TOPIC: INVENTORY VALUATION AND NON CURRENT ASSETS

Learner Note: Make sure you are able to answer theory type of questions

SECTION A: TYPICAL EXAM QUESTIONS

HINTS

- Always answer in point form
- Make sure you that you show calculations to earn part marks
- Open ended questions do not have one correct answer

QUESTION 1 **33 marks** **20 minutes** *(GDE Prep. Exam 2008)*

INVENTORY (STOCK) VALUATION

The following information was extracted from the accounting records of Goodie2Shoes.

INFORMATION:

Goodie2Shoes buys and sells one type of shoes. The business uses the periodic inventory system and the weighted average method of valuing inventory.

Inventory (Stock):

- 145 pairs were on hand at R180 per pair on 1 August 2009.
- 125 pairs were purchased at R210 per pair on 7 August 2009.
- One of the suppliers was having a sale. Purchased 100 pairs for R11 000 on 20 August 2009.
- 110 pairs were imported at R230 per pair on 26 August 2009. Import duties paid was R3 610.
- 140 pairs were on hand on 31 August 2009.

Shoes are sold at R400 per pair.

REQUIRED:

1.1 Calculate the weighted average value per unit on 31 August 2009. (9)

1.2 Calculate the value of the inventory (stock) on hand on 31 August 2009. (Round off to the nearest Rand.) (3)

1.3 Draw up the trading account to determine the gross profit for the month ended 31 August 2009. (9)

1.4 The owner, Bongi Modiba, wants to sell her business. She approached you as the accountant of Goodie2Shoes and requested that you change their inventory (stock) valuation method to the FIFO method to create a higher profit and a higher closing inventory for the business to enable her to sell the business at a much higher price.

1.4.1 Calculate the value of the inventory (stock) on hand on 31 August 2009 by using the FIFO inventory (stock) valuation method. (7)

1.4.2 Will it be ethical for Bongi Modiba to change the inventory (stock) valuation method? Provide TWO reasons to support your answer. (5)

[33]

QUESTION 2 30 marks 25 minutes *(DOE Exemplar 2 2008)*

INVENTORIES

You are provided with information relating to Dean's Sport, a small business owned by Dean, that sells one type of soccer ball to spectators who attend soccer matches.

The business uses the periodic stock system. He sells the soccer balls for R120 each, although the cost price has been changing over the months. He has always made use of the FIFO method for valuing his stock.

REQUIRED:

2.1 Calculate the value of the closing stock using the **FIFO** method. (7)

2.2 Calculate the gross profit made on the stock if the **FIFO** method is used. (7)

2.3 Dean has been told that he would make a larger gross profit if he used the **weighted average method** of valuing his stock. However, he feels it will make no difference to the overall profits of the business over a period of time. Do you agree? Explain your answer. You are not required to make any calculations. (4)

2.4 Dean is concerned, as the Gross Profit has decreased from last year. Discuss one possible reason for this based on the information given to you and provide a possible solution to this problem. (6)

2.5 Dean heard from a friend of his who did accounting at school that he should use the perpetual stock system instead of the periodic system. He is confused and has asked you for advice in this matter. Explain to him the difference and give him advice on which method he should use. (6)

INFORMATION

Dean has given the following information to you on all his purchases and sales over the last 3 months.

	Number of soccer balls	Unit price	Total
Opening stock 1 June 2008	30	R40	R1 200
Total purchases:	60		R3 800
June 2008	20	R55	R1 100
July 2008	25	R60	R1 500
August 2008	15	R80	R1 200
Sales of soccer balls: June – August 2008	70		

[30]

QUESTION 3 35 marks 30 minutes *(DOE Nov. 2008)*

FIXED ASSETS AND INTERNAL CONTROL

You are provided with information in respect of Bloemfontein Hardware for the year ended 29 February 2008. The business is owned by Mike Moore and Milly Miles.

REQUIRED:

3.1 Prepare the Asset Disposal Account for office equipment (computers) stolen on 30 June 2007 (see information 1 below). (12)

3.2 One of the office employees, Di Vulge, knows that the insurance policy only covers theft if there is evidence of forced entry. She also knows that Mike broke the security gate of the office to make the incident look like forced entry. She is not sure if Milly knows about this.

What advice would you give Di? Explain ONE point. (3)

3.3 Explain how and why the Fixed Assets Register will assist the internal auditor in his duties. (3)

3.4 In order to solve their cash flow problems, Mike has sold a portion of the premises at cost price. Milly disagrees with him on this.

Do you support Milly's opinion? Give a reason. (3)

3.5 The business owns three delivery vehicles. Refer to the information in respect of each delivery vehicle from the Fixed Asset Register (see information 4 below).

- Identify the cost price of delivery vehicle 3. (3)
- Explain why delivery vehicle 2 is shown at a book value of R1,00 (one rand). (2)

3.6 As a service to their customers, the business delivers goods within Bloemfontein. They charge a flat rate of R250 per delivery. Clients pay cash directly to the drivers.A total of 3 680 deliveries was done during the year. The delivery service operated on 260 days during the year.

You are the internal auditor and you are concerned about possible problems relating to the delivery vehicles and their drivers.

Refer to the information in point 4 below. Identify and explain ONE major problem relating to each delivery vehicle or its driver. Quote figures from the information to support your answer. Provide a valid solution to each problem. (9)

INFORMATION:

1. Office equipment and disposals:

Office equipment includes the office computers. Six of the office computers were stolen on 30 June 2007. These six computers were originally bought at a cost price of R13 200 each. The insurance company, Ace Insurers, only paid out R5 000 for each computer. These computers were replaced at a higher price on 31 August 2007

2. Delivery vehicles:

The business owns three delivery vehicles that they use to generate their income.

3. Information from the financial statements for year ended 29 February 2008:

FIXED ASSETS	Land & buildings	Office equipment	Vehicles
Carrying value at beginning of year	1 200 000	630 000	403 501
Cost	1 200 000	980 000	699 000
Accumulated depreciation		(350 000)	(295 499)
Movements	(700 000)	19 560	(111 000)
Additions		240 000	
Disposals at carrying value	(700 000)	(63 360)	
Depreciation		(157 080)	(111 000)
Carrying value at end of year	500 000	649 560	292 501
Cost	500 000	1 140 800	699 000
Accumulated depreciation		(491 240)	(406 499)

4. Information from the Fixed Assets Register and the accounting records on 29 February 2008:

Fixed Assets Register	Delivery vehicle 1	Delivery vehicle 2	Delivery vehicle 3
Date purchased	1 April 2007	1 January 1999	1 April 2005
Cost price of vehicle	R315 000	R144 000	?
Accumulated depreciation	R94 500	R143 999	R168 000
Carrying value	**R220 500**	**R1**	**R72 000**

Information from the accounting records	Delivery vehicle 1	Delivery vehicle 2	Delivery vehicle 3
Name of driver	***Solly***	***Themba***	***Goldie***
Number of days worked	210 days	260 days	260 days
Number of deliveries done	280 deliveries	2 100 deliveries	1 300 deliveries
Cash paid in by drivers	R70 000	R525 000	R275 000
Salary paid to drivers	R52 000	R52 000	R52 000
Fuel and maintenance costs for the year	R36 400	R430 500	R201 500
Fuel and maintenance costs per kilometre	R1,30	R2,05	R1,55

[35]

SECTION B: ADDITIONAL CONTENT NOTES

STOCK VALUATION

As a result of changing prices and inflation as well as other economic factors, the actual value of stock changes all the time. Thus a business is faced with the dilemma of deciding what the correct value of stock on hand should be. It is apparent from what we already know, that the value of stock will determine our cost of sales which, in turn, will have an impact on the gross profit as well as the net profit of the business. Therefore, stock valuation plays an important role in determining the true financial performance of the business. The value of stock on hand is also reflected in the notes to the financial statements, and has an impact on the current assets of the business, therefore, playing an important role in establishing the financial position of the business as reflected in the Balance Sheet. Valuation of stock is also important for manufacturing concerns in terms of determining the cost of raw materials used when determining the cost of production.

Consider the following situation:

During the financial year, an enterprise paid different prices for various stock purchases. Only a portion of the stock purchased will be left at the end of the financial period. A decision has to be taken as to which of the various prices paid for the stock purchased during the year, must be regarded as the purchase price for those items still on hand.

Methods of determining stock value

When adopting a method to determine the cost price of the stock still on hand, the wisest choice would be that method which can facilitate the most realistic determination of profits for any specific business.

The four methods most generally used to determine cost price of stock on hand at the end of the financial period are:

- Specific identification method
- Weighted average method
- First-in-first-out method (FIFO)
- Last-in-first-out method (LIFO)

Please note: At school level we will be working with FIFO and the weighted average method.

FIFO means that the stock that was purchased first is sold first. Hence it can be deduced that the stock left over at the end of the year should consist of those items that were purchased most recently.

The above point can be illustrated by the following example:

- **Information**

Transactions concluded in respect of a particular stock item:

Feb		
1	Stock on hand	60 units @ R7.50 per unit
3	Sales	40 units
5	Received	90 units @R8.00 per unit
18	Sales	50 units
27	Returned to supplier	15 units (received on 5 Feb)

Calculation of stock at the end of February

FIFO METHOD										Total stock
Date	Purchased / Bought			Cost of Sales			Balance			
Feb	Quantity	Price	Amount	Quantity	Price	Amount	Quantity	Price	Amount	
1							60	7.50	450.00	**450.00**
3				40	7.50	300.00	20	7.50	150.00	**150.00**
5	90	8.00	720.00				20	7.50	150.00	
							90	8.00	720.00	***870.00**
18				***20**	7.50	150.00				
				***30**	8.00	240.00	60	8.00	480.00	**480.00**
27	(15)	8.00	(120.00)				45	8.00	360.00	**360.00**

Take Note:

- 1st Opening balance 60 units @ 7.50
- 3rd 60 units – 40 units sold = 20 units @ 7.50
- 5th – 20 units @ 7.50 old stock + 90 units @ 8.00 new stock
- 18th – 50 units were sold of which the first 20 units were from the stock that came in first @7.50 and the remainder 30 units were from the stock that came in on the 5th @ 8.00. Therefore, the remaining stock is 60 units (90 – 30) @ 8.00.
- 27th 15 units @ 8.00 were returned; therefore, the balance is 45 units @ 8.00.

NON CURRENT ASSETS

Steps to be followed when recording the disposal of a fixed asset:

- **Step 1**
  Calculate and record the depreciation on the asset sold. (This does not apply if the asset was sold at the beginning of the year).
  Dr Depreciation
  Cr Accumulated depreciation

- **Step 2**
  Transfer the asset sold to the Asset Disposal account. (Use the cost price of the asset).
  Dr Asset disposal
  Cr Asset account

- **Step 3**
  Transfer the total accumulated depreciation on that asset to the Asset Disposal account. **# Total accumulated depreciation = Accumulated depreciation at the beginning of the year on that asset + the depreciation calculated as in step 1.**
  Dr Accumulated depreciation
  Cr Asset disposal

- **Step 4**
  Record the sale / disposal of the asset. Use the selling price or the price obtained for the asset.

If for cash then:	Dr Bank
	Cr Asset disposal
If on credit then:	Dr Debtors' control
	Cr Asset disposal
If a trade-in then:	Dr Creditors' control
	Cr Asset disposal

- **Step 5**
  Determine whether there is a profit or a loss on the disposal of the asset.

  If selling price > carrying value = Profit on sale of asset
  DR Asset disposal
  CR Profit on sale of asset
  If selling price < carrying value = Loss on sale of asset
  DR Loss on sale of asset
  CR Asset disposal

NB: Thereafter, depreciation on the remainder of the fixed assets should be calculated, if the information is to be completed for the year-end.

Fixed Asset account

Balance	B/d	xxxx	Asset disposal	GJ	xxxx
Bank/Debtors/Creditors		xxxx	Balance	C/d	xxxx
		xxxx			xxxx
Balance	B/d	xxxx			

Accumulated depreciation account

Asset disposal	GJ	xxxx	Balance	B/d	xxxx
			Depreciation	GJ	xxx
Balance	C/d	xxxx	Depreciation		xxxx
		xxxx			xxxx
			Balance	B/d	xxxx

Nominal section

Asset disposal account

Fixed asset	GJ	xxxx	Accumulated depreciation	GJ	xxxx
Profit on sale of asset		xxxx	Bank/Debtors/Creditors		xxxx
			Loss on sale of asset		xxxx
		xxxx			xxxx

Depreciation account

Accumulated depreciation	GJ	xxxx	Profit and loss	GJ	xxxx
Accumulated depreciation	GJ	xxxx			

Learner Note: From the above you can see the importance of understanding your concepts of non-current assets and stock valuation. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

SECTION C: HOMEWORK

QUESTION 1 40 marks 24 minutes *(DOE Nov. 2009)*

INVENTORY VALUATION AND CONTROL

You are provided with information relating to Banyana Traders, owned by David Hambeck, for the financial year ended 28 February 2009. The business is situated in Johannesburg.

David buys and sells soccer balls and jerseys. The business uses the periodic inventory system.

The soccer balls are bought from South African suppliers, and the soccer jerseys of different clubs and countries are imported from overseas.

David employs salespersons to control each item of stock:

- James controls and sells the soccer balls
- Cyril controls and sells the soccer jerseys

David has decided on the following accounting policies for valuing inventory:

- Soccer balls – Weighted-average method
- Soccer jerseys – First-in-first-out method (FIFO)

REQUIRED:

1.1 Although this business has done well, David is considering closing it down and investing his capital in fixed property. State TWO points that he should consider before making a final decision. (4)

1.2 David suspects that a number of soccer balls have been shoplifted. Calculate the number of soccer balls stolen. (5)

1.3 Use the relevant information to calculate the closing stock value of:

- Soccer balls (using the weighted-average method)
- Soccer jerseys (using the FIFO method)

Show your workings to earn part-marks. (11

1.4 Calculate the following for soccer jerseys (you may prepare a Trading Account to calculate these figures):

- Cost of sales (5)
- Mark-up % on cost (4)
- Stock turnover rate (5)

1.5 If David decides to continue with this business, what advice would you offer him? State TWO points and quote financial indicators or specific information from the question to support your answer. (6)

INFORMATION:

1. **Inventories:**

The stocks were valued as follows at the beginning and end of the financial year:

Date	Soccer balls			Soccer jerseys		
	No. of units	Per unit	Total value	No. of units	Per unit	Total value
01/03/08	1 200	R120	R144 000	520	R320	R166 400
28/02/09	900	?	?	250	?	?

2. **Purchases:**

During the financial year ended 28 February 2009, the following stock items were purchased:

Date of purchases	Soccer balls			Soccer jerseys		
	No. of units	Per unit	Total value	No. of units	Per unit	Total value
31/03/08	1 300	R120	R156 000	400	R200	R 80 000
30/06/08	900	R150	R135 000	600	R225	R135 000
30/09/08	1 000	R175	R175 000	1 400	R255	R357 000
02/01/09	200	R180	R 36 000	100	R300	R 30 000
Totals	3 400		R502 000	2 500		R602 000

3. **Carriage on purchases:**

During the year, the business paid a total of R30 200 to transport soccer balls to the shop. The price of the soccer jerseys includes carriage.

4. **Sales:**

Items	Details	Total
Soccer balls	3 500 units at R320 each	R1 120 000
Soccer jerseys	2 770 units at R400 each	R1 108 000

5. **Financial indicators:**

Items	Mark-up % on cost	Stock turnover rate
Soccer balls	48,5%	3,9 times p.a.
Soccer jerseys	?	? times p.a.

[40]

SECTION D: SOLUTIONS AND HINTSTO SECTION A

QUESTION 1

1.1

145	x	R180	=	R26 100 ✓
125	x	R210	=	R26 250 ✓
100	x	R110	=	R11 000 ✓
110	x	R230	=	R25 300 ✓
		Import duties	=	R 3 610 ✓
480			=	R92 260

$$\frac{\text{R92 260}\ ✓}{480\ ✓}$$

= R192,21 ✓☑ (9)

1.2 *As per 6.1*

140 ✓ x R192,21 ☑

= R26 909 ☑

Give method mark for operation if one of components is correct. (3)

1.3

TRADING ACCOUNT									
2009 Aug	31	Opening inventory	GJ	✓ 26 100	2009 Aug	31	(480 – 140 x R400) Sales	GJ	✓✓☑ 136 000
		Purchases *[1]	GJ	✓☑ 62 550			Closing inventory	GJ	☑ 26 909
		Import duties	GJ	✓ 3 610					*As per 6.2*
		Profit & loss	GJ	☑ 70 649					
		Balancing figure		162 909					162 909

*[1] R26 250 + R11 000 + R25 300 (9)

1.4

1.4.1 110 x R230 = R25 300 ✓✓

Import duty R3 610✓

30/140 x R110 = R 3 300 ✓✓

= R32 210 ☑✓

Give method mark for operation if one of components is correct. (7)

1.4.2 Unethical ✓

Reasons:

Two reasons – 2 marks each ✓✓ ✓✓

Good = 2 Satisfactory = 1 Incorrect = 0

Misrepresentation of actual profit and value of inventory to mislead prospective buyers – cannot be done without disclosing it in financial statements. ✓✓

Must apply in writing to SARS stating reason for change – SARS will not accept change to increase value of assets and profits to ensure higher selling price – any changes must also be disclosed in financial statements. ✓✓ (5)

[33]

QUESTION 2

2.1 90 – 70 = 20 balls
15 ✓ x 80 ✓ = R1 200 ✓
5 ✓ x 60 ✓ = R 300 ✓
20 R1 500 ✓ (7)

2.2

Trading account			
Opening stock ✓	1 200	Sales ✓✓	8 400
Purchases ✓	3 800	Closing stock ☑	1 500
Profit and loss ☑☑	4 900		

OR CALCULATION:

8 400 ✓✓ – (1 200 ✓ + 3 800 ✓ + - 1 500 ☑)
= R4 900 ☑☑ (7)

2.3 YES.✓ Closing stock of one year becomes the opening stock of the next year. Therefore, over a period of time the overall profit will balance out.✓✓✓ (4)

2.4 *Good explanation and quoting appropriate figures = 6*

Good explanation = 5 Reasonable = 3 Poor = 1 Incorrect = 0

Possible answer:
The selling price per soccer ball has remained the same (R120) but the cost price of the soccer balls has increased from R40 to R80. Therefore, less profit is being made. Mark-up % was 200% on the opening stock but only 50% on the purchases for August. (6)

2.5 Continuous (perpetual): stock figures are updated continuously **OR** stock deficits identified easily and quickly. ✓✓

Periodic: stock figures are not updated and can only be determined by taking stock **OR** cannot detect deficits. ✓✓
Any one valid measure ✓✓ *Possible answer*
It is easy to determine the cost price of the soccer balls and to detected theft and, therefore, it will be advisable to use the perpetual system (6)
[30]

QUESTION 3

3.1

ASSET DISPOSAL							
June	30	Equipment ✓	✓✓ 79 200	June	30	Accu Depr on Equip ✓	✓☑# 15 840
						* Bank ✓	✓✓ 30 000
						* Loss on disposal/theft of assets ✓	✓☑$ 33 360
			79 200			# Any figure $ Inspection	79 200

* If these two entries are combined to debit Insurance Claim/Debtors/the Loss account/Suspense, then 2 marks for relevant details and 4 marks for R63 360. (12)

3.2 *Any one valid point provided it is ethical e.g.* ✓✓✓

Excellent = 3 Good = 2 Satisfactory = 1 Unethical = 0

- She should take the morally and ethically correct action – advise Mike not to lay the insurance claim.
- Advise/find out if Milly knows about Mike's dishonesty – affects partners' relationship in the business
- Consider whistle-blowing issues – e.g. should she speak to Mike / advise Mike first / inform the partner or the insurance company (3)

3.3 Any valid response e.g. ✓✓✓

Excellent = 3 Good = 2 Satisfactory = 1 Incorrect = 0

- Assists internal control – he can check the physical existence of the assets and compare these to the register which must agree with the ledger – he will then be sure that all fixed assets are accounted for.
- Could see the complete history / life-span of the assets & their depreciation – for valuation of the asset & financial reporting. (3)

3.4 Yes ✓ Any valid reason ✓✓

Reasons for Yes:

- This will affect the operations of the business in future.
- Property is a growing investment which will appreciate in future – they should have sold it at a lot more than cost price / market value.
- The property should rather have been kept and a mortgage loan should have been taken out.

OR

No ✓ Any valid reason ✓✓

Reasons for No:

- If the property is not being properly utilised or is situated in an area where there is no appreciation in property values

Do not accept solving of cash flow problem as a reason (3)

3.5 ✓ ✓ ✓

R699 000 – (R315 000 + R144 000) = R240 000

OR R168 000 + R72 000 = R240 000)

The delivery vehicle is very old and has been fully depreciated, but the business must reflect it at a value in the books / The vehicle is still in use and has not reached the end of its life-span although full depreciated

✓✓ *part-marks may be given*

Do not accept accu depr of R143 999 as an answer (5)

3.6 **Delivery vehicle 1:** Any valid problem identified ✓ Quoting of relevant figure ✓

Possible responses:

- The driver has been lazy/not working too hard – only did 280 deliveries in the year.
- The driver is absent from work too often – 50 days away from work.
- The vehicle is not being utilised enough – only did 10% of the trips yet it has the lowest running costs (R1,30).
- The driver is being paid the same salary as other drivers despite only doing 10% of the work.
- Lack of internal control/This vehicle is running at a loss – income R70 000 less expenses R88 400 = R18 400 loss.

Any valid solution related to the problem identified above✓

Possible responses

- Pay drivers per delivery – this will encourage them to work harder.
- Allocate this vehicle to the busiest driver.

Delivery vehicle 2: Any valid problem identified ✓ Quoting of relevant figure ✓

Possible responses:

- The driver has been working too hard – did 8 deliveries per day (2100 / 260).
- This vehicle is old / has a high running cost yet it is used for 2 100 out of 3 680 deliveries.

Any valid solution related to the problem identified above✓

Possible responses

- Allocate this vehicle to the least busy driver.
- Restrict usage of this vehicle.

Delivery vehicle 3: Any valid problem identified ✓ Quoting of relevant figure ✓

Possible responses:

The driver has been fraudulent – fees collected are R50 000 short (R325 000 – R275 000).

Any valid solution related to the problem identified above✓

Possible responses

- Conduct an internal audit of fees collected.
- Conduct a disciplinary enquiry against the driver. (9)

[35]