

Task IM-9.48: Inventory valuation

OSTENWALDE (Pty) Ltd. is a dealership for coffee machines which are sold to cafes. On 1.01.20X0, the company is established by an ordinary share issue of 50,000 shares at 1.00 EUR each. The shares are issued at an issue price of 1.20 EUR/share.

At the end of the Accounting period 20X6, OSTENWALDE (Pty) Ltd. discloses the balance sheet below.

OSTENWALDE (Pty) Ltd.'s STATEMENT of FINANCIAL POSITION as at 31.12.20X6			
A			C, L
<i>Non-current assets</i>	[EUR]	<i>Equity</i>	[EUR]
P, P, E	60,000.00	Share capital	50,000.00
Intangibles		Reserves	10,000.00
Financial assets		Retained earnings	70,000.00
<i>Current assets</i>		<i>Liabilities</i>	
Inventory	90,000.00	Interest bear liab	
Accounts receivables		Accounts payables	40,000.00
Prepaid expenses		Provisions	
Cash/Bank	50,000.00	Tax liabilities	30,000.00
Total assets	200,000.00	Total equity and liab.	200,000.00

Exhibit 1: Balance sheet

The amount of P, P, E results from the acquisition of the store equipment bought on 3.01.20X0. Depreciation applies along straight line method over its useful life of 10 years.

The inventory is based on 20 coffee/espresso machines at 4,500.00 EUR each.

OSTENWALDE applies the weighted average method for inventory valuation.

On 2.01.20X7, OSTENWALDE (Pty) Ltd. purchase 12 further coffee/espresso machines. The cost of purchase are 5,000.00 EUR/u. OSTENWALDE (Pty) Ltd. pays the amount due on cash instantly. The new coffee/espresso machines are of the same kind as the previous ones (on stock).

In January 20X7, OSTENWALDE (Pty) Ltd. sells 27 coffee machines at 9,600.00 EUR/u (gross amount).

In order to keep the case simple, assume all machines are sold at the same time and paid on cash.

One customer returns 1 coffee machine bought in January 20X7 and receives a voucher in return. The machine is not working properly and is returned to OSTENWALDE (Pty) Ltd.'s supplier. It can be traced back by the serial number being a machine bought in 20X6. OSTENWALDE (Pty) Ltd. gets a cash refund for the machine from its supplier based on the paid price in 20X6.

Operational costs for running the store (labour) are paid in 20X7 to an extent of: 30,000.00 EUR/a. (not subject to VAT, depreciation not included)

Required: Prepare a Profit and Loss account and an adjusted trial balance for the Accounting period 20X7. Do not forget to pay income taxes and depreciate the store equipment! Consider VAT at a VAT-rate of 20 %.

Solution:

(1) Payment of income tax: 30,000.00 EUR

DR Income Tax Liabilities	30,000.00 EUR
CR Cash/Bank	30,000.00 EUR

(2) Depreciation equals to $(60,000 / (1 - 7 \times 10\%)) / 10 = 20,000.00$ EUR

DR Depr	20,000.00 EUR
CR Acc Depr	20,000.00 EUR

(3) Purchase of 12 coffee/espresso machines at 5,000.00 EUR/u cost of purchase. The gross amount equals to: $12 \times 5,000 \times 120\% = 60,000.00$ EUR.

DR Purchase	60,000.00 EUR
DR VAT	12,000.00 EUR
CR Cash/Bank	72,000.00 EUR

(4) Putting the coffee/espresso machines on stock.

DR Inventory	60,000.00 EUR
CR Purchase	60,000.00 EUR

(5) Sale of 27 coffee/espresso machines at 9,600.00 EUR/u: The revenue equals to: $27 \times 9,600 / 120\% = 216,000.00$ EUR.

DR Cash/Bank	259,200.00 EUR
CR VAT	43,200.00 EUR
CR Revenue	216,000.00 EUR

(6) Recording cost of sales: $27 \times (20 \times 4,500 + 12 \times 5,000) / 32 = 126,562.50$ EUR.

DR Cost of Sales	126,562.50 EUR
CR Inventory	126,562.50 EUR

(7a, 7b, 7c) Return inwards by the customer. The customer is refunded by OSTENWALDE per voucher. The inventory movement is based on the weighted average method as applied at the time of sale. The amount equals to: $(20 \times 4,500 + 12 \times 5,000) / 32 = 4,687.50$ EUR.

DR Returns Inwards	8,000.00 EUR
DR VAT	1,600.00 EUR
CR Voucher (A/P)	9,600.00 EUR

DR Inventory	4,687.50 EUR
CR Cost of Sales	4,687.50 EUR
DR Revenue	8,000.00 EUR
CR Returns Inwards R.I.	8,000.00 EUR

(8a, 8b) Returns outwards is at the price paid and is linked to the purchase of the machine. It was purchased at 4,500.00 EUR. Accordingly to that, the return is recorded at a gross amount of: $120\% \times 4,500 = 5,400.00$ EUR.

DR Cash/Bank	5,400.00 EUR
CR VAT	900.00 EUR
CR Returns Outwards R.O.	4,500.00 EUR
DR Returns Outwards R.O.	4,500.00 EUR
CR Inventory	4,500.00 EUR

(9) Recording operational costs: 30,000.00 EUR

DR Operational Costs	30,000.00 EUR
CR Cash/Bank	30,000.00 EUR

Observe the accounts:

P, P, E			Acc depr		
D		C	D		C
OV	200,000.00	c/d 200,000.00		OV	140,000.00
b/d	200,000.00		c/d 160,000.00	(2)	20,000.00
			160,000.00		160,000.00
				b/d	160,000.00

Inventory			Cash/Bank		
D		C	D		C
OV	90,000.00	(6) 126,562.50	OV	50,000.00	(1) 30,000.00
(4)	60,000.00	(8b) 4,500.00	(5)	259,200.00	(3) 72,000.00
(7b)	4,687.50	c/d 23,625.00	(8a)	5,400.00	(9) 30,000.00
	154,687.50	154,687.50			c/d 182,600.00
b/d	23,625.00			314,600.00	314,600.00
			b/d	182,600.00	

Exhibit 2: Accounts

D		Issued capital	C
c/d	<u>50,000.00</u>	OV	<u>50,000.00</u>
		b/d	<u>50,000.00</u>

D		Reserves	C
c/d	<u>10,000.00</u>	OV	<u>10,000.00</u>
		b/d	<u>10,000.00</u>

D		Retained earnings	C
c/d	<u>70,000.00</u>	OV	<u>70,000.00</u>
		b/d	<u>70,000.00</u>
c/d	<u>95,287.50</u>	R/E	<u>25,287.50</u>
	<u>95,287.50</u>		<u>95,287.50</u>
		b/d	<u>95,287.50</u>

D		Accounts payables A/P	C
		OV	<u>40,000.00</u>
c/d	<u>49,600.00</u>	(7a)	<u>9,600.00</u>
	<u>49,600.00</u>		<u>49,600.00</u>
		b/d	<u>49,600.00</u>

D		Income tax liabilities	C
(1)	<u>30,000.00</u>	OV	<u>30,000.00</u>
		P&L	<u>10,837.50</u>

D		Depreciation	C
(2)	<u>20,000.00</u>	c/d	<u>20,000.00</u>
b/d	<u>20,000.00</u>	P&L	<u>20,000.00</u>

D		Purchase	C
(3)	<u>60,000.00</u>	(4)	<u>60,000.00</u>

D		VAT	C
(3)	<u>12,000.00</u>	(5)	<u>43,200.00</u>
(7a)	<u>1,600.00</u>	(8a)	<u>900.00</u>
c/d	<u>30,500.00</u>		<u>44,100.00</u>
	<u>44,100.00</u>	b/d	<u>30,500.00</u>

D		Revenue	C
(7c)	<u>8,000.00</u>	(5)	<u>216,000.00</u>
c/d	<u>208,000.00</u>		<u>216,000.00</u>
	<u>216,000.00</u>	b/d	<u>208,000.00</u>
P&L	<u>208,000.00</u>		

D		Cost of Sales	C
(6)	<u>126,562.50</u>	(7b)	<u>4,687.50</u>
	<u>126,562.50</u>	c/d	<u>121,875.00</u>
b/d	<u>121,875.00</u>		<u>126,562.50</u>
		P&L	<u>121,875.00</u>

D		Returns inwards R.I.	C
(7a)	<u>8,000.00</u>	(7c)	<u>8,000.00</u>

D		Returns outwards R.O.	C
(8b)	<u>4,500.00</u>	(8a)	<u>4,500.00</u>

Exhibit 2: Accounts (continued)

D		Operational costs	C		D		Profit and Loss	C	
(9)	30,000.00	c/d	30,000.00		COS	121,875.00	Rev	208,000.00	
b/d	30,000.00	P&L	30,000.00		OpC	30,000.00			
					Dpr	20,000.00			
					EBT	36,125.00			
						208,000.00		208,000.00	
					ITL	10,837.50	b/d	36,125.00	
					R/E	25,287.50			
						36,125.00		36,125.00	

The trial balance (not required) is displayed below:

**Ostenwalde (Pty) Ltd.'s
TRIAL BALANCE
as at 31.12.20X7**

Account	Debit entries	Credit entries
P, P, E	200,000.00	0.00
Acc depr	0.00	160,000.00
Inventory	23,625.00	0.00
Cash/Bank	182,600.00	0.00
Issued capital	0.00	50,000.00
Reserves	0.00	10,000.00
Retained earnings	0.00	70,000.00
Accounts payables A/P	0.00	49,600.00
Income tax liabilities	0.00	0.00
Depreciation	20,000.00	0.00
Purchase	0.00	0.00
VAT	0.00	30,500.00
Revenue	0.00	208,000.00
Cost of Sales	121,875.00	0.00
R.I.	0.00	0.00
R.O.	0.00	0.00
Operational Costs	30,000.00	0.00
Total:	578,100.00	578,100.00

Exhibit 3: Trial balance (not required)

**Ostenwalde (Pty) Ltd.'s
ADJUSTED TRIAL BALANCE
as at 31.12.20X7**

Account	Debit entries	Credit entries
P, P, E	200,000.00	0.00
Acc depr	0.00	160,000.00
Inventory	23,625.00	0.00
Cash/Bank	182,600.00	0.00
Issued capital	0.00	50,000.00
Reserves	0.00	10,000.00
Retained earnings	0.00	95,287.50
Accounts payables A/P	0.00	49,600.00
Income tax liabilities	0.00	10,837.50
Depreciation	0.00	0.00
Purchase	0.00	0.00
VAT	0.00	30,500.00
Revenue	0.00	0.00
Cost of Sales	0.00	0.00
R.I.	0.00	0.00
R.O.	0.00	0.00
Operational Costs	0.00	0.00
Total:	406,225.00	406,225.00

Exhibit 4: Adjusted trial balance

In case of the application of the Trading Account, it looks as below. Note, the closing stock is calculated based on the inventory movements: $90,000 + 60,000 - (27 - 1) \times 4,687.50 - 4,500 = \mathbf{23,625.00 \text{ EUR}}$.

Trading Account				Profit and Loss			
D			C	D			C
OV	90,000.00	Rev	216,000.00	OpC	30,000.00	T/A	86,125.00
Prh	60,000.00	clSt	23,625.00	Dpr	20,000.00		5.00
R.I.	8,000.00	R.O.	4,500.00	EBT	36,125.00		1.00
GP	86,125.00				86,125.00		86,131.00
	<u>244,125.00</u>		<u>244,125.00</u>	ITL	10,837.50	b/d	36,125.00
P/L	86,125.00	b/d	86,125.00	R/E	25,287.50		
					<u>36,125.00</u>		<u>36,125.00</u>

Exhibit 5: Accounts in case the periodic inventory system applies.