UNIT 2 TEST ANSWER SET

SHORT ANSWER SECTION – *55 marks total*

4.

a)	S
b)	A
c)	N
d)	N
e)	A

5.

a) GAFS=OI+P=36,500

	LIFO	FIFO	Average Cost
PERPETUAL	Cost of Goods Sold COGS = 200X$90 + 100X$60 + 50X$50 **= $26,500**	Cost of Goods Sold = 150X$50 + 100X$60 + 100X$90 **= $22,500**	Cost of Goods Sold = 350X($31,500/450) **= $24,500**
	Ending Inventory = GAFS – COGS = $36,500 - $26,500 **= $10,000**	Ending Inventory = $36,500 - $22,500 **= $14,000**	Ending Inventory = $36,500 - $24,500 **= $12,000**
PERIODIC	Cost of Goods Sold = 50X$100 + 200X$90 + 100X$60 **= $29,000**	Cost of Goods Sold = 150X$50 + 100X$60 + 100X$90 **= $22,500**	Cost of Goods Sold = 350X(36,500/500) **= $25,550**
	Ending Inventory = $36,500 - $29,000 **= $7,500**	Ending Inventory = $36,500 - $22,500 **= $14,000**	Ending Inventory = $36,500 - $25,550 **= $10,950**

b) FGH takes a physical count of inventory and finds that 25 units are missing. Assuming the periodic method is used, prepare the journal entry to record the shrinkage loss assuming that FGH uses (i) LIFO and (ii) FIFO.
(Application - 5 marks – 1 mark for each unique account and amount)

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
July 31	Cost of Goods Sold Expense / Purchases	$1,250	
	Inventory		$1,250
	(Shrinkage LIFO: 25 X $50)		

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
July 31	Shrinkage Expense	$2,250	
	Inventory		$2,250
	(Shrinkage FIFO: 25 X $90)		

c) (To answer this question, assume that part b) never happened.) On July 31, the remaining units could be replaced at the current market price of $25 each. Prepare the journal entry. Use FIFO periodic (if needed).
(Application – 3 marks – 1 mark for each account and amount)

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
July 31	Loss on the write down of inventory Expense	$11,500	
	Inventory		$11,500
	(EI is $17,500 and should be $6,000 $6,000 = 150 units X $40)		

d) The earliest layers of inventory are sold regardless of method.

6. Explain what JIT stands for and name one major advantage and disadvantage of JIT. *(Knowledge - 3 marks)*

   Just-in-time inventory. ADV: no inventory; no storage DISADV: 100% reliable; production shut down

7. WXY Company lost all of its inventory in a fire on December 28, 2014. The accounting records showed the following gross profit data for November and December:

Account	November	December
Sales	$674,000	$965,390
Sales Returns and Allowances	14,000	26,600
Purchases	441,190	621,660
Purchases Returns and Allowances	13,750	22,575
Freight-in	6,860	12,723.50
Beginning Inventory	34,050	39,405
Ending Inventory	39,405	???

WXY Company is fully insured for the fire losses but must prepare a report for the insurance company.

a. Prepare the November Income Statement up to the Gross Margin line. *(Application – 10 marks)*

XYZ Company Income Statement 31-Dec-17			
Revenue			
Sales		$674,000	
Less: Sales Returns and Allowances		$14,000	$660,000
Cost of Goods Sold			
Opening Inventory		$34,050	
Add: Purchases	$441,190		
Less: Purchases Returns and Allowances	$13,750	$427,440	
Freight-in		$6,860	
Goods Available for Sale		$468,350	
Less: Ending Inventory		$39,405	$428,945
Gross Margin			$231,055

b. Determine the amount of inventory lost by WXY as a result of the fire using the gross profit method. Solve for the November cost ratio, the December estimated cost of goods sold, and, the December estimated ending inventory. *(Application – 10 marks – 2 marks + 3 marks + 5 marks)*

Find Cost Ratio:
Cost Ratio = COGS / Sales = $428,945 / $660,000 = 65%

Find December COGS
COGS = net Sales X 65% = ($965,390 - $26,600) X 65% = $610,213.50

Calculate Ending Inventory
EI = OI + net Purchases + Freight-in – COGS
= $39,405 + ($621,660 – 22,575) + $12,723.50 - $610,213.50
= $40,000

CASE – *10 marks total*

8. You are making a detailed analysis of the financial statements of two companies in the same industry: APP and BFF. Both businesses are organized as corporations and, therefore, must pay income taxes on their earnings. Both companies maintain large inventories and the replacement costs of their products have been rising steadily for several years. A note to APP's financial statements discloses that the company's inventory is shown at a cost that is far below current replacement cost. BFF's inventory, in contrast, is presented at a cost that is very close to its current replacement cost.

Answer the following questions explaining clearly the reasoning behind your answers. Each answer is worth 1 mark – ½ for the correct answer, ½ for the correct logic.

a) What method of inventory valuation is probably used by APP? By BFF?
(Thinking - 2 marks)

APP – lowest ending inventory; highest COGS = LIFO
BFF – highest ending inventory; lowest COGS = FIFO

b) If we assume that the two companies are identical except for the method used in valuing inventory:
   i) Which company probably has been reporting the higher net income in recent years?
   (Thinking - 1 mark)

   The company with the highest Gross Margin = lowest COGS = BFF

   ii) Which company's financial statements probably imply the higher inventory turnover rate (COGS / Inventory)?
   (Thinking - 1 mark)

   The company with highest COGS and lowest inventory = APP

   iii) Which company's Balance Sheet probably has the higher inventory?
   (Thinking - 1 mark)

   Highest ending inventory = BFF

c) If both companies sold their entire inventory at the same sales prices, which company would you expect to report the larger amount of gross profit?
(Thinking - 2 marks)

Highest gross profit = lowest COGS = sell lowest ending inventory = APP

d) Explain which inventory flow assumption is disallowed in most countries and explain the two accounting principles that guide that decision.
(Communication - 3 marks)

LIFO is disallowed. The inventory is not at NRV; neither inventory or COGS is conservatively stated.