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Profit and Inventory Under IFRS and GAAP

Gabriele Lingenfelter, Christopher Newport University
Abby Brooks, Christopher Newport University

Introduction

The hot sun was setting on the street as Sabrina took down her sign which had advertised her ice cream bar sale in the neighborhood. While most of her friends sold lemonade to make a little money during the summer months, Sabrina decided she wanted to sell ice cream bars this hot July afternoon. She had sold the ice cream bars since the early afternoon and was almost running out of inventory, when she decided that she had made enough money to buy the toy she had seen in the store a couple days earlier. After Sabrina took the cooler with the remaining ice cream bars and the table she had used back to the house, she counted her money and yelled excitedly to her mother who was in the kitchen: “Mom, I made $70.50 during the afternoon.” Sabrina’s enthusiasm was short lived, as she was to learn why the $70.50 she received in cash was not entirely profit.

Basic Business Lessons

Sabrina’s parents tried to teach basic financial concepts to their two children starting at an early age. They asked their kids to participate in working on the family budget and paid them a modest, monthly allowance, of which they had to save 10 %. The kids also knew they had to do chores, pet-sit or cut the neighbors’ grass if they wanted additional spending money. This hot July morning Sabrina had decided to make some money selling ice cream bars at the intersection of the street that everybody in the neighborhood passed a few times a day.

The Ice Cream Bar Sale

While Sabrina’s mom went to Walmart (see Table 1) to buy three different types of ice cream bars, Sabrina set up a card table in the neighbor’s yard by the intersection. Her homemade sign hung from the side of the table and announced: “Ice cream bars: $1.50 each.” She also filled a large cooler with ice from the ice machine and two bags of store bought ice that her family kept in the big freezer. When her mother returned from Walmart, Sabrina added the bars to the cooler and began selling the bars for $1.50 each. When she was running low on inventory after a couple hours of the sale, her mother went to Food Lion (see Table 2) a few blocks down the street and purchased another supply of ice cream bars. Finally, as the day drew to a close, Sabrina’s mom bought a few more ice cream bars at the corner gas stations (see Table 3). The cost and quantity of the ice cream bars purchased were listed in the tables below.

The Business Lesson

As Sabrina spread the $70.50 on the kitchen table and placed the remaining ice cream bars (see Table 4) from the cooler into the freezer, she gleamed with excitement about how much money she made. Her mother put a calculator and a piece of blank paper on the table, while pulling up a chair. "Honey, you have done a great job, but you really did not make $70.50. You forgot to include the cost of your inventory in your calculation." Inclusion of the cost of inventory only began to address the issue. Complication arose when the prices paid for inventory varied. Which costs needed to be reported on a Balance Sheet as the ending balance of the ice cream bars in the freezer? Which costs needed to be expensed via Cost of Goods Sold on an Income Statement to reflect how much money Sabrina really had made? To answer these questions and to calculate how much money Sabrina made at her ice cream bar sale, she had to carefully consider the flow of the varied costs of her inventory.

Table 1: Walmart Purchase

Ice Cream Bar	Unit Cost	# Units Purchased
Lemon	$1.10	10
Vanilla	$ 0.90	10
Chocolate	$1.05	10

Table 2: Food Lion Purchase

Ice Cream Bar	Unit Cost	# Units Purchased
Lemon	$1.15	7
Vanilla	$1.00	5
Chocolate	$1.10	10

Table 3: Gas Station Purchase

Ice Cream Bar	Unit Cost	# Units Purchased
Lemon	$1.25	2
Vanilla	$1.10	10
Chocolate	$1.10	3

Table 4: End of Day Inventory

Ice Cream Bar	# Units Left
Lemon	4
Vanilla	11
Chocolate	5