KEY TERMS

First in first out (FIFO) – a method of stock valuation which involves issuing stock in the order in which it is delivered, so that the remaining stock is valued closer to its replacement cost.
Last in first out (LIFO) – a method of stock valuation which involves issuing more recent deliveries first, so that closing stock is valued at the older and possibly lower purchase price.
Reducing or declining balance method – a method used to calculate the annual depreciation allowance which involves writing off the same percentage rate each year.
Straight line method – a method used to calculate the annual depreciation allowance by subtracting the estimated scrap value from the cost and dividing the result by the expected life of the asset.

KNOWLEDGE

1. Why is it necessary to provide for depreciation?
2. What are the main differences between the straight line and reducing balance methods of calculating depreciation?
3. State two advantages of the straight line method of calculating depreciation.
4. State two advantages of the reducing balance method of calculating depreciation.
5. What is meant by opening stock and closing stock?
6. Explain the difference between the LIFO and FIFO methods of stock valuation.
7. Why is stock not valued at its selling price?

Case Study: Glencoe Service Station

Stella McDonald runs the Glencoe Service Station in the Scottish Highlands. Most of the revenue is generated from the sale of petrol to tourists and other motorists passing through Glencoe on the busy A82. The garage also carries out minor motor repairs and provides a breakdown service. Movements of petrol stocks for July 2008 are shown in Table 10.

In 2008 Stella purchased a new breakdown truck for the business. The cost was £30,000 and the truck was expected to have a useful life of ten years. At the end of ten years it was estimated that the truck would have a residual value of £4,000.

Table 10: Petrol stock movements - July 2008

Date	Purchases (Litres)	Stocks used (Litres)
04.07.08	400,000 @ 100p	
07.07.08		350,000
07.07.08	400,000 @ 100p	
12.07.08		410,000
14.07.08	400,000 @ 100p	
18.07.08		360,000
19.07.08	400,000 @ 105p	
23.07.08		460,000
24.07.08	400,000 @ 105p	
28.07.08		410,000

(a) Calculate the value of closing stock at the end of July 2008 using the FIFO method. (8 marks)
(b) Assuming that petrol sales for July 2008 were £2,133,000, calculate the gross profit for the month. (Gross profit is turnover minus cost of sales. Cost of sales can be calculated using opening stock, closing stock and purchases. Assume opening stock for the month is zero.) (6 marks)
(c) (i) Calculate the closing stock using the LIFO method. (8 marks)
(ii) Show the effect on gross profit at the end of July. (4 marks)
(d) Using the straight line method of depreciation, calculate: (i) the annual depreciation provision for the breakdown truck; (4 marks) (ii) the book value of the breakdown truck at the end of each year. (4 marks)
(e) If Stella sold the breakdown truck for £12,000 at the end of year 6, what would be the profit or loss on disposal? (6 marks)