CH 8 - Additional Recommended Problems
Inventory Errors

1) The income statements for Sherman Corp. for a two-year period shows the following:

	2010	2011
Revenues	$2,000,000	$2,400,000
COGS	1,400,000	1,630,000
Gross Profit	600,000	770,000
Expenses	450,000	500,000
Net Income	$150,000	$270,000

An audit revealed the following information:

1. 2010 ending inventory was overstated by $20,000.
2. During 2011, purchases amounting to $10,000 were not recorded. They were included in the physical count at year-end.

Required: Determine the correct amounts for each of the following:

a. 2010 Gross Profit: $ O 20,000

b. 2011 Net Income $ U 10,000

	2010
BI	OK
+P	OK
GAS	OK
-EI	↑20,000
COGS	↓20,000
NI	↑20,000

	2011
BI	↑20,000
+P	↓10,000
GAS	↑10,000
-EI	OK
COGS	↑10,000
NI	↓10,000

2) ABC Company, which uses the periodic inventory method, has discovered the following inventory errors:

The 2009 year-end inventory was understated by $10,000.
The 2010 year-end inventory was overstated by $13,000.
The 2011 year-end inventory was overstated by $15,000.

How would these errors affect net income for 2010 and 2011? Ignore income tax considerations. Use O for overstated, U for understated and NE for no effect. Be sure to state the amount.

2010 O 23,000 2011 O 2,000

Error	NI 2009	NI 2010	NI 2011
1) EI ('09) U 10,000	↓10,000	↑10,000	
2) EI ('10) O 13,000	NE	↑13,000	↓13,000
3) EI ('11) O 15,000	NE	NE	↑15,000
	↓10,000	↑23,000	↑2,000

	A =	L	+ SHE		
('09)	↓10,000 Inv =		↓10,000	Beg RE ('10)	↓10,000
				+NI ('10)	↑23,000
('10)	↑13,000 Inv =		↑13,000	End RE ('10)	↑13,000
				+NI ('11)	↑2,000
('11)	↑15,000 Inv =		↑15,000	End RE ('11)	↑15,000

* Whatever the effect on EI, it will have the same effect on NI that same Year; It will reverse in the NEXT Yr.

3) On December 31, 2011, ABC Co. reported current assets of $300,000 and current liabilities of $180,000. ABC uses the periodic inventory method. The following items may have been recorded incorrectly:

(a)
BI OK
+P ↑15,000
GAS ↑15,000
-EI OK
COGS ↑15,000
NI ↓15,000

a. Goods purchased costing $15,000 were shipped f.o.b. destination by a supplier on December 26 and arrived on January 2. ABC received and recorded the invoice on December 31. Purch ↑15,000 A/P ↑15,000 EI OK

b. Goods purchased costing $10,000 were shipped f.o.b. shipping point by a supplier on December 28 and were received on January 4. ABC received and recorded the invoice on December 29. Purch OK A/P OK EI ↓10,000
*NOT included in EI and should have been.

c. Goods held on consignment from XYZ Company were included in ABC's physical count of inventory at $6,000. Title never transfers on consigned goods. EI ↑6,000

	A =	L +	SHE	
(a)	NE =	↑15,000	↓15,000	(COGS O 15,000)
(b)	↓10,000 =	NE	↓10,000	Whatever the effect on EI, same effect on NI.
(c)	↑6,000 =	NE	↑6,000	
	↓4,000 =	↑15,000	↓19,000	

After all corrections are made, what are total current assets? $ 304,000
(300,000 + 10,000 - 6,000 = 304,000)

After all corrections are made, what are total current liabilities? $ 165,000
(180,000 - 15,000 = 165,000)

By what amount is Net Income overstated/understated? U 19,000

4) Baker Company follows a calendar-year end. Its financial statements for the years 2011 and 2010 contained errors as follows. Answer the following questions by indicating O for Overstated; U for understated; or NE for No Effect. If there is an effect, state the dollar amount.

	2011	2010
Ending Inventory	$7,000 Understated	$12,000 Understated

a. Determine the effect on 2011 Net Income A. ↑5,000

b. Indicate the effect on 2011 Ending Retained Earnings: B. ↓7,000

Error	NI 2010	NI 2011
1) EI ('10) ↓12,000	↓12,000	↑12,000
2) EI ('11) ↓7,000	NE	↓7,000
	↓12,000	↑5,000

Beg RE ('11) ↓12,000
+ NI ('12) ↑5,000
End RE ('12) ↓7,000

A =	L +	SHE
↓ 7000 =		↓ 7,000

5) On December 27, 2011, ABC sold merchandise on account with a selling price of $6,000 to XYZ Company. The terms of the sale were FOB destination. The goods, which had cost $4,000, were shipped on December 27, 2011 and were received by XYZ on January 3, 2012. ABC uses a periodic inventory system. ABC recorded the sale on December 27, 2011 and excluded the merchandise from the ending inventory. Determine the effect of the above transaction on the financial statements for ABC for the year ended December 31, 2011:

a. Total Assets are understated by $4,000.
b. Stockholder's Equity is overstated by $2,000.
c. Liabilities are understated by $4,000.
d. Net Income is overstated by $6,000.

* Based on FOB Destination, Don't record sale or take out of invt. until Goods arrive @ buyers destination.

A =	L +	SHE
A/R ↑ 6,000		↑ 6,000 Rev
Invt ↓ 4,000		(↑ 4,000) COGS
Assets ↑ 2,000 =		↑ 2,000 NI & RE.

BI	OK
+ P	OK
GAS	OK
− EI	↓ 4,000
COGS	↑ 4,000