

Chapter 9

Merchandise Inventory

Decision Guidelines – Excel

Solution

Note: Inventory costs rose from \$30 per unit to \$34.75 per unit.

1. The lowest cost of goods sold is produced by FIFO. Under FIFO, the oldest inventory costs are used first for computing cost of goods sold. When prices are rising, the oldest inventory costs are the lowest, and that makes cost of goods sold the lowest.
2. The lowest ending inventory is produced by LIFO. Under LIFO, the newest inventory costs are used first to compute cost of goods sold, so the oldest costs are left in ending inventory. That makes ending inventory the lowest under LIFO.
3. Gross profit is maximized by choosing the inventory method that produces the lowest cost of good sold. In periods of rising prices, such as our example, that method would be FIFO. FIFO does *not* do a good job of matching inventory expense (cost of goods sold) to sales revenue because FIFO assigns to cost of goods sold the oldest inventory costs of the period.

T Questions

1. A jeweler should use the *perpetual* inventory system for good internal control over its inventory. A hardware store would likely use the *periodic* system because its inventory consists of a large number of low-unit-cost items. It may not be economical to maintain a perpetual system for such an inventory, and, for this reason, many hardware stores use the periodic system.

2. a. Entries under the perpetual inventory system:

To record credit purchases:

Inventory.....	X	
Accounts Payable.....		X

To record credit sales:

Accounts Receivable.....	X	
Sales Revenue.....		X

Cost of Goods Sold.....	X	
Inventory.....		X

- b. Entries under the periodic inventory system:

To record credit purchases:

Purchases.....	X	
Accounts Payable.....		X

To record credit sales:

Accounts Receivable.....	X	
Sales Revenue.....		X

To record beginning and ending inventory:

Cost of Goods Sold.....	X	
Inventory (beginning balance).....		X

Inventory (ending balance).....	X	
Cost of Goods Sold.....		X

3. Cost of goods sold = \$10,000 + \$85,000 - \$12,700
= \$82,300
4. Ending inventory = \$32,000 + \$119,000 - \$127,000
= \$24,000
5. The *specific unit cost* method assigns each inventory item its particular cost. The specific unit cost method is used for inventory items that are individually identifiable, like jewels and automobiles.

The *weighted-average cost* method assigns the weighted-average cost of inventory available during the period to ending inventory and cost of goods sold.

Under the *first-in, first-out (FIFO)* method, the first inventory costs incurred during the period are assigned to cost of goods sold. The latest unit costs are assigned to ending inventory. When prices are rising, FIFO produces the highest reported income.

Under the *last-in, first-out (LIFO)* method, the last inventory costs incurred during the period are the first to be assigned to cost of goods sold. The earliest (oldest) unit costs of the period are assigned to ending inventory. When prices are rising, LIFO produces the lowest reported income.

6. *FIFO* results in the ending inventory being valued at the most current cost. The earliest costs of the period are assigned to cost of goods sold, leaving the last (that is, the most current) costs for ending inventory.

LIFO results in the cost-of-goods-sold amount being valued at the last (the most current) cost.
7. The most attractive feature of LIFO is that it minimizes income tax payments during periods of increasing prices. (During periods of decreasing prices, FIFO results in the lowest income tax payments.)

8. The chief criticism of LIFO is that it allows managers to manipulate income by timing the purchase of inventory. To decrease reported income at a time when prices are increasing, managers can purchase inventory right before year end. The high inventory costs are used in computing cost of goods sold, thus decreasing income for the year. To report higher income, managers can avoid purchasing inventory before year-end, keeping those high costs from entering the computation of the current period's cost of goods sold.
9. Conservatism requires that inventory be valued at the lower of its cost or market value (replacement cost).

10.

<i>Cost</i>	<i>Current Replacement Cost</i>	<i>Appropriate Amount for Reporting Inventory Under the Lower-of-Cost-or-Market Rule</i>
\$48,000	\$51,000	\$48,000
48,000	45,000	45,000

Conservatism is the basis for reporting inventory at the lower of its cost or market value.

11. Overstating ending inventory by \$10,000 understates cost of goods sold and overstates gross profit of period 1 by that amount. The ending inventory of period 1 is the beginning inventory of period 2. Therefore, beginning inventory of period 2 is overstated by \$10,000. As a result, cost of goods sold of period 2 is overstated by the same \$10,000, and gross profit of period 2 is understated by \$10,000. In the final analysis, gross profit for the combined two-year period is correct because the error of period 2 counterbalances the error of period 1.
12. The *gross profit method* is based on the familiar cost-of-goods-sold model.

13. The statement is false. Any company that sells inventory needs internal controls. The goods should be safeguarded from theft, damage, and decay. Also, purchases should be made in economical quantities, and controls should ensure that enough inventory is kept on hand to prevent shortages, which could lead to lost sales.

T Daily Exercises

(10 min.) **DE 9-1**

Beakman Ventures	
Balance Sheet	
December 31, 20X0	
Current assets:	
Inventory (400 @ \$60)	\$24,000

Beakman Ventures	
Income Statement	
Year Ended December 31, 20X0	
Sales revenue [1,600 × (\$60 + \$40)]	\$160,000
Cost of goods sold (1,600 @ \$60)	<u>96,000</u>
Gross profit	\$ 64,000

(5 min.) **DE 9-2**

1. Inventory purchases.....	\$ 560,000
2. Sales	\$ 900,000
Cost of goods sold	<u>(540,000)</u>
Gross profit.....	360,000
Ending inventory	\$ 120,000

3. Deckers is using the perpetual inventory system. This is clear from the debit to Inventory for the purchase and the credit to the Inventory account for the cost of goods sold.

Perpetual System:

Periodic System:

Journal				
DATE	ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
	Inventory		85,000	
	Accounts Payable			85,000
	Accounts Receivable		103,000	
	Sales Revenue			103,000
	Cost of Goods Sold		42,500	
	Inventory (\$85,000 × 1/2)			42,500

Journal				
DATE	ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
	Purchases		85,000	
	Accounts Payable			85,000
	Accounts Receivable		103,000	
	Sales Revenue			103,000

Income statement:

Sales revenue.....	\$ 103,000
Cost of goods sold.....	<u>42,500</u>
Gross profit.....	\$ 60,500

We cannot yet measure gross profit under the periodic system because we do not know cost of goods sold. To compute cost of goods sold, we need to know the costs of both beginning inventory and ending inventory.

(10 min.) **DE 9-5**

1. Inventory costs are *increasing* from \$14 to \$18 per unit.
2. *LIFO* results in the *lowest* amount for *ending inventory* (\$240) because under LIFO, the ending inventory is costed at the oldest costs. When costs are increasing, the oldest costs are the lowest costs.
3. LIFO results in the *highest cost of goods sold*. This occurs because the last costs of the period are assigned to cost of goods sold. When costs are increasing, the last costs are the highest.
4. LIFO results in the *lowest gross profit* because cost of goods sold, the expense, is the highest. (Sales revenue is unaffected by the inventory costing method.)

(10 min.) **DE 9-6**

1. Inventory costs are *increasing* from \$14 to \$18 per unit.
2. *FIFO* results in the *highest* amount for *ending inventory* (\$360) because under FIFO, the ending inventory is costed at the last costs incurred during the period. When costs are increasing, the last costs are the highest costs.
3. FIFO results in the *lowest cost of goods sold*. This occurs because the oldest costs are assigned to cost of goods sold. When costs are increasing, the oldest costs are the lowest.
4. FIFO results in the *highest gross profit* because cost of goods sold, the expense, is the lowest. (Sales revenue is unaffected by the inventory costing method.)

(10 min.) **DE 9-7**

	Weighted-Average	FIFO	LIFO
Cost of goods available for sale	\$900	\$900	\$900
Ending inventory:			
Weighted-average (10 @ \$15)	150		
FIFO (10 @ \$18)		180	
LIFO (10 @ \$10)			100
Cost of goods sold:			
Weighted-average (50 @ \$15)	<u>\$750</u>		
FIFO (10 @ \$10) + (25 @ \$14) + (15 @ \$18)		<u>\$720</u>	
LIFO (25 @ \$18) + (25 @ \$14)			<u>\$800</u>

(15 min.) **DE 9-8**

Accounts	Weighted-Average	FIFO	LIFO
Inventory (800 × \$14).....	11,200	11,200	11,200
Accounts Payable.....	11,200	11,200	11,200
Purchases on account.			
Accounts Receivable (700 × \$22)..	15,400	15,400	15,400
Sales Revenue.....	15,400	15,400	15,400
Sales on account.			
Cost of Goods Sold ¹	9,422	9,300	9,800
Inventory.....	9,422	9,300	9,800
Cost of goods sold.			

¹Cost of goods sold:

Weighted-average cost:

Beginning inventory (100 × \$9.14)	\$ 914
Purchases (800 × \$14)	<u>11,200</u>
Cost of goods available	<u>\$12,114</u>

$$\text{Average cost per unit} = \frac{\$12,114}{900 \text{ units}} = \underline{\$13.46}$$

Cost of goods sold (700 × \$13.46) \$ 9,422

FIFO cost:

(100 × \$9) + (600 × \$14) \$ 9,300

LIFO cost:

(700 × \$14) \$ 9,800

(10-15 min.) **DE 9-9**

Jetlink Data Systems			
Income Statement			
Year Ended December 31, 20XX			
	Weighted-Average	FIFO	LIFO
Sales revenue (700 × \$22)	\$15,400	\$15,400	\$15,400
Cost of goods sold (700 × \$13.46)	9,422		
(100 × \$9) + (600 × \$14)		9,300	
(700 × \$14)			9,800
Gross profit	\$ 5,978	6,100	5,600
Operating expenses	4,000	4,000	4,000
Net income	<u>\$ 1,978</u>	<u>\$ 2,100</u>	<u>\$ 1,600</u>

(10 min.) **DE 9-10**

Jetlink Data Systems			
Income Statement			
Year Ended December 31, 20XX			
	Weighted-Average	FIFO	LIFO
Sales revenue (700 × \$22)	\$15,400	\$15,400	\$15,400
Cost of goods sold (700 × \$13.46)	9,422		
(100 × \$9) + (600 × \$14)		9,300	
(700 × \$14)			9,800
Gross profit	\$ 5,978	6,100	5,600
Operating expenses	4,000	4,000	4,000
Income before income tax	\$ 1,978	\$ 2,100	\$ 1,600
Income tax expense (40%)	\$ 791	\$ 840	\$ 640

Method to maximize reported income. Method to minimize income tax expense.

(5 min.) **DE 9-11**

The Lands' End managers can buy a large amount of inventory before the end of the year. Under LIFO, these high inventory costs immediately become expense—as cost of goods sold. As a result, the income statement reports a lower net income.

(5-10 min.) **DE 9-12**

- Deckers uses the FIFO method. On November 12, Deckers sold 13 pairs of sandals. Under FIFO, Deckers first costed out (to cost of goods sold) the older 4 pairs at \$30 each and then costed out the newer 9 pairs that cost \$31 each. This is how FIFO works—first-in, first-out.
- Income statement:**

Sales revenue (40 × \$50).....	\$2,000
Cost of goods sold.....	<u>1,235</u>
Gross profit.....	<u>\$ 765</u>

(5-10 min.) **DE 9-13**

Balance sheet:

Current assets:
Inventories, at market (which is lower than \$640 cost)..... \$ 550

Income statement:

Cost of goods sold [\$1,235 + (\$640 ! \$550)]..... \$1,325

(5-10 min.) **DE 9-14**

	Correct Amount (Millions)
a. Inventory (\$18.1 ! \$3.0).....	<u>\$ 15.1</u>
b. Cost of goods sold (\$64.5 + \$3.0).....	<u>\$ 67.5</u>
c. Gross profit (\$45.1 ! \$3.0).....	<u>\$ 42.1</u>
d. Net income (net loss) (\$2.9 ! \$3.0).....	<u>\$ (0.1)</u>

(10 min.) **DE 9-15**

1. Last year's reported net income was *understated*.
Correct net income last year was \$8.3 million (\$6.3 + \$2).
2. This year's net income is *overstated*.
Correct net income for this year is \$5 million (\$7 ! \$2).
3. Warren's perspective is better because correcting the error changes the trend of net income from up (good) to down (bad), as follows:

	<i>Millions</i>		
	Last Year	This Year	Trend
Reported net income.....	\$6.3	\$7	↑ Up (Good)
Correct net income.....	\$8.3	\$5	↓ Down (Bad)

(5-10 min.) **DE 9-16**

1. *Unethical*. The company falsified its reported inventory purchases, cost of goods sold, and net income in order to cheat the government (and the people) out of income tax.
2. *Unethical*. The company falsified its reported amount of inventory in order to cheat the government (and the people) out of taxes.
3. *Ethical*. There is nothing wrong with buying inventory whenever a company wishes.
4. *Ethical*. Same answer as 3.
5. *Unethical*. The company falsified its reported amounts of inventory and net income.

(10-15 min.) **DE 9-17**

1.	Beginning inventory.....	\$ 350,000
	+ Purchases.....	<u>1,600,000</u>
	= Cost of goods available for sale.....	1,950,000
	! Cost of goods sold.....	<u>(1,800,000)</u>
	= Ending inventory.....	<u>\$ 150,000</u>
2.	Beginning inventory.....	\$ 350,000
	+ Purchases.....	<u>1,600,000</u>
	= Cost of goods available for sale.....	1,950,000
	! Cost of goods sold:	
	Sales revenue.....	\$ 3,000,000
	Less Estimated gross profit (40%)	<u>(1,200,000)</u>
	Estimated cost of goods sold.....	<u>(1,800,000)</u>
	= Estimated cost of ending inventory.....	<u>\$ 150,000</u>

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T Exercises

(15-20 min.) **E 9-1**

Req. 1

Journal			
Perpetual System			
	ACCOUNTS AND EXPLANATIONS	DEBIT	CREDIT
		<i>Thousands</i>	
1.	<i>Purchases:</i>		
	Inventory	3,105	
	Accounts Payable		3,105
2.	<i>Sales:</i>		
	Cash	879	
	Accounts Receivable	3,516	
	Sales Revenue		4,395
	Cost of Goods Sold	2,821	
	Inventory		2,821
3.	<i>End-of-period entries:</i>		
	None		

(continued) **E 9-1**

Req. 2

	<i>Thousands</i>
Balance sheet:	
Current assets:	
Inventory	\$ 654
Income statement:	
Sales revenue	4,395
Cost of goods sold	<u>2,821*</u>
Gross profit	\$1,574

Req. 3 (Computation of cost of goods sold in the periodic system)

$$*\$370 + \$3,105 - \$654 = \$2,821$$

Periodic System			
		<i>Thousands</i>	
	Purchases	3,105	
	Accounts Payable		3,105
	Cash	879	
	Accounts Receivable	3,516	
	Sales Revenue		4,395
<i>End-of-period entries:</i>			
	Cost of Goods Sold	370	
	Inventory (beginning balance)		370
	Inventory (ending balance)	654*	
	Cost of Goods Sold		654
	Cost of Goods Sold	3,105	
	Purchases		3,105

$$*\$370 + \$3,105 - \$2,821 = \$654$$

Req. 2

Balance sheet:		<i>Thousands</i>
Current assets:		
Inventory		\$ 654
Income statement:		
Sales revenue		4,395
Cost of goods sold:		
Beginning inventory	\$ 370	
Purchases	<u>3,105</u>	
Cost of goods available	3,475	
Ending inventory	<u>(654)</u>	
Cost of goods sold		<u>2,821</u>
Gross profit		\$1,574

<i>Cost of goods available for sale</i>			
Oct. 1	Beginning inventory	9 @	\$160 = \$1,440
8	Purchase.....	4 @	160 640
15	Purchase.....	12 @	170 2,040
26	Purchase.....	<u>3 @</u>	<u>176 528</u>
31	Goods available for sale.....	<u>28</u>	<u>\$4,648</u>

	<u>Ending inventory</u>	<u>Cost of goods sold</u>
(1) Specific unit cost (4 @ \$170) + (4 @ \$160) = <u>\$1,320</u>	\$4,648 ! \$1,320 =	<u>\$3,328</u>
(2) Weighted-average cost (\$4,648 / 28 units = average unit cost of \$166 × 8) = <u>\$1,328</u>	\$4,648 ! \$1,328 =	<u>\$3,320</u>
(3) FIFO (3 @ \$176) + (5 @ \$170) = <u>\$1,378</u>	\$4,648 ! \$1,378 =	<u>\$3,270</u>
(4) LIFO 8 @ \$160 = <u>\$1,280</u>	\$4,648 ! \$1,280 =	<u>\$3,368</u>

(10-15 min.) **E 9-3**

For the year ended January 31, 2000:

Millions

Budgeted cost of goods sold (\$8,191 × 1.06).....	\$8,682
Budgeted ending inventory.....	<u>2,020</u>
Budgeted cost of goods available for sale.....	10,702
Actual beginning inventory.....	<u>(1,902)</u>
Budgeted purchases.....	<u>\$8,800</u>

(10 min.) **E 9-5**

(Perpetual Inventory System)

Journal			
DATE	ACCOUNTS AND EXPLANATIONS	DEBIT	CREDIT
	a. Inventory (\$640 + \$2,040 + \$528)	3,208	
	Accounts Payable		3,208
	b. Accounts Receivable (20 @ \$300)	6,000	
	Sales Revenue		6,000
	Cost of Goods Sold (\$4,648 ! \$1,378)	3,270	
	Inventory		3,270

(15 min.) **E 9-6**

(Periodic Inventory System)

Journal			
DATE	ACCOUNTS AND EXPLANATIONS	DEBIT	CREDIT
	a. Purchases (\$640 + \$2,040 + \$528)	3,208	
	Accounts Payable		3,208
	b. Accounts Receivable (20 @ \$300)	6,000	
	Sales Revenue		6,000
	c. Cost of Goods Sold	1,440	
	Inventory (beginning balance)		1,440
	Inventory [ending balance: (8 @ \$160)]	1,280	
	Cost of Goods Sold		1,280
	Cost of Goods Sold	3,208	
	Purchases		3,208

Cost of Goods Sold

Beginning inventory		Ending inventory	1,280
(9 × \$160)	1,440		
Purchases	3,208		
	3,368		

(15-20 min.) **E 9-7**

	FIFO	LIFO
Sales revenue.....	\$8,000	\$8,000
Cost of goods sold		
FIFO = (9 @ \$160) + (4 @ \$160) + (7 @ \$170) ...	<u>3,270</u>	
LIFO = (3 @ \$176) + (12 @ \$170) + (5 @ \$160) ...		<u>3,368</u>
Gross profit	4,730	4,632
Operating expenses.....	<u>1,100</u>	<u>1,100</u>
Income before income tax	<u>\$3,630</u>	<u>\$3,532</u>
Income tax expense		
FIFO = \$3,630 × .30.....	<u>\$1,089</u>	
LIFO = \$3,532 × .30.....		<u>\$1,060</u>
LIFO advantage in tax savings (\$1,089 ! \$1,060)....		<u>\$ 29</u>

Short-cut computation:

Inventory difference (\$3,368 ! \$3,270).....	\$ 98
Income tax rate.....	× .30
LIFO advantage in tax savings.....	<u>\$ 29</u>

(20-30 min.) **E 9-8**

- a. \$64,800 (\$101,800 ! \$37,000)
 - b. \$137,300 (\$94,100 + \$43,200)
 - c. \$24,350 (\$25,450 + \$93,000 ! \$94,100)
 - d. \$30,200 (Let d = beginning inventory;
d + \$54,900 ! \$22,600 = \$62,500
d = \$30,200)
 - e. \$32,200 (\$94,700 ! \$62,500)
 - g. \$37,200 (\$84,300 ! \$47,100)
- Note: Must solve for g before determining f.*
- f. \$34,700 (Let f = Net purchases;
\$10,700 + f ! \$8,200 = \$37,200
f = \$34,700)

Magnolia Company		
Income Statement		
Year Ended December 31, 20XX		
Net sales		\$84,300
Cost of goods sold:		
Beginning inventory	\$10,700	
Net purchases	<u>34,700</u>	
Cost of goods available	45,400	
Ending inventory	<u>(8,200)</u>	
Cost of goods sold		<u>37,200</u>
Gross profit		47,100
Operating expenses		<u>31,600</u>
Net income		<u><u>\$15,500</u></u>

(15-20 min.) **E 9-9**

<u>Company</u>	<u>Gross Profit Percentage</u>	<u>Inventory Turnover</u>
Maple	$\frac{\$37,000}{\$101,800} = 36.3\%$	$\frac{\$64,800}{(\$12,500 + \$19,400) / 2} = 4.1 \text{ times}$
Walnut	$\frac{\$43,200}{\$137,300} = 31.5\%$	$\frac{\$94,100}{(\$25,450 + \$24,350) / 2} = 3.8 \text{ times}$
Pine	$\frac{\$32,200}{\$94,700} = 34.0\%$	$\frac{\$62,500}{(\$30,200 + \$22,600) / 2} = 2.4 \text{ times}$
Magnolia	$\frac{\$47,100}{\$84,300} = 55.9\%$	$\frac{\$37,200}{(\$10,700 + \$8,200) / 2} = 3.9 \text{ times}$

Based on gross profit percentage and rate of inventory turnover, Magnolia Company looks the most profitable.

MEMO

DATE: _____

TO: Investor

FROM: _____

RE: Investment Recommendation

Magnolia Company appears to be the most profitable because it earns the highest percentage of its net sales as gross profit and has almost the fastest rate of inventory turnover. Overall, Magnolia looks like the best investment among the four companies.

(15-20 min.) **E 9-10**

Perpetual Inventory Record										
ITEM: HONEYDEW GUITARS										
DATE		RECEIVED			SOLD			BALANCE		
		QTY	UNIT COST	TOTAL COST	QTY	UNIT COST	TOTAL COST	QTY	UNIT COST	TOTAL COST
May	1							5	\$95	\$475
	6				3	\$95	\$285	2	95	190
	8	11	\$83	\$913				2	95	190
								11	83	913
	17				2	95	190			
					2	83	166	9	83	747
	30				1	83	83	8	83	\$664
Totals		11	—	\$913	8	—	\$724	8	\$83	\$664

Cost of goods sold Ending inventory

	A	B	C	D	E
1	HOMESTAKE INDUSTRIES				
2	ESTIMATED INCOME UNDER FIFO AND LIFO				
3	MARCH 20XX				
4					
5		FIFO	LIFO	FIFO	LIFO
6					
7	Sales	\$295,000	\$295,000	\$295,000	\$295,000
8					
9	Cost of goods sold				
10	Beginning inventory	63,000	63,000	63,000	63,000
11	Net purchases	159,000	159,000	182,000	182,000
12					
13	Cost of goods available	222,000	222,000	245,000	245,000
14	Ending inventory	85,000	78,000	85,000	78,000
15					
16	Cost of goods sold	137,000	144,000	160,000	167,000
17					
18	Gross profit	158,000	151,000	135,000	128,000
19	Operating expenses	83,000	83,000	83,000	83,000
20					
21	Net income	<u>\$ 75,000</u>	<u>\$ 68,000</u>	<u>\$ 52,000</u>	<u>\$ 45,000</u>

DATE: _____

TO: Bruce Willitz

FROM: Student Name

SUBJECT: Proposal for Saving Income Tax

We can save income tax by buying above-normal quantities of inventory before the end of the year. Inventory costs are rising, and the company uses the LIFO inventory method. Under LIFO, the high cost of year-end purchases of inventory goes straight into cost of goods sold. This increases cost of goods sold and decreases net income and income taxes. Because our inventory levels are lower than normal, we need the inventory anyway. In effect, we can use our cash to buy inventory or to pay income taxes. I think it would be wiser to buy inventory.

(10-15 min.) **E 9-13**

- LIFO a. Generally associated with saving income taxes.
- FIFO b. Results in a cost of ending inventory that is close to the current cost of replacing the inventory.
- Specific unit cost c. Used to account for automobiles, jewelry, and art objects.
- Weighted-average d. Provides a middle-ground measure of ending inventory and cost of goods sold.
- FIFO e. Maximizes reported income.
- LIFO f. Enables a company to buy high-cost inventory at year end and thereby to decrease reported income.
- LIFO g. Reported income and income taxes rise when the company liquidates older, low-cost, layers of inventory.
- LIFO h. Matches the most current cost of goods sold against sales revenue.
- LIFO i. Results in an old measure of the cost of ending inventory.

(5-10 min.) **E 9-14**

Alcoa Enterprises	
Income Statement (partial)	
For the Year Ended December 31, 20X1	
Sales revenue	\$225,000
Cost of goods sold [\$113,245 + (\$18,028 ! \$16,840)]	<u>114,433</u>
Gross profit	<u>\$110,567</u>

Note: Cost was used for beginning inventory because cost was lower than market. Market (replacement cost) was used for ending inventory because market was lower than cost.

(10 min.) **E 9-15**

Income statement:

Sales revenue	\$112,000
Cost of goods sold:	
Beginning inventory	\$17,200
Net purchases	<u>51,700</u>
Cost of goods available for sale	68,900
Ending inventory	<u>(19,800)</u>
Cost of goods sold	<u>49,100</u>
Gross profit.....	<u>\$62,900</u>

Balance sheet:

Inventories at LCM (Cost, \$23,800) ...	<u>\$19,800</u>
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(10-15 min.) **E 9-16**

Lazlo Power Tools				
Income Statements				
Years Ended September 30, 20X2 and 20X1				
	20X2		20X1	
Sales revenue		\$137,300		\$121,700
Cost of goods sold:				
Beginning inventory	\$10,500		\$12,800	
Net purchases	<u>72,000</u>		<u>66,000</u>	
Cost of goods available	82,500		78,800	
Ending inventory	<u>(16,600)</u>		<u>(10,500)*</u>	
Cost of goods sold		<u>65,900</u>		<u>68,300</u>
Gross profit		71,400		53,400
Operating expenses		<u>30,300</u>		<u>26,100</u>
Net income		<u>\$ 41,100</u>		<u>\$ 27,300</u>

*\$14,000 ! \$3,500 = \$10,500

Net income for the two years combined is the same in both cases—
 \$68,400 (that is, \$41,100 + \$27,300 = \$68,400 = \$37,600 + \$30,800)
 because the error in 20X2 counterbalances the error in 20X1.

(10-15 min.) **E 9-17**

Beginning inventory	\$47,500
Net purchases.....	<u>37,600</u>
Cost of goods available for sale	85,100
Cost of goods sold:	
Net sales revenue	\$60,000
Less estimated gross profit of 40%	<u>(24,000)</u>
Estimated cost of goods sold.....	<u>(36,000)</u>
Estimated cost of inventory destroyed	<u>\$49,100</u>

Another reason managers use the gross profit method to estimate inventory cost on a regular basis:

To determine ending inventory cost for monthly and quarterly financial statements.

(5-10 min.) **E 9-18**

- a. Company is using LIFO (because of a possible LIFO liquidation).
- b. Use FIFO.
- c. Buy inventory late in the year.
- d. Use any method. They all produce the same results because costs are stable.
- e. Use the average-cost method.
- f. Use FIFO.

(15 min.) **E 9-19**

Req. 1

Campbell Soup Company		
Income Statement (<i>in millions</i>)		
Year Ended July 31, 19X9		
Revenues:		
Revenues, total		\$6,424
Expenses:		
Cost of goods sold	\$3,050	
Other expenses	<u>2,650</u>	
Total expenses		<u>5,700</u>
Net income		<u>\$ 724</u>

Req. 2

Campbell Soup Company			
Balance Sheet (<i>in millions</i>)			
July 31, 19X9			
ASSETS		LIABILITIES	
Total assets	\$5,522	Total liabilities	\$5,287
		OWNERS' EQUITY	
		Owners' equity	235
		Total liabilities and	
Total assets	<u>\$5,522</u>	owners' equity	<u>\$5,522</u>