

E7-4**Inferring Merchandise Purchases**

Abercrombie and Fitch is a leading retailer of casual apparel for men, women, and children. Assume that you are employed as a stock analyst and your boss has just completed a review of the new Abercrombie annual report. She provided you with her notes, but they are missing some information that you need. Her notes show that the ending inventory for Abercrombie in the current and previous years was \$424,393,000 and \$399,795,000, respectively. Net sales for the current year were \$3,492,690,000. Cost of goods sold was \$1,408,848,000. Income before taxes was \$55,161,000. For your analysis, you determine that you need to know the amount of purchases for the year.

Required:

Can you develop the information from her notes? Explain and show calculations. (Hint: Use the cost of goods sold equation or the inventory T-account to solve for the needed value.)

Simply rearrange the cost of goods sold equation:

$$BI + P - EI = CGS$$

$$P = CGS - BI + EI$$

Cost of goods sold	\$ _____
– Beginning inventory	(_____)
+ Ending inventory	_____
Purchases	<u><u>\$ _____</u></u>

E7-10**Evaluating the Choice among Three Alternative Inventory Methods Based on Cash Flow Effects**

Following is partial information for the income statement of Arturo Technologies Company under three different inventory costing methods, assuming the use of a periodic inventory system:

	FIFO	LIFO	AC
Cost of goods sold			
Beginning inventory (400 units @ \$30)	\$12,000	\$12,000	\$12,000
Purchases (400 units @ \$20)	8,000	8,000	8,000
Goods available for sales			
Ending inventory (500 units)			
Cost of goods sold	\$	\$	\$
Sales, 300 units; unit sales price, \$50			
Expenses, \$2,500			

Required:

1. Compute cost of goods sold under the FIFO, LIFO, and average cost inventory costing methods.
2. Prepare an income statement through pretax income for each method.
3. Rank the three methods in order of preference based on income taxes paid (favorable cash flow) and explain the basis for your ranking.

1.

	FIFO	LIFO	AC
Cost of goods sold			
Beginning inventory (400 units @ \$30)	\$12,000	\$12,000	\$12,000
Purchases (400 units @ \$20)	8,000	8,000	8,000
Goods available for sales	_____	_____	_____
Ending inventory (500 units)	_____	_____	_____
Cost of goods sold	\$_____	\$_____	\$_____
Sales, 300 units; unit sales price, \$50			
Expenses, \$2,500			

*Computation of ending inventory:

FIFO: _____

LIFO: _____

Average: _____

**Cost of goods sold computations:

FIFO: _____

LIFO: _____

Average: _____

2. Pretax income

	FIFO	LIFO	Average Cost
Sales revenue	\$ _____	\$ _____	\$ _____
Cost of goods sold	_____	_____	_____
Gross profit	_____	_____	_____
Expenses	_____	_____	_____
Pretax income	_____	_____	_____

3. Rank:

Explain:

E7-13

Reporting Inventory at Lower of Cost or Net Realizable Value

Sanchez Company was formed on January 1 of the current year and is preparing the annual financial statements dated December 31, current year. Ending inventory information about the four major items stocked for regular sale follows:

Item	ENDING INVENTORY, CURRENT YEAR		
	Quantity on Hand	Unit Cost When Acquired (FIFO)	Net Realizable Value (Market) at Year-End
A	30	\$ 20	\$ 15
B	55	40	44
C	35	52	55
D	15	27	32

Required:

1. Compute the valuation that should be used for the current year ending inventory using lower of cost or net realizable value applied on an item-by-item basis. (**Hint:** Set up columns for Item, Quantity, Total Cost, Total Net Realizable Value, and Lower of Cost or NRV.)
2. What will be the effect of the write-down of inventory to lower of cost or net realizable value on cost of goods sold for the year ended December 31, current year?

1. Computation

Item	Quantity	Total cost			Total Market			LCM Valuation
A	_____	X	_____	= \$ _____	X	_____	= \$ _____	\$ _____
B	_____	X	_____	= _____	X	_____	= _____	_____
C	_____	X	_____	= _____	X	_____	= _____	_____
D	_____	X	_____	= _____	X	_____	= _____	_____
	Total			\$ _____			\$ _____	\$ _____

2.

E7-19**Analyzing Notes to Adjust Inventory from LIFO to FIFO**

BorgWarner Inc. is a leading global supplier of highly engineered automotive systems and components primarily for powertrain applications. The following note was contained in its recent annual report:

NOTE 3. INVENTORIES, NET		
As of December 31 (in millions)		
	Current Year	Prior Year
Raw materials and supplies	\$319.5	\$279.8
Work in progress	89.0	78.0
Finished goods	115.5	116.3
FIFO inventories	524.0	474.1
LIFO reserve	(18.3)	(16.0)
Total inventories, net	\$505.7	\$458.1

Source: BorgWarner Inc.

Required:

1. What amount of ending inventory would have been reported in the current year if BorgWarner had used only FIFO?
2. The cost of goods sold reported by BorgWarner for the current year was \$6,548.7 million. Determine the cost of goods sold that would have been reported if BorgWarner had used only FIFO for both years.
3. Explain why BorgWarner management chose to use LIFO for certain of its inventories.

1. Ending inventory in the current year = _____

2.

Beginning LIFO reserve (excess of FIFO over LIFO)	\$ _____
Less: Ending LIFO reserve (excess of FIFO over LIFO)	_____
Difference in cost of goods sold under FIFO	_____
Cost of goods sold under LIFO	_____
Cost of goods sold under FIFO	\$ _____

3. Explain:
