**Notes**

**Inventory**

Inventory operates under the perpetual inventory system, and states inventory at the lower of cost or market. Sales and cost of goods sold are recorded using the First-in, First-out accounting principle. First-in, first-out was chosen rather than Last-in, first-out or weighted moving average because it is the fairest representation of CWB’s sales.

**Property, Plant and Equipment and Depreciation/Amortization**

Cherry and White Bike Company utilizes the straight-line method of depreciation over the estimated useful lives of the assets:

|  |  |
| --- | --- |
| Display Cases | 5 Years |
| Light Fixtures | 5 Years |

Cherry and White Company capitalizes light fixtures as it is considered a leasehold improvement considering it is technically owned by the lessor since CWB cannot take the light fixtures upon departure. The sale of old light fixtures to replace with new light fixtures is considered a gain of $190 on the statement of income. Light Fixtures may be considered to have a useful life of 3 years, but there is not enough historical data to confirm that they should be amortized over the span of 3 years. To fairly represent the leasehold improvement, the light fixtures must be stated according to the life span of the equipment itself.

**Cash Equivalents**

The Company classifies all highly liquid investments with stated maturities of three months or less from the date of purchase as cash equivalents. This is seen on the excel file labeled balance sheet in the 3-month Treasury Bill under current assets.

**Revenue Recognition**

Cherry and White Bike Company recognizes service revenue from tune-ups on the last day of the month. Every bike tune-up is $85, and all customers pay in cash. CWB provides refunds in full. CWB’s policy is to provide a customer with a full refund within 30 days of purchase as long as the bike is returned in good condition. Sales returns are estimated based on historical sales and costs information. Bike deposits are accepted. CWB does not recognize revenue until the customer receives the bicycle, so deposits result in deferred revenue.

**Memo**

Cherry and White Bike Company has experienced great success in the year ended December 31, 2017. With the new addition of Lisa Marton as acting Store Manager, Cherry and White Bike Company has experienced a net income of $22,914.50. Assets are experiencing great liquidity, with a current ratio of roughly 1.05. Compared to Cherry and White Bike Company’s equity, there are great returns with a return on equity ratio of .735, and debt to equity ratio of only .97 (these statistics can be seen in the Excel tab labeled Ratios). We expect to grow and improve. The following are explanations for different accounting methods used in preparation for the financial statements ended December 31, 2017.

**Analysis of Inventory**

Three systems were analyzed; First-in, First-out, Last-in, First-out, and moving average. The FIFO method shows the highest profit margin, and gross profit margin; a model of the comparisons can be seen in the Excel sheet labeled FIFO, LIFO, and Moving Avg. FIFO shows the highest profitability through its impact on the profit margin, gross profit margin, and current ratio. Calculated in the Excel file labeled “FIFO,” FIFO shows the greatest margins due to the increase in prices throughout the year. The smaller costs at the beginning of the year allowed this system to display a smaller cost of goods sold. LIFO had a cost of goods sold of $11,620, moving average had a cost of goods sold of $11,023.66, and FIFO had a cost of goods sold of $10,725. This shows that the most profitable system to use is the FIFO system due to its ability to be recorded with decreased expenses. On the balance sheet, the current ratio for FIFO is the most beneficial. The ending inventory for FIFO is $2730, the ending inventory for moving average is $2431.34, and the ending inventory for LIFO is $1835. Under the FIFO method inventory will be higher on the balance sheet because the prices are higher toward the end of the year. Inventory under current assets will be higher under this method, which raises the current ratio and shows greater liquidity and solvency.

**Analysis of Property, Plant and Equipment and Depreciation/Amortization**

Considering light fixtures to be leasehold improvements allows Cherry and White Company to increase current assets as light fixtures will be represented in the current assets portion of the Balance Sheet. This can be seen in the Excel tab labeled Balance Sheet. Raising the current assets makes the current ratio increase, showing higher liquidity and solvency.

Choosing to amortize light fixtures using straight-line depreciation showed the greatest profitability compared to double-declining depreciation. Straight-line amortization is best because it shows a lower yearly depreciation expense toward the beginning of the equipment/leasehold improvement’s useful life. Converting that yearly depreciation/amortization expense to monthly to accrue expenses at the end of year results in a lower expense to the Income Statement, and lower accumulated depreciation/amortization on the Balance Sheet. This helps to show greater liquidity, solvency, and profitability. Models can be seen under the Excel tab Depreciation.