

Question #1 of 89

United Corporation and Intrepid Company are similar firms operating in the same industry. United follows U.S. Generally Accepted Accounting Principles and Intrepid follows International Financial Reporting Standards. At the end of last year, Intrepid had a higher inventory turnover ratio than United. Are the following plausible explanations for the difference?

Explanation #1 – United accounts for its inventory using the first-in, first-out method and Intrepid uses the last-in, first-out method.

Explanation #2 – United recognized an upward valuation of inventory that had been previously written down. Intrepid does not revalue its inventory upward.

	<u>Explanation #1</u>	<u>Explanation #2</u>	
A) No	No		✓
B) No	Yes		✗
C) Yes	No		✗

Explanation

While the LIFO firm will typically report lower average inventory (higher inventory turnover), Intrepid cannot be a LIFO firm because LIFO is not permitted under IFRS. An upward revaluation of inventory would lower the inventory turnover ratio; however, United cannot revalue its inventory upward because it follows U.S. GAAP. U.S. GAAP prohibits upward inventory revaluations (except in very limited circumstances which are beyond the scope of the Level I exam).

(Study Session 8, Module 27.5, LOS 27.I)

Question #2 of 89

Which of the following statements about inventory presentation and disclosures is *most* accurate?

- A) Changing from FIFO to LIFO is a change in accounting principle that must be applied retrospectively. ✗
- B) An analyst must determine which inventory cost method was used by examining the firm's current and historical inventory values. ✗
- C) IFRS permits reversals of inventory writedowns but the firm must disclose the circumstances of the reversal in its financial statements. ✓




Explanation

IFRS requires a firm that reverses an inventory writedown to discuss the circumstances that led to the reversal. Both IFRS and U.S. GAAP require firms to disclose the inventory cost flow method they use. While a change to LIFO from another inventory cost method is a change in accounting principle, under U.S. GAAP this change is not applied retrospectively. The carrying value of inventory is considered to be the first LIFO layer.

(Study Session 8, Module 27.4, LOS 27.i)

Question #3 of 89

For balance sheet purposes, inventories based on:

- A) LIFO are preferable to those based on average cost, as they more closely reflect the current costs. 
- B) FIFO are preferable to those based on LIFO, as they more closely reflect current costs. 
- C) LIFO are preferable to those based on FIFO, as they more closely reflect the 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.

(Study Session 8, Module 27.5, LOS 27.I)

Question #4 of 89

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) \$3,250. 
- C) \$3,850. 

Explanation

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



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

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

(Study Session 8, Module 27.2, LOS 27.c)

Question #5 of 89

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

- A) weighted average because it allocates average prices to cost of good sold (COGS) and provides a better measure of current income. 
- B) FIFO because it allocates historical prices to cost of good sold (COGS) and provides a better measure of current income. 

C) LIFO because it allocates current 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.

(Study Session 8, Module 27.2, LOS 27.d)

Question #6 of 89

In an inflationary environment, a company's:

A) net income will be larger if it uses LIFO than if it uses FIFO.



B) assets will be lower if it uses LIFO than if it uses FIFO.



C) Cost of goods sold will be lower 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.

(Study Session 8, Module 27.2, LOS 27.d)

Question #7 of 89

Given the following data on a firm's inventory, purchases, and sales:

	Units	Unit Price
Beginning Inventory	559	\$1.00
Purchases	785	\$5.00
Sales	848	\$15.00

Ending inventory using the first in, first out (FIFO) method is:

A) \$3,988.



B) \$2,480.



C) \$2,356.



Explanation

Because unit sales exceeded beginning inventory, all the units in ending inventory will be valued at the \$5 cost of this period's purchases. Units remaining in inventory = $(559 + 785) - 848 = 496$. Ending inventory = $496 \times \$5 = \$2,480$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #8 of 89

The *most likely* effect of a write-down of inventory to net realizable on a firm's total asset turnover is:

- A) no change.
- B) a decrease.
- C) an increase.



Explanation

Total asset turnover is revenue divided by total assets. Writing down inventory to NRV decreases total assets and has no effect on revenue. As a result, total asset turnover increases.

(Study Session 8, Module 27.4, LOS 27.h)

Question #9 of 89

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

- A) Last in, first out (LIFO).
- B) First in, first out (FIFO).
- 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.

(Study Session 8, Module 27.5, LOS 27.k)

Question #10 of 89

In an increasing price environment, what effect does a LIFO liquidation have on a firm's gross profit?

- A) Increase.
- B) Decrease.
- C) No effect.



Explanation

In an increasing price environment, a LIFO liquidation increases gross profit because COGS includes older inventory layers of units at a cost lower than their current (replacement) cost. This increase is unsustainable because a firm can only sell from inventory until it is exhausted.

(Study Session 8, Module 27.3, LOS 27.e)

Question #11 of 89

Given the following inventory information about the Buckner Company:

- Year-end LIFO inventory of \$6,500.
- Year-end LIFO reserve of \$2,500.
- The previous year's LIFO reserve was \$2,000.
- The current year's LIFO cost of goods sold (COGS) is \$15,000.
- After-tax income is \$1,600.

How much higher would the firm's retained earnings be on a FIFO basis if the firm's tax rate is 40%?

A) \$2,100.



B) \$1,500.



C) \$1,800.



Explanation

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

(Study Session 8, Module 27.3, LOS 27.f)

Question #12 of 89

First in, first out (FIFO) inventory equals:

A) LIFO cost of goods sold – change in LIFO reserve.



B) LIFO inventory + LIFO reserve.



C) change in LIFO reserve – ending LIFO reserve.



Explanation

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

(Study Session 8, Module 27.3, LOS 27.e)

Question #13 of 89

A company purchased inventory on January 1, 20X2, for \$600,000. On December 31, 20X2, the inventory had a net realizable value (NRV) of \$550,000 and a replacement cost of \$525,000, which is also the NRV less the normal profit margin. What would be the carrying value of the inventory on the company's December 31, 20X2, balance sheet using:

lower of cost or NRV?; lower of cost or market?

A) \$525,000; \$550,000



B) \$525,000; \$525,000



C) \$550,000; \$525,000



Explanation

Lower of cost or NRV is \$550,000. Using lower of cost or market, the replacement cost of \$525,000 would be used because it is below NRV and equal to the NRV less the normal profit margin.

(Study Session 8, Module 27.4, LOS 27.g)

Question #14 of 89

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.

$$\text{FIFO COGS} = \text{LIFO COGS} - (\text{ending LIFO reserve} - \text{beginning LIFO reserve})$$

$$\$800 - (\$70 - \$80) = \$810$$

(Study Session 8, Module 27.3, LOS 27.f)

Question #15 of 89

Given the following data on a firm's inventory, purchases, and sales:

	Units	Unit Price
Beginning Inventory	559	\$1.00
Purchases	785	\$5.00
Sales	848	\$15.00

Cost of goods sold using the weighted average cost method is *closest* to:

A) \$2,830.



B) \$2,000.



C) \$3,990.



Explanation




$$\text{Weighted average cost} = [559(\$1) + 785(\$5)] / (559 + 785) = \$3.3363$$

$$\text{COGS} = \text{Units sold} \times \text{weighted average cost} = 848 \times 3.3363 = \$2,829.19$$

(Study Session 8, Module 27.1, LOS 27.c)

Question #16 of 89

For a firm that uses the LIFO inventory cost method, the LIFO reserve is:

- A) a provision for taxes when FIFO is required for tax reporting. 
- B) the difference between LIFO inventory and FIFO inventory. 
- C) the difference between LIFO cost of sales and FIFO cost of sales. 

Explanation

LIFO reserve is the difference between inventory under the LIFO cost method and inventory under the FIFO cost method.

(Study Session 8, Module 27.3, LOS 27.e)

Question #17 of 89

A firm booked revenue of \$2.25 million during 20X6 on unit sales of 150. The replacement cost per unit of inventory is currently \$9,300.

Inventory purchases:

Date	Quantity	Unit Cost
Begin inventory	50 units	\$7,000
4/1/X6	80 units	7,500
7/1/X6	30 units	8,100
10/1/X6	20 units	8,700

Assuming the FIFO inventory costing method and a perpetual inventory system are used, the firm's gross profit and ending inventory are closest to:

- | | <u>Gross profit</u> | <u>Ending inventory.</u> |
|----|---------------------|--------------------------|
| A) | \$1,138,000 | \$255,000 |
| B) | \$1,138,000 | \$279,000 |
| C) | \$1,112,000 | \$279,000 |

Explanation

The table in the problem can be used to tabulate the cost of goods available for sale.

Date	Quantity	Unit Cost	Total Cost
Begin inv.	50 units	× \$7,000	= \$350,000
4/1/X6	80 units	× 7,500	= 600,000
7/1/X6	30 units	× 8,100	= 243,000
10/1/X6	20 units	× 8,700	= 174,000
	180 units		\$1,367,000

Note that COGS and inventory under FIFO are the same under either a perpetual and periodic inventory system.

$$\text{COGS} = \$350,000 + \$600,000 + (20 \times \$8,100) = \$1,112,000$$

$$\text{gross profit} = \text{net sales} - \text{COGS} = \$2,250,000 - \$1,112,000 = \$1,138,000.$$

Ending inventory under FIFO will include the most recently purchased inventory.

$$\text{ending inventory} = \$174,000 + (10 \times \$8,100) = \$255,000.$$

(Study Session 8, Module 27.2, LOS 27.c)

Question #18 of 89

In an environment of increasing prices, the last-in first-out (LIFO) inventory cost method results in:

- A) cost of sales near current cost and inventory below replacement cost.
- B) cost of sales below current cost and inventory above replacement cost.
- C) inventory near replacement cost and cost of sales below current cost.



Explanation

LIFO assumes the most recently purchased items are the first items sold. In an increasing or decreasing price environment, LIFO results in cost of sales that are nearer to current costs compared to other inventory cost methods, and inventory values based on outdated prices (below replacement cost if prices are increasing, above replacement cost if prices are decreasing).

(Study Session 8, Module 27.1, LOS 27.b)

Question #19 of 89

Under which financial reporting standards is a firm required to discuss the circumstances when reversing an inventory writedown?

- A) Both IFRS and U.S. GAAP.
- B) Neither IFRS nor U.S. GAAP.
- C) IFRS, but not U.S. GAAP.



Explanation

Reversals of inventory writedowns are permitted under IFRS but not under U.S. GAAP. If an IFRS reporting firm reverses an inventory writedown, the firm is required to discuss the circumstances of the reversal.

(Study Session 8, Module 27.4, LOS 27.i)

Question #20 of 89

An analyst is comparing a company that uses the LIFO inventory cost method to companies that use FIFO for inventories. The analyst should adjust the LIFO firm's inventories by adding the:

- A) LIFO reserve, net of tax.
- B) LIFO reserve.
- C) change in the LIFO reserve.



Explanation

FIFO inventory equals LIFO inventory plus the LIFO reserve.

(Study Session 8, Module 27.3, LOS 27.f)

Question #21 of 89

A U.S. company uses the LIFO method to value its inventory for their income tax return. For its financial statements prepared for shareholders, the company may:

- A) use the FIFO method, but must disclose a LIFO reserve.
- B) only use the LIFO method.
- C) use any other inventory method under generally accepted accounting principles (GAAP).



Explanation

The LIFO conformity rule in the U.S. requires firms to use LIFO for their financial statements if they use LIFO for income tax purposes.

(Study Session 8, Module 27.1, LOS 27.b)

Question #22 of 89

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

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

(Study Session 8, Module 27.4, LOS 27.j)

Question #23 of 89

The inventory turnover ratio and the number of days in inventory are *least likely* used to evaluate the:

A) effectiveness of a firm's inventory management.



B) age of a firm's inventory.



C) stability of a firm's inventory levels.



Explanation

Neither metric is directly relevant in evaluating the stability of a firm's inventory levels. Determining stability would presumably require other information such as purchase and sales levels, for example. The inventory turnover ratio and the number of days in inventory can be used to evaluate the relative age of a firm's inventory as well as the effectiveness of a firm's inventory management.

(Study Session 8, Module 27.5, LOS 27.k)

Question #24 of 89

Diabelli Inc. is a manufacturing company that is operating at normal capacity levels. Which of the following inventory costs is *most likely* to be recognized as an expense on Diabelli's financial statements when the inventory is sold?

A) Selling cost.



B) Administrative overhead.



C) Allocation of fixed production overhead.






Explanation

Assuming normal capacity levels, allocation of fixed production overhead is a product cost that is capitalized as part of inventory. Thus, this cost will not be recognized as an expense until the inventory is sold (it becomes part of COGS for that period). Administrative overhead and selling costs are period costs that must be expensed in the period incurred.

(Study Session 8, Module 27.1, LOS 27.a)

Question #25 of 89

Which of the following circumstances is *most likely* indicative of an increase in a company's future earnings?

- A) Work-in-process inventory increasing faster than finished goods inventory. 
- B) Finished goods inventory increasing faster than sales. 
- C) Finished goods inventory increasing faster than work-in-process inventory. 

Explanation

Work-in-process inventory increasing faster than finished goods inventory is a likely indicator that a firm expects demand to increase, which should increase future revenues and earnings. Finished goods inventory increasing faster than sales or work-in-process inventory may indicate that demand is decreasing. Analysts should refer to sources such as management's commentary to further examine the reasons for an increase in finished goods inventory.

(Study Session 8, Module 27.4, LOS 27.j)

Question #26 of 89

The exhibit below provides relevant data and financial statement information about Acme's inventory purchases and sales of inventory for the last year.

	Units	Unit Price
Beginning Inventory	699	\$5.00
Purchases	710	\$8.00
Sales	806	\$15.00

The cost of goods sold using the first in, first out (FIFO) method is:

- A) \$5,248. 
- B) \$4,133. 
- C) \$4,351. 




Explanation

FIFO COGS = $(699 \times 5) + (107 \times 8) = \$4,351.00$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #27 of 89

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

(Study Session 8, Module 27.2, LOS 27.d)

Question #28 of 89

Brigham Corporation uses the last-in, first-out (LIFO) method of accounting for inventory. For the year 20X5, 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), cost of goods sold for 20X5 would be:

A) \$20,250.



B) \$3,750.



C) \$29,250.



Explanation

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

(Study Session 8, Module 27.3, LOS 27.f)

Question #29 of 89

A U.S. GAAP reporting firm changes its inventory cost flow assumption from average cost to LIFO. The firm must apply this change:

A) prospectively, with LIFO layers calculated from past purchases and sales.



B) prospectively, with the carrying value as the first LIFO layer.



C) retrospectively, because it is a change in accounting principle.



Explanation

Changing the inventory cost flow assumption to LIFO is an exception to the retrospective application of changes in accounting principle. This change is applied prospectively, with the carrying value of inventory on the date of the change as the first LIFO layer.

(Study Session 8, Module 27.4, LOS 27.i)

Question #30 of 89

If prices are decreasing, the *best* estimates of inventory and cost of goods sold from an analyst's point of view are provided by:

A) FIFO inventory and FIFO cost of goods sold.



B) FIFO inventory and LIFO cost of goods sold.



C) LIFO inventory and FIFO cost of goods sold.



Explanation

Whether prices are increasing or decreasing, LIFO cost of goods sold and FIFO inventory are preferred because they are the closest estimates of current costs.

(Study Session 8, Module 27.2, LOS 27.d)

Question #31 of 89

LIFO liquidation may result when:

A) cost of goods sold is less than the available inventory.



B) purchases are less than goods sold.



C) purchases are more than goods sold.



Explanation

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

(Study Session 8, Module 27.3, LOS 27.e)

Question #32 of 89

For a firm that uses the LIFO inventory cost method, a LIFO liquidation occurs if:

A) sales decrease during a reporting period.



B) the firm changes to a different inventory cost method.



C) inventory quantity decreases during a reporting period.



Explanation

LIFO liquidation occurs when the quantity of inventory decreases during a reporting period. In an increasing price environment this results in older, lower costs being included in COGS for the period.

(Study Session 8, Module 27.3, LOS 27.e)

Question #33 of 89

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) \$1,575.



B) \$3,100.



C) \$3,475.



Explanation

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

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

(Study Session 8, Module 27.1, LOS 27.c)

Question #34 of 89

The exhibit below provides relevant data and financial statement information about Acme's inventory purchases and sales of inventory for the last year.

	Units	Unit Price
Beginning Inventory	699	\$5.00
Purchases	710	\$8.00
Sales	806	\$15.00

Cost of goods sold using the weighted average cost method is closest to:

A) \$4,350.



B) \$5,250.



C) \$4,980.



Explanation

Weighted average = cost of goods available / total units available.

$[(699 \times 5) + (710 \times 8)] / (699 + 710) = 6.51171$

$\text{COGS} = \text{Units sold} \times \text{Weighted average cost} = 806 \times 6.51171 = \$5,248.44.$

(Study Session 8, Module 27.1, LOS 27.c)

Question #35 of 89

Given the following data for a firm:

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

What is the ending inventory level in dollars using the FIFO method?

A) \$3,604.



B) \$1,744.



C) \$1,836.



Explanation

Under FIFO, the 709 units in beginning inventory and 250 of the units purchased ($= 959 - 709$) are included in cost of goods sold. Ending inventory $= (556 - 250) \times \$6 = \$1,836.00$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #36 of 89

A firm determines that inventory of manufactured goods with a cost of €10 million has a net realizable value of €9 million and writes down its carrying value to this amount. One period later, the firm determines that the net realizable value of this inventory has increased to €11 million. Under IFRS, the carrying value of this inventory:

A) must remain valued at €9 million.



B) may be revalued up to €11 million.



C) may be revalued up to €10 million.



Explanation

Under IFRS, inventory is measured at the lower of cost or net realizable value. Inventory that has been written down can later be revalued upward if its net realizable value recovers, but only to the extent that reverses the writedown (i.e., no higher than cost). Under U.S. GAAP, inventory that has been written down may not be revalued upward.

(Study Session 8, Module 27.4, LOS 27.g)

Question #37 of 89

A company that uses the LIFO inventory cost method records the following purchases and sales for an accounting period:

Beginning inventory, July 1: \$5,000, 10 units

July 8: Purchase of \$2,600 (5 units)

July 12: Sale of \$2,200 (4 units)

July 15: Purchase of \$2,800 (5 units)

July 21: Sale of \$1,680 (3 units)

The company's cost of goods sold using a perpetual inventory system is:

A) \$3,500.



B) \$3,780.



C) \$3,760.



Explanation

With a perpetual inventory system, units purchased and sold are recorded in inventory in the order that the purchases and sales occur. Cost of goods sold for the July 12 sale uses 4 of the units purchased on July 8: $4 \times (\$2,600 / 5) = \$2,080$. Cost of goods sold for the July 21 sale uses 3 of the units purchased on July 15: $3 \times (\$2,800 / 5) = \$1,680$. $\text{COGS} = \$2,080 + \$1,680 = \$3,760$.

(Study Session 8, Module 27.2, LOS 27.c)

Question #38 of 89

MJ Inc. reported cost of goods sold of \$80,000 for the year under the LIFO inventory valuation method. MJ had a beginning LIFO reserve of \$8,000 and an ending LIFO reserve of \$11,000. Cost of goods sold under the FIFO inventory valuation method is:

A) \$83,000.



B) \$77,000.



C) \$91,000.



Explanation

$\text{COGS} = 80,000 - (11,000 - 8,000) = 77,000$.

(Study Session 8, Module 27.3, LOS 27.f)

Question #39 of 89

In periods of decreasing prices, which of the following statements is *most accurate*? Compared to FIFO, LIFO results in:

A) lower COGS, lower taxes and higher net income.



B) higher inventory balances and higher working capital.



C) higher inventory balances and lower working capital.



Explanation

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

(Study Session 8, Module 27.2, LOS 27.d)

Question #40 of 89

Costs that are included in the balance sheet value of inventory *most likely* include:

A) Selling costs.



B) Manufacturing overhead.



C) Administrative overhead.



Explanation

Product costs that are capitalized to inventory include purchase cost, conversion or manufacturing costs (including labor and overhead), and other costs to bring inventory to its present state and location. Period costs recognized as expenses when incurred include abnormal waste, storage costs not required for production, selling costs, and administrative overhead.

(Study Session 8, Module 27.1, LOS 27.a)

Question #41 of 89

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		
<u>FIFO</u>	<u>LIFO</u>	<u>Cost Average</u>	
A) \$650	\$750	\$990	
B) \$677	\$650	\$677	
C) \$650	\$750	\$677	

Explanation

$$\text{Sales} = (15 * 60) + (35 * 45) + (85 * 35) = 5,450$$

$$\text{COGS}_{\text{FIFO}} = (20 * 50) + (35 * 40) + (80 * 30) = 4,800$$

$$\text{GM}_{\text{FIFO}}: \$5,450 - 4,800 = \$650$$

$$\text{COGS}_{\text{LIFO}} = (15 * 50) + (35 * 40) + (85 * 30) = 4,700$$

$$\text{GM}_{\text{LIFO}}: \$5,450 - \$4,700 = \$750$$

$$\text{COGS}_{\text{Average}} = (20 * 50) + (35 * 40) + (85 * 30) = 4,950$$

$$4,950 * 135 / 140 = 4,773.21$$

$$\text{GM}_{\text{Cost Average}}: \$5,450 - \$4,773.21 = \$676.79$$

(Study Session 8, Module 27.2, LOS 27.c)

Question #42 of 89

The exhibit below provides relevant data and financial statement information about Acme's inventory purchases and sales of inventory for the last year.

	Units	Unit Price
Beginning Inventory	699	\$5.00
Purchases	710	\$8.00
Sales	806	\$15.00

The ending inventory value in dollars using the FIFO method is:

A) \$6,160.

B) \$4,582.

C) \$4,824.

Explanation

There are $(699 + 710 - 806) = 603$ items left in inventory. Ending inventory value = $603 \times \$8 = \$4,824$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #43 of 89

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) \$1,575.

B) \$3,450.



C) \$1,225.



Explanation

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

$$(20 \text{ units})(\$50/\text{unit}) + (5 \text{ units})(\$45/\text{unit}) =$$

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

(Study Session 8, Module 27.1, LOS 27.c)

Question #44 of 89

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.

(Study Session 8, Module 27.2, LOS 27.d)

Question #45 of 89

The *most likely* effect of a write-down of inventory to net realizable value on a firm's quick ratio is:

A) a decrease.



B) no change.



C) an increase.



Explanation

The quick ratio is current assets other than inventories divided by current liabilities. Neither the numerator nor the denominator is affected by an inventory writedown.

(Study Session 8, Module 27.4, LOS 27.h)

Question #46 of 89

Orchard Supply Company uses LIFO inventory valuation. Orchard had a cost of goods sold of \$1 million for the most recent year. Inventory was \$500,000 at the beginning of the year and \$600,000 at the end of the year. Orchard Supply's LIFO reserve was \$100,000 at the beginning of the year and \$200,000 at the end of the year. What is Orchard Supply's cost of goods sold using FIFO inventory valuation?

A) \$900,000.



B) \$800,000.



C) \$1.1 million.



Explanation

FIFO COGS = LIFO COGS – change in LIFO reserve = \$1 million – \$100,000 = \$900,000.

(Study Session 8, Module 27.3, LOS 27.f)

Question #47 of 89

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

A) higher under LIFO than FIFO or average cost.



B) the same for both LIFO and FIFO.



C) higher under the average cost than LIFO or FIFO.



Explanation

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

(Study Session 8, Module 27.2, LOS 27.d)

Question #48 of 89

In a decreasing price environment, the first-in first-out (FIFO) inventory cost method results in:

A) lower cost of goods sold compared to last-in first-out.



B) higher inventory compared to last-in first-out.



C) lower gross profit compared to last-in first-out.



Explanation

If prices are decreasing, FIFO assumes the higher-cost earliest purchases are the first items sold. This results in higher COGS, lower inventory, and lower gross profit compared to LIFO.

(Study Session 8, Module 27.2, LOS 27.d)

Question #49 of 89

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.

(Study Session 8, Module 27.2, LOS 27.d)

Question #50 of 89

Given the following data on a firm's inventory, purchases, and sales:

	Units	Unit Price
Beginning Inventory	559	\$1.00
Purchases	785	\$5.00
Sales	848	\$15.00

Cost of goods sold using the first in, first out (FIFO) method is *closest* to:

A) \$8,730.



B) \$2,830.



C) \$2,004.



Explanation

$\text{COGS} = 559 \times \$1 + (848 - 559) \times \$5 = \$2,004.$

(Study Session 8, Module 27.1, LOS 27.c)

Question #51 of 89

If a company chooses to write down inventory, which ratio is *most likely* to improve?

A) Debt-to-equity ratio.



B) Total asset turnover.



C) Operating profit margin.



Explanation

Total asset turnover should improve, as the numerator (sales) would not be affected while the denominator (total assets) would be lower. Profitability ratios and the debt-to-equity ratio would be worse due to lower profits and lower equity due to the inventory writedown.

(Study Session 8, Module 27.5, LOS 27.k)

Question #52 of 89

Under U.S. GAAP, the LIFO reserve is a required financial statement disclosure:

A) only for firms that use the LIFO inventory cost method.



B) for all firms except those that use the specific identification cost method.



C) for firms that use either the LIFO or FIFO inventory cost methods.



Explanation

Only firms that use the LIFO inventory cost method are required to disclose a LIFO reserve.

(Study Session 8, Module 27.3, LOS 27.e)

Question #53 of 89

For a company uses the LIFO inventory valuation method, a financial analyst can adjust the current ratio to the FIFO method by:

A) adding the LIFO reserve to current liabilities.



B) adding the LIFO reserve to current assets.



C) subtracting the LIFO reserve from current assets.



Explanation

FIFO inventory = LIFO inventory + LIFO reserve, and inventory is included in current assets, the numerator in the current ratio.

(Study Session 8, Module 27.5, LOS 27.k)

Question #54 of 89

Cushinson Corp. had a beginning inventory of \$9,500 (250 units) and made three inventory purchases during the fiscal year:

	Purchases	Units	Total Cost
3/1/X6	400		\$14,800
7/1/X6	450		\$14,850
9/1/X6	550		\$15,950

The company began operations on Jan. 1, 20X6. Costing uses the LIFO method of determining cost of goods sold. First year sales were 1,300 units. The *most likely* effects of using LIFO inventory costing as compared to FIFO in Cushinson's 20X6 financial statements are:

A) higher net income; lower working capital.



B) higher net income; higher working capital.



C) lower net income; lower working capital.



Explanation

The first step is to determine the direction of prices:

Purchase	Total Cost	Units	Per-unit Cost
----------	------------	-------	---------------

Begin inv.	\$9,500	÷ 250	= \$38
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3/1/X6	14,800	÷ 400	= \$37
--------	--------	-------	--------

7/1/X6	14,850	÷ 450	= \$33
--------	--------	-------	--------

9/1/X6	15,950	÷ 550	= \$29
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Notice that per-unit prices are falling. Under falling prices, LIFO inventory costing will result in higher net income because the recent units were cheaper than the older purchases (and beginning inventory), making the cost of goods sold lower and net income higher. Working capital will be higher because LIFO inventory is greater than FIFO inventory when prices are falling.

(Study Session 8, Module 27.5, LOS 27.I)

Question #55 of 89

A U.S. GAAP firm writes down inventory to net realizable value. In the period of the writedown, what is the *most likely* effect on cost of goods sold?

A) Decrease.



B) Increase.



C) No effect.



Explanation

A write-down of inventory to net realizable value is typically recognized under U.S. GAAP as an increase in cost of goods sold in the period of the write-down. Consider the inventory equation:

$$\text{ending inventory} = \text{beginning inventory} + \text{purchases} - \text{cost of goods sold}$$

A write-down to NRV decreases ending inventory, with no effect on beginning inventory or purchases. For the inventory equation to hold, cost of goods sold must increase.

(Study Session 8, Module 27.4, LOS 27.h)

Question #56 of 89

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) \$2,800.



B) \$2,400.



C) \$4,000.



Explanation

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

$$(\text{LIFO reserve})(1 - t) = \$4,000(1 - 0.4) = \$2,400.$$

(Study Session 8, Module 27.3, LOS 27.f)

Question #57 of 89

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) \$2,933.



B) \$3,141.



C) \$2,878.



Explanation

Average cost per unit purchased:

$$40 \text{ units at } \$60/\text{per unit} = \$2,400$$

$$50 \text{ units at } \$55/\text{per unit} = \$2,750$$

$$60 \text{ units at } \$45/\text{per unit} = \$2,700$$

$$\text{Total} = 150 \text{ units} = \$7,850$$

$$\text{Average cost per unit} = \$7,850 / 150 \text{ units} = \$52.33/\text{unit}$$

$$\text{Purchased } 40 + 50 + 60 = 150 \text{ units. Sold } 25 + 30 + 40 = 95$$

$$\text{Ending inventory} = 150 - 95 = 55 \text{ units} \times \$52.33/\text{unit} = \$2,878$$

(Study Session 8, Module 27.2, LOS 27.c)

Question #58 of 89

Lincoln Corporation and Continental Incorporated are identical companies except that Lincoln complies with U.S. Generally Accepted Accounting Principles and Continental complies with International Financial Reporting Standards. Assuming an inflationary environment and stable inventory quantities, which permissible cost flow assumption will minimize each firm's pre-tax financial income?

<u>Lincoln</u>	<u>Continental</u>
<u>Corporation</u>	<u>Incorporated</u>

- A) Last-in, first-out Average cost ✔
- B) Last-in, first-out Last-in, first-out ✘
- C) First-in, first-out First-in, first-out ✘

Explanation

LIFO will result in the lowest pre-tax financial income and FIFO will result in the highest pre-tax income. Average cost pre-tax financial income will fall in the middle. LIFO is allowed under U.S. GAAP but is not allowed under IFRS. Thus, Lincoln should choose LIFO and Continental should choose average cost in order to minimize pre-tax financial income.

(Study Session 8, Module 27.2, LOS 27.d)

Question #59 of 89

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) \$3,100. ✘
- C) \$1,800. ✔

Explanation

$(\text{units sold} \times \text{sales price}) - [(\text{inventory cost} \times \text{unit cost}) + (\text{inventory cost} \times \text{unit cost})] = \text{sales} - \text{COGS} = \text{gross profit}$

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

(Study Session 8, Module 27.1, LOS 27.c)

Question #60 of 89

Judah Inc. prepares its financial statements under IFRS. On December 31, 20X8, Judah has inventory of manufactured goods with a cost of \$720,000. The estimated selling cost of that inventory is \$50,000 and its market value is \$740,000. By January 31, 20X9, none of the inventory has been sold but its market value has increased to \$810,000. Selling costs remain the same. Which of the following entries is *most likely* permissible under IFRS?

- A) Write down inventory by \$30,000 on December 31, 20X8 and write up inventory by \$70,000 on January 31, 20X9. ✘

B) Write down inventory by \$30,000 on December 31, 20X8 and write up inventory by \$30,000 on January 31, 20X9.



C) Make no adjustments to the valuation of inventory on either date.



Explanation

IFRS rules require inventory to be valued at the lower of cost or net realizable value (NRV). NRV is calculated as estimated sales price less estimated selling costs. At December 31, 20X8, $\text{NRV} = \$740,000 - \$50,000 = \$690,000$. Since cost is \$720,000, then the lower of cost or NRV is \$690,000 and a \$30,000 writedown is required.

At January 31, 20X9, $\text{NRV} = \$810,000 - \$50,000 = \$760,000$. Under IFRS, when inventory recovers in value after being written down, it may be "written up" and a gain recognized in the income statement. The amount of such gain, however, is limited to the amount previously recognized as a loss. Under IFRS it is not permissible to report inventory on the balance sheet at an amount that exceeds original cost, except in the case of some agricultural and mineral products. Since cost is \$720,000, the lower of cost of NRV is \$720,000.

(Study Session 8, Module 27.4, LOS 27.g)

Question #61 of 89

Goldberg Inc. produces and sells electronic equipment. Which of the following inventory costs is *most likely* to be recognized as an expense on Goldberg's financial statements in the period incurred?

A) Freight costs on inputs.



B) Conversion cost.



C) Selling cost.



Explanation

Selling costs are expensed in the period incurred since they result in no future benefit (i.e. the inventory has been sold). Conversion costs and freight costs add value in assisting in the future sale of the related inventory. Therefore, these costs are not recognized until the inventory is ultimately sold.

(Study Session 8, Module 27.1, LOS 27.a)

Question #62 of 89

	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?

	<u>FIFO</u>	<u>LIFO</u>
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

(Study Session 8, Module 27.1, LOS 27.c)

Question #63 of 89

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
		Total Liabilities & Equity	\$13,000,000
LIFO Reserve at Jan. 1	400,000		
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 had used first in, first out (FIFO), return on total equity would:

A) increase to 21.1%.



B) decrease to 18.3%.



C) increase to 23.0%.



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 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%.

(Study Session 8, Module 27.5, LOS 27.k)

Question #64 of 89

McKay Company uses a periodic inventory system and the FIFO inventory cost method. In the most recent period, McKay had beginning inventory of \$4,200, purchases of \$1,400, cost of sales \$1,300, and ending inventory of \$4,300. If McKay had used a perpetual inventory system, its ending inventory would have been:

A) \$4,300.



B) \$4,200.



C) \$4,400.



Explanation

For a firm that uses the FIFO inventory cost method, cost of sales and ending inventory are unaffected by the choice between periodic and perpetual inventory systems.

(Study Session 8, Module 27.2, LOS 27.c)

Question #65 of 89

Given the following data for a firm:

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

Cost of goods sold using the average cost method and using the first in first out (FIFO) method are *closest to*:

Average cost FIFO

A) \$3,600 \$3,400



B) \$3,600 \$2,900



C) \$4,150 \$3,400



Explanation

Average cost = cost of goods available / total units available

$$= (709 \times \$2 + 556 \times \$6) / (709 + 556) = \$3.7581$$

$$\text{COGS using average cost} = \text{Units sold} \times \text{average cost} = 959 \times \$3.7581 = \$3,604.02$$

$$\text{FIFO COGS} = (709 \times \$2) + [(959 - 709) \times \$6] = \$2,918.00$$

(Study Session 8, Module 27.1, LOS 27.c)

Question #66 of 89

The exhibit below provides relevant data and financial statement information about Acme's inventory purchases and sales of inventory for the last year.

	Units	Unit Price
Beginning Inventory	699	\$5.00
Purchases	710	\$8.00
Sales	806	\$15.00

The value of the ending inventory level in dollars using the last-in-first-out (LIFO) method is:

A) \$6,160.



B) \$3,015.



C) \$4,824.



Explanation

There are $(699 + 710 - 806) = 603$ items left in inventory. Ending inventory = $603 \times \$5 = \$3,015$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #67 of 89

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
		Total Liabilities & Equity	11,800,000
LIFO Reserve at Jan. 1	600,000		
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) 4.18



B) 4.06



C) 3.73



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 $\$12,340,000 / \$3,040,000 = 4.06$.

(Study Session 8, Module 27.5, LOS 27.k)

Question #68 of 89

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) \$3,250.



B) \$3,200.



C) \$3,600.



Explanation

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

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

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

(Study Session 8, Module 27.2, LOS 27.c)

Question #69 of 89

An analyst is comparing a company that uses the LIFO inventory cost method to companies that use FIFO for inventories. The analyst should adjust the LIFO firm's cost of goods sold by subtracting the:

A) LIFO reserve.



B) LIFO reserve, net of tax.



C) change in the LIFO reserve.



Explanation

FIFO cost of goods sold equals LIFO cost of goods sold minus the change in the LIFO reserve.

(Study Session 8, Module 27.3, LOS 27.f)

Question #70 of 89

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) \$382,500.



B) \$485,000.



C) \$434,583.



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. $\text{COGS} = \$200,000 + \$120,000 + (5 \times \$12,500) = \$382,500$.

(Study Session 8, Module 27.1, LOS 27.c)

Question #71 of 89

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

A) FIFO firms will have greater stockholder's equity than LIFO firms.



B) LIFO firms have higher gross profit margins than FIFO firms.



C) FIFO firms have higher debt to equity ratios than LIFO firms.



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.)

In periods of rising prices and inventory levels (all else constant), FIFO firms have lower debt to equity ratios than LIFO firms because stockholder's equity is higher and debt is unaffected. LIFO firms have lower gross profit margins because the more expensive last purchases are assigned to COGS, decreasing the numerator.

(Study Session 8, Module 27.2, LOS 27.d)

Question #72 of 89

Which of the following ratio levels would suggest that a company is holding obsolete inventory?

A) Low inventory turnover ratio.



B) Low number of days in inventory.



C) Low inventory value compared to cost of goods sold.



Explanation

Low inventory turnover (high number of days in inventory) may be a sign of slow-moving or obsolete inventory, especially when coupled with low or declining revenue growth compared to the industry. Low inventory value compared to cost of goods sold, however, implies a high inventory turnover ratio. This suggests much less risk of obsolescence.

(Study Session 8, Module 27.5, LOS 27.k)

Question #73 of 89

Under the first-in-first-out (FIFO) inventory valuation method, ending inventory reflects the costs of the:

A) earliest purchases.



B) specific units available for sale.



C) most recent purchases.



Explanation

Under the FIFO inventory valuation method, ending inventory reflects the costs of the most recently purchased items and cost of sales reflects the costs of the earliest purchases. If prices are increasing or decreasing, ending inventory is unlikely to reflect the costs of the specific units available for sale.

(Study Session 8, Module 27.1, LOS 27.b)

Question #74 of 89

Barber Inc., which uses LIFO inventory accounting under U.S. GAAP, 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. What is the value of the recorders on December 31?

A) \$78.



B) \$74.



C) \$73.






Explanation

Under U.S. GAAP, a LIFO firm values inventory at the lower of cost or market. 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.

(Study Session 8, Module 27.4, LOS 27.g)

Question #75 of 89

If a firm pledges inventories as collateral for a loan, the firm must:

- A) create a contra asset account in the amount of the pledged inventories. 
- B) offset the pledged inventories against current liabilities. 
- C) disclose the carrying value of the pledged inventories. 




Explanation

Carrying value of inventories pledged as collateral is one of the required disclosures under both IFRS and U.S. GAAP.

(Study Session 8, Module 27.4, LOS 27.i)

Question #76 of 89

The year-end financial statements for a firm using LIFO inventory accounting show an inventory level of \$5,000, cost of goods sold 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 cost of goods sold have been using FIFO inventory accounting?

- A) \$18,500. 
- B) \$12,000. 
- C) \$13,500. 

Explanation




FIFO COGS = LIFO COGS – change in LIFO reserve

= \$16,000 – (\$4,000 – \$1,500) = \$13,500.

(Study Session 8, Module 27.3, LOS 27.f)

Question #77 of 89

Inventory, cost of sales, and gross profit can be different under periodic and perpetual inventory systems if a firm uses which inventory cost method?

- A) LIFO or weighted average cost, but not FIFO. 
- B) LIFO or FIFO, but not weighted average cost. 
- C) FIFO or weighted average cost, but not LIFO. 

Explanation

The LIFO and weighted average cost methods can provide different values for inventory, cost of sales, and gross profit depending on whether the firm uses a periodic or perpetual inventory system. FIFO produces the same values from either a periodic or perpetual inventory system.

(Study Session 8, Module 27.2, LOS 27.c)

Question #78 of 89

In an increasing price environment, an analyst who wants to consider tax effects when converting a LIFO firm's balance sheet to a FIFO basis is *most likely* to decrease the LIFO firm's:

A) retained earnings.



B) inventories.



C) cash.



Explanation

To adjust a LIFO firm's financial statements to a FIFO basis including tax effects, an analyst should increase inventory by the LIFO reserve, decrease cash by (LIFO reserve \times tax rate), and increase retained earnings by [LIFO reserve \times (1 – tax rate)].

(Study Session 8, Module 27.3, LOS 27.f)

Question #79 of 89

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

A) higher cost of sales, lower income, higher cash flows, and lower inventory.



B) higher cost of sales, lower income, lower cash flows, and lower inventory.



C) lower cost of sales, higher income, identical cash flows, and lower inventory.



Explanation

In periods of rising prices and stable or increasing inventory quantities, the LIFO method will result in higher cost of sales, lower taxes, lower net income, lower inventory balances, lower working capital, and higher cash flows.

(Study Session 8, Module 27.2, LOS 27.d)

Question #80 of 89

The effect of an inventory writedown on a firm's return on assets (ROA) is *most accurately* described as:

A) lower ROA in the current period and no effect on ROA in later periods.



B) lower ROA in the current period and higher ROA in later periods.



C) higher ROA in the current period and lower ROA in later periods.



Explanation

Writing down inventory to net realizable value decreases both net income and total assets in the period of the writedown. Because net income is most likely less than assets, the result in the period is a decrease in ROA. In later periods, lower-valued inventory will decrease COGS and increase net income. Combined with a lower value of total assets, this will increase ROA.

(Study Session 8, Module 27.4, LOS 27.h)

Question #81 of 89

If prices are increasing, the weighted average cost method *most likely* results in inventory values that are higher than the inventory values using:

- A) first-in first-out (FIFO).
- B) specific identification.
- C) last-in first-out (LIFO).



Explanation

In a increasing price environment, inventory values reported under LIFO are lower than the values reported under FIFO, and the values that result from weighted average cost are between the LIFO and FIFO values. Thus, the value of inventory using weighted average cost is higher than inventory using LIFO. The value of inventory using specific identification depends on which particular items from inventory are sold, and thus can be higher or lower than the inventory values that result from the other methods.

(Study Session 8, Module 27.2, LOS 27.d)

Question #82 of 89

Other things equal, compared to using the first-in-first-out (FIFO) inventory cost method, using the last-in-first-out (LIFO) method in a rising price environment will result in a higher:

- A) inventory turnover ratio.
- B) quick ratio.
- C) gross profit margin.



Explanation

The inventory turnover ratio is cost of sales / average inventory. Compared to FIFO, LIFO results in higher cost of sales and lower average inventory when prices are increasing, and therefore results in a higher inventory turnover ratio. Because cost of sales is higher with LIFO, gross profit margin is lower. The quick ratio is unaffected by the inventory cost assumption.

(Study Session 8, Module 27.5, LOS 27.k)

Question #83 of 89

If prices and inventory quantities are increasing, the last-in first-out (LIFO) inventory cost method results in:

- A) lower cost of goods sold compared to first-in first-out.
- B) lower gross profit compared to first-in first-out.
- C) higher inventory compared to first-in first-out.



Explanation

In an environment of increasing prices, LIFO results in higher COGS, lower inventory value, and lower gross profit compared to FIFO.

(Study Session 8, Module 27.2, LOS 27.d)

Question #84 of 89

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

- A) higher inventory.
- B) higher earnings.
- C) lower earnings.



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.

(Study Session 8, Module 27.3, LOS 27.e)

Question #85 of 89

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.
- B) market price minus selling costs minus normal profit margin.
- C) net realizable value minus selling costs.



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.

(Study Session 8, Module 27.4, LOS 27.g)

Question #86 of 89

From an analyst's point of view, which accounting methods are preferable for income statements and balance sheets?

- A) First in, first out (FIFO) for both income statements and balance sheets.
- B) Last in, first out (LIFO) for the balance sheet and first in, first out (FIFO) for the income statement.
- C) Last in, first out (LIFO) for income statements and first in, first out (FIFO) for the balance sheet.



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.

(Study Session 8, Module 27.5, LOS 27.l)

Question #87 of 89

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* appropriate?

A) Increase shareholders' equity by \$13.



B) Increase assets by \$20.



C) Increase cash by \$7.



Explanation

Declining prices (negative LIFO reserve) would result in FIFO inventory being less than LIFO inventory. 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 \times 35% tax rate). To bring the accounting equation into balance, the analyst would decrease shareholders' equity by \$13 [\$20 LIFO reserve \times (1 - 35% tax rate)].

(Study Session 8, Module 27.3, LOS 27.f)

Question #88 of 89

	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) \$6,027.56.



B) \$5,676.00.



C) \$6,213.98.



Explanation

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




(Study Session 8, Module 27.1, LOS 27.c)

Question #89 of 89

Information related to Bledsoe Corporation's inventory, as of December 31, 20x7, follows:

Estimated selling price	\$3,500,000
Estimated disposal costs	50,000
Estimated completion costs	300,000
Original FIFO cost	3,200,000
Replacement cost	3,300,000

Using the appropriate valuation method, what adjustment is necessary to accurately report Bledsoe's inventory at the end of 20x7, and will this adjustment affect Bledsoe's quick ratio?

- | | <u>Adjustment</u> | <u>Quick ratio</u> | |
|------------------------|-------------------|--------------------|---|
| A) \$50,000 write-down | Yes | |  |
| B) \$50,000 write-down | No | |  |
| C) \$100,000 write-up | No | |  |

Explanation

Inventories are valued on the balance sheet at the lower of cost or net realizable value. Net realizable value is equal to \$3,150,000 (\$3,500,000 selling price – \$300,000 completion costs – \$50,000 disposal costs). Since the original cost of \$3,200,000 exceeds the net realizable value of \$3,150,000, a \$50,000 write-down is necessary. An inventory write-down has no impact on the quick ratio since inventory is excluded from both the numerator and denominator of the quick ratio.

(Study Session 8, Module 27.4, LOS 27.g)