16. What is a situation in which estimates of the amount of inventory may be useful or even necessary?
17. How can management manipulate net income using inventory fraud?
18. If the amount of goods available for sale is $123,000, the amount of sales is $130,000, and the gross margin is 25 percent of sales, what is the amount of ending inventory?
19. Assume that inventory is overstated by $1,500 at the end of 2016 but is corrected in 2017. What effect will this have on the 2016 income statement? The 2016 balance sheet? The 2017 income statement? The 2017 balance sheet?
20. What information does inventory turnover provide?
21. What is an example of a business that would have a high inventory turnover? A low inventory turnover?

MULTIPLE-CHOICE QUESTIONS

Multiple-choice questions are available in the Connect library.

EXERCISES—SERIES A

All applicable Exercises in Series A are available with McGraw-Hill's Connect Plus Accounting.

LO 5-1

Exercise 5-1A *Effect of inventory cost flow assumption on financial statements*

Required

For each of the following situations, indicate whether FIFO, LIFO, or weighted average applies:

a. In a period of falling prices, net income would be highest.
b. In a period of falling prices, the unit cost of goods would be the same for ending inventory and cost of goods sold.
c. In a period of rising prices, net income would be highest.
d. In a period of rising prices, cost of goods sold would be highest.
e. In a period of rising prices, ending inventory would be highest.

LO 5-1

Exercise 5-2A *Allocating product cost between cost of goods sold and ending inventory*

Jones Co. started the year with no inventory. During the year, it purchased two identical inventory items at different times. The first purchase cost $1,060 and the other, $1,380. Jones sold one of the items during the year.

Required

Based on this information, how much product cost would be allocated to cost of goods sold and ending inventory on the year-end financial statements, assuming use of

a. FIFO?
b. LIFO?
c. Weighted average?

LO 5-1

Exercise 5-3A *Allocating product cost between cost of goods sold and ending inventory: multiple purchases*

Cortez Company sells chairs that are used at computer stations. Its beginning inventory of chairs was 100 units at $60 per unit. During the year, Cortez made two batch purchases of this chair. The first was a 150-unit purchase at $68 per unit; the second was a 200-unit purchase at $72 per unit. During the period, it sold 270 chairs.

Required

Determine the amount of product costs that would be allocated to cost of goods sold and ending inventory, assuming that Cortez uses

a. FIFO.
b. LIFO.
c. Weighted average.

Exercise 5-4A *Effect of inventory cost flow (FIFO, LIFO, and weighted average) on gross margin*

LO 5-1

The following information pertains to Mason Company for 2016:

Beginning inventory	90 units @ $40
Units purchased	310 units @ $45

Ending inventory consisted of 30 units. Mason sold 370 units at $90 each. All purchases and sales were made with cash. Operating expenses amounted to $4,100.

Required

a. Compute the gross margin for Mason Company using the following cost flow assumptions: (1) FIFO, (2) LIFO, and (3) weighted average.

b. What is the amount of net income using FIFO, LIFO, and weighted average? (Ignore income tax considerations.)

c. Compute the amount of ending inventory using (1) FIFO, (2) LIFO, and (3) weighted average.

Exercise 5-5A *Effect of inventory cost flow on ending inventory balance and gross margin*

LO 5-1

The Shirt Shop had the following transactions for T-shirts for 2016, its first year of operations:

Jan. 20	Purchased 400 units @ $ 8	=	$3,200
Apr. 21	Purchased 200 units @ $10	=	2,000
July 25	Purchased 280 units @ $13	=	3,640
Sept. 19	Purchased 90 units @ $15	=	1,350

During the year, The Shirt Shop sold 810 T-shirts for $30 each.

Required

a. Compute the amount of ending inventory The Shirt Shop would report on the balance sheet, assuming the following cost flow assumptions: (1) FIFO, (2) LIFO, and (3) weighted average.

b. Record the above transactions in general journal form and post to T-accounts assuming (1) FIFO, (2) LIFO, and (3) weighted average methods. Use a separate set of journal entries and T-accounts for each method. Assume all transactions are cash transactions.

c. Compute the difference in gross margin between the FIFO and LIFO cost flow assumptions.

Exercise 5-6A *Income tax effect of shifting from FIFO to LIFO*

LO 5-1

The following information pertains to the inventory of Parvin Company:

Jan. 1	Beginning inventory	400 units @ $30
Apr. 1	Purchased	2,000 units @ $35
Oct. 1	Purchased	600 units @ $38

During 2016, Parvin sold 2,700 units of inventory at $90 per unit and incurred $41,500 of operating expenses. Parvin currently uses the FIFO method but is considering a change to LIFO. All transactions are cash transactions. Assume a 30 percent income tax rate. Parvin started the period with cash of $75,000, inventory of $12,000, common stock of $50,000, and retained earnings of $37,000.

Required

a. Record the above transactions in general journal form and post to T-accounts using (1) FIFO and (2) LIFO. Use a separate set of journal entries and T-accounts for each method.

b. Prepare income statements using FIFO and LIFO.

suspicious because The Luggage Company had no direct marketing program. When the outside sales were ultimately traced back to Chun, the company discovered that it had lost over $10,000 in sales revenue because of her criminal activity.

Required

Identify an internal control procedure that could have prevented the company's losses. Explain how the procedure would have stopped the embezzlement.

LO 6-1

Exercise 6-4A *Internal control procedures to prevent deception*

Regional Medical Centers (RMC) hired a new physician, Fred Clark, who was an immediate success. Everyone loved his bedside manner; he could charm the most cantankerous patient. Indeed, he was a master salesman as well as an expert physician. Unfortunately, Clark misdiagnosed a case that resulted in serious consequences to the patient. The patient filed suit against RMC. In preparation for the defense, RMC's attorneys discovered that Clark was indeed an exceptional salesman. He had worked for several years as district marketing manager for a pharmaceutical company. In fact, he was not a physician at all! He had changed professions without going to medical school. He had lied on his application form. His knowledge of medical terminology had enabled him to fool everyone. RMC was found negligent and lost a $3 million lawsuit.

Required

Identify the relevant internal control procedures that could have prevented the company's losses. Explain how these procedures would have prevented Clark's deception.

LO 6-2

Exercise 6-5A *Internal control for cash*

Required

a. Why are special controls needed for cash?

b. What is included in the definition of *cash*?

LO 6-1, 6-2

Exercise 6-6A *Internal controls for small businesses*

Required

Assume you are the owner of a small business that has only two employees.

a. Which of the internal control procedures are most important to you?

b. How can you overcome the limited opportunity to use the segregation-of-duties control procedure?

LO 6-4

Exercise 6-7A *Treatment of NSF check*

Han's Supplies' bank statement contained a $270 NSF check that one of its customers had written to pay for supplies purchased.

Required

a. Show the effects of recognizing the NSF check on the financial statements by recording the appropriate amounts in a horizontal statements model like the following one:

Assets = Liab. + Equity	Rev. − Exp. = Net Inc.	Cash Flow
Cash + Accts. Rec.		

b. Is the recognition of the NSF check on Han's books an asset source, use, or exchange transaction?

c. Suppose the customer redeems the check by giving Han $290 cash in exchange for the bad check. The additional $20 paid a service fee charged by Han. Show the effects on the financial statements in the horizontal statements model in Requirement *a*.

d. Is the receipt of cash referenced in Requirement *c* an asset source, use, or exchange transaction?

e. Record in general journal form the adjusting entry for the NSF check and the entry for redemption of the check by the customer.

Exercise 6-8A *Adjustments to the balance per books*

LO 6-3

Required

Identify which of the following items are added to or subtracted from the unadjusted *book balance* to arrive at the true cash balance. Distinguish the additions from the subtractions by placing a + beside the items that are added to the unadjusted book balance and a − beside those that are subtracted from it. The first item is recorded as an example.

Reconciling Items	Book Balance Adjusted?	Added or Subtracted?
Credit memo	Yes	+
Interest revenue		
Deposits in transit		
Debit memo		
Service charge		
Charge for printing checks		
NSF check from customer		
Note receivable collected by the bank		
Outstanding checks		

Exercise 6-9A *Adjustments to the balance per bank*

LO 6-3

Required

Identify which of the following items are added to or subtracted from the unadjusted *bank balance* to arrive at the true cash balance. Distinguish the additions from the subtractions by placing a + beside the items that are added to the unadjusted bank balance and a − beside those that are subtracted from it. The first item is recorded as an example.

Reconciling Items	Bank Balance Adjusted?	Added or Subtracted?
Bank service charge	No	NA
Outstanding checks		
Deposits in transit		
Debit memo		
Credit memo		
Certified checks		
Petty cash voucher		
NSF check from customer		
Interest revenue		

Exercise 6-10A *Adjusting the cash account*

LO 6-3

As of June 30, 2016, the bank statement showed an ending balance of $19,500. The unadjusted Cash account balance was $15,200. The following information is available:

1. Deposit in transit, $2,400.
2. Credit memo in bank statement for interest earned in June, $30.
3. Outstanding check, $6,690.
4. Debit memo for service charge, $20.

Required

a. Determine the true cash balance by preparing a bank reconciliation as of June 30, 2016, using the preceding information.
b. Record in general journal format the adjusting entries necessary to correct the unadjusted book balance.

LO 6-3

Exercise 6-11A *Determining the true cash balance, starting with the unadjusted bank balance*

The following information is available for Trinkle Company for the month of June:

1. The unadjusted balance per the bank statement on June 30 was $81,500.
2. Deposits in transit on June 30 were $3,150.
3. A debit memo was included with the bank statement for a service charge of $40.
4. A $5,611 check written in June had not been paid by the bank.
5. The bank statement included a $950 credit memo for the collection of a note. The principal of the note was $900, and the interest collected amounted to $50.

Required

Determine the true cash balance as of June 30. (*Hint:* It is not necessary to use all of the preceding items to determine the true balance.)

LO 6-3

Exercise 6-12A *Determining the true cash balance, starting with the unadjusted book balance*

Nickleson Company had an unadjusted cash balance of $7,750 as of May 31. The company's bank statement, also dated May 31, included a $72 NSF check written by one of Nickleson's customers. There were $800 in outstanding checks and $950 in deposits in transit as of May 31. According to the bank statement, service charges were $50, and the bank collected a $800 note receivable for Nickleson. The bank statement also showed $13 of interest revenue earned by Nickleson.

Required

Determine the true cash balance as of May 31. (*Hint:* It is not necessary to use all of the preceding items to determine the true balance.)

LO 6-4

Exercise 6-13A *Effect of establishing a petty cash fund*

Chen Company established a $200 petty cash fund on January 1, 2016.

Required

a. Is the establishment of the petty cash fund an asset source, use, or exchange transaction?

b. Record the establishment of the petty cash fund in a horizontal statements model like the following one:

Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow
Cash + Petty Cash										

c. Record the establishment of the fund in general journal format.

LO 6-4

Exercise 6-14A *Effect of petty cash events on the financial statements*

Fresh Foods established a petty cash fund of $100 on January 2. On January 31, the fund contained cash of $9.20 and vouchers for the following cash payments:

Maintenance expense	$61.50
Office supplies	12.50
Transportation expense	15.00

The three distinct accounting events affecting the petty cash fund for the period were (1) establishment of the fund, (2) reimbursements made to employees, and (3) recognition of expenses and replenishment of the fund.