

Form a six-member team, evaluate the following fact situation, and complete the indicated requirements.

Lynne Pastor is chief financial officer for Lots of Advertising. The company has received an exclusive contract to distribute a unique parking lot striping machine that imprints advertising messages in parking lot stripes. Lots of Advertising is planning for rapid growth and needs to raise expansion capital.

Lynne has identified a long-term source of financing on very favorable terms, but the following stipulations must be met:

Gross Profit Percentage for the first year	Must exceed 50%
Inventory Turnover for the first year (for this calculation assume year-end inventory is the "average" level)	Must exceed 1.4
Current ratio at year's end	Must exceed 3:1

The financing agreement requires that Lots of Advertising use FIFO, LIFO, or the weighted-average cost method, applied on a periodic basis. It is anticipated that year-end current assets, excluding inventory will total \$5,500,000. Current liabilities will be \$4,750,000. For purposes of your analysis, you may assume that inventory purchases do not change current liabilities (e.g., they will be financed via the long-term source of capital).

Projected first-year sales of the new machine are 16,000 units at \$5,000 per unit. Physical purchases are anticipated according to the following schedule:

<u>Date</u>	<u>Purchases</u>
1st quarter	4,000 units @ \$2,000 each
2nd quarter	6,000 units @ \$2,200 each
3rd quarter	8,000 units @ \$2,400 each
4th quarter	10,000 units @ \$2,600 each

- (a) First Team Member -- Assuming FIFO, identify if the lender conditions are anticipated to be met.
- (b) Second Team Member -- Obtain the first team member's results. If all lender conditions were not met, determine if a change in planned 4th quarter purchases could be accomplished that would allow all conditions to be met.
- (c) Third Team Member -- Assuming LIFO, identify if the lender conditions are anticipated to be met.
- (d) Fourth Team Member -- Obtain the third team member's results. If all lender conditions were not met, determine if a change in planned 4th quarter purchases could be accomplished that would allow all conditions to be met.
- (e) Fifth Team Member -- Assuming the weighted-average inventory method, identify if the lender conditions are anticipated to be met.
- (f) Sixth Team Member -- Obtain the fifth team member's results. If all lender conditions were not met, determine if a change in planned 4th quarter purchases could be accomplished that would allow all conditions to be met.
- (g) Entire Team -- Discuss your findings. In particular, decide if the choice of inventory method impacts financial statement results and measures. Further, analyze the degree to which the scheduling of purchases impacts the various measures. Discuss whether it is reasonable for inventory accounting methods and the specific scheduling of purchases to impact the reported results and financial position.