

Inventory Held for Sale

The entries illustrated in this case study are to address FASAB Statement of Federal Financial Accounting Standard Number three, Accounting for Inventory and Related Property. This is not an authoritative guidance but an illustration of inventory transactions using U.S. Standard General Ledger accounts. This case study does not include all situations.

ASSUMPTIONS:

- 1) The following entries are illustrated to represent a REVOLVING FUND in second year of its operation.
- 2) The entity engages in retail and manufacturing activities.

Post Closing Trial Balance from Year 1

1010	40,000		4201	40,000
1523	5,000			
1527	10,000		4450	40,000
1750	5,000			
3310	60,000			
	60,000	60,000	40,000	40,000

Account 1527 has the following items:

Item A	\$4,000
Item B	\$2,000
Item C	\$2,000
Item D	<u>\$2,000</u>
	\$10,000

- 1) To anticipate revenue from sale of its inventory.

proprietary

None

budgetary

4210	Anticipated reimbursements & other income	35,000
	4450 Unapportioned authority - available	35,000

2) To record apportionments of the anticipated reimbursements, and prior year unobligated balance brought forward.

proprietary
None

budgetary

4450	Unapportioned authority - available	75,000	
4590	Apportionments unavailable		35,000
4510	Apportionments		40,000

3) To record an allotment of apportioned authority

proprietary
None

budgetary

4510	Apportionments	40,000	
4610	Allotments - realized resources		40,000

THE ENTRIES ILLUSTRATED BELOW SHOW A MANUFACTURING ACTIVITY

4) To record raw material purchased for its manufacturing activity

proprietary

1525	Inventory - Raw Materials	5,000	
2110	Accounts payable		5,000

budgetary

4610	Allotments - realized resources	5,000	
4901	Expended authority - unpaid		5,000

5) To record receipt of a customer (a gov't agency) order for \$8,000 without an advance

proprietary
None

budgetary

4221	Unfilled customer orders - w/o advance	8,000	
4210	Anticipated reimbursements & other income		8,000

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4590	Apportionments - Unavailable	8,000	
4610	Allotments - realized resources		8,000

(See Budgetary Accounting Guide, pg51, entry 8)

6) To record raw materials used to produce goods

proprietary

1526	Inventory - Work in Process	4,000	
1525	Inventory - Raw Materials		4,000

budgetary

None

7) To record incurrence of direct labor (salary of production workers - \$10,000) during the production of an item

proprietary

1526	Inventory - Work in Process	10,000	
2210	Accrued funded payroll and benefits		10,000

budgetary

4610	Allotments - realized resources	10,000	
4901	Expended authority - unpaid		10,000

8) To record incurrence of other factory overhead (\$2,000) such as factory rent, factory utilities, depreciation on production equipments (\$500), indirect labor (\$3,000) utilized and etc.

proprietary

6100	Operating expense/Program costs (overhead)	5,000	
6710	Depreciation expense	500	
1759	Accumulated depreciation		500
2110	Accounts payable		2,000
2210	Accrued funded payroll and benefits		3,000

budgetary

4610	Allotments - realized resources	5,000	
4901	Expended authority - unpaid		5,000

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9) To record overhead applied¹, the budget rate is determined to be \$5.00/per direct labor hour. The direct labor hour was determined to be 900 hours. 900 hours * \$5.00 = \$4,500.

proprietary

1526	Inventory - Work in Process	4,500	
6600	Applied overhead		4,500

budgetary

None

10) To pay salary to the employees

proprietary

2210	Accrued payroll and benefits	13,000	
1010	Fund balance		13,000

budgetary

4901	Expended authority - unpaid	13,000	
4902	Expended authority - pd		13,000

11) To reclassify fully completed goods which are ready to be sold

proprietary

1527	Inventory - Finished Goods	14,500	
1526	Inventory - Work in Process		14,500

budgetary

None

¹ “Overhead is applied to products because of management’s desire for a close approximation of costs of different products. If such product costs are to help management for product pricing, income determination, and inventory valuation, they must be timely as well as accurate. If the purpose were to apply all actual overhead to actual production for the year, the most accurate application of overhead could be made only at the end of the year, after actual results were determined. However, this timing would be too late. Managers want product cost information throughout the year. Therefore overhead application rates are usually computed in advance of production.” (Charles T Horngren, George Foster, Cost Accounting A Managerial Emphasis, 6th edition pg 98).

12) To record a sale (see entry #6)

proprietary

1010	Fund balance	8,000	
5100	Revenue from goods sold		8,000
6500	Cost of goods sold	8,000	
1527	Inventory - Finished Goods		8,000

budgetary

4252	Reimbursements & other income earned - collected		8,000
4221	Unfilled customer orders - w/o advance		8,000

13) To liquidate liabilities for the purchase of raw materials and other overhead costs

proprietary

2110	Accounts payable	7,000	
1010	Fund balance		7,000

budgetary

4901	Expended authority - unpd	7,000	
4902	Expended authority - pd		7,000

To close overhead underapplied² (applied overhead is budgeted less than the actual overhead), which is deemed immaterial- **Refer to the closing entry section to see the actual dollar amount**

proprietary

6600	Applied overhead	xxx	
6500	Cost of goods sold	xxx	
6100	Operating expense/Program costs (overhead)		xxx
6710	Depreciation expense		xxx

[If overhead is overapplied (applied overhead is budgeted more than the actual), the adjustment will be credited to CGS]

² If the under applied or over applied amount is immaterial, the difference in the applied and the actual amount is adjusted to CGS. But if the under applied or over applied amount is material then the difference is prorated to the WIP, finished goods, and CGS. (Charles T Horngren, George Foster, Cost Accounting A Managerial Emphasis, 6th edition pgs103-104).

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If the difference between the actual and applied overhead amount is material, then the difference is prorated to WIP, finished goods and CGS accounts.

Assumption: most of the factory overhead is reported in account 6100 but if there are any other appropriate production cost accounts, they should be reported when applicable.

To close overhead accounts and prorate underapplied overhead among the three accounts:

1526	Inventory - Work in Process	xxx	
1527	Inventory - Finished Goods	xxx	
6500	Cost of goods sold	xxx	
6600	Applied overhead	xxx	
	6100 Operating expense/Program costs (overhead)		xxx
	And any other actual overhead accounts that were used		xxx

(The difference between the applied overhead and overhead is prorated to WIP, finished goods and CGS)

To close overhead accounts and prorate overapplied overhead among the three accounts:

6600	Applied overhead	xxx	
1526	Inventory - Work in Process	xxx	
1527	Inventory - Finished Goods	xxx	
6500	Cost of goods sold		xxx
6100	Operating exp/Program costs (overhead)		xxx
	And any other actual overhead accounts that were used		xxx

(The difference between the applied overhead and overhead is prorated to WIP, finished goods and CGS)

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THE ENTRIES ILLUSTRATED BELOW SHOW A RETAIL ACTIVITY

14) To record inventory purchased for sale under historical cost (title was passed) [¶19].

100 units of item A @ \$60 = \$6,000

20 units of item C @ \$50 = \$1,000

proprietary

1521	Inventory Purchased for Resale	7,000	
	2110 Accounts payable		7,000

budgetary

4610	Allotments - realized resources	7,000	
	4901 Expended authority - unpaid		7,000

15) To record receipt of customer order for 180 units of item A, without an advance

proprietary

None

budgetary

4221	Unfilled customer orders - without advance	8,800	
	4210 Anticipated reimbursements & other income		8,800
	4590 Apportionments - Unavailable	8,800	
	4610 Allotments - realized resources		8,800

16) To record sale of 180 units of item A [¶19]. Note: Inventory is valued under FIFO method (First in first out)

Year 1 purchased 100 units of item A @ \$40

Year 2 purchased 100 units of item A @ \$60

proprietary

1010	Fund balance with Treasury	8,800	
	5100 Revenues from Goods Sold		8,800
	6500 Cost of Goods Sold	8,800	
	1521 Inventory Purchased for Resale		8,800

budgetary

4252	Reimbursements & other income earned-collected	8,800	
	4221 Unfilled customer orders - without advance		8,800

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17) To liquidate payables for goods purchased

proprietary

2110	Accounts payable	7,000	
	1010 Fund balance		7,000

budgetary

4901	Expended authority - unpd	7,000	
	4902 Expended authority - pd		7,000

18) To expense abnormal cost of handling goods that were deemed excessive. [¶ 21] For example, the cost of moving items several times due to base closure

proprietary

6100	Operating expense	3,000	
	2110 Accounts payable		3,000

budgetary

Abnormal cost was not recorded previously as undelivered orders

4610	Allotments - realized resources	3,000	
	4901 Expended authority - unpaid		3,000

19) To record inventory acquired through exchange of nonmonetary assets [¶21]

proprietary

1527	Inventory - Finished Goods (FMV)	1,000	
7210	Loss on disposition of assets		200
	1527 Inventory - Finished Goods (BV)		1,200

[Note: The credit entry can be any surrendered nonmonetary asset]

budgetary

None

20) To record receipt of a donated inventory item from the public [¶21]

proprietary

1527	Inventory - Finished Goods (FMV)	2,000	
	5600 Donated Revenue		2,000

budgetary

None

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21) To reclassify inventory held for sale which meet management's criteria for future sale. [¶27]
Note: Under Latest Acquisition Cost method, the allowance accounts that are associated with inventory shall be reclassified as well

proprietary

1522	Inventory held in reserve for future sale	2,500	
1527	Inventory - Finished Goods		2,500
1521	Inventory Purchased for resale		xxx

budgetary

None

22) To reclassify inventory held for sale that was damaged and unrepairable. The net realizable value of the damaged item (its salvage value) was estimated to be \$250. [¶30] This entry would also apply to inventory in excess and obsolete for which the net realizable value is less than the book value.

proprietary

1524	Inventory - excess, obsolete and unserviceable	250	
7290	Other losses	200	
1527	Inventory - Finished Goods		450
1521	Inventory Purchased for Resale		xxx

budgetary

None

22a) The item was later disposed and the entity received \$50 [¶30]

proprietary

1010	Fund balance	50	
7210	Losses on disposition of asset	200	
1524	Inventory - excess, obsolete and unserviceable		250

budgetary

4252	Reimbursements & other income earned - collected	50	
4210	Anticipated reimbursements & other income	50	
4590	Apportionments - Unavailable	50	
4610	Allotments - realized resources		50

Some of the inventory held for sale had a minor damage that need repair

ALLOWANCE METHOD [¶32]

23a) To record damaged inventory items that need repairs

proprietary

1523	Inventory held for repair	2,000	
	1527	Inventory - Finished Goods	2,000
	1521	Inventory Purchased for Resale	xxx

budgetary

None

23b) To record repair costs for item A & B are estimated to be \$500 each for the period

proprietary

6100	Operating expense (repair)	1,000	
	1529	Inventory - allowance	1,000

budgetary

None

23c) To record actual repair cost of item A which was \$200 lower than previously estimated.

proprietary

1529	Inventory - allowance	500	
	2110	Accounts payable	300
	6100	Operating expense	200

The repair cost was not recorded as undelivered orders, previously

budgetary

4610	Allotments - realized resources	300	
	4901	Expended authority-unpd	300

23d) To record actual repair cost of item B which was \$100 more than previously estimated.

proprietary

1529	Inventory - allowance	500	
6100	Operating expense	100	
	2110	Accounts payable	600

budgetary

The repair cost was not recorded as undelivered orders, previously

4610	Allotments - realized resources	600	
4901	Expended authority - unpaid		600

24) To reclassify items that are repaired and are ready to be sold

proprietary

1527	Inventory - Finished Goods		2,000
1521	Inventory Purchased for Resale		xxx
1523	Inventory held for repair		2,000

budgetary

None

25) To record an entity making a transition to allowance method which resulted in recognizing an accumulated amount of repairs that were not previously accounted. [¶34]

proprietary

7400	Prior period adjustment	5,000	
1529	Inventory - allowance		5,000

budgetary

None

DIRECT METHOD [¶33]

proprietary

26a) To record damaged inventory items that need repairs. The repair expenses for items C & D are estimated to be \$1,000 each

1523	Inventory held for repair	2,000	
6100	Operating exp (repair)	2,000	
1527	Inventory - Finished Goods		4,000
1521	Inventory Purchased for Resale		xxx

26b) To record actual repair cost of item C, which was \$1,200.

proprietary

1523	Inventory held for repair	1,000	
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6100	Operating exp (repair)	200	
2110	Accounts payable		1,200

The repair cost was not recorded previously as undelivered orders
budgetary

4610	Allotments - realized resources	1,200	
4901	Expended authority - unpd		1,200

26c) To record actual repair cost of item D, which was \$700.

proprietary

1523	Inventory held for repair	1,000	
6100	Operating exp (repair)		300
2110	Accounts payable		700

The repair cost was not recorded previously as undelivered orders
budgetary

4610	Allotments - realized resources	700	
4901	Expended authority - unpd		700

27) To reclassify items that are repaired and are ready to be sold

proprietary

1527	Inventory - Finished Goods	2,000	
1521	Inventory Purchased for Resale	xxx	
1523	Inventory held for repair		2,000

budgetary

None

28) To record an entity making a transition to direct method which resulted in recognizing an accumulated amount of repairs that were not previously accounted. [¶34]

proprietary

7400	Prior period adjustment	6,000	
1523	Inventory held for repair	6,000	

budgetary

None

A REPAIR METHOD DEALING WITH TRADE-INS

Note: This is the way that Department of Defense accounts for its repairable items dealing with trade-ins.

ASSUMPTIONS:

- a) Assume the entries illustrated below is a federal entity (a vehicle procurer) which buys motor vehicles and sells them to other federal entities.

- b) Assume this entity receives motor vehicles that need repairs. It does not repair the vehicles directly but makes arrangements with a repair facility to fix the vehicles and then sells repaired vehicles back to a customer entity.

- c) Note that repair method dealing with trade-in illustrated below does **not** show a complete process.

A customer entity wants to get a new motor vehicle and trade in his old motor vehicle that needs a repair. The FMV of the old vehicle is \$3,000 and the vehicle procurer wants another \$2,000 in cash. The customer agrees and promises to pay \$2,000 in 10 days and takes the new motor vehicle back to his organization. On vehicle procurer's book, the following entries are made:

NOTE: ENTRIES 29A, 29B, AND 29C OCCUR SIMULTANEOUSLY

29a) The vehicle procurer and the customer entered into an agreement and \$2,000 will be paid by the customer

proprietary

None

budgetary

4221	Unfilled customer order - without advance	2,000	
	4210 Anticipated reimbursements and other income		2,000
4590	Apportionments - Unavailable	2,000	
	4610 Allotments - realized resources		2,000

29b) To record issuance of a new motor vehicle to the customer

proprietary

6500	Cost of goods sold	3,300	
1529	Inventory - allowance for holding gains/losses	700	
	1527 Inventory - Finished Goods		4,000

(Cost of goods sold represent the cost of the new vehicle; Upon a sale, inventory

allowance is adjusted to reduce the previously unrealized holding gains/losses.)

budgetary

None

29c) To record an old motor vehicle that was traded in for a new motor vehicle. This entry is to show trade-in only and additional entry for indirect cost is not included.

proprietary

1310	Accounts receivable	2,000	
1523	Inventory held for repair	4,000	
5100	Revenue from goods sold		2,000
5790	Other financing source		3,000
1529	Inventory - allowance for estimated repair cost		1,000

(Account receivable represents the cash amount the vehicle procurer will receive from the customer; Inventory held for repair represents the value of an asset after it is repaired (value of a similar new asset); Other financing source represents FMV of the old vehicle - other financing source was used instead of revenue from goods sold due to trade-in which is not a budgetary resource; Inventory allowance represents the estimated repair cost of the damaged vehicle)

budgetary

4251	Reimbursements & other income earned - receivable	2,000	
4221	Unfilled customer orders - without advance		2,000

29d) To record the cash received from the customer entity in exchange for the broken vehicle

proprietary

1010	Fund balance with Treasury	2,000	
1310	Accounts receivable		2,000

budgetary

4252	Reimbursements & other income earned - collected	2,000	
4251	Reimbursements & other income earned - receivable		2,000

29e) To record actual repair cost of \$1,000 for the damaged vehicle recorded on entry #29c, and to set up payable to repair installation. (Note: In DoD the vehicle procurer absorbs both losses and gains due to incorrect estimation).

proprietary

1529	Inventory - allowance for estimated repair cost	1,000	
2110	Accounts payable		1,000

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(Inventory - allowance amount represents the estimated repair cost from entry #29c; Accounts payable represent the amount payable to repair facility for fixing the old vehicle from entry #29c)

budgetary

4610	Allotments - realized resources	1,000	
4901	Expended authority - unpaid		1,000

29f) To reclassify an old vehicle from entry #21a which is now fixed and ready to be sold

proprietary

1527	Inventory - Finished Goods	4,000	
1523	Inventory held for repair		4,000

budgetary

None

LATEST ACQUISITION COST METHOD

This section of the Inventory held for sale shows illustration on Latest Acquisition Cost Method (LAC) [¶23]

ASSUMPTION: The entity decided to buy item Y and sell it to other entities during the year. The item Y would be valued under the Latest Acquisition Cost Method.

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TABLE -Current Year Activity

	<u>Item</u>	<u>Qty</u>	<u>Unit cost</u>		<u>Total cost</u>		<u>Unrealized</u>
			<u>HC</u>		<u>HC</u>		<u>gain/(loss)</u>
							HC = Historical Cost
2/14	Y	20	30		600		
6/25	Y	30	40		1,200		
11/3	Y	<u>30</u>	<u>50</u>		<u>1,500</u>		
12/31		80	@	50	3,300	4,000	<u>700</u>

30a) To record goods purchased on 2/14

proprietary

1521	Inventory Purchased for Resale	600	
2110	Accounts payable		600

budgetary

4610	Allotments - realized resources	600	
4901	Expended authority - unpaid		600

30b) To record goods purchased on 6/25

proprietary

1521	Inventory Purchased for Resale	1,200	
2110	Accounts payable		1,200

budgetary

4610	Allotments - realized resources	1,200	
4901	Expended authority - unpaid		1,200

30c) To record goods purchased on 11/3

proprietary

1521	Inventory Purchased for Resale	1,500	
2110	Accounts payable		1,500

budgetary

4610	Allotments - realized resources	1,500	
4901	Expended authority - unpaid		1,500

30d) The order was received on 11/20 without an advance

proprietary

None

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budgetary

4221	Unfilled customer orders - without advance	2,400	
4210	Anticipated reimbursements & other income	2,400	
4590	Apportionments - Unavailable	2,400	
4610	Allotments - realized resources		2,400

30e) To record sale of inventory on 12/5 (40@ \$60)

proprietary

1010	Fund balance	2,400	
5100	Revenue from goods sold	2,400	

budgetary

4252	Reimbursements & other income earned-collected	2,400	
4221	Unfilled customer orders - without advance		2,400

30f) To revalue inventory at the end of the period³ using latest acquisition method [¶23]

proprietary

1521	Inventory Purchased for Resale	350	
1529	Inventory - allowance		350

(To revalue inventory at latest acquisition method $\$50 \times 80 = \$4,000 - \$3,300$ (actual cost) = $700 \times 40 / 80 = 350$)

budgetary

None

30g) To record cost of goods sold for the period [¶25]

proprietary

6500	Cost of goods sold	1,650	
1521	Inventory Purchased for Resale		1,650

budgetary

None

³ Period - refers to an accounting period which is a span of time covered by an income statement; period can be on monthly, quarterly or annual basis.

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Cost of goods sold calculations:

Beginning Inventory at LAC		0
Less: beginning allowance for unrealized holding gains		0
Plus: actual purchases		<u>3,300</u>
Cost of goods available for sale		3,300
Less: ending inventory at end of the period LAC		
\$50*[80-40(#sold)] = 2,000	2,000	
Plus: Ending allowance for unrealized holding gains		<u>350</u>
		<u>1,650</u>
<u>Cost of Goods Sold</u>		<u>1,650</u>

ADJUSTING ENTRIES:

Budgetary

4590	Apportionments - Unavailable	13,750	
4210	Anticipated reimbursements and Other income		13,750

CLOSING ENTRIES:

Proprietary

To close overhead underapplied from manufacturing activity, which is deemed immaterial.

6600	Applied overhead	4,500	
6500	Cost of goods sold	1,000	
6100	Operating expense/Program costs (overhead)		5,000
6710	Depreciation expense		500

[If overhead is overapplied (applied overhead is budgeted more than the actual), the adjustment will be credited to CGS]

To close all revenue and expense accounts

5100	Revenue from goods sold	21,200	
5600	Donated revenue	2,000	
5790	Other financing sources	3,000	
3310	Cumulative results of operations		26,200

3310	Cumulative results of operations	40,150	
6100	Operating expenses		5,800
6500	Cost of goods sold		22,750
7210	Losses on disposition of assets		400
7290	Other losses		200
7400	Prior period adjustments		11,000

Budgetary

To close budgetary accounts

4902	Expended authority - unpd	27,000	
4201	Total actual resources - collected		5,750
4252	Reimbursements and other income earned - coll		21,250
4610	Allotments - realized resources		24,150
4450	Unapportioned authority - available		24,150

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