

FRS INC.

“Last month’s warehouse fire was a disaster!” exclaimed Paul May, FRS Inc.’s Chief production officer. “We need to fill out the insurance forms as soon as possible to get back all our lost inventories. It seems the fire destroyed our accounting system as well as backup production documentation”, he continued.

John Christensen, the company’s controller walks into Mr. May’s office and shouts “I was able to salvage some of last year’s data. Have a look.”

John’s data contained the following:

Beginning Inventories:

Direct Materials: \$40,000
Finished Goods Inventory: \$48,000
Work-in-Process: \$64,000.

“I also know that our gross profit percentage is 40% and that prime costs are 60% of manufacturing costs” continued John.

“That sounds about right” replies Paul May. “I was also told that overhead costs amount to 40% of conversion costs. Also, I’d say that our ending work-in process inventories were about 20% of the monthly manufacturing costs.”

After further discussions, it was revealed that last year’s sales were \$1,000,000 and that direct labour costs and direct material purchase costs amounted to \$400,000 and \$550,000 respectively.

“John, can you get back to me by tomorrow letting me know how much we can expect to get from our insurance company? I know that they won’t pay for any scrap incurred during the production process, which I estimate to be 10% of production.”

Required:

Assume the role of John Christensen and estimate the amount recoverable in insurance proceeds.