

(Statement and Note Disclosure, LCM, and Purchase Commitment) Garth Brooks, a division of Fresh Horses Inc., manufactures three models of gear shift components are sold to bicycle manufacturers, retailers, and catalog outlets. Since beginning Brooks has used normal absorption costing and has assumed a first-in, first-out perpetual inventory system. The balances of the inventory accounts at the end November 30, 2007, are shown below. The inventories are stated at cost before adjustments.

Finished Goods	\$647,000
Work-in-process	112,500
Raw materials	240,000
Factory supplies	69,000

The following information relates to Brooks's inventory and operations.

1. The finished goods inventory consists of the items analyzed below.

	<u>Cost</u>
<u>Down tube shifter</u>	
Standard model	\$ 67,500
Click adjustment model	94,500
Deluxe model	108,000
Total down tube shifters	<u>270,000</u>
<u>Bar end shifter</u>	
Standard model	83,000
Click adjustment model	99,000
Total bar end shifters	<u>182,000</u>
<u>Head tube shifter</u>	
Standard model	78,000
Click adjustment model	117,000
Total head tube shifters	<u>195,000</u>
Total finished goods	<u><u>\$ 647,000</u></u>

2. One-half of the head tube shifter finished goods inventory is held by catalog
3. Three-quarters of the bar end shifter finished goods inventory has been pledged to a bank loan.
4. One-half of the raw materials balance represents derailleurs acquired at a discount center above the current market price. The market value of the rest of the raw
5. The total market value of the work-in-process inventory is \$108,700
6. Included in the cost of factory supplies are obsolete items with an historical market value of the remaining factory supplies is \$65,900.
7. Brooks applies the lower-of-cost-or-market method to each of the three types

goods inventory. For each of the other three inventory accounts, Brooks applies the lower-of-cost-or-market method to the total of each inventory account.

8. Consider all amounts presented above to be material in relation to Brooks' financial statements taken as a whole.

Brooks Specialty Company,  
 inventories for bicycles that  
 are in operations in 1975,  
 and the cost flow in its  
 operations of Brooks's fiscal year,  
 as of any year-end

<u>Market</u>
\$ 67,000
87,000
110,000
<u>264,000</u>
90,050
97,550
<u>187,600</u>
77,650
119,300
196,950
<u>\$ 648,550</u>

outlets on consignment.  
 pledged as collateral for

contracted price 20 per  
 materials is \$127,400.

cost of \$4,200. The

es of shifters in finished

a. Prepare the inventory section of Brooks's balance sheet as of

Gary Brooks Sp
Balance Sheet
<u>As November 30, 2007</u>
Inventories
Finished goods
Down tube shifter
Bar end shifter
Head tube shifter
Total finished goods
Work-in-process
Raw materials
Factory supplies
<b>Total inventories</b>

**Notes:**

- (1) Each is the lower of cost or market, is using normal cost and has assumed a first-in, first-out cost flow in its purchases. The historical cost of \$136,500 (\$182,000 \* .75) of the bar end shifters has a market value of \$136,500. The historical cost of \$97,500 (\$195,000 / 2) of the head tube shifters is higher than market value.
- (2) \$108,700 is lower of cost or market to that of \$110,000.
- (3) One half of the raw materials represents deraille market price.  
 $\$240,000 / 2 = \$120,000$ ... $\$120,000 / 1.20 = \$100,000$
- (4) A historical cost of \$4,200 are obsolete items of total cost \$69,000 - \$4,200 = \$64,800

b. Without prejudice to your answer to (a), assume that the market value of the inventory declines to \$600,000. Explain how this decline would be presented in Brooks' income statement.

When market value is less than cost, there are two methods in which the loss can be presented. In the first method, the loss would be presented in cost of goods sold. In the second method, the loss would be presented in a separate line item resulting from the market decline of inventory prices.

c. Assume that Brooks has a firm purchase commitment for the inventory as of November 30, 2007, and that the purchase contract price is \$650,000. Explain how this commitment would be presented in Brooks' income statement.