

Question 8

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(a) Stock Valuation

(i)	Purchases in units	Unit Cost	Purchases at cost €
	4,500	€6	27,000
	2,400	€7	16,800
	1,400	€6	8,400
	<u>2,600</u>	€8	<u>20,800</u>
	10,900		73,000

<u>Credit Sales</u>		<u>Cash Sales</u>		<u>Total Sales</u>	
Units	€	Units	€	Units	€
1,200 @ €10	12,000	1,100 @ €11	12,100	2,300	24,100
2,200 @ €11	24,200	1,400 @ €12	16,800	3,600	41,000
1,400 @ €10	14,000	1,600 @ €13	20,800	3,000	34,800
<u>1,600 @ €11</u>	<u>17,600</u>	<u>1,100 @ €13</u>	<u>14,300</u>	<u>2,700</u>	<u>31,900</u>
6,400	<u>67,800</u>	5,200	<u>64,000</u>	11,600	<u>131,800</u>

Closing Stock in Units = Opening Stock 5,200 + Purchases 10,900 – Sales 11,600 = 4,500 units [7]

Closing Stock Valuation:		Units	@	€	=	€	
		2,600	@	€8	=	20,800	[3]
		1,400	@	€6	=	8,400	[3]
		<u>500</u>	@	€7	=	<u>3,500</u>	[3]
		<u>4,500</u>				<u>32,700</u>	[4]

(ii) Trading Account for the year ended 31/12/2014

Sales		131,800	[3]
Less Cost of sales			
Opening Stock	31,200		[2]
Add Purchases	<u>73,000</u>		[3]
	104,200		
Less Closing Stock	<u>(32,700)</u>		[2]
Gross Profit		<u>(71,500)</u>	
		<u>60,300</u>	[4]

(iii) [4]

Implications of an incorrect stock valuation

Incorrect valuation of stock affects:

- The Financial Statements of two years or two accounting periods ie. the closing stock of one accounting period and the opening stock of the next accounting period.
- The figures for cost of sales, gross profit, net profit and subsequently figures in the balance sheet
- In the balance sheet it will affect the figures for current assets and working capital/net assets
- In carrying out ratio analysis the figure for stock will affect the stock turnover, percentage mark-up on cost, gross profit percentage, net profit percentage and the current ratio
- The opinion of the firm in financial circles, its tax liability, its ability to borrow, public opinion and consequently its share price

The mark-up on cost in an industry provides a valuable measure for any firm in that industry. A mark-up that is out of line with the norm is a cause for concern and should lead to immediate investigation to locate the reason and take remedial action

Stock turnover determines the total volume of profit. Therefore, the higher the better.

(b)

(i)

Production overheads	Units	Total Cost
		€
High	28,500	140,400
Low	<u>21,000</u>	<u>106,800</u>
Difference	<u>7,500</u>	<u>33,600</u>

The variable cost of 7,500 units is 33,600 therefore the variable cost per unit is €4.48 [4]

Total production overhead cost	106,800	126,960	140,400
Less variable costs [units × €4.48]	<u>(94,080)</u>	<u>(114,240)</u>	<u>(127,680)</u>
Therefore, Fixed cost	<u>12,720</u>	<u>12,720</u>	<u>12,720</u> [4]

Other overheads	Units	Total Cost
		€
High	28,500	95,800
Low	<u>21,000</u>	<u>71,800</u>
Difference	<u>7,500</u>	<u>24,000</u>

The variable cost of 7,500 units is 24,600 therefore the variable cost per unit is €3.20 [4]

Total other overhead cost	71,800	86,200	95,800
Less variable costs [units × €3.20]	<u>(67,200)</u>	<u>(81,600)</u>	<u>(91,200)</u>
Therefore, Fixed cost	<u>4,600</u>	<u>4,600</u>	<u>4,600</u> [4]

(ii)

Flexible Budget in Marginal Costing format

	€	€
Sales		1,202,100 [3]
Less: Variable Costs		
Direct Materials [27,000 × 15.00]	405,000 [2]	
Direct Labour [27,000 × 11.00]	297,000 [2]	
Production overheads [27,000 × 4.48]	120,960 [2]	
Other overhead costs [27,000 × 3.20]	<u>86,400 [2]</u>	(909,360)
Contribution		<u>292,740 [4]</u>
Less Fixed Costs		
Production overheads	12,720 [1]	
Other overheads	4,600 [1]	
Administration	<u>35,000 [1]</u>	<u>(52,320)</u>
Profit		<u>240,420 [2]</u>

Total cost is 80% of sales.

Total cost is [909,360 + 52,320] = 961,680

80% of sales = 961,680

100% = 1,202,100

(iii) [6]

Controllable Costs: Are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.
E.g. - all variable costs are controllable. Commission to sales personnel can be controlled by the sales manager.

Uncontrollable Costs: Are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. e.g. - rates to the local authority are uncontrollable.