

Case 6-2

Lewis Corporation*

Lewis Corporation had traditionally used the FIFO method of inventory valuation. You are given the infor-

mation shown in Exhibit 1 on transactions during the year affecting Lewis's inventory account. (The purchases are in sequence during the year. The company uses a periodic Inventory method.)

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EXHIBIT 1 Inventory Transactions 2009-2011

2009			
Beginning balance	1,840	cartons @	\$20.00
Purchases	600	cartons @	20.25
	800	cartons @	21.00
	400	cartons @	21.25
	200	cartons @	21.50
Sales	2,820	cartons @	34.00
2010			
Beginning balance	1,020	cartons	
Purchases	700	cartons @	21.50
	700	cartons @	21.50
	700	cartons @	22.00
	1,000	cartons @	22.25
Sales	3,080	cartons @	35.75
2011			
Beginning balance	1,040	cartons	
Purchases	1,000	cartons @	22.50
	700	cartons @	22.75
	700	cartons @	23.00
	700	cartons @	23.50
Sales	2,950	cartons @	35.75

Questions

1. Calculate the cost of goods sold and year-end inventory amounts for 2009, 2010, and 2011 using the (a) FIFO, (b) LIFO, and (c) average cost methods.
2. Lewis Corporation is considering switching from FIFO to LIFO to reduce its income tax expense. Assuming a corporate income tax rate of 40 percent, calculate the tax savings this would have made for 2009 to 2011. Would you recommend that Lewis make this change?
3. Dollar sales for 2012 are expected to drop by approximately 8 percent, as a recession in Lewis's market is forecasted to continue at least through the first three quarters of the year. Total sales are forecasted to be 2,700 cartons. Lewis will be unable to raise its selling price from the 2011 level of \$35.75. However, costs are expected to increase to \$24 per

carton for the whole year. Due to these cost/price pressures, the corporation wishes to lower its investment in inventory by holding only the essential inventory of 400 cartons at any time during the year. What is the effect of remaining on FIFO, assuming Lewis had adopted FIFO in 2009? What is the effect of remaining on LIFO, assuming Lewis adopted LIFO in 2009? What method would you recommend now?

4. What is the LIFO reserve in 2009? What is the LIFO reserve in 2010? What is the significance of the LIFO reserve number? How much did the LIFO reserve increase in 2010? What is the significance of this increase?
5. Despite continuing inflation in the United States in the 1980s and the early 1990s, many companies continued to use FIFO for all or part of their domestic inventories. Why do you believe this was the case?