

Financial & Managerial Accounting for Decision Makers, 3rd Edition by Dyckman, Hanlon, Magee, Pfeiffer, Hartgraves, and Morse

Chapter 7—Reporting and Analyzing Inventory

Solutions to Practice Quiz

1. Purity Lamps, Inc. reports the following in its purchase journal and inventory ledger:

		<u>Units</u>	<u>Cost</u>
Beginning Inventory		1,600	56,000
Purchases	1	1,900	70,300
	2	1,100	43,450
	3	1,500	60,000

Ending inventory for Purity was 2,000 units.

What is Purity's cost of ending inventory assuming FIFO?

- a. \$70,800
- b. \$80,000
- c. \$70,000
- d. \$79,750

Answer: d

Rationale:

	Units	Cost	Total Cost
FIFO	1,500	40.00	60,000
	<u>500</u>	39.50	<u>19,750</u>
	2,000		79,750

2. Purity Lamps, Inc. reports the following in its purchase journal and inventory ledger:

		<u>Units</u>	<u>Cost</u>
Beginning Inventory		1,600	56,000
Purchases	1	1,900	70,300
	2	1,100	43,450
	3	1,500	60,000

Ending inventory for Purity was 2,000 units.

What is Purity's cost of ending inventory assuming LIFO?

- a. \$70,800
- b. \$70,000
- c. \$79,500
- d. \$80,000

Answer: A

Rationale:

	<u>Units</u>	<u>Cost</u>	<u>Total Cost</u>
LIFO	1,600	35.00	56,000
	<u>400</u>	37.00	<u>14,800</u>
	2,000		70,800

3. Smith Company provides the following financial data:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenues.....	9,252	8,453	8,000
Cost of Goods Sold.....	3,750	3,580	3,400
Gross Profit.....	5,502	4,873	4,600
Inventories.....	1,505	1,658	1,858

What is the Inventory Turnover for 2015 and 2016, respectively?

- a. 2.939 and 3.656
- b. 1.830 and 2.159
- c. 2.159 and 2.492
- d. 2.036 and 2.371

Answer: d

Rationale:

2015: $\$3,580 / [(\$1,658 + \$1,858) / 2] = 2.036$

2016: $\$3,750 / [(\$1,505 + \$1,658) / 2] = 2.371$

4. The following data refer to Barton Company's ending inventory.

<u>Item code</u>	<u>Quantity</u>	<u>Unit Cost</u>	<u>Unit Market</u>
Small	110	\$54	\$57
Medium	410	47	43
Large	590	43	39
Extra-Large	190	53	63

Determine the ending inventory amount by applying the lower of cost or market rule to each item of inventory.

- a. \$50,700
- b. \$56,650
- c. \$60,650
- d. \$58,880

Answer: b

Rationale:

$$\begin{aligned} & (110 \times \$54) + (410 \times \$43) + (590 \times \$39) + (190 \times \$53) \\ &= \$5,940 + \$17,630 + \$23,010 + \$10,070 \\ &= \$56,650 \end{aligned}$$

5. Assume that Overland Company has inventory levels of \$356,345 and \$367,345 in 2012 and 2016, respectively. Also assume that cost of goods sold for 2016 is \$1,000,000.

What is the average inventory days outstanding for Overland?

- a. 2.8 days
- b. 131 days
- c. 132 days
- d. 134 days

Answer: c

Rationale: Average inventory days outstanding = Average Inventory / Avg. Daily COGS.

$$\begin{aligned} \text{Overland Company Average Inventory Days Outstanding} &= \$361,845 / (\$1,000,000 / 365) \\ &= 132 \end{aligned}$$

6. As a retailer, which of the following percentages is the most attractive to you?
- a. Operating income as a percentage of net sales equal to 35%
 - b. Cost of sales as a percentage of net sales equal to 65%
 - c. Gross profit of 35%
 - d. All three have the same attractiveness

Answer: a

Rationale: Operating income is calculated as:
 $\text{Net sales} - \text{Cost of Sales} = \text{Gross Profit}$
 $\text{Gross Profit} - \text{Operating Expenses} = \text{Operating Income}$

Therefore, an operating income that is 35% of net sales would be more attractive than cost of sales of 65% or gross profit of 35%.

7. Assume that two companies operate in an inflationary environment. In a situation where all other things are equal except that one company uses LIFO and one company uses FIFO, which of the following statements is true?
- a. The company using FIFO will have a higher inventory turnover.
 - b. The company using LIFO will have a higher inventory turnover.
 - c. Inventory valuation methods do not affect inventory turnover.
 - d. Inventory turnover will be the same for both companies.

Answer: b

Rationale: Inventory turnover is equal to: $\text{Cost of goods sold} / \text{Average inventory}$.
In an inflationary environment, the last costs will be higher and under LIFO, will be included in Cost of Goods Sold and excluded from ending inventory. Therefore, the numerator will be greater and the denominator will be smaller under LIFO, so inventory turnover will be higher.

8. All of the following statements are *true* regarding LIFO liquidation *except*:
- a. LIFO liquidation lowers gross profit.
 - b. LIFO liquidation results when there is a decline in inventory quantities, i.e., you sell more than what you buy in current period.
 - c. The older costs in the LIFO layer liquidated are matched with current sales dollars.
 - d. Previously ignored holding gains are included in income as old LIFO layers are liquidated.

Answer: a

Rationale: LIFO liquidation results in inflated gross profit because older, lower costs are matched against revenues based on current sales prices.

9. Yang Imports reports net sales of \$675,000, gross profit of \$225,000, and net income of \$15,000. The company's cost of goods sold is:
- a. \$450,000
 - b. \$435,000
 - c. \$465,000
 - d. \$885,000

Answer: a

Rationale: $\$675,000 - \$225,000 = \$450,000$

10. The January 1, 2016 beginning inventory for Everest Supply Company was \$290,000. Projections are that sales growth will be strong during 2016, so the company wants to have an ending inventory on December 31, 2016 of \$360,000.

If net sales for 2016 are projected to be \$1,600,000, and the gross profit rate is expected to be 30%, what cost of merchandise should be purchased during 2016?

- a. \$1,480,000
- b. \$1,120,000
- c. \$1,190,000
- d. \$1,050,000

Answer: c

Rationale:

$\$1,600,000 \times 0.70 = \$1,120,000$ (Cost of Goods Sold)

$\$1,120,000 + \$360,000 = \$1,480,000$ (Goods Available)

$\$1,480,000 - \$290,000 = \$1,190,000$ (Purchases)