

Accounting Foundations

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7 Unsold Stock

Previously we have assumed that goods purchased for resale have all been sold by the end of the financial year. We see how unsold stock affects the accounts.

7.1 Unsold Stock

Purchases We start a new business selling garden supplies. We purchase 100 bags of compost at £4.00 each (including VAT). Our purchases total $100 \times £4 = £400$.

Sales During the year we sell 60 bags at £5.00 each. The total sales is $60 \times £5 = £300$.

Gross Profit The cost (to us) of compost sold is $60 \times £4 = £240$. The gross profit is sales less cost of goods sold i.e. $£300 - £240 = £60$. Check. We make £1.00 on each bag. We sold 60 bags. So we made £60.

Closing Stock We *start* the year with 100 bags in stock. We *finish* the year with $100 - 60 = 40$ bags in stock. The cost (to us) of the compost left in stock is $40 \times £4.00 = £160$.

DR	Trading and Profit and Loss Account for Year Ending 31 Dec Year 1		CR
	£		£
Purchases	400	Sales	300
Gross Profit	<u>60</u>	Closing Stock	<u>160</u>
	460		460

The double-entry for the £160 Closing Stock debit is shown in the Stock Account.

DR	Stock Account		CR
	£		£
Dec 31 Year 1	Trading a/c	160	

The unsold stock at the end of Year 1 is an asset and the balance on the Stock Account will appear on the Balance Sheet as an asset on that date.

We start the *next* year with the same 40 bags. Our closing stock for Year 1 becomes our opening stock for Year 2.

In Year 2 we purchase a further 100 bags of compost at £4.00 per bag. And we sell 120 bags at £5.00 each. Our gross profit is sales less cost of sales i.e. $£600$ less $£480 = £120$.

The opening stock is $40 + 100 = 140$ bags. The closing stock is 140 less $120 = 20$ bags.

DR		Trading and Profit and Loss Account for Year Ending 31 Dec Year 2		CR	
		£		£	
	Opening Stock	160		Sales	600
	Purchases	400		Closing Stock	80
	Gross Profit	120			
		<u>680</u>			<u>680</u>

DR		Stock Account		CR	
		£		£	
Dec 31 Yr 1	Trading a/c	160	Dec 31 Yr 2	Trading a/c	160
		<u>160</u>			
Dec 31 Yr 2	Trading a/c	80			

We close off the Stock Account at the end of Year 1 and transfer its £160 to the debit side of the Trading Account for Year 2 as Opening Stock.

We re-open Stock Account with the closing stock figure at end of Year 2. And complete the double entry by crediting the Trading Account.

The balance on the Stock Account of £80 will be shown in the Balance Sheet as at 31 Dec Year 2 as an asset at that date.

What have we done?

1. We have cleared last year's Stock Account figure out and transferred it to the Trading Account
2. We have inserted this year's stock figure into the Trading Account and the Stock Account.

These are the only kind of entries that will ever be made in the Stock Account. The purchases of stock made during the year are recorded in the Purchases Account. The sales are recorded in the Sales Account. The Stock Account is used to record adjustments to the Trading Account to allow for unsold purchases at the beginning and end of each year.

When we complete a Trial Balance, before starting our Trading and Profit and Loss Account, the balance on the Stock Account will be the closing stock figure for the previous year, and this figure will appear on the Trial Balance. The new stock figure at the end of this current year has not yet made an appearance in the Stock Account. It will not appear until we start the Trading Account, then we will credit the Trading Account and debit the Stock Account with the new figure.

The closing stock at 31 Dec Year 2 will not appear in the Trial Balance as at 31 Dec Year 2. but the closing stock at 31 Dec Year 1 will appear in the Trial Balance because this will be the only balance showing in the Stock Account at this point.

It is customary to emphasise the cost of goods sold and to show closing Stock as a deduction on the debit side of a Trading Account.

DR	Trading and Profit and Loss Account for Year Ending 31 Dec Year 2		CR
	£		£
Opening Stock	160	Sales	600
Purchases	400		
	560		
Less Closing Stock	80		
Cost of Goods Sold	480		
Gross Profit c/d to Profit & Loss A/c	120		
	<u>680</u>		<u>680</u>

7.2 Carriage Inwards

Payment of carriage charges on our purchases is an expense. We debit the Carriage Inwards Account and credit the Cash (or Bank) account. But at the end of the year the total of carriage inwards charges would be transferred to the Trading Account (and not to the Profit and Loss Account along with other expenses). This type of expense is really an additional cost of purchases. If we purchase goods for £100 and have to pay £10 to get the goods delivered to us then the goods would have cost us £110 altogether. But the two amounts are kept in two different accounts - Purchases and Carriage Inwards. Both accounts are transferred to the Trading Account at the end of the year.

Carriage Inwards is the only expense that is included in the Trading Account. All other expenses, including Carriage Outwards, are transferred to the debit side of the Profit and Loss Account at the end of the year.

7.3 Exemplar Trading Account

A model Trading Account is shown below.

DR	Trading & Profit & Loss Account for Year Ending ...		CR	
	£	£	£	
Opening Stock		6,000	Sales	60,000
Purchases	30,000		Less returns	700
Less returns	500			<u>59,300</u>
	<u>29,500</u>			
Carriage Inwards	400			
		<u>29,900</u>		
		35,900		
Less Closing Stock		4,900		
Cost of Goods Sold		<u>31,000</u>		
Gross Profit c/d		28,300		
		<u>59,300</u>		<u>59,300</u>
			Gross Profit b/d	<u>28,300</u>

(from HARRISON W Stage One Financial Accounting)

Exercise 7.1**1 Prepare**

- a) the Trading and Profit and Loss Accounts and
- b) the Balance Sheet

for the Trial Balance shown below.

Trial Balance as at 31 December 2013

	DR	CR
	£	£
Capital Account		12,980
Discounts	200	240
Stock 1 Jan 2012	4,080	
Purchases and Sales	17,520	31,060
Debtors and Creditors	7,820	4,180
Purchases Returns		440
Sales Returns	780	
Office Furniture	1,200	
Wages and Salaries	7,860	
Rent and Rates	1,440	
Cash at Bank	6,780	
Cash in Hand	100	
General Office Expenses	160	
Travelling Expenses	960	
	48,900	48,900

The value of stock at 31 December 2013 is £5,040.

2 Prepare

- a) the Trading and Profit and Loss Accounts and
- b) the Balance Sheet

for the Trial Balance shown on the next page below.

Trial Balance as at 31 December 2013

	DR £	CR £
Capital Account 1 Jan 2013		44,000
Freehold Land and Buildings	34,000	
Furniture and Fittings	2,000	
Motor Vehicles	5,000	
Purchases and Sales	100,000	140,600
Discounts Received		200
Vehicle Expenses	800	
Stock 1 Jan 2013	10,000	
Returns Outwards		400
General Expenses	1,600	
Property Expenses including Rates	2,400	
Debtors and Creditors	16,000	10,000
Wages and Salaries	18,000	
Cash at Bank and In Hand	5,400	
	<u>195,200</u>	<u>195,200</u>

Valuation of Stock at 31 December 2013 is £12,000.

We have seen how to deal with unsold stock at the end of the financial year. **Next** we look at valuing stock..

Bibliography

HARRISON W *Stage One Financial Accounting* Northwick Publishers 1986 pp 72 .. 82