

Fact Pattern:

Ramseur Company employs a process costing system for its two-department manufacturing operation using the first-in, first-out (FIFO) inventory method. When units are completed in Department 1, they are transferred to Department 2 for completion. Inspection takes place in Department 2 immediately before the direct materials are added, when the process is 70% complete with respect to conversion. The specific identification method is used to account for lost units.

The number of defective units (that is, those failing inspection) is usually below the normal tolerance limit of 4% of units inspected. Defective units have minimal value, and the company sells them without any further processing for whatever it can. Generally, the amount collected equals, or slightly exceeds, the transportation cost. A summary of the manufacturing activity for Department 2, in units for the current month, is presented below.

	Physical Flow (output units)
Beginning inventory (60% complete with respect to conversion)	20,000
Units transferred in from Department 1	180,000
Total units to account for	<u>200,000</u>
Units completed in Department 2 during the month	170,000
Units found to be defective at inspection	5,000
Ending inventory (80% complete with respect to conversion)	<u>25,000</u>
Total units accounted for	<u>200,000</u>

The units that failed inspection during the current month would be classified by Ramseur as

- A. Normal waste.
- B. Abnormal spoilage.
- C. Normal reworked units.
- D. Normal scrap.

Answer (D) is **correct**.

The units that failed inspection are classified as normal scrap because they have minimal value and can be sold without further reworking. The defective units are less than the 4% tolerance limit for normal spoilage ($5,000 \text{ defective units} \div 200,000 \text{ total units} = 2.5\%$, $< 4\%$ tolerance limit). Scrap can be sold, disposed of, or reused.