Inventories: Implications for Financial Statements and Ratios

Test ID: 7440393

Question #1 of 111

Question ID: 461995

In periods of falling prices, which of the following statements is CORRECT? Compared to FIFO, LIFO results in:

- ✗ **A) higher inventory balances and lower working capital.**
- ✓ **B)** higher inventory balances and higher working capital.
- ✗ **C)** lower COGS, lower taxes and higher net income.

Explanation

In periods of falling prices, LIFO results in lower COGS, higher taxes, higher net income, higher inventory balances, higher working capital, and lower cash flows compared to FIFO.

Question #2 of 111

Question ID: 462031

The Orchard Supply Company uses LIFO inventory valuation. Orchard Supply had a cost of goods sold of $1 million for the period. The inventory at the beginning of the period was $0.5 million, and the inventory at the end of the period was $0.6 million. Orchard Supply's LIFO reserve was $0.1 million for the previous year and $0.2 million for the current year. What is Orchard Supply's ending inventory according to FIFO inventory valuation?

- ✗ **A) $0.5 million.**
- ✗ **B)** $0.7 million.
- ✓ **C)** $0.8 million.

Explanation

FIFO Inventory = $0.6 + 0.2 = $0.8 million.

Question #3 of 111

Question ID: 461977

JME had beginning inventory of $200 and ending inventory of $300. JME had COGS of $800. JME must have purchased inventory amounting to:

- ✗ **A) $1,100.**
- ✗ **B)** $700.
- ✓ **C)** $900.

Explanation

beginning inv. + purchases - COGS = ending inv.

200 + purchases - 300 = 800

purchases = 900

Question #4 of 111

Question ID: 467386

	Units	*Unit Price*
Beginning Inventory	709	$2.00
Purchases	556	$6.00
Sales	959	$13.00

What is gross profit using the FIFO method and LIFO method?

		FIFO	LIFO
✓	**A)**	**$9,549**	**$8,325**
✗	**B)**	$8,325	$8,862
✗	**C)**	$8,862	$9,549

Explanation

FIFO COGS = (709 units)($2/unit) + (959 − 709)($6/unit) = $1,418 + $1,500 = $2,918

Sales = (959 units)($13/unit) = $12,467

Gross profit = Sales − COGS

= 12,467 − 2,918 = $9,549

LIFO COGS = (556 units)($6/unit) + (959 − 556)($2/unit) = $3,336 + $806 = $4,142

Sales = (959 units)($13/unit) = $12,467

Gross profit = Sales − COGS

= 12,467 − 4,142 = $8,325

Question #5 of 111

Question ID: 462062

Tim Rogers is senior equity analyst with White Capital LLP. While analyzing the financial statements of Drako Toys Inc., a toy manufacturer based in Cleveland, Ohio, Tim concludes that Drako is expected to see above-average sales growth over the next three years. Which of the following conditions *most likely* support Tim's conclusion?

✗ **A) Increase in finished goods inventory and corresponding decline in raw-materials and work-in-progress inventory over the last two years.**

✓ **B)** Increase in raw-materials and work-in-progress inventory and corresponding decline in finished goods inventory over the last two years.

✗ **C)** Finished goods inventory growing faster than sales in the last two years.

Explanation

An increase in raw materials and/or work-in-process inventory is probably an indication of an expected increase in demand. Conversely, an increase in finished goods inventory, while raw materials and work-in-process are decreasing, may be an indication of decreasing demand. Finished goods inventory that is growing faster than sales may be an indication of declining demand.

Question #6 of 111

Question ID: 461992

An analyst acquires the following information regarding a company:

	Units	*Unit Price*
Beginning Inventory	559	$1.00
Purchases	785	$5.00
Sales	848	$15.00
SGA Expenses	$3,191 per annum	

What are the Earnings Before taxes using the Weighted Average Method?

✗ **A) $5,500.**

✗ **B)** $6,200.

✓ **C)** $6,700.

Explanation

EBT = Sales − (COGS + SGA)

COGS = Beginning inventory + Purchases − Ending inventory
Ending inventory in units = 559 + 785 − 848 = 496 units
Average cost = (559 × $1 + $785 × $5) / (559 + 785)
= ($559 + $3,925) / 1,344 = $3.3363
Ending inventory = 496 × $3.3363 = $1,654.81

COGS = $559 + $3,925 − $1,654.81 = $2,829.19

EBT = 12,720 − (2,829.19 + 3,191) = $6,699.81.

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Question ID: 461985

The Mountain Bike Supply Company had 500 units in its beginning inventory. Each of these units cost $5. During the period, Mountain Bike Supply first purchased 400 units at $6 each and then 200 units at $7 each. At the end of the period, Mountain Bike Supply had 600 units. What is the cost of goods sold and inventory for Mountain Bike Supply if it uses FIFO inventory valuation?

	COGS	Inventory
✓ **A)**	**$2,500**	**$3,800**
✗ **B)**	$3,200	$3,100
✗ **C)**	$2,500	$3,100

Explanation

Under FIFO:

COGS = 500 @ $5 = $2,500
Inventory = 200 @ $7 + 400 @ $6 = $3,800

Question #8 of 111

Question ID: 462023

Selected information from Jenner, Inc.'s financial statements for the year ended December 31 included the following (in $):

Cash	$200,000	Accounts Payable	$300,000
Accounts Receivable	300,000	Deferred Tax Liability	600,000
Inventory	1,500,000	Long-term Debt	8,100,000
Property, Plant & Equip.	11,000,000	Common Stock	2,200,000
Total Assets	13,000,000	Retained Earnings	1,800,000
LIFO Reserve at Jan. 1	400,000	Total Liabilities & Equity	$13,000,000
LIFO Reserve at Dec. 31	600,000		
Net Income (after 40% tax rate)	800,000		

Jenner uses the last in, first out (LIFO) inventory cost flow assumption. If Jenner changed from LIFO to first in, first out (FIFO) in 2001, return on total equity would:

✗ **A) decrease from 20.0 to 18.3%.**
✗ **B)** increase from 20.0 to 23.0%.
✓ **C)** increase from 20.0 to 21.1%.

Explanation

Return on total equity (net income / total equity) was ($800,000 / ($2,200,000 + $1,800,000) =) 20%. Under FIFO, net income increases by the increase in the LIFO reserve multiplied by (1 - tax rate). FIFO net income for 2001 was ($800,000 + ($600,000 - $400,000) (1 - 0.40) =) $920,000. Total equity increases by the amount of accumulated FIFO profits that are added to retained earnings which is calculated by multiplying the amount of the ending LIFO reserve by (1 - tax rate) for an increase of (($600,000) × (1 - 0.40) =) $360,000. Total equity is ($2,200,000 + $1,800,000 + $360,000 =) $4,360,000. FIFO return on total equity is ($920,000 / $4,360,000 =) 21.1%.

Question #9 of 111

Question ID: 461997

Which inventory method will provide the largest net income during periods of falling prices?

✓ **A) LIFO.**
✗ **B)** Weighted average cost.
✗ **C)** FIFO.

Explanation

During periods of falling prices last in, first out (LIFO) provides a higher net income than first in, first out (FIFO) or the average cost methods because the items most recently purchased are the ones being sold first and these costs are continually falling increasing net income. Using FIFO during periods of falling prices would cause net income to be lower than LIFO or average cost methods because the first inventory purchased is the first sold but during periods of falling prices this is the most expensive inventory causing net income to be lower.

Question #10 of 111

Question ID: 462004

In case of a decline in LIFO reserve, to obtain a better analysis an analyst should:

✗ **A) adjust the income statement, regardless of the reasons for the decline.**

✗ **B)** not make any adjustments.

✓ **C)** adjust the income statement, only if such a decline is due to LIFO liquidation.

Explanation

A decline in LIFO reserve is due to either falling prices or LIFO liquidations. In the case of LIFO liquidation, the income statement does not reflect the current costs and should be adjusted. In the case of falling prices, the LIFO income statement amounts are current and do not need adjustment.

Questions #11-16 of 111

Wallace Lumber uses LIFO and had the following note in its last financial statement: "Wallace Lumber showed a LIFO reserve of $90,000 in 2012 and $86,000 in 2013." Wallace's marginal tax rate is 31%. Assume normal inflationary conditions.

Question #11 of 111

Question ID: 462056

If Wallace's 2013 year-end LIFO inventory balance was $400,000, the firm's inventory based on FIFO would be *closest to*:

✗ **A) $400,000.**

✗ **B)** $314,000.

✓ **C)** $486,000.

Explanation

INV_F	= INV_L + LIFO reserve
	= $400,000 + $86,000
	= $486,000

(LOS 17.c)

Question #12 of 111

Question ID: 462057

If Wallace's 2013 LIFO COGS was $70,000, the firm's FIFO COGS would be *closest to*:

✓ **A) $74,000.**

✗ **B)** $64,000.

✗ **C)** $66,000.

Explanation

$COGS_F$	= $COGS_L$ − (LIFO $reserve_E$ − LIFO $reserve_B$)
	= $70,000 − ($86,000 − $90,000)
	= $74,000

(LOS 17.c)

Question #13 of 111

Question ID: 462058

If Wallace's 2013 reported net income was $12,000, the firm's FIFO net income would be *closest to*:

✗ **A) $14,760.**

✓ **B)** $9,240.

✗ **C)** $12,000.

Explanation

NI(F)	= NI(L) + (LIFO $reserve_E$ − LIFO $reserve_B$)(1 − T)
	= $12,000 + ($86,000 − $90,000)(0.69)
	= $9,240

(LOS 17.c)

Question #14 of 111

Question ID: 479057

If Wallace Lumber had reported using the FIFO cost flow assumption, the firm's net income would be:

✗ **A) the same.**

✗ **B)** higher.

✓ **C)** lower.

Explanation

In this scenario we have LIFO liquidation, and hence net income (and retained earnings) will be higher under LIFO leading to a higher equity and lower debt-to-equity ratio. Under FIFO, the benefit of LIFO liquidation would not exist (as evidenced by lower Net Income under FIFO) and hence debt-to-equity ratio would be higher. (LOS 17.e)

Question #15 of 111

Question ID: 462060

Compared to Wallace's current ratio under LIFO, the firm's current ratio under FIFO is *most likely* to be:

✓ **A) higher.**

✗ **B)** lower.

✗ **C)** the same.

Explanation

LIFO inventory would be lower by the LIFO reserve, hence FIFO current ratio will be higher than the LIFO current ratio. (LOS 17.e)

Question #16 of 111

Question ID: 462061

An analyst wanting to use Wallace Lumber's profit margin ratio for forecasting purposes, would *most likely*:

✗ **A) use the profit margin without adjustment, as LIFO reflects the most-recent costs.**

✗ **B)** use FIFO profit margin instead.

✓ **C)** adjust the computed ratio lower.

Explanation

Under inflationary conditions, Wallace Lumber's decreasing LIFO reserve must be due to a LIFO liquidation, leading to a one-off boost to reported profits which is not sustainable. An analyst should revise the computed ratio lower. (LOS 17.b)

Question #17 of 111

Question ID: 414467

Assuming inventory levels remain constant during the year and prices have been stable over time, COGS would be:

✗ **A) higher under the average cost than LIFO or FIFO.**

✗ **B)** higher under LIFO than FIFO or average cost.

✓ **C)** the same for both LIFO and FIFO.

Explanation

During stable prices inventory levels are the same for both LIFO and FIFO.

Question #18 of 111

Question ID: 462044

In periods of rising prices and stable or increasing inventory quantities, a company using LIFO rather than FIFO will report cost of goods sold and cash flows which are, respectively:

		COGS	Cash Flows
✗	**A)**	**Lower**	**Lower**
✓	**B)**	Higher	Higher
✗	**C)**	Higher	Lower

Explanation

In this situation, LIFO results in higher cost of goods sold because it uses the more recent and higher costs than FIFO. LIFO results in higher cash flows because with lower reported income, income tax will be lower.

Question #19 of 111

Question ID: 462029

Costiuk Ltd. uses the LIFO inventory cost flow assumption. Its inventory balance is $400 at the end of 20X8 and was $350 at the end of 20X7. A footnote in its financial statements reads: "Inventories would have been $70 higher in 20X8 and $80 higher in 20X7 using the FIFO cost flow assumption."

Which of the following amounts represents the inventory balance under FIFO at the end of 20X8?

✗ **A) $410.**

✗ **B)** $390.

✓ **C)** $470.

Explanation

The $70 and $80 amounts represent the LIFO reserves which are differences between LIFO inventory and its value under FIFO.

FIFO inventory (20X8) = LIFO inventory (20X8) + LIFO reserve (20X8)

$400 + $70 = $470

Question #20 of 111

Question ID: 462001

A company's beginning inventory was overstated by $3,000, now ending inventory is understated by $2,000. If purchases were properly reported, then earnings before taxes will be:

✓ **A) understated by $5,000.**

✗ **B)** overstated by $1,000.

✗ **C)** overstated by $5,000.

Explanation

The key relationship being tested is beginning inventory + purchases - COGS = ending inventory. So, beginning inventory + purchases - ending inventory = COGS. You could solve the equation as +3000 +0 - -2000 = +5000. However, it is probably easier to conceptualize by making up numbers that meet the requirements.

Actual (I made these numbers up):
20,000 + 5,000 - 15,000 = 10,000
Reported:
(20,000 + 3,000) + 5,000 - (15,000-2,000) = 15,000

COGS will be overstated by 5,000 so earnings before taxes (EBT) will be understated by 5,000.

Questions #21-26 of 111

The cost flow assumption of LIFO vs. FIFO has several implications while analyzing financial statements, especially when comparing companies using different methods.

Suppose that we are comparing two firms: Alpha (which uses LIFO) and Beta (which uses FIFO).

Question #21 of 111

Question ID: 462036

In an inflationary scenario, with rising inventory levels, which company is *most likely* to report a COGS that reflects current prices?

✗ **A) Both Alpha and Beta.**

✓ **B)** Alpha only.

✗ **C)** Beta only.

Explanation

The LIFO cost flow assumption transfers the most recent purchases to COGS and hence reflects current prices. Alpha, which uses the LIFO cost flow assumption, would therefore report current prices in their COGS. (LOS 17.a)

Question #22 of 111

Question ID: 462037

In a deflationary scenario, with rising inventory levels, which company is *most likely* to report a COGS that reflects current prices?

✓ **A) Alpha only.**

✗ **B)** Both Alpha and Beta.

✗ **C)** Beta only.

Explanation

The LIFO cost flow assumption transfers the most recent purchases to COGS and hence COGS will reflect current prices. This holds true whether prices are rising or falling. Alpha, which uses the LIFO cost flow assumption, will therefore report current prices in the firm's COGS. (LOS 17.a)

Question #23 of 111

Question ID: 462038

For this question only, suppose that there is a third company Gamma. Like Alpha, Gamma also uses the LIFO cost flow assumption. However, unlike Alpha, Gamma's LIFO reserve has been decreasing over the years. In an inflationary scenario, which company is *most likely* to report COGS that reflect current prices?

✓ **A) Alpha.**

✗ **B)** Gamma.

✗ **C)** Beta.

Explanation

Both Alpha and Gamma will reflect more-current prices in COGS than Beta does in its COGS. However, since Gamma has a LIFO liquidation (while Alpha does not), Gamma's COGS includes some older price inventory. Alpha's inventory levels are increasing and therefore its COGS would reflect the most current prices. (LOS 17.a)

Question #24 of 111

Question ID: 462039

Suppose Beta is considering an inventory write-down. Which group of ratios is *most likely* to look worse due to such a move?

✓ **A) Profitability and leverage.**

✗ **B)** Inventory turnover and leverage.

✗ **C)** Profitability and inventory turnover.

Explanation

An inventory write-down would lower inventory values and the current period's reported profits. Profitability ratios would suffer. The turnover ratio would be favorable due to the lower asset (inventory) values. Leverage ratios would also suffer due to lower equity (via retained earnings). (LOS 17.d)

Question #25 of 111

Question ID: 462040

Which cost-flow assumption is *least likely* to be associated with inventory writedowns?

✗ **A) Specific Identification.**

✓ **B)** LIFO.

✗ **C)** FIFO.

Explanation

Specific Identification, FIFO and weighted average cost methods are more likely to be associated with inventory write-downs compared to the LIFO method. LIFO reflects the oldest costs in inventory and in a normal inflationary environment would already reflect a conservative valuation of inventory. (LOS 17.a, d)

Question #26 of 111

Question ID: 462041

Which of the following is *most likely* to signal inventory obsolescence? An increase in:

✗ **A) raw material and work-in-progress inventory.**

✗ **B)** raw material inventory only.

✓ **C)** finished goods inventory with falling raw material inventory.

Explanation

An increase in finished goods inventory, along with falling raw material/work-in-progress inventory, is generally an indication of obsolete inventory. Increases in raw material/work-in-progress may signal expectations of increasing demand for a company's products. (LOS 17.f)

Question #27 of 111

Question ID: 414454

Given the following data and assuming a periodic inventory system, what is the ending inventory value using the FIFO method?

Purchases	*Sales*
50 units at $50/unit	25 units at $55/unit
60 units at $45/unit	30 units at $50/unit
70 units at $40/unit	45 units at $45/unit

✗ **A) $3,600.**

✗ **B)** $3,200.

✓ **C)** $3,250.

Explanation

Purchased 50 + 60 + 70 = 180 units. Sold 25 + 30 + 45 = 100.

Ending inventory = 180 - 100 = 80 of the last units purchased.

(70 units)($40/unit) + (10 units)($45/unit) = $2,800 + $450 = $3,250.

Question #28 of 111

Question ID: 462051

Which of the following statements concerning a period of rising prices is *least* accurate?

✗ **A) The debt-to-equity ratio is greater using the last in, first out (LIFO) inventory valuation method than using the first in, first out (FIFO) method.**

✓ **B)** Inventory turnover is less using the last in, first out (LIFO) inventory valuation method than using the first in, first out (FIFO) method.

✗ **C)** Gross profit using the last in, first out (LIFO) inventory valuation method is less than the gross profit using the first in, first out (FIFO) method.

Explanation

LIFO results in lower inventory and higher cost of goods sold (COGS) during a period of rising prices, hence a higher inventory turnover.

Question #29 of 111

Question ID: 414450

Arlington, Inc. uses the first in, first out (FIFO) inventory cost flow assumption. Beginning inventory and purchases of refrigerated containers for Arlington were as follows:

	Units	*Unit Cost*	*Total Cost*
Beginning Inventory	20	$10,000	$200,000
Purchases, April	10	12,000	120,000
Purchases, July	10	12,500	125,000
Purchases, October	20	15,000	300,000

In November, Arlington sold 35 refrigerated containers to Johnson Company. What is the cost of goods sold assigned to the 35 sold containers?

✗ **A) $434,583.**

✓ **B)** $382,500.

✗ **C)** $485,000.

Explanation

Under FIFO, cost of goods sold is the value of the first units purchased. The 35 units sold consist of the 20 units in beginning inventory, the 10 units purchased in April, and 5 of the units purchased in July. COGS = $200,000 + $120,000 + (5 × $12,500) = $382,500.

Question #30 of 111

Question ID: 462053

Assuming high inflation in the short run and lower levels of inflation in the long run, the current ratio of a company using last in, first out (LIFO) relative to a firm using first in, first out (FIFO), will be:

✗ **A) higher, and the difference between the two firms' current ratios will decrease as inflation decreases.**

✓ **B)** lower, and the difference between the two firms' current ratios will increase as inflation decreases.

✗ **C)** lower, and the difference between the two firms' current ratios will decrease as inflation decreases.

Explanation

The LIFO firm's current ratio will be lower and the difference between the two firms' current ratios will increase as inflation decreases. For example, assume purchases equal sales so the quantity of inventory is constant. Inventory value under LIFO will also remain constant as inflation decreases, whereas FIFO inventory value will increase even as the inflation rate decreases. As long as inflation remains positive, the FIFO inventory value and the difference between LIFO and FIFO inventory values will increase, as will the difference between the LIFO and FIFO firms' current ratios.

Question #31 of 111

Question ID: 414446

JME purchased 400 units of inventory that cost $4.00 each. Later the firm purchased an additional 500 units that cost $5.00 each. JME sold 700 units of inventory for $7.00 each. If JME uses a first in, first out (FIFO) cost flow method, the amount of gross profit appearing on the income statement is:

✗ **A) $2,400.**

✓ **B)** $1,800.

✗ **C)** $3,100.

Explanation

(units sold × sales price) - [(inventory cost × unit cost) + (inventory cost × unit cost)] = sales - COGS = gross profit

(700 × 7.00) - [(400 × 4.00) + (300 × 5.00)] = 1,800

Question #32 of 111

Question ID: 414472

Barber Inc. sells DVD recorders. On October 14, it purchased a large number of recorders at a cost of $90 each. Due to an oversupply of recorders remaining in the marketplace due to lower than anticipated demand during the Christmas season, the

selling price at December 31 is $80 and the replacement cost is $73. The normal profit margin is 5 percent of the selling price and the selling costs are $2 per recorder.

Under U.S. GAAP, what is the value of the recorders on December 31?

✓ **A) $74.**

✗ **B)** $73.

✗ **C)** $78.

Explanation

Under U.S. GAAP, market is equal to the replacement cost subject to replacement cost being within a specific range. The upper bound is net realizable value (NRV), which is equal to selling price ($80) less selling costs ($2) for an NRV of $78. The lower bound is NRV ($78) less normal profit (5% of selling price = $4) for a net amount of $74. Since replacement cost ($73) is less than NRV minus normal profit ($74), then market equals NRV minus normal profit ($74). As well, we have to use the lower of cost ($90) or market ($74) principle so the recorders should be recorded at the lower amount of $74.

Question #33 of 111

Question ID: 462026

The year-end financial statements for a firm using last in first out (LIFO) acounting show an inventory level of $5,000, cost of goods sold (COGS) of $16,000, and inventory purchases of $14,500. If the LIFO reserve is $4,000 at year-end and was $1,500 at the beginning of the year, what would the COGS have been using FIFO accounting?

✗ **A) $18,500.**

✗ **B)** $12,000.

✓ **C)** $13,500.

Explanation

COGS from LIFO to FIFO:

$COGS_F = COGS_L$ − change in LIFO reserve
$= COGS_L$ - (LIFO $reserve_E$ − LIFO $reserve_B$)
= $16,000 − ($4,000 − $1,500)
= $16,000 − $2,500
= $13,500

Question #34 of 111

Question ID: 462012

LIFO liquidation may result when:

✗ **A) purchases are more than goods sold.**

✓ **B)** purchases are less than goods sold.

✗ **C)** cost of goods sold is less than the available inventory.

Explanation

For LIFO companies, when more goods are sold than are purchased during a period, the goods held in opening inventory are in included in COGS. This will result in LIFO liquidation.

Question #35 of 111

Question ID: 414447

Given the following data what is the ending inventory value using the LIFO method, assuming a periodic inventory system?

Purchases	*Sales*
50 units at $50/unit	25 units at $55/unit
60 units at $45/unit	30 units at $50/unit
70 units at $40/unit	45 units at $45/unit

✗ **A) $3,200.**

✓ **B)** $3,850.

✗ **C)** $3,250.

Explanation

Purchased 50 + 60 + 70 = 180 units. Sold 25 + 30 + 45 = 100.

Ending inventory = 180 - 100 = 80 of the first units purchased.

(50 units)($50/unit) + (30 units)($45/unit) = $2,500 + $1,350 = $3,850.

Question #36 of 111

Question ID: 414451

Given the following inventory data about a firm:

- Beginning inventory 20 units at $50/unit
- Purchased 10 units at $45/unit
- Purchased 35 units at $55/unit
- Purchased 20 units at $65/unit
- Sold 60 units at $80/unit

What is the inventory value at the end of the period using LIFO?

✓ **A) $1,225.**

✗ **B)** $1,575.

✗ **C)** $3,450.

Explanation

Ending inventory equals 20 + 10 + 35 + 20 − 60 = 25 of the first units purchased equals:

(20 units)($50/unit) + (5 units)($45/unit) =

$1,000 + $225 = $1,225

Question #37 of 111

Question ID: 414463

During periods of rising prices, which of the following is *most likely* to occur?

✗ **A) LIFO COGS < FIFO COGS, therefore LIFO net income < FIFO net income.**

✗ **B)** LIFO COGS > FIFO COGS, therefore LIFO net income > FIFO net income.

✓ **C)** LIFO COGS > FIFO COGS, therefore LIFO net income < FIFO net income.

Explanation

Under the assumptions of this question and using LIFO, the most expensive units go to COGS, resulting in lower net income.

Question #38 of 111

Question ID: 462045

During a period of rising prices, the financial statements of a firm using first in, first out (FIFO) reporting, instead of last in, first out (LIFO) reporting would show:

✗ **A) lower total assets and higher net income.**

✗ **B)** lower total assets and lower net income.

✓ **C)** higher total assets and higher net income.

Explanation

When the FIFO method is used when prices are rising, the cheaper goods in beginning inventory, reflecting earlier purchases, are assigned to COGS (hence, higher income) and the more expensive units (last purchases) are assigned to ending inventory (greater current assets). When the LIFO method is used during a period when prices are rising, the more expensive last purchases are assigned to COGS (hence, lower income) and the cheaper units in beginning inventory and earlier purchases are assigned to ending inventory.

Question #39 of 111

Question ID: 462003

An analyst gathers the following information about a firm:

- Last in, first out (LIFO) inventory = $10,000
- Beginning LIFO reserve = $2,500
- Ending LIFO reserve = $4,000
- LIFO cost of goods sold = $15,000
- LIFO net income = $1,500
- Tax rate is 40%

To convert the financial statements to a FIFO basis, the amount the analyst should add to the stockholders' equity is *closest to*:

✗ **A) $4,000.**

✓ **B)** $2,400.

✗ **C)** $2,800.

Explanation

If the firm had used FIFO inventory cost, tax liability would be higher by (LIFO reserve × tax rate) and retained earnings would be higher by [LIFO reserve × (1 − tax rate)].

(LIFO reserve)(1 − t) = $4,000(1 − 0.4) = $2,400

Question #40 of 111

Question ID: 462030

Due to declining prices, Steffen Inc. has a LIFO reserve of -$20. Its income tax rate is 35%. If an analyst is converting Steffen's financial statements to a FIFO basis, which of the following adjustments is *most likely* required?

✓ **A) Increase cash by $7.**

✗ **B)** Increase shareholders' equity by $13.

✗ **C)** Increase assets by $20.

Explanation

Declining prices (negative LIFO reserve) would result in FIFO inventory being less than LIFO inventory based on the following equation:

FIFO inventory = LIFO inventory + LIFO reserve

The balance sheet adjustment would decrease assets (inventory) by the $20 LIFO reserve. In addition, the analyst would increase cash by $7 ($20 LIFO reserve × 35% tax rate). To bring the accounting equation into balance, the analyst would decrease shareholders' equity by $13 [$20 LIFO reserve × (1 − 35% tax rate)].

Question #41 of 111

Question ID: 461971

A firm uses the last in, first out (LIFO) accounting method and posts $100,000 as ending inventory. Last year's financial statements show inventory at $110,000. This period's income statement shows costs of goods sold at $90,000 with a LIFO reserve of $30,000. How much inventory was purchased this period, and what would the ending inventory balance be under first in, first out (FIFO)?

	Inventory purchases	Ending inventory (FIFO)
✗ **A)**	**$90,000**	**$130,000**
✓ **B)**	$80,000	$130,000
✗ **C)**	$80,000	$70,000

Explanation

EI = BI + P - COGS

100 = 110 + P - 90

P = $80,000

In order to convert ending inventory under FIFO to LIFO you have to add the LIFO reserve to the ending inventory under LIFO.
EI_{FIFO} = $100,000 + $30,000 = $130,000

Question #42 of 111

Question ID: 414453

Given the following information and assuming beginning inventory was zero and a periodic inventory system was used, what is the gross profit at the end of the period using the FIFO, LIFO, and average cost methods?

Purchases	*Sales*
20 units at $50	15 units at $60
35 units at $40	35 units at $45
85 units at $30	85 units at $35

	FIFO	LIFO	Cost Average
✗ **A)**	**$650**	**$750**	**$990**
✗ **B)**	$677	$650	$677
✓ **C)**	$650	$750	$677

Explanation

Sales = (15 * 60) + (35 * 45) + (85 * 35) = 5,450

$COGS_{FIFO}$ = (20 * 50) + (35 * 40) + (80 * 30) = 4,800
GM_{FIFO}: $5,450 − 4,800 = $650

$COGS_{LIFO}$ = (15 * 50) + (35 * 40) + (85 * 30) = 4,700
GM_{LIFO}: $5,450 − $4,700 = $750

$COGS_{Average}$ = (20 * 50) + (35 * 40) + (85 * 30) = 4,950
4,950*135 / 140 = 4,773.21
$GM_{Cost\ Average}$: $5,450 − $4,773.21 = $676.79

Question #43 of 111

Question ID: 462049

In general, when analyzing profitability and costs, or when analyzing asset and equity ratios, which of the following should be used?

	Profitability/Cost Ratios	Asset/Equity Ratios
✗ **A)**	**FIFO**	**FIFO**
✗ **B)**	FIFO	LIFO
✓ **C)**	LIFO	FIFO

Explanation

In general, an analyst should use LIFO when examining profitability or cost ratios and FIFO when examining asset or equity ratios.

Question #44 of 111

Question ID: 462028

A financial analyst could adjust the current ratio in which a company uses the LIFO inventory valuation method to the FIFO method by:

✗ **A) deducting the LIFO reserve from the current asset.**

✓ **B)** adding the LIFO reserve to the current assets.

✗ **C)** adding the LIFO reserve to the current liabilities.

Explanation

The LIFO reserve increases the inventory value under FIFO and inventory is included in the numerator in the current ratio.

Question #45 of 111

Question ID: 414464

Which accounting methods are preferable for income statements and balance sheets?

✓ **A) Last in, first out (LIFO) for income statements and first in, first out (FIFO) for the balance sheet.**

✗ **B)** First in, first out (FIFO) for both income statements and balance sheets.

✗ **C)** Last in, first out (LIFO) for the balance sheet and first in, first out (FIFO) for the income statement.

Explanation

LIFO allocates the most recent prices to the cost of goods sold and provides a better measure of current income. For balance sheet purposes, inventories based on FIFO are preferable since these values most closely resemble current cost and economic value.

Question #46 of 111

Question ID: 461989

In a period of rising prices and stable or increasing inventory quantities, use of the first in, first out (FIFO) inventory cost flow assumption results in all of the following EXCEPT:

✓ **A) lower inventory balances than under last in, first out (LIFO).**

✗ **B)** higher earnings before taxes than under last in, first out (LIFO).

✗ **C)** higher earnings after taxes than under last in, first out (LIFO).

Explanation

Ending Inventory under FIFO includes more recently purchased higher cost goods than under LIFO. The LIFO inventory consists of older,

cheaper goods. Both before and after tax earnings under FIFO will be higher because less expensive goods are used for the cost of goods sold (COGS). Working capital, which is equal to current assets - current liabilities will also be higher under FIFO due the higher inventory balance causing a higher level of current assets.

Question #47 of 111

Question ID: 462020

The Orchard Supply Company uses last in, first out (LIFO) inventory valuation. Orchard Supply had a cost of goods sold (COGS) of $1 million for the period. The inventory at the beginning of the period was $500,000 and the inventory at the end of the period was $600,000. Orchard Supply's LIFO reserve was $100,000 at the end of the previous year and $200,000 at the end of the current year. What is Orchard Supply's COGS according to first in, first out (FIFO) inventory valuation?

✗ **A) $800,000.**

✗ **B)** $1.1 million.

✓ **C)** $900,000.

Explanation

FIFO COGS = LIFO COGS − change in LIFO reserve

FIFO COGS = $1 million − $100,000 = $900,000

Question #48 of 111

Question ID: 472475

The following information has been gathered about a firm:

- LIFO inventory = $10,000
- Beginning LIFO reserve = $2,500
- Ending LIFO reserve = $4,000
- LIFO cost of goods sold = $15,000
- LIFO net income = $1,500
- Tax rate is 40%

What is the FIFO COGS?

✗ **A) $16,500.**

✗ **B)** $19,000.

✓ **C)** $13,500.

Explanation

FIFO COGS = LIFO COGS - change in LIFO reserve

= $15,000 - (4,000 − 2,500) = $13,500

Question #49 of 111

Question ID: 462006

First in, first out (FIFO) inventory equals:

✓ **A) LIFO inventory + LIFO reserve.**

✗ **B)** the change in LIFO reserve − LIFO ending reserve.

✗ **C)** LIFO cost of goods sold − changes in LIFO reserve.

Explanation

To convert LIFO inventory balances to a FIFO basis, simply add the LIFO reserve to the LIFO inventory:

$INV_F = INV_L$ + LIFO Reserve

Question #50 of 111

Question ID: 461972

A firm's financial statements reflect the following information:

Beginning inventory	$3,200,000
Purchase during the year	$1,700,000
Ending inventory	$2,100,000
Sales	$4,800,000
Gross profit margin	????

What was the firm's gross profit margin?

✗ **A) 0.58.**

✗ **B)** 2.29.

✓ **C)** 0.42.

Explanation

First we can determine the COGS by: COGS = beginning inventory + purchases - ending inventory = $2,800,000.
Then, gross profit margin = (sales - COGS) / sales = 0.42.

Question #51 of 111

Question ID: 461991

Which of the following statements regarding inventory methods used during periods of rising prices is *least* accurate?

✗ **A) FIFO results in higher taxes than LIFO.**

✗ **B)** FIFO results in higher inventory balances than LIFO.

✓ **C)** LIFO results in lower cost of goods sold than FIFO.

Explanation

LIFO results in *higher* cost of goods sold during periods of rising prices because the last items bought, which are the most expensive, are the first items sold resulting in a higher cost of goods sold.

Question #52 of 111

Question ID: 462000

Which of the following is *least likely* to be a result of using last in, first out (LIFO) as the inventory method during periods of decreasing prices compared to using first in, first out (FIFO)?

✗ **A) Lower COGS.**

✗ **B)** Higher taxes.

✓ **C)** Higher cash flows.

Explanation

Using LIFO during periods of declining prices will result in lower cash flows because net income will be higher than if FIFO is used leading to more taxes being paid out.

Question #53 of 111

Question ID: 461990

In an inflationary environment, a company's:

✓ **A) assets will be lower if it uses last in, first out (LIFO) as opposed to FIFO.**

✗ **B)** COGS sold will be lower if it uses LIFO as opposed to FIFO.

✗ **C)** net income will be larger if it uses LIFO than if it uses FIFO.

Explanation

In an inflationary period, assets will be lower under LIFO since the last, higher priced items are charged to the income statement.

Question #54 of 111

Question ID: 462017

Which of the following is *least likely* to happen after a last in, first out (LIFO) liquidation in an environment of rising prices?

✗ **A) Increase taxable income.**

✗ **B)** Increase gross income.

✓ **C)** Increase cost of goods sold (COGS).

Explanation

In a LIFO liquidation, a firm allows inventory to decrease so that it is using lower-cost materials (purchased in the past). This will lower the COGS and increase income and profit. This is one of the ways that a firm's management can manipulate earnings.

Question #55 of 111

Question ID: 461976

Which of the following statements is *least* accurate?

✗ **A) In a period of rising prices, LIFO gives the best COGS, whereas FIFO gives the best inventory balance on the balance sheet.**

✗ **B)** LIFO produces a tax benefit in a period of rising prices, therefore results in higher cash flows than FIFO.

✓ **C)** In a period of rising prices, FIFO gives the best COGS, whereas LIFO gives the best inventory balance on the balance sheet.

Explanation

If prices are rising steadily, FIFO inventory is valued at the more recent purchase prices which are higher and provide a better estimate of the replacement value of the inventory. LIFO costing will produce a cost of goods sold much closer to replacement cost which provides a better estimate than using FIFO.

Question #56 of 111

Question ID: 462034

Selected financial data from Krandall, Inc.'s balance sheet for the year ended December 31 was as follows (in $):

Cash	$1,100,000	Accounts Payable	$400,000
Accounts Receivable	300,000	Deferred Tax Liability	700,000
Inventory	2,400,000	Long-term Debt	8,200,000
Property, Plant & Eq.	8,000,000	Common Stock	1,000,000
Total Assets	11,800,000	Retained Earnings	1,500,000
LIFO Reserve at Jan. 1	600,000	Total Liabilities & Equity	11,800,000
LIFO Reserve at Dec. 31	900,000		

Krandall uses the last in, first out (LIFO) inventory cost flow assumption. The tax rate is 40%. If Krandall used first in, first out (FIFO) instead of LIFO and paid any additional tax due, its assets-to-equity ratio would be *closest to:*

✓ **A) 4.06**

✗ **B)** 3.73

✗ **C)** 4.18

Explanation

With FIFO instead of LIFO:

- Inventory would be higher by $900,000, the amount of the ending LIFO reserve.
- Cumulative pretax income would also be higher by $900,000, so taxes paid would be higher by 0.40($900,000) = $360,000. Therefore cash would be lower by $360,000.
- Cumulative retained earnings would be higher by (1 − 0.40)($900,000) = $540,000.

So assets under FIFO would be $11,800,000 + $900,000 - $360,000 = $12,340,000 and equity would be $1,000,000 + $1,500,000 + $540,000 = $3,040,000. The assets-to-equity ratio would be $12,340,000 / $3,040,000 = 4.06.

Question #57 of 111

Question ID: 414468

During periods of declining prices, which inventory method would result in the *highest* net income?

✓ **A) LIFO.**

✗ **B)** Average Cost.

✗ **C)** FIFO.

Explanation

When prices are declining and LIFO is used the COGS is smaller than if FIFO is used leading to a larger net income.

Question #58 of 111

Question ID: 462018

A firm ended the last period with inventory of $4.0 million and a last in, first out (LIFO) reserve of $175,000. During the year, it made purchases of $2.0 million and reported sales of $5.5 million with a gross margin of 0.32. At the end of the year, it reported a LIFO reserve of $75,000. What is the value of the firm's cost of goods sold (COGS) on a first in, first out (FIFO) basis?

✓ **A) $3,840,000.**

✗ **B)** $3,740,000.

✗ **C)** $3,640,000.

Explanation

With sales of $5.5 million and a gross margin of 0.32, the COGS (on a LIFO basis) is $3.74 million. In order to convert COGS to a FIFO basis, we need to subtract the change in LIFO reserve during the year: $3,740,000 − ($75,000 − $175,000) = $3,840,000.

Question #59 of 111

Question ID: 414473

Using the lower of cost or market principle under U.S. GAAP, if the market value of inventory falls below its historical cost, the minimum value at which the inventory can be reported in the financial statements is the:

✗ **A) net realizable value minus selling costs.**

✗ **B)** net realizable value.

✓ **C)** market price minus selling costs minus normal profit margin.

Explanation

When inventory is written down to market, the replacement cost of the inventory is its market value, but the "market value" must fall between net realizable value (NRV) and NRV less normal profit margin. NRV is the market price of the inventory less selling costs. Therefore the minimum value is the market price minus selling costs minus normal profit margin.

Question #60 of 111

Question ID: 462024

If a company using last in, first out (LIFO) reports an inventory balance of $22,000 and a LIFO reserve of $4,000 (assume a 40% effective tax rate), the estimated value for the inventory on a first in, first out (FIFO) basis would be:

✗ **A) $24,400.**

✓ **B)** $26,000.

✗ **C)** $18,000.

Explanation

FIFO INV = LIFO INV + LIFO Reserve

X = 22,000 + 4,000

X = 26,000

The effective tax rate is not used in this calculation.

Questions #61-66 of 111

Inventory transaction information for a manufacturing firm is provided chronologically below.

Purchases	*Sales*
20 units at $50	15 units at $60
35 units at $40	35 units at $45
85 units at $30	85 units at $35

Assume that beginning inventory was zero.

Question #61 of 111

Question ID: 461979

Inventory value at the end of the period using the average cost method is *closest to*:

✗ **A) $4,680.**

✓ **B)** $177.

✗ **C)** $1,540.

Explanation

Average Cost = Cost of Goods Available / Total Units Available

Average Cost = $4,950 / 140 = $35.36

EOP Inventory Value = $35.36 × 5 = $176.79

(LOS 17.a)

Question #62 of 111

Question ID: 461980

Inventory value at the end of the period if using FIFO is *closest to*:

✗ **A) $1,200.**

✗ **B)** $175.

✓ **C)** $150.

Explanation

(Units purchased minus units sold) times cost = EOP value
(140 - 135) × $30 = $150

(LOS 17.a)

Question #63 of 111

Question ID: 461981

Inventory value at the end of the period if using LIFO, is *closest to*:

✗ **A) $1,200.**

✓ **B)** $250.

✗ **C)** $2,400.

Explanation

5 × $50 = $250. Under LIFO we assume that the inventory items purchased or manufactured most recently are sold first, so the items remaining in inventory are assumed to be the oldest items purchased or manufactured. (LOS 17.a)

Question #64 of 111

Question ID: 461982

The change in LIFO reserve during the year is *closest to*:

✗ **A) $250.**

✗ **B)** $100.

✓ **C)** −$100.

Explanation

LIFO reserve (ending)= $INV_{FIFO} - INV_{LIFO} = 150 - 250 = -100$. Beginning LIFO reserve = 0 (there is no beginning inventory). Change in LIFO reserve = −100 − 0 = −100. (LOS 17.b)

Question #65 of 111

Question ID: 461983

For this question only, assume that the tax rate is 30%. The cost of goods sold (COGS) under LIFO is *closest to*:

✗ **A) $4,800.**

✗ **B)** $4,950.

✓ **C)** $4,700.

Explanation

Number of units sold during the year = 15 + 35 + 85 = 135.
LIGO COGS = (85 × 30) + (35 × 40) + (15 × 50) = 4,700.

(LOS 17.a)

Question #66 of 111

Question ID: 461984

Reversal of previous inventory write-downs may occur under:

✗ **A) Neither U.S. GAAP nor IFRS.**

✗ **B)** U.S. GAAP but not under IFRS.

✓ **C)** IFRS but not under U.S. GAAP.

Explanation

Reversal of previous inventory write-downs may occur under IFRS but is not allowed under U.S. GAAP. (LOS 17.d)

Question #67 of 111

Question ID: 461970

Which of the following statements about inventory accounting is *least* accurate?

✗ **A) During periods of rising prices, last in, first out (LIFO) income will be lower than under first in, first out (FIFO) but cash flows will be higher.**

✓ **B)** During periods of rising prices, first in, first out (FIFO) based current ratios will be smaller than last in, first out (LIFO) based current ratios.

✗ **C)** If a U.S. firm uses last in, first out (LIFO) for tax reporting it must use LIFO for financial reporting.

Explanation

During periods of rising prices, FIFO based current ratios will be *larger* than LIFO based current ratios because the more expensive units (last purchases) are assigned to ending inventory, resulting in greater current assets.

Question #68 of 111

Question ID: 461993

A firm's financial statements reflect the following information:

Beginning inventory	$2,900,000
Purchase during the year	$1,600,000
Ending inventory	????
Sales	$3,900,000
Gross Margin	0.41

What was the firm's ending inventory for this period?

✗ **A) $1,699,000.**

✓ **B)** $2,199,000.

✗ **C)** $2,799,000.

Explanation

First we can determine the cost of goods sold (COGS) by: COGS = sales (1 − gross margin) = $2,301,000.
Then, the ending inventory = beginning inventory + purchases − COGS = $2,199,000.

Question #69 of 111

Question ID: 462007

Given the following data:

- Beginning LIFO Reserve $2,300
- Cost of Goods Sold (COGS) using LIFO $6,100
- COGS using FIFO of $4,300

What is the Ending LIFO reserve?

✗ **A) $500.**

✗ **B)** $2,800.

✓ **C)** $4,100.

Explanation

Ending LIFO Reserve = (LIFO COGS − FIFO COGS) + Beginning LIFO Reserve = (6,100 − 4,300) + 2,300 = $4,100.

Question #70 of 111

Question ID: 414469

During periods of decreasing prices, a firm using a periodic inventory system will report higher gross profit if its inventory cost assumption is:

✓ **A) LIFO because during periods of decreasing prices, COGS will be lower, resulting in a higher gross profit.**

✗ **B)** FIFO because during periods of decreasing prices, COGS will be higher, resulting in a higher gross profit.

✗ **C)** FIFO because during periods of decreasing prices, COGS will be lower, resulting in a higher gross profit.

Explanation

In periods of falling prices, LIFO results in lower COGS, and therefore higher gross profit than FIFO, because LIFO assumes the most recently purchased (lower cost) goods are sold first.

Question #71 of 111

Question ID: 462048

If all else holds constant in periods of rising prices and inventory levels:

✗ **A) FIFO firms have higher debt to equity ratios than LIFO firms do.**

✓ **B)** FIFO firms will have greater stockholder's equity than LIFO firms do.

✗ **C)** LIFO firms have higher gross profit margins than FIFO firms do.

Explanation

The FIFO method of inventory accounting assigns the cost of the earliest units acquired to goods transferred out and the cost of most recent acquisitions to ending inventory. *When prices are rising*, the *cheaper goods in beginning inventory reflecting earlier purchases are assigned to COGS* (hence, higher income and higher shareholder's equity through retained earnings.)

Explanations for other choices:

In periods of rising prices and inventory levels (all else constant):

- FIFO firms have *lower debt to equity* ratios than LIFO firms do because stockholder's equity is higher and debt is constant.
- LIFO firms have *lower gross profit margins* ((Sales-COGS)/Sales) because the more expensive last purchases are assigned to COGS, lowering the numerator.

Question #72 of 111

Question ID: 462054

During periods of rising prices:

✗ **A) LIFO Gross Profit Margin > FIFO Gross Profit Margin.**

✗ **B)** LIFO Inventory Turnover < FIFO Inventory Turnover.

✓ **C)** LIFO Debt to Equity Ratio > FIFO Debt to Equity Ratio.

Explanation

FIFO inventory, and therefore FIFO assets and equity, will be higher by the LIFO reserve.

Question #73 of 111

Question ID: 462016

The Baker Company uses the last in, first out (LIFO) inventory valuation method and reported its inventory at $200,000 and its cost of goods sold (COGS) at $500,000. The company's LIFO reserve increased from $5,000 to $30,000 during the year. What amounts would the company report for ending inventory and cost of goods sold if it were to use the first in, first out (FIFO) method?

	Ending Inventory	COGS
✗ **A)**	**$170,000**	**$525,000**
✗ **B)**	$230,000	$525,000
✓ **C)**	$230,000	$475,000

Explanation

Ending inventory under FIFO is equal to LIFO ending inventory + LIFO reserve

= 200,000 + 30,000 = 230,000

COGS under FIFO equals LIFO COGS − (ending LIFO reserve − beginning LIFO reserve)

= 500,000 − (30,000 − 5,000) = 475,000.

Question #74 of 111

Question ID: 462015

Under last in first out (LIFO) accounting during periods of inflation, when a firm sells a greater quantity of its inventory than it

produces or acquires, the result is:

- ✗ **A) lower earnings.**
- ✓ **B)** an understatement of the cost of goods sold (COGS).
- ✗ **C)** an increase in the LIFO reserve.

Explanation

This is a LIFO liquidation which refers to a declining inventory balance (the units available for sale are declining). In this case the prices for goods that are being sold are no longer recent prices and can be many years out of date. This would make COGS appear to be very low and gross and net profits to be artificially high.

Question #75 of 111

Question ID: 414482

When analyzing profitability ratios, which inventory accounting method is preferred?

- ✗ **A) First in, first out (FIFO).**
- ✓ **B)** Last in, first out (LIFO).
- ✗ **C)** Weighted average.

Explanation

Using LIFO cost of goods sold (COGS) gives a more accurate measure of future earnings because the LIFO COGS is more representative of the current cost of product sold as compared to using FIFO therefore net income will be more accurately represented.

Question #76 of 111

Question ID: 462050

Which of the following statements regarding inventory accounting methods is *most* accurate? In periods of:

- ✗ **A) rising prices and stable unit purchases, using the FIFO method results in higher inventory turnover than the LIFO method.**
- ✓ **B)** rising prices and stable unit purchases, using the LIFO method results in a lower current ratio than the FIFO method.
- ✗ **C)** declining prices FIFO results in higher net income than LIFO.

Explanation

In periods of rising prices LIFO results in lower current assets because the ending inventory is based on inventory items that were purchased first at a lower price.

Question #77 of 111

Question ID: 462009

The formula to convert an ending inventory value from the LIFO to the FIFO method is to:

✓ **A) FIFO inventory = LIFO inventory + LIFO reserve.**

✗ **B)** FIFO inventory = LIFO inventory × LIFO reserve.

✗ **C)** FIFO inventory = LIFO inventory − LIFO reserve.

Explanation

The formula to convert an ending inventory value from the LIFO to the FIFO method is to FIFO inventory = LIFO inventory + LIFO reserve.

Question #78 of 111

Question ID: 462013

Pischke Motors provided you with the following financials:

- Beginning LIFO reserve $2,484.
- Cost of goods sold (COGS) using LIFO $3,988.
- COGS using FIFO $2,004.

What is the ending LIFO reserve?

✓ **A) $4,468.**

✗ **B)** $500.

✗ **C)** $1,984.

Explanation

Ending LIFO reserve = (LIFO COGS − FIFO COGS) + Beginning LIFO reserve
= ($3,988 − $2,004) + $2,484
= $4,468

Question #79 of 111

Question ID: 462010

If a firm has a first in, first out (FIFO) inventory of 9,000 and a last in, first out (LIFO) inventory of 6,500, what is the value of the LIFO reserve assuming a 40% tax rate?

✗ **A) $1,000**

✓ **B)** $2,500.

✗ **C)** $1,500.

Explanation

LIFO reserve = FIFO inventory − LIFO inventory = 9,000 − 6,500 = 2,500

Question #80 of 111

Question ID: 414465

For balance sheet purposes, inventories based on:

✗ **A) LIFO are preferable to those based on FIFO, as they more closely reflect the current costs.**

✗ **B)** LIFO are preferable to those based on average cost, as they more closely reflect the current costs.

✓ **C)** FIFO are preferable to those based on LIFO, as they more closely reflect current costs.

Explanation

The inventories based on FIFO are preferable to those presented under LIFO or average cost for balance sheet purposes. Under FIFO, the older inventories are taken out first, and the ending inventory balance consists of the recent purchases and thus most closely reflect the current (economic) value.

Question #81 of 111

Question ID: 461986

An analyst provided the following information about a company:

- Purchases throughout the year $55,000
- COGS $60,000
- Ending inventory $35,000

The beginning inventory was:

✓ **A) $40,000.**

✗ **B)** $55,000.

✗ **C)** $45,000.

Explanation

COGS of $60,000 + ending inventory of $35,000, less purchases of $55,000.

Question #82 of 111

Question ID: 462043

Selected information from Mendota, Inc.'s financial statements for the year ended December 31 includes the following (in $):

Sales	7,000,000
Cost of Goods Sold	5,000,000
LIFO Reserve on Jan. 1	600,000
LIFO Reserve on Dec. 31	850,000

Mendota uses the last in, first out (LIFO) inventory cost flow assumption. The tax rate is 40%. If Mendota changed from LIFO to first in, first out (FIFO), its gross profit margin would:

✗ **A) increase to 40.1%.**

✗ **B)** increase to 30.0%.

✓ **C)** increase to 32.1%.

Explanation

Gross profit margin under LIFO ((sales - cost of goods sold) / sales) is (($7,000,000 − $5,000,000) / $7,000,000) = 28.6%. Under FIFO, cost of goods sold is reduced by the increase in the LIFO reserve, and the resulting FIFO gross profit margin is (($7,000,000 - ($5,000,000 - ($850,000 - $600,000)) / $7,000,000) = 32.1%. Note that the tax rate only affects income totals after income tax expense is shown and does not affect the gross profit margin.

Question #83 of 111

Question ID: 462027

Granulated Corp. uses the last in, first out (LIFO) inventory cost flow assumption. Selected information from Granulated's financial statements for the years ended December 31, 20X3 and 20X4 was as follows (in $):

	20X3	*20X4*
Beginning Inventory	4,375,000	5,525,000
Purchases	10,200,000	11,300,000
Ending Inventory	5,525,000	6,100,000
Beginning LIFO Reserve	825,000	975,000
Ending LIFO Reserve	975,000	1,125,000

If Granulated changed from LIFO to first in, first out (FIFO) for 20X4, Granulated's cost of goods sold (COGS) in 20X4 under FIFO would be:

✗ **A) $10,325,000.**

✗ **B)** $11,850,000.

✓ **C)** $10,575,000.

Explanation

Granulated's 20X4 LIFO cost of goods sold (beginning inventory plus purchases less ending inventory) was ($5,525,000 + $11,300,000 − $6,100,000 =) $10,725,000. To convert to FIFO the LIFO cost of goods sold would be reduced by the increase in the LIFO reserve during 20X4 ($1,125,000 − $975,000 =) $150,000. The FIFO COGS in 2001 was ($10,725,000 − $150,000 =) $10,575,000.

Question #84 of 111

Question ID: 414448

Given the following inventory data about a firm:

- Beginning inventory 20 units at $50/unit
- Purchased 10 units at $45/unit
- Purchased 35 units at $55/unit
- Purchased 20 units at $65/unit
- Sold 60 units at $80/unit

What is the inventory value at the end of the period using first in, first out (FIFO)?

✗ **A) $3,100.**

✓ **B)** $1,575.

✗ **C)** $3,475.

Explanation

Ending inventory equals 20 + 10 + 35 + 20 − 60 = 25 of last units purchased in inventory.

(20 units)($65/unit) + (5 units)($55/unit) = $1,300 + $275 = $1,575

Question #85 of 111

Question ID: 462032

Premier Corp.'s year-end last in, first out (LIFO) reserve was $2,500,000 in 2000 and $2,300,000 in 2001. Premier's $200,000 decline in the LIFO reserve could be explained by each of the following EXCEPT:

✗ **A) declining inventory prices.**

✗ **B)** a LIFO liquidation occurred.

✓ **C)** the LIFO reserve was being amortized.

Explanation

A decline in the LIFO reserve occurs when the increasing prices that created the reserve begin declining or when the inventory is liquidated (i.e. less units in inventory at the end of the year than at the beginning). LIFO reserves are not amortized.

Question #86 of 111

Question ID: 462011

In a period of rising prices, LIFO liquidation results in:

✗ **A) lower earnings.**

✓ **B)** higher earnings.

✗ **C)** increase in inventory.

Explanation

Since older layers of inventory that are liquidated were purchased at lower prices, the cost of goods sold will be lower and earnings will be higher.

Question #87 of 111

Question ID: 462052

Assume that Hunter Round Restaurant Supply currently uses the last in, first out (LIFO) method to account for inventory and that the business environment is one of rising prices and stable or growing inventory balances. In addition, Hunter Round has an effective tax rate of zero percent due to tax loss carrybacks. All else equal, which of the following statements is *least likely* valid? By using LIFO instead of first in, first out (FIFO), Hunter Round has:

✗ **A) lower net income.**

✗ **B)** lower working capital.

✓ **C)** higher cash flows.

Explanation

In the absence of taxes, there is *no difference* in cash flow between LIFO and FIFO. The other statements are true. *For the examination*, memorize the financial impact of rising *and* falling prices for the two inventory methods.

Question #88 of 111

Question ID: 462022

Selected information from Oldtown, Inc.'s financial statements for the year ended December 31, 2004 included the following (in $):

Cash	1,320,000	Accounts Payable	1,620,000
Accounts Receivable	2,430,000	Deferred Tax Liability	715,000
Inventory	6,710,000	Long-term Debt	15,230,000
Property, Plant & Equip.	12,470,000	Common Stock	1,000,000
Total Assets	22,930,000	Retained Earnings	4,365,000
		Total Liabilities & Equity	22,930,000
Sales	15,000,000		
Net Income	3,000,000		
LIFO Reserve at Jan. 1	1,620,000		
LIFO Reserve at Dec. 31	1,620,000		

Oldtown uses the last in, first out (LIFO) inventory cost flow assumption. The tax rate was 40%. If Oldtown changed from LIFO to first in, first out (FIFO) for 2004, net profit margin would:

✓ **A) remain unchanged at 20.0%.**

✗ **B)** decrease from 20.0 to 16.8%.

✗ **C)** decrease from 20.0 to 13.5%.

Explanation

Net profit margin under LIFO (net income / net sales) was ($3,000,000 / $15,000,000 =) 20.0%. Under FIFO, net income does not change in 2004 because there was no change in the LIFO reserve balance, and no adjustment of net income is made.

Question #89 of 111

Question ID: 462021

Given the following inventory information about the Buckner Company:

- Year-end last in, first out (LIFO) inventory of $6,500.
- Year-end LIFO reserve of $2,500.

- The current year's LIFO cost of goods sold (COGS) is $15,000.
- After tax income is $1,600.
- The previous year's LIFO reserve was $2,000.

How much higher would the firm's retained earnings be on a first in, first out (FIFO) basis if the firm's tax rate is 40%?

✗ **A) $2,100.**

✗ **B)** $1,800.

✓ **C)** $1,500.

Explanation

Adjustment to retained earnings = LIFO reserve (1 − t) = $2,500(1 − 0.4) = $1,500

Question #90 of 111

Question ID: 462046

The *best* way to compute an inventory turnover ratio is to use:

✗ **A) last in, first out (LIFO) for both cost of goods sold (COGS) and average inventory.**

✗ **B)** first in, first out (FIFO) for both cost of goods sold (COGS) and average inventory.

✓ **C)** last in, first out (LIFO) for cost of goods sold (COGS) and first in, first out (FIFO) for average inventory.

Explanation

Inventory turnover makes no sense at all for firms using LIFO due to the mismatching of costs (the numerator is current while the denominator is historical). FIFO based inventory is relatively unaffected by price changes and is a good approximation of actual turnover. In this way, current costs are matched in the numerator and denominator.

Question #91 of 111

Question ID: 462014

M J Inc reported COGS of $80,000 for the year under the LIFO inventory valuation method. M J had a beginning LIFO reserve of $8,000 and an ending LIFO reserve of $11,000. The COGS under the FIFO inventory valuation method is:

✗ **A) $83,000.**

✓ **B)** $77,000.

✗ **C)** $91,000.

Explanation

FIFO COGS is reduced when a LIFO reserve is increased. So, COGS = 80,000 − (11,000 − 8,000) = 77,000.

Question #92 of 111

Question ID: 461999

An analyst notes the following about a company:

- Beginning inventory was reported as $5,000.
- Costs of goods sold were reported as $8,000.
- Ending inventory is $7,000 (the analyst has physically verified this amount).

Which of the following statements is *most* accurate?

✗ **A) Purchases must have been $6,000.**

✗ **B)** If the analyst discovered that beginning inventory was overstated by $1,000, then cost of goods sold must have been understated by $1,000.

✓ **C)** If the analyst discovered that beginning inventory was understated by $2,000, then earnings before taxes must have been overstated by $2,000.

Explanation

If inventory is overstated then COGS must also be overstated or purchases were understated, since you are told that ending inventory is ok.

Question #93 of 111

Question ID: 462025

The formula to convert cost of goods sold (COGS) from last in, first out (LIFO) to first in, first out (FIFO) is:

✗ **A) COGS FIFO = COGS LIFO + beginning LIFO reserve.**

✓ **B)** COGS FIFO = COGS LIFO - change in the LIFO reserve.

✗ **C)** COGS FIFO = COGS LIFO + change in the LIFO reserve.

Explanation

The formula for converting COGS from LIFO to FIFO is $COGS_F = COGS_L - (\text{LIFO reserve}_E - \text{LIFO reserve}_B)$

Question #94 of 111

Question ID: 462047

Selected information from Newcomb, Inc.'s financial statements for the year ended December 31, 20X4 included the following (in $):

Cash	70,000	Accounts Payable	90,000
Accounts Receivable	140,000	Deferred Tax Liability	100,000
Inventory	460,000	Long-term Debt	520,000
Property, Plant & Equip.	1,200,000	Common Stock	600,000
Total Assets	1,870,000	Retained Earnings	360,000
		Total Liabilities & Equity	1,870,000
Earnings Before Interest and Taxes	280,000		
Interest Expense	60,000		

Income Tax Expense	75,000
Net Income	145,000
LIFO Reserve at Jan. 1	185,000
LIFO Reserve at Dec. 31	250,000

If Newcomb had used first in, first out (FIFO) for 20X4 and we assume that average total capital was $1,700,000 for both the LIFO and FIFO computations, the return on total capital would:

✗ **A) remain unchanged at 16.5%.**
✗ **B)** decrease from 16.5 to 12.6%.
✓ **C)** increase from 16.5 to 20.3%.

Explanation

The return on total capital under LIFO (EBIT / average total capital) was $280,000 / $1,700,000 = 16.5%. Under FIFO, EBIT is increased by the increase in the LIFO reserve during the year. FIFO return on total capital is ($280,000 + ($250,000 − $185,000)) / $1,700,000 = 20.3%.

Question #95 of 111

Question ID: 462042

In periods of rising prices and stable or increasing inventory quantities, using the LIFO method for inventory accounting compared to FIFO will have:

✗ **A) higher COGS, lower income, lower cash flows, and lower inventory.**
✓ **B)** higher COGS, lower income, higher cash flows, and lower inventory.
✗ **C)** lower COGS, higher income, identical cash flows, and lower inventory.

Explanation

In periods of rising prices and stable or increasing inventory quantities, the LIFO method - as compared with FIFO - will result in higher COGS, lower taxes, lower net income, lower inventory balances, lower working capital, and higher cash flows.

Question #96 of 111

Question ID: 462063

Jim Banaji, credit analysts for HEQ, a fixed income fund, is evaluating three bonds. One of the bonds, issue by Prime Inc, a large printing and packaging company, has six years remaining to maturity and has limited liquidity in the market. While evaluating the financial statements of Prime, Banaji notices the following:

Excerpts (Financial statements for years 20X9 and 20X8)

($'000)	20X9	20X8
Sales	11300	10800
ROE	12%	11.6%
R&D expense	288	381
Inventory:		

Finished goods	492	368
Raw Materials	329	324
Dividends	144	132

Based on the information gathered, which of the following conclusions are *most likely?*

✓ **A) Sales are expected to decrease in the future or grow at a slower pace.**

✗ **B)** Sales are expected to grow at a more rapid pace in the future.

✗ **C)** Profits are expected to grow at a more rapid pace.

Explanation

Sales are expected to grow at a slower pace (or decrease). This is evidenced by growth in finished goods inventory accompanied with a stable raw materials inventory (as a proportion of sales).

Question #97 of 111

Question ID: 462005

GR Corporation uses the last-in, first out (LIFO) method of accounting for inventory and $70,000 is reported as cost of goods sold (COGS) on their income statement. However, if GR had used first-in, first-out (FIFO), the COGS would have been $60,000. If the ending LIFO reserve (LR) reported in the financial statements is $40,000, the beginning LIFO reserve is:

✗ **A) $50,000.**

✓ **B)** $30,000.

✗ **C)** $20,000.

Explanation

Beginning LR + ΔLR = Ending LR

ΔLR = COGS(LIFO) - COGS(FIFO) = $70,000 - 60,000 = $10,000

Beginning LR = $40,000 - 10,000 = $30,000

Question #98 of 111

Question ID: 414456

	Units	*Unit Price*
Beginning Inventory	709	$2.00
Purchases	556	$6.00
Sales	959	$13.00
Sales Expenses	$2,649 per annum	

Ignoring taxes, what is profit using the weighted average method?

✗ **A) $5,676.00.**

✗ **B)** $6,027.56.

✓ **C)** $6,213.98.

Explanation

weighted average cost per unit = (709 units)($2/unit) + (556 units)($6/unit) = $4,754 / 1,265units = $3.7581

weighted average COGS = ($3.7581)(959 units) = $3,604.02

Sales = (959 units)($13/unit) = $12,467

Profit = Sales − COGS − Sales Expenses = 12,467 − 3,604.02 − 2,649 = $6,213.98

Question #99 of 111

Question ID: 461973

While attending a local university, CFA candidate Anjolie Webster accepts a temporary position with a small manufacturing firm. Currently, the firm uses LIFO to account for inventory, but the owner is "just curious" about how the financial results would look if the company used FIFO. The owner hands Webster a photocopy of the inventory data for the current period (summarized below).

- Beginning inventory of 1,000 units at $30 cost.
- Ending inventory of 800 units.
- Sales of 1,100 units.
- Three inventory purchases (listed from earliest purchase to latest purchase): 400 units at $27 each, 300 units at $25 each, and an unreadable number of units at $22 each. (Unfortunately, when the owner copied the original document, he left a yellow sticky note covering some of the inventory information.)
- Current assets (less inventory) of $75,000.
- Current liabilities of $65,000.

Using the information provided, determine which of the following statements is *least* accurate? All else equal, compared to LIFO, using FIFO would result in:

✓ **A) a current ratio of approximately 1.60.**

✗ **B)** a lower ending inventory balance.

✗ **C)** a lower gross margin.

Explanation

To calculate the current ratio (which includes the ending inventory balance) using FIFO, we first need to determine how many units were purchased in the third illegible purchase order.

Ending inventory = beginning inventory + units purchased - units sold, so
units purchased = units sold + ending inventory - beginning inventory
= 1,100 + 800 - 1,000 = 900
Third purchase units = 900 - 400 - 300 = 200

- FIFO ending inventory = [(300 × 27) + (300 × 25) + (200 × 22)] = $20,000
- FIFO current ratio (all else equal) = (75,000 + 20,000) / 65,000 = approximately **1.46**

The other choices are correct. Since prices are *decreasing*, FIFO cost of goods sold is higher (and gross margin is lower) than LIFO. And, FIFO ending inventory is lower than LIFO ending inventory. No LIFO calculations are necessary.

Question #100 of 111

Question ID: 461974

Which of the following is *least likely* part of the basic inventory equation?

- ✓ **A) Beginning inventory − ending inventory − cost of goods sold = purchases.**
- ✗ **B)** Beginning inventory + purchases = ending inventory + cost of goods sold.
- ✗ **C)** Purchases − ending inventory + beginning inventory = cost of goods sold.

Explanation

To solve for purchases the basic inventory equation would then be: ending inventory + COGS − beginning inventory = purchases.

Question #101 of 111

Question ID: 461975

Sweet Milk Inc uses the last in, first out (LIFO) inventory method and had 5,000 units of beginning inventory on January 1, 2002, that was valued at $10.00 a unit. The company purchased 50,000 units at $12 a unit and sold 52,000 units at $15 a unit. Sweet Milk is considering an additional purchase of 10,000 units at $13 a unit. The company will make the purchase at the end of December or in the early part of year 2003. Which statement about the effect of the purchase decision on net income is *most* accurate?

- ✗ **A) Income for year 2002 will not be affected no matter when the inventory is purchased.**
- ✓ **B)** Postponing the purchase until January will increase income for 2002 by $14,000.
- ✗ **C)** Making the purchase in December will increase income by $16,000 in year 2002.

Explanation

By postponing the purchase until January, cost of goods sold (COGS) would be $620,000. A purchase in December would increase COGS to $634,000.

COGS for January purchase = (50,000 × 12) + (2,000 × 10) = 620,000

COGS for December purchase = (10,000 × 13) + (42,000 × 12) = 634,000

Question #102 of 111

Question ID: 461996

Jefferson Corp. decided to change its inventory valuation method from first in, first out (FIFO) to last in, first out (LIFO) in a period of rising prices. What was the result of the change for the ending inventory and net income?

	Ending Inventory	Net Income
✗ **A)**	**Increases**	**Increases**
✗ **B)**	Decreases	Increases
✓ **C)**	Decreases	Decreases

Explanation

LIFO provides the lowest inventory values and the lowest net income under rising prices because the least expensive purchases are left in inventory and the more expensive purchases flow to cost of goods sold (COGS) which lowers net income.

Question #103 of 111

Question ID: 461988

During inflationary periods, which of the following statements is CORRECT?

✗ **A) LIFO will generate lower earnings, but lower after tax cash flows.**

✗ **B)** LIFO will generate higher earnings, but lower after tax cash flows.

✓ **C)** FIFO will generate higher earnings, but lower after tax cash flows.

Explanation

During inflation, FIFO will generate higher earnings because cost of goods will be lower than if LIFO was used. However, LIFO will generate higher cash flows since cash outflows for taxes will be lower for LIFO.

Question #104 of 111

Question ID: 461987

Which is the preferred inventory method for purposes of analysis and which is the preferred method for reporting cost of goods sold?

	Inventory Analysis	COGS
✓ **A)**	**FIFO**	**LIFO**
✗ **B)**	LIFO	FIFO
✗ **C)**	LIFO	LIFO

Explanation

FIFO is the preferred inventory method for purposes of analysis and LIFO is the preferred method for reporting cost of goods sold.

Question #105 of 111

Question ID: 414466

During periods of rising prices and stable or growing inventories, the most informative inventory accounting method for income statement purposes is:

✗ **A) FIFO because it allocates historical prices to cost of good sold (COGS) and provides a better measure of current income.**

✓ **B)** LIFO because it allocates current prices to cost of good sold (COGS) and provides a better measure of current income.

✗ **C)** weighted average because it allocates average prices to cost of good sold (COGS) and provides a better measure of current income.

Explanation

LIFO is the most informative inventory accounting method for income statement purposes in periods of rising prices and stable or growing inventories. It allocates the most recent purchase prices to COGS, and thus provides a better measure of current income and future profitability.

Question #106 of 111

Question ID: 461994

In 2004, Torrence Co. had a beginning inventory of $19,924 and made purchases of $15,923. If the ending inventory level was $19,204, what was the cost of goods sold (COGS) for year 2004?

✗ **A) $15,923.**

✓ **B)** $16,643.

✗ **C)** $15,203.

Explanation

Beginning Inventory + Purchases − Ending Inventory = COGS
$19,924 + $15,923 − $19,204 = $16,643

Question #107 of 111

Question ID: 462033

Moore Ltd. uses the LIFO inventory cost flow assumption. Its cost of goods sold in 20X8 was $800. A footnote in its financial statements reads: "Using FIFO, inventories would have been $70 higher in 20X8 and $80 higher in 20X7." Moore's COGS if FIFO inventory costing were used in 20X8 is *closest to*:

✓ **A) $810.**

✗ **B)** $790.

✗ **C)** $730.

Explanation

The ending LIFO reserve is $70 and the beginning LIFO reserve is $80.

FIFO COGS = LIFO COGS − (ending LIFO reserve − beginning LIFO reserve)

$800 − ($70 − $80) = $810

Question #108 of 111

Question ID: 462019

A firm ended the last period with inventory of $3.0 million and a last in, first out (LIFO) reserve of $40,000. During the year, it made purchases of $1 million and reported sales of $4 million with a gross margin of 0.58. At the end of the year, it reported a LIFO reserve of $75,000. What is the value of the firm's ending inventory converted to a first in, first out (FIFO) basis?

✗ **A) $2,360,000.**

✓ **B)** $2,395,000.

✗ **C)** $2,320,000.

Explanation

With sales of $4 million and a gross margin of 0.58, the COGS (on a LIFO basis) is 1.68 million. This would leave an ending inventory of 3 million + 1 million − 1.68 million = $2.32 million on a LIFO basis. In order to adjust this to FIFO, we would add the ending LIFO reserve of $75,000 to arrive at $2.395 million.

Question #109 of 111

Question ID: 461998

Which of the following inventory accounting methods must be used for financial reporting purposes if a U.S. firm uses last in, first out (LIFO) for tax purposes?

✗ **A) The firm may use any of the above methods.**

✗ **B)** FIFO.

✓ **C)** LIFO.

Explanation

If a U.S. firm uses LIFO for tax purposes, it must also use LIFO for financial reporting purposes, according to U.S. tax law.

Question #110 of 111

Question ID: 462002

Brigham Corporation uses the last-in, first-out (LIFO) method of accounting for inventory. For the year 2005, the following is provided:

- Cost of goods sold (COGS): $24,000
- Beginning inventory: $6,000
- Ending inventory: $7,500
- The notes accompanying the financial statements indicate that the LIFO reserve at the beginning of the year was $2,250 and at the end of the year was $6,000

If Brigham had used first-in, first-out (FIFO), the COGS for 2005 would be:

✓ **A) $20,250.**

✗ **B)** $3,750.

✗ **C)** $29,250.

Explanation

FIFO COGS = LIFO COGS − change in LIFO reserve. Therefore, $24,000 − ($6,000 − 2,250) = $20,250.

Question #111 of 111

Question ID: 414452

Given the following data and assuming a periodic inventory system, what is the ending inventory using the average cost method?

Purchases	*Sales*

40 units at $60/unit	25 units at $65/unit
50 units at $55/unit	30 units at $60/unit
60 units at $45/unit	40 units at $50/unit

✗ **A) $3,141.**

✗ **B)** $2,933.

✓ **C)** $2,878.

Explanation

Average cost per unit purchased:

40 units at $60/per unit = $2,400
50 units at $55/per unit = $2,750
60 units at $45/per unit = $2,700

Total = 150 units = $7,850

Average cost per unit = $7,850 /150 units = $52.33/unit

Purchased 40 + 50 + 60 = 150 units. Sold 25 + 30 + 40 = 95

Ending inventory = 150 − 95 = 55 units × $52.33/unit = $2,878