year ended 31 December 2014

	$	$
Inventory of raw materials at 1 January 2014		*5 600*
Purchases of raw materials	*71 100*	
Less purchases returns	*1 000*	
	70 100	
Less drawings	*2 000*	
	68 100	
Carriage inwards	*2 100*	
		70 200
		75 800
Inventory of raw materials at 31 December 2014		*4 200*
Cost of raw materials consumed		*71 600*
Direct labour		*52 550*
Prime cost		*124 150*

(c) Suggest one reason why Harrington might want to know his cost of production.

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Answer: *To set prices OR to compare the cost of manufacturing with the cost of buying the goods in.*

(d) Calculate the value of inventory in Harrington's statement of financial position at 31 December 2014.

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Answer: *4200 + 1800 + 5500 = 11 500*

2 The rent of a manufacturing business is split 60% factory, 10% offices and 30% showrooms. Business rent is $40 000 a year and salesmen's salaries are $12 000 a year.

How much appears in the manufacturing account for these costs?

A $24 000 ☐

B $31 200 ☐

C $36 000 ☐

D $46 800 ☐

Answer: *A. $24 000*

3 **(a)** Name three types of inventory which might be held by a manufacturing business.

1 2 ....

....

3 ....

(b) State how inventory should be valued.

....

....

(c) State how Asrul, a retailer, records goods taken for his personal use.

Account debited	Account credited

(d) Name the accounting principle which Asrul is applying.

....

(e) State one reason why Asrul prepares a bank reconciliation statement.

....

(f) State what is meant by a bank statement.

....

....

Answer: *(a) Raw materials; work in progress; finished goods/purchased finished goods*

(b) Lower of cost and net realisable value

(c)

Account debited	Account credited
Drawings	*Purchases*

(d) Business entity

(e) To check for errors and omissions in his books of account
To check the errors in the bank statement
To identify stale cheques
To identify unpresented cheques
To identify amounts not credited
To calculate the correct bank balance in his cash book
To verify the balance in his cash book
To correct/amend his cash book

4 A manufacturing business provided the following information about its first year of trading.

	$
Purchases of raw materials	128 000
Closing inventory of raw materials	13 000
Purchases of finished goods	65 000
Closing inventory of finished goods	29 000
Factory direct wages	77 000
Supervisor’s salary	21 000
Depreciation of machinery	19 000

What was the prime cost?

A $38 000

B $74 000

C $152 000

D $192 000

Answer: *D. $192 000*

5 **(a)** Give **two** examples of items which might appear as non-current assets in the statement of financial position of a manufacturing business.

1 ....

2 ....

(b) Explain how a non-current asset differs from a current asset.

....

....

....

(c) Give **one** example of a capital receipt.

....

(d) Complete the following table using a tick (✓) to indicate if **each** item is capital or revenue expenditure.

	Capital expenditure	Revenue expenditure
Purchase of inventory		
Purchase of stationery		
Legal fees on purchase of land		
Construction costs of factory		

(e) Name the account which is opened when a non-current asset is sold.

....

(f) Name the accounting principle applied when the same rate of depreciation is maintained each year.

....

(g) State **one** limitation of financial statements.

....

....

Answer: *(a) Any two e.g. plant and equipment, factory premises, office premises, delivery vehicle*

(b)

non-current asset	current asset
lasting more than 12 months	*lasting less than 12 months*
bought to keep and use in the business	*bought to resell/expected to turn into cash within 12 months*
depreciated	*not depreciated*

(c) *Amount received when a non-current asset is sold*
Receipt of a loan
Share issue/capital introduced

(d)

	Capital expenditure	Revenue expenditure
Purchase of inventory		✓
Purchase of stationery		✓
Legal fees on purchase of land	✓	
Construction costs of factory	✓	

(e) *Disposal*

(f) *Consistency*

(g) *Historical/only deals with the past*
Difficulties of definition
Non-financial aspects
Unable to predict future
Doesn't identify the cause of a problem

6 The company provided the following additional information for the year ended 31 December 2014.

	$
Revenue	227 000
Purchases	129 000
Sales assistants' wages	15 900
Office salaries	12 060
Rent	24 000
Other operating expenses	6 220
Dividend paid	10 000
Interest paid	15 000
Transfer to general reserve	5 000

Inventory values were as follows.

	$
1 January 2014	41 200
31 December 2014	44 520

REQUIRED

(a) Prepare the income statement for the year ended 31 December 2014.

General Stores Limited
Income Statement for the year ended 31 December 2014

	$	$
…………………………………………………………………	………………	………………
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Answer:

General Stores Limited
Income Statement for the year ended 31 December 2014

	$	$
Revenue		*227 000*
Inventory 1 January 2014	*41 200*	
Purchases	*129 000*	
	170 200	
Inventory 31 December 2014	*44 520*	
Cost of sales		*125 680*
Gross profit		*101 320*
Sales assistants' wages	*15 900*	
Office salaries	*12 060*	
Depreciation	*12 870*	
Rent	*24 000*	
Sundry expenses	*6 220*	*71 050*
Profit from operations		*30 270*
Interest		*15 000*
Profit for the year		*15 270*

(b) Complete the following statement of changes in equity for the year ended 31 December 2014.

General Stores Limited
Statement of Changes in Equity for the year ended 31 December 2014

Details	Share capital $	General reserve $	Retained earnings $	Total $
On 1 January 2014	100 000	20 000	4 810	124 810
Profit for the year	....	....	....	....
Dividend paid	....	....	....	....
Transfer to general reserve	....	....	....	....
On 31 December 2014	....	....	....	....

Answer:

General Store Limited *Statement of Changes in Equity for the year ended 31 December 2014*				
Details	*Share capital* *\$*	*General reserve* *\$*	*Retained earnings* *\$*	*Total* *\$*
On 1 January 2014	*100 000*	*20 000*	*4 810*	*124 810*
Profit for the year	………	………	*15 270*	*15 270*
Dividend paid	………	………	*(10 000)*	*(10 000)*
Transfer to general reserve	………	*5 000*	*(5 000)*	–
On 31 December 2014	*100 000*	*25 000*	*5 080*	*130 080*

(c) Calculate to **two** decimal places the net profit margin.

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Answer: *30 270/227 000 × 100 = 13.33%*
OR
15 270 / 227 000 × 100 = 6.73%

(d) Explain why the ratio for General Stores Limited is lower than that of the neighbouring shop.

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Answer: *Neighbouring shop may sell different mix of goods with a higher gross profit margin.*

Neighbouring shop may have different policies for instance for depreciation.

Illustration with figures e.g. if depreciation rate was 10% then net profit margin would be 3.8% higher.

Neighbouring shop controls expenses better.

Neighbouring shop may own premises and avoid rent payment. Illustration with figures e.g. rent accounts for 10.57% of revenue.

If using profit after interest also allow Neighbouring shop may have more equity/capital and not have the interest cost.

Illustration with figures e.g. interest amounts to 6.6% of sales.

(e) Suggest **three** ways in which General Stores Limited might improve its net profit margin.

1 ....

....

2 ....

....

3 ....

....

Answer: *Increase selling prices/increase gross profit margin/reduce cost of sales*
Reduce expenses/rent cheaper premises
Find cheaper lenders of finance to reduce interest charges
Review depreciation rate – do fixtures only have a life of 3 to 4 years
Turn overdrafts and short term loans into long term loans to reduce interest rate

7 David and Harold are in partnership. The partnership agreement states that David is to receive an annual salary of $12 000 and that profits and losses are to be shared in the ratio 2:1.

The following balances were extracted from the partnership books on 31 March 2016.

	$	
Capital accounts – David	80 000	
– Harold	25 000	
Current accounts – David	8 100	debit
– Harold	6 200	credit
Fixtures and fittings at cost	37 200	
Provision for depreciation of fixtures and fittings	11 160	
Inventory at 1 April 2015	36 000	
Trade receivables	7 000	
Trade payables	6 140	
Bank	12 100	debit
Sales (Revenue)	142 000	
Purchases	83 100	
Rent	12 000	
Other operating expenses	11 800	
Wages	16 500	
Drawings – David	32 000	
– Harold	14 700	

Additional information

1 Other operating expenses included $500 for insurance which was paid in advance at 31 March 2016.

2 Inventory on 31 March 2016 amounted to $26 800.

3 Fixtures and fittings are depreciated at the rate of 10% per annum on the straight line basis. A full year's depreciation is provided in the year of purchase. The current year's depreciation has not yet been provided.

4 All the fixtures and fittings were purchased when the partnership was formed.

David and Harold were surprised to see that inventory had fallen during the year. In previous years the percentage of gross profit to revenue had been 45% and they believed that this had been maintained.

REQUIRED

(a) Calculate the value of inventory at 31 March 2016 with which the percentage of gross profit to revenue would have been constant.

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(b) Suggest **one** reason for the lower inventory value.

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Answer: *(a)* *Cost of sales = [142 000 × (1 – 0.45)] = $78 100*

(36 000 + 83 100) – 78 100 = 41 000

OR

	$
Opening inventory	*36 000 }*
Purchases	*83 100 }*
Cost of sales	*(78 100)**
Expected closing inventory	*41 000*

**142 000 – 63 900 = $78 100*

(b) Any reasonable answer e.g. Theft, pilferage, damage, obsolescence, more/higher sales activity.

8 Sue is a trader. Her financial year ends on 31 December.

She provided the following information about her inventory for the financial year ended 31 December 2014.

	Cost	Net realisable value
	$	$
Inventory 1 January	6800	7100
Inventory 31 December	8200	7800

REQUIRED

(a) Define the following terms.

(i) cost ....

....

....

(ii) net realisable value ....

....

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(b) Explain why the inventory at 31 December 2014 was included in the financial statements at net realisable value rather than cost.

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After the preparation of the income statement for the year ended 31 December 2014 it was discovered that the inventory on 1 January had been included at net realisable value.

REQUIRED

(c) Complete the following table to indicate the effect of this error on the cost of sales and the profit for the year ended 31 December 2014.

Place a tick (✓) under the correct heading to indicate whether each item would be overstated or understated.

	overstated	understated
cost of sales		
profit for the year		

Sue provided the following information for the year ended 31 December 2015.

	$
Cost of sales	49 900
Average inventory	7 500

REQUIRED

(d) **(i)** State the formula for the calculation of the rate of inventory turnover.

....

....

(ii) Calculate the rate of inventory turnover for the year ended 31 December 2015. The calculation should be correct to **two** decimal places.
Show your workings.

....

....

Sue's rate of inventory turnover for the previous year was 8.15 times.

REQUIRED

(e) State whether you consider that Sue would be satisfied with the change in the rate of inventory turnover. Give a reason for your answer.

Satisfied? ....

Reason ....

....

(f) Suggest **one** way in which the rate of inventory turnover could be improved.

....

....

Answer: *(a) (i) Cost is the purchase price of the goods plus any additional costs incurred in bringing the inventory to its present condition and position.*
(ii) Net realisable value is the estimated receipts from the sale of the inventory less any costs of completing or selling the goods.

(b) Inventory should always be valued at the lower of cost and net realisable value
This is an application of the principle of prudence
Over-valuing the inventory causes the profit for the year to be overstated
Over-valuing the inventory causes the current assets to be overstated

(c)

	overstated	understated
cost of sales	✓	
profit for the year		✓

(d)

(i) Either $\dfrac{\textit{cost of goods sold }\}}{\textit{average inventory }\}}$ *whole formula*

Or $\dfrac{\textit{average inventory }\}}{\textit{cost of goods sold }\}} \times 365$ *whole formula*

(ii)Either $\dfrac{49\ 900\ \}}{7500\ \}}$ *whole formula = 6.65 times*

Or $\dfrac{7500}{49\ 900} \times \underline{365}$ *whole formula = 54.86 days = 55 days*

(e) *Unsatisfied*
Or OF based on answer to (d) (ii)

Not selling goods as quickly as previously
OR OF based on answer to (d) (ii)

(f) *Reduce inventory levels*
Increase sales activity
Only replace inventory when necessary

9 Paul's financial year ends on 31 December.

He maintains one combined account for rent and rates.

On 1 January 2015 three months' rates, totalling $900, were prepaid. On the same date four months' rent, totalling $3200, was prepaid.

The following transactions took place during the year ended 31 December 2015.

April 1 Paid rates by cheque, $3960, for 12 months to 31 March 2016.

May 1 Paid rent by cheque, $4800, for 6 months to 31 October 2015.

REQUIRED

(a) Complete the rent and rates account for the year ended 31 December 2015.
Balance the account and bring down the balances on 1 January 2016.

Paul
Rent and rates account

Date	Details		$	Date	Details	$
2015						
Jan 1	*Balance*	*b/d*		....	....	....
	Rates	*900*				
	Rent	*3200*	*4100*	....	....	....
....	....		....	....	....	....
....	....		....	....	....	....
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....	....		....	....	....	....
....	....		....	....	....	....
....	....		....	....	....	....

Paul always values his inventory at the lower of cost and net realisable value.

REQUIRED

(b) Explain why Paul should continue his policy of including inventory in his financial statements at the lower of cost and net realisable value.

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After the preparation of the income statement for the year ended 31 December 2015 it was discovered that the inventory on 31 December 2014 had been valued at net realisable value which was higher than the cost price.

REQUIRED

(c) Complete the following table to indicate the effect of this error.

Place a tick (✓) under the correct heading to indicate the **effect** of this error on **each** item.

	overstated	understated	no effect
Profit for the year ended 31 December 2014			
Profit for the year ended 31 December 2015			
Cost of sales for the year ended 31 December 2015			
Current assets at 31 December 2014			
Current assets at 31 December 2015			

Answer: *(a)*

Rent and rates account

Date	Details	$	Date	Details	$
2015			*2015*		
Jan1	*Balance b/d Rates900 Rent3200*	*4 100*	*Dec 31*	*Income statement Rates3870 Rent9600*	*13 470*
Apl1	*Bank (rates)*	*3 960*		*Balance c/d (rates)*	*990*
May1	*Bank (rent)*	*4 800*			
Dec 31	*Balance c/d (rent)*	*1 600*			
		14 460			*14 460*
2016			*2016*		
Jan1	*Balance b/d (rates)*	*990*	*Jan1*	*Balance b/d (rent)*	*1 600*

(b) *This is an application of the principle of prudence*
Over-valuing the inventory causes the profit for the year to be overstated
Over-valuing the inventory causes the current assets to be overstated

(c)

	overstated	understated	no effect
Profit for the year ended 31 December 2014	✓		
Profit for the year ended 31 December 2015		✓	
Cost of sales for the year ended 31 December 2015	✓		
Current assets at 31 December 2014	✓		
Current assets at 31 December 2015			✓

10 Hamza is a trader who does not maintain a full set of accounting records. His financial year ends on 31 August.

In December 2015 it was discovered that some errors had been made in the financial statements for the year ended 31 August 2015.

REQUIRED

(a) Complete the following table to indicate the effect of **correcting each error** on the profit for the year.

The first one has been completed as an example.

	Effect on profit of correcting error	
	increase $	decrease $
Purchases returns, $2000, had not been recorded.	2000	
Wages owing at 31 August 2015, $450, were not recorded.		
Discount allowed, $115, had been recorded as discount received.		
The provision for doubtful debts, $950, should have been adjusted to 2½% of trade receivables, who owed $36 000.		
Inventory at 1 September 2014 had been valued at net realisable value, $16 700, instead of at cost, $15 300.		

Answer:

	Effect on profit of correcting error	
	increase $	decrease $
Wages owing at 31 August 2015, $450 were not recorded.		*450*
Discount allowed, $115, had been recorded as discount received.		*230*
The provision for doubtful debts, $950, should have been adjusted to 2 ½% of trade receivables, who owed $36 000.	*50*	
Inventory at 1 September 2014 had been valued at net realisable value, $16 700 instead of at cost, $15 300.	*1400*	

11 Jai's financial year ends on 31 January. He has not maintained a full set of accounting records.

All goods are sold on a cash basis and all purchases are made on credit terms. Jai has no record of his sales and purchases for the year ended 31 January 2017.

The following information was available.

	$
On 1 February 2016	
Amount owing to credit suppliers	4 600
Inventory	2 900
During the year ended 31 January 2017	
Amounts paid to credit suppliers	32 725
Cash discount received	640
Interest charged by credit supplier on overdue account	15
At 31 January 2017	
Amount owing to credit suppliers	5 350
Inventory	3 400

The gross profit margin is 20%.

Jai always values his inventory at the lower of cost and net realisable value.

(a) Name the accounting principle which is being applied.

....

(b) Complete the following table to indicate the effect of Jai overvaluing his inventory at 31 January 2017. An example has been provided.

	overstated	understated
Current assets at 31 January 2017	✓	
Profit for the year ended 31 January 2017		
Profit for the year ending 31 January 2018		

Jai is considering increasing his gross profit margin.

REQUIRED

(c) Suggest **two** ways in which Jai might achieve this increase.

1..

....

2..

....

Answer: *(a)* *Prudence*

(b)

	overstated	understated
Current assets at 31 January 2017	✓	
Profit for the year ended 31 January 2017	✓	
Profit for the year ending 31 January 2018		✓

(c) *Increase selling price*
Reduce trade discount allowed to customers
Reduce purchase price
Find cheaper supplier
Obtain better trade discount

12 Which item is **not** included as part of the calculation of net realisable value when valuing inventory?

A carriage inwards ☐

B cost of completing the goods ☐

C estimated receipts from sale of the goods ☐

D selling expenses ☐

Answer: *A. carriage inwards*