

53.1 A drill to practise comparing cost and net realizable value to determine the value of closing stock

REQUIRED: for each of the following sets of data:

1. determine the net realizable value of the closing stock
2. compare the cost of the stock against its net realizable value, and state the profit or loss expected when the stock is ultimately disposed of
3. state whether the closing stock should be valued at cost or at net realizable value, and explain your decision with reference to the accounting principle of prudence.

STOCK	A £	B £	C £	D £	E £
cost	1 000	20 000	40 000	4 800	12 000
expected sales value	1 500	30 000	50 000	7 000	16 000
expected future costs	300	12 000	10 000	3 000	3 000

Response

1. to determine net realizable value:

	A £	B £	C £	D £	E £
expected sales value	1 500	30 000	50 000	7 000	16 000
expected future costs	(300)	(12 000)	(10 000)	(3 000)	(3 000)
net realizable value	£1 200	£18 000	£40 000	£4 000	£13 000

2. to determine the expected profit or loss and compare cost and NRV:

	A £	B £	C £	D £	E £
net realizable value	1 200	18 000	40 000	4 000	13 000
less cost to date	(1 000)	(20 000)	(40 000)	(4 800)	(12 000)
expected profit (loss)	£ 200	£(2 000)	£ 0	£(800)	£1 000
which is the lower of Cost and NRV?	cost	NRV	n/a	NRV	cost

3. stock should be valued as shown below:

A	B	C	D	E
cost	NRV	cost	NRV	cost
£1 000	£18 000	£40 000	£4 000	£12 000

If the net realizable value of stock (what can be got out of it) is lower than its cost, then the firm will realize a loss when the stock is sold. If NRV is greater than cost, then the firm will realize a profit when the stock is sold.

Valuing stock at the lower of cost and net realizable value ensures that no profit will be recognized in the accounts until the stock is sold, while any loss will be recognized immediately, in accordance with the principle of prudence.