

SS 08 Financial Reporting and Analysis: Inventories, Long-lived Assets, Income Taxes, and Non-current Liabilities

Answers

Question #1 of 159

Question ID: 467386

	<i>Units</i>	<i>Unit Price</i>
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>
X A)	\$8,862	\$9,549
✓ B)	\$9,549	\$8,325
X C)	\$8,325	\$8,862

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #2 of 159

Question ID: 414457

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

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

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #3 of 159

Question ID: 683868

An analyst will *most likely* use the average age of depreciable assets to estimate the company's:

- X **A)** earnings potential.
- ✓ **B)** near-term financing requirements.
- X **C)** cash flows.

Explanation

Average age of depreciable assets is useful for estimating financing required for major capital expenditures in the near term to replace depreciated assets.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS
-

Question #4 of 159

Question ID: 683863

Meyer Investment Advisory and Smith Brothers Investments are operationally identical except that Meyer capitalizes some costs that Smith expenses. Compared to Smith, Meyer is likely to have:

- X **A)** lower profitability (ROA and ROE) in early years and higher in later years.
- ✓ **B)** higher cash flows from operations and lower cash flow from investing.
- X **C)** higher debt/equity ratio and higher debt/assets ratio.

Explanation

The net cash flow remains the same regardless of which accounting method is used. But components of cash flows change and cash flows from operations will be higher when costs are capitalized and lower when expensed. On the other hand, cash flows from investing will be lower when costs are capitalized and higher when expensed. Compared to firms expensing costs, firms that capitalize costs will have smaller debt to equity ratios and higher initial ROAs, but lower ROAs in the future.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #5 of 159

Question ID: 414489

Capitalized interest costs are typically reported in the cash flow statement as an outflow from:

- ✓ **A)** investing.
- X **B)** financing.
- X **C)** operating.

Explanation

Capitalized interest costs are reported as CFI on the statement of cash flows, as they are treated as part of the cost of the constructed capital asset.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #6 of 159

Question ID: 683859

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 assets.
- X **B)** adding the LIFO reserve to current liabilities.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #7 of 159

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.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #8 of 159

Question ID: 414513

A firm revalues its long-lived assets upward. All other things equal, which of the following financial impacts is *least likely* to occur?

- ☐ A) Higher earnings in the revaluation period.
- ☐ B) Lower solvency ratios.
- ☒ C) Higher profitability in the periods after revaluation.

Explanation

Because the asset has now been increased to a higher depreciable base, there will now be higher depreciation expense and therefore, lower profitability in the periods after revaluation. There could be higher earnings in the revaluation period because there may be impairment losses that can be reversed on the income statement. Otherwise, there will be an adjustment to earnings through other comprehensive income. Solvency ratios (i.e. debt to equity) will decrease since the increase in assets will be balanced by an increase in equity. Higher denominators and unchanged numerators will result in lower solvency ratios.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #9 of 159

Question ID: 414458

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

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

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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #10 of 159

Question ID: 683852

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:

- X **A)** \$29,250.
- X **B)** \$3,750.
- ✓ **C)** \$20,250.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #11 of 159

Question ID: 414487

Which of the following statements regarding the capitalization of an expense is *least accurate*?

- X **A)** Capitalized expenses increases equity.
- ✓ **B)** Capitalizing an expense lowers current period net income.
- X **C)** Capitalizing an expense creates an asset.

Explanation

Capitalizing expenses reduces current period expenses by the amount capitalized. The amount capitalized is added to assets which increases equity by increasing net income and retained earnings in the current period.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #12 of 159

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)?

- X **A)** \$3,100.
- ✓ **B)** \$1,575.
- X **C)** \$3,475.

Explanation

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #13 of 159

Question ID: 434292

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

	<i>Units</i>	<i>Unit Price</i>
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:

- X **A)** \$4,350.
- ✓ **B)** \$5,250.
- X **C)** \$4,980.

Explanation

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

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #14 of 159

Question ID: 456299

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>
X A) \$100,000 write-up	No
X B) \$50,000 write-down	Yes
✓ C) \$50,000 write-down	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.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS

Question #15 of 159

Question ID: 683864

Compared to firms that expense costs, firms that capitalize expenses will have:

- X **A)** higher leverage ratios.
- X **B)** lower cash flow from operations.
- ✓ **C)** lower variability of income.

Explanation

Firms that capitalize expenses have less variability of net income because the capitalized expense becomes an asset that is depreciated over years instead of all at once which happens when costs are expensed. Capitalizing expenses will result in higher cash flows from operations because capitalizing an expense becomes an investing cash flow instead of an operating cash flow which occurs when expenditures are expensed. Firms that capitalize expenses have lower leverage ratios because assets and equity are increased so any leverage ratio that have assets and equity in the denominator will decrease.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #16 of 159

Question ID: 414476

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

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

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.

References

Question From: Session 8 > Reading 28 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #17 of 159

Question ID: 598977

With an operating lease, the leased asset appears on the balance sheet of:

- ✓ **A)** the lessor.
- X **B)** neither the lessor nor the lessee.
- X **C)** the lessee.

Explanation

With an operating lease, the leased asset remains on the lessor's balance sheet and the lessor recognizes depreciation expense on the asset.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS

Question #18 of 159

Question ID: 598957

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

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

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.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #19 of 159

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.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS

Question #20 of 159

Question ID: 414443

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

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.

References

Question From: Session 8 > Reading 28 > LOS b

Related Material:

- Key Concepts by LOS

Question #21 of 159

Question ID: 414456

	<i>Units</i>	<i>Unit Price</i>
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)** \$6,213.98.
- X **B)** \$6,027.56.
- X **C)** \$5,676.00.

Explanation

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

weighted average COGS = $(\$3.7581)(959 \text{ units}) = \$3,604.02$

Sales = $(959 \text{ units})(\$13/\text{unit}) = \$12,467$

Profit = Sales – COGS – Sales Expenses = $12,467 - 3,604.02 - 2,649 = \$6,213.98$

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #22 of 159

Question ID: 434296

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

- ✓ **A)** Total asset turnover.
- X **B)** Operating profit margin.
- X **C)** Debt-to-equity ratio.

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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #23 of 159

Question ID: 496419

For a firm that uses the cost basis for valuing its long-lived assets, fair value is a consideration when calculating a gain or loss on:

- ✓ **A)** exchanging an asset.
- X **B)** abandoning an asset.
- X **C)** selling an asset.

Explanation

When exchanging one long-lived asset for another, a gain or loss is recorded as the difference between the old asset's carrying value and its fair value (or the fair value of the asset received in exchange, if that value is more evident). When selling an asset, the gain or loss is the difference between the carrying value and the cash received. When abandoning an asset, a firm records a loss equal to the carrying value of the asset.

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #24 of 159

Question ID: 683848

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 included in COGS. This will result in LIFO liquidation.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #25 of 159

Question ID: 434289

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) \$2,480.
- ☐ B) \$2,356.
- ☐ C) \$3,988.

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 = $496 \times \$5 = \$2,480$.

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #26 of 159

Question ID: 414468

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

- ☐ A) FIFO.
- ☐ B) Average Cost.
- ☒ C) LIFO.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #27 of 159

Question ID: 683856

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) \$730.
- ☐ C) \$790.

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

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #28 of 159

Question ID: 414442

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)** Selling cost.
- X **B)** Conversion cost.
- X **C)** Freight costs on inputs.

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.

References

Question From: Session 8 > Reading 28 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #29 of 159

Question ID: 598970

The average age of a firm's property, plant, and equipment can be estimated by dividing:

- ✓ **A)** accumulated depreciation by depreciation expense.
- X **B)** gross PP&E by depreciation expense.
- X **C)** net PP&E by depreciation expense.

Explanation

Average age = accumulated depreciation / annual depreciation expense.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS
-

Question #30 of 159

Question ID: 683847

First in, first out (FIFO) inventory equals:

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

X **B)** LIFO cost of goods sold – change in LIFO reserve.

X **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.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #31 of 159

Question ID: 598956

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:

	<i>Units</i>	<i>Unit Cost</i>	<i>Total Cost</i>
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.

X **B)** \$434,583.

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #32 of 159

Question ID: 414478

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 the carrying value as the first LIFO layer.
- X **B)** prospectively, with LIFO layers calculated from past purchases and sales.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #33 of 159

Question ID: 414494

The amortized cost of a trademark is *least likely* to appear on a firm's balance sheet if the trademark was:

- X **A)** purchased from another firm.
- X **B)** obtained in the acquisition of another firm.
- ✓ **C)** developed internally.

Explanation

Costs of developing a trademark are expensed in the period incurred. The value of a trademark can appear on the balance sheet if the trademark was purchased or obtained in a business acquisition.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #34 of 159

Question ID: 414518

As part of a major restructuring of business units, General Security (an industrial conglomerate operating solely in the U.S. and subject to U.S. GAAP) recognizes significant impairment losses. The Investor Relations group is preparing an informational

packet for shareholders, employees, and the media. Which of the following statements is *least* accurate?

- X **A)** The write-downs are reported as a component of income from continuing operations.
- ✓ **B)** Write-downs taken on asset values can be reversed in later years if market conditions improve.
- X **C)** During the year of the write-downs, retained earnings and deferred taxes will decrease.

Explanation

Impairments cannot be restored under U.S. GAAP. Both remaining statements are correct.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #35 of 159

Question ID: 414522

An analyst determined the following information concerning Franklin, Inc.'s stamping machine:

- Acquired seven years ago for \$22 million
- Straight line method used for depreciation
- Useful life estimated to be 12 years
- Salvage value originally estimated to be \$4 million

The stamping machine is expected to generate \$1,500,000 per year for five more years and will then be sold for \$1,000,000.

Under U.S. GAAP, the stamping machine is:

- X **A)** impaired because expected salvage value has declined.
- X **B)** not impaired.
- ✓ **C)** impaired because its carrying value exceeds expected future cash flows.

Explanation

The carrying value of the stamping machine is its cost less accumulated depreciation. Depreciation taken through 7 years was $(\$22,000,000 - \$4,000,000) / 12 \times 7 = \$10,500,000$, so carrying value is $\$22,000,000 - \$10,500,000 = \$11,500,000$. Because the \$11,500,000 carrying value is more than expected future cash flows of $(5 \times \$1,500,000) + \$1,000,000 = \$8,500,000$, the stamping machine is impaired.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #36 of 159

Question ID: 598964

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 higher ROA in later periods.
- X **B)** lower ROA in the current period and no effect on ROA in later periods.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS h

Related Material:

- Key Concepts by LOS

Question #37 of 159

Question ID: 496904

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

	<u>Purchases</u>	<u>Units</u>	<u>Total Cost</u>
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; higher working capital.
- X **B)** lower net income; lower working capital.
- X **C)** higher net income; lower working capital.

Explanation

The first step is to determine the direction of prices:

<u>Purchase</u>	<u>Total Cost</u>	<u>Units</u>	<u>Per-unit Cost</u>
Begin inv.	\$9,500	÷ 250	= \$38
3/1/X6	14,800	÷ 400	= \$37
7/1/X6	14,850	÷ 450	= \$33

$$9/1/X6 \quad 15,950 \quad \div 550 \quad = \$29$$

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.

References

Question From: Session 8 > Reading 28 > LOS l

Related Material:

- Key Concepts by LOS
-

Question #38 of 159

Question ID: 414481

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

- ✓ **A)** stability of a firm's inventory levels.
- X **B)** age of a firm's inventory.
- X **C)** effectiveness of a firm's inventory management.

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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #39 of 159

Question ID: 414490

Dobkin Company decides to expense costs that it would have otherwise capitalized. Compared to capitalizing, expensing these costs will result in:

- X **A)** lower asset levels and lower liability levels.
- ✓ **B)** lower asset levels and lower equity levels.
- X **C)** lower asset levels and higher equity levels.

Explanation

Expensing instead of capitalizing results in lower assets. Since the entire expense is recognized in the current period (whereas only a portion of the expenditure is amortized when capitalizing), net income (and therefore equity, via retained earnings) is lower with expensing than with capitalizing. Liabilities are unaffected.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #40 of 159

Question ID: 598974

Under IFRS, the principal portion of a finance lease payment:

- ☐ A) may be recognized as CFO by either the lessor or the lessee.
- ☒ B) is recognized as CFF by the lessee and CFI by the lessor.
- ☐ C) is recognized as CFI by both the lessor and the lessee.

Explanation

The principal portion of a finance lease is treated like an amortizing loan and classified as a CFF outflow by the lessee (i.e., the borrower) and a CFI inflow by the lessor (i.e., the lender). Under IFRS the interest portion (not the principal portion) of a finance lease payment may be classified as CFO or CFF by the lessee and as CFO or CFI by the lessor.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS
-

Question #41 of 159

Question ID: 414444

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

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

References

Question From: Session 8 > Reading 28 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #42 of 159

Question ID: 414517

For a firm to use the revaluation model for balance sheet reporting of long-lived assets:

- ☐ **A)** the firm must choose which assets of each type to revalue, and which to report at cost.
- ☐ **B)** the firm must report under U.S. GAAP.
- ☒ **C)** an active market must exist for the assets.

Explanation

Under IFRS, a firm may use the revaluation model for long-lived assets that have an active market which can be used to determine the fair value of the assets. The firm must use the same model for all assets of a similar type. U.S. GAAP reporting firms must use the cost model for long-lived assets.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #43 of 159

Question ID: 496420

The revaluation model for investment property is permitted under:

- ☒ **A)** neither IFRS nor U.S. GAAP.
- ☐ **B)** both IFRS and U.S. GAAP.
- ☐ **C)** IFRS, but not U.S. GAAP.

Explanation

For long-lived assets classified as investment property, IFRS allows either the cost model or the fair value model. The revaluation model is permitted for long-lived assets that are not classified as investment property. U.S. GAAP only permits the cost model for valuation of long-lived assets and does not identify investment property as a specific subset of long-lived assets.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #44 of 159

Question ID: 414485

When comparing capitalizing versus expensing costs which of the following statements is *most* accurate?

- ☐ A) Capitalizing costs creates lower cash flows from operations and higher cash flows from investing.
- ☒ B) Capitalizing costs creates higher cash flows from operations and lower cash flows from investing.
- ☐ C) Expensing costs creates lower cash flows from operations and lower cash flows from investing.

Explanation

Although net cash flows are not affected by the choice of capitalization or expensing, the components of cash flow are affected. Because, a firm that capitalizes classifies the expenditure as investing (not operations), cash flow from operations will be higher for firms that capitalize and investing cash flows will be lower than that of an expensing firm.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #45 of 159

Question ID: 683844

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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #46 of 159

Question ID: 598962

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) change in the LIFO reserve.
- ☒ C) LIFO reserve.

Explanation

FIFO inventory equals LIFO inventory plus the LIFO reserve.

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #47 of 159

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) \$3,450.
- ☐ C) \$1,575.

Explanation

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

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #48 of 159

Question ID: 683857

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 assets by \$20.
- ☐ B) Increase shareholders' equity by \$13.
- ☒ 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 ($\$20 \text{ LIFO reserve} \times 35\% \text{ tax rate}$). To bring the accounting equation into balance, the analyst would decrease shareholders' equity by \$13 [$\$20 \text{ LIFO reserve} \times (1 - 35\% \text{ tax rate})$].

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #49 of 159

Question ID: 598961

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) cash.
- ☐ B) inventories.
- ☐ C) retained earnings.

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 ($\text{LIFO reserve} \times \text{tax rate}$), and increase retained earnings by [$\text{LIFO reserve} \times (1 - \text{tax rate})$].

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #50 of 159

Question ID: 434297

Mammoth, Inc. reports under U.S. GAAP. Mammoth has begun a long-term project to develop inventory control software for external sale. On its financial statements, Mammoth should:

- X **A)** capitalize all costs of this project.
- X **B)** expense all costs of this project in the periods incurred.
- ✓ **C)** expense all costs of this project until technological feasibility has been established.

Explanation

Under IFRS and U.S. GAAP, costs of developing software are expensed until technological feasibility is established, and capitalized after technological feasibility has been established.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS

Question #51 of 159

Question ID: 683861

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 out (FIFO), return on total equity would:

- ✓ **A)** increase to 21.1%.
- X **B)** increase to 23.0%.
- X **C)** decrease to 18.3%.

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 $(1 - \text{tax rate})$. 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 $(1 - \text{tax rate})$ for an increase of $(\$600,000) \times (1 - 0.40) = \$360,000$. Total equity is $\$2,200,000 + \$1,800,000 + \$360,000 = \$4,360,000$. FIFO return on total equity is $\$920,000 / \$4,360,000 = 21.1\%$.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS

Question #52 of 159

Question ID: 414454

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

<i>Purchases</i>	<i>Sales</i>
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.
- X **B)** \$3,200.
- X **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.

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #53 of 159

Question ID: 414510

Schubert, Inc. acquires 100% of another firm. As a result of the acquisition, Schubert reports on its balance sheet 1) a patent with five years remaining and a carrying value of \$2 million and 2) goodwill with a carrying value of \$4 million. Using the straight-line

method, total amortization expense in the first year for these two intangible assets is:

- ✓ **A)** \$400,000.
- X **B)** \$800,000.
- X **C)** \$1,200,000.

Explanation

Amortization expense for the patent is \$2 million / 5 = \$400,000. Goodwill is an intangible asset with an indefinite life and is not amortized.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #54 of 159

Question ID: 414507

Allocating an intangible asset's cost to the income statement over time is known as:

- X **A)** depletion.
- ✓ **B)** amortization.
- X **C)** depreciation.

Explanation

Allocating an intangible asset's cost to the income statement over time is known as amortization. The same process is known as depreciation for tangible assets. For natural resources, allocation of cost to the income statement over time is commonly referred to as depletion.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #55 of 159

Question ID: 598963

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)** change in the LIFO reserve.
- X **B)** LIFO reserve, net of tax.

☒ **C)** LIFO reserve.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #56 of 159

Question ID: 414471

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 LIFO cost of goods sold.
- ☒ **B)** FIFO inventory and FIFO 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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #57 of 159

Question ID: 683853

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.

X **C)** \$1,800.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #58 of 159

Question ID: 683867

Taking an impairment of long-lived assets will result in:

- ✓ **A)** higher future return on assets.
- X **B)** higher deferred tax liabilities.
- X **C)** a lower debt-to-equity ratio.

Explanation

In future years, less depreciation expense is recognized on the written-down asset, resulting in higher net income and return on assets since $ROA = NI/Total\ Assets$. Deferred tax liabilities related to the asset decrease because the impairment cannot be deducted from taxable income until the asset is sold or disposed of. The debt-to-equity ratio increases because equity decreases while debt is unchanged.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #59 of 159

Question ID: 683865

Train, Inc.'s cash flow from operations (CFO) in 20X8 was \$14 million. Train paid \$8 million cash to acquire a franchise at the beginning of 20X8 that was expensed in 20X8. If Train had elected to amortize the cost of the franchise over eight years, 20X8 cash flow from operations (CFO) would have been:

- X **A)** \$21 million.
- ✓ **B)** \$22 million.
- X **C)** \$14 million.

Explanation

If Train decided to amortize the cost, the franchise would be capitalized as a balance sheet asset and the cash outflow would have been classified as CFI. As a result CFO would have been \$8 million higher, or \$14 million + \$8 million = \$22 million. Amortization would be a non-cash expense.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #60 of 159

Question ID: 414500

JME acquired an asset on January 1, 2004, for \$60,000 cash. At that time JME estimated the asset would last 10 years and have no salvage. During 2006 JME estimated the remaining life of the asset to be only three more years with a salvage value of \$3,000. If JME uses straight line depreciation, what is the depreciation expense for 2006?

- X **A)** \$6,000.
- X **B)** \$12,000.
- ✓ **C)** \$15,000.

Explanation

first two years = $(60,000 - 0) / 10 = 6,000$ per year

yr. 2006 = $(60,000 - 12,000 - 3,000) / 3 = 15,000$

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #61 of 159

Question ID: 498759

For impaired long-lived assets, a firm reporting under IFRS is *least likely* required to disclose the:

- X **A)** amounts of impairment losses and reversals by asset class.
- ✓ **B)** estimated probabilities of reversing impairment losses.
- X **C)** circumstances that caused the impairment losses or reversals.

Explanation

Under IFRS, firms with impaired assets must disclose the amounts of impairment losses and reversals by asset class, the circumstances that caused the impairment losses or reversals, and where the losses or reversals are recognized on the income statement.

References

Question From: Session 8 > Reading 29 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #62 of 159

Question ID: 598972

Compared to a firm that purchases a PP&E asset for cash and capitalizes the asset, a firm that leases the same asset with an operating lease will have lower:

- ✓ **A)** long-lived assets.
- X **B)** long-term liabilities.
- X **C)** current liabilities.

Explanation

With an operating lease, the lessee does not recognize a long-lived asset on its balance sheet. Neither an operating lease nor a capitalized purchase for cash involves a balance sheet liability.

References

Question From: Session 8 > Reading 29 > LOS o

Related Material:

- Key Concepts by LOS
-

Question #63 of 159

Question ID: 496418

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

- ✓ **A)** Manufacturing overhead.
- X **B)** Administrative overhead.
- X **C)** Selling costs.

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.

References

Question From: Session 8 > Reading 28 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #64 of 159

Question ID: 414441

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?

- X **A)** Selling cost.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #65 of 159

Question ID: 496422

An IFRS-reporting firm reclassifies a building it owns from "owner-occupied" to "investment property." The fair value of the building is greater than its carrying value. Under the fair value model for investment property, the firm will recognize a gain:

- ✓ **A)** only if it reverses a previously recognized loss.
- X **B)** in other comprehensive income but not on the income statement.
- X **C)** equal to the difference between fair value and carrying value.

Explanation

When reclassifying a property from owner-occupied to investment property and using the fair value model for valuation of investment property, IFRS specifies that the firm should treat the event as a revaluation, recognizing a gain only if it reverses a previously recognized loss.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS
-

Question #66 of 159

Question ID: 414462

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:

- X **A)** \$4,400.
- X **B)** \$4,200.
- ✓ **C)** \$4,300.

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.

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #67 of 159

Question ID: 496421

Under IFRS, if a firm reports investment property using the fair value model, unrealized gains and losses on investment property are:

- X **A)** disclosed in the financial statement notes.
- ✓ **B)** recognized on the income statement.
- X **C)** recognized in other comprehensive income.

Explanation

Under the fair value model for investment property, unrealized gains and losses are recognized on the income statement.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS
-

Question #68 of 159

Question ID: 414504

Component depreciation is required under:

- ✓ **A)** IFRS, but not U.S. GAAP.
- ✗ **B)** U.S. GAAP, but not IFRS.
- ✗ **C)** both IFRS and U.S. GAAP.

Explanation

IFRS requires firms to use component depreciation, which refers to depreciating the identifiable components of an asset separately. U.S. GAAP permits component depreciation but does not require it.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #69 of 159

Question ID: 683846

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.
- ✗ **B)** LIFO firms have higher gross profit margins than FIFO firms.
- ✓ **C)** FIFO firms will have greater stockholder's equity 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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #70 of 159

Question ID: 414527

Lucille Edgewater, CFA, is analyzing Pfaff Company, which reports its long-lived assets using the revaluation model. Edgewater needs to determine 1) what Pfaff's carrying value of property, plant and equipment would be under the historical cost model, and 2) which of Pfaff's intangible assets have finite useful lives. Will these items be disclosed in Pfaff's financial statements?

- ☐ A) Only one of these items is required to be disclosed.
- ☒ B) Both of these items are required to be disclosed.
- ☐ C) Neither of these items is required to be disclosed.

Explanation

Under IFRS, firms that use the revaluation model for PP&E must disclose its carrying value under the historical cost model. Firms must also disclose whether the useful lives of intangible assets are finite or indefinite.

References

Question From: Session 8 > Reading 29 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #71 of 159

Question ID: 683843

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

- ☒ A) higher inventory balances and higher working capital.
- ☐ B) higher inventory balances and lower working capital.
- ☐ C) lower COGS, lower taxes and higher net income.

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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #72 of 159

Question ID: 414483

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.

Explanation #1 Explanation #2

- | | |
|-----------------|-----|
| X A) Yes | No |
| X B) No | Yes |
| ✓ C) No | 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).

References

Question From: Session 8 > Reading 28 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #73 of 159

Question ID: 598969

Accelerated depreciation methods for financial reporting are *most likely* to have which of the following effects on a company's financial ratios during the early years of an asset's life?

- ✓ **A)** Higher asset turnover ratio.
- X **B)** Lower current ratio.
- X **C)** Lower debt-to-equity ratio.

Explanation

Given the higher depreciation expense recorded in the early years under accelerated depreciation methods, total assets will be lower, causing a higher asset turnover ratio versus straight-line.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #74 of 159

Question ID: 414501

Walsh Furniture has purchased a machine with a 7-year useful life for \$250,000. At the end of its life it will have an estimated salvage value of \$15,000. Using the double-declining balance (DDB) method, depreciation expense in year 2 is *closest* to:

- ✓ **A)** \$51,020.
- X **B)** \$58,750.
- X **C)** \$71,430.

Explanation

Year	$2 / \text{Depreciable Life}$	$\times \text{Book Value at Beginning of the Year}$	= Depreciation
1	0.2857	250,000	71,429
2	0.2857	178,571	51,020

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #75 of 159

Question ID: 414461

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.
- X **B)** LIFO or FIFO, but not weighted average cost.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #76 of 159

Question ID: 414491

A firm that capitalizes rather than expensing costs will have:

- ☐ A) lower profitability in the earlier years.
- ☒ B) lower cash flows from investing.
- ☐ C) lower cash flows from operations.

Explanation

A firm that capitalizes costs classifies them as an investing cash flow rather than an operating cash flow. Investing cash flows will be lower and cash flow from operations will be higher when costs are capitalized.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #77 of 159

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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #78 of 159

Question ID: 414521

An impairment write-down is *least likely* to decrease a company's:

- X **A)** assets.
- X **B)** future depreciation expense.
- ✓ **C)** debt-to-equity ratio.

Explanation

An impairment write-down reduces equity and has no effect on debt. The debt-to- equity ratio would therefore increase.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #79 of 159

Question ID: 683860

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 & Equip.	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:

- X **A)** 3.73
- ✓ **B)** 4.06
- X **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 $\$12,340,000 / \$3,040,000 = 4.06$.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #80 of 159

Question ID: 498757

La Crosse Partners LLC has a franchise agreement with Arnolds Crispy Fry that expires in seven years, but is renewable at each expiration date for a nominal fee. If the franchise agreement is initially valued at \$60,000:

- ☐ A) amortization expense in the first year will be one-seventh of \$60,000.
- ☒ B) amortization expense in the sixth year will be zero.
- ☐ C) an accelerated amortization method is more appropriate than the straight-line method.

Explanation

Because the franchise agreement is renewable for a nominal fee, it is treated as an intangible asset with an indefinite life and therefore not amortized but tested for impairment regularly.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #81 of 159

Question ID: 414479

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.

References

Question From: Session 8 > Reading 28 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #82 of 159

Question ID: 695547

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)** Increase.
- X **B)** Decrease.
- X **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:

ending inventory = beginning inventory + purchases - 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.

References

Question From: Session 8 > Reading 28 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #83 of 159

Question ID: 414497

A company is switching from straight-line depreciation to an accelerated method of depreciation. Assuming all other revenue and expenses are at the same levels for the next period, switching to an accelerated method will *most likely* increase the company's:

- X **A)** total assets on the balance sheet.
- X **B)** net income/sales ratio.
- ✓ **C)** fixed asset turnover ratio.

Explanation

The use of an accelerated depreciation method will increase depreciation expenses early in the asset's life. The book value of the asset will be lower. Fixed asset turnover ratio (sales/fixed assets) will increase, because the book value of the fixed assets will be lower.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #84 of 159

Question ID: 434295

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

	<i>Units</i>	<i>Unit Price</i>
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)** \$3,015.
- X **B)** \$4,824.
- X **C)** \$6,160.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #85 of 159

Question ID: 683862

From an analyst's point of view, 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.
- X **B)** Last in, first out (LIFO) for the balance sheet and first in, first out (FIFO) for the income statement.
- X **C)** First in, first out (FIFO) for both income statements and balance sheets.

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.

References

Question From: Session 8 > Reading 28 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #86 of 159

Question ID: 598966

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

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

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.

References

Question From: Session 8 > Reading 28 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #87 of 159

Question ID: 598965

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

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

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.

References

Question From: Session 8 > Reading 28 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #88 of 159

Question ID: 414488

Capitalizing interest costs related to a company's construction of assets for its own use is *required* by:

- ☐ A) U.S. GAAP only.
- ☒ B) both IFRS and U.S. GAAP.
- ☐ C) IFRS only.

Explanation

Both U.S. GAAP and IFRS require companies to capitalize the interest that accrues during a the construction of capital assets for their own use.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #89 of 159

Question ID: 448956

Lakeside Co. recently determined that one of its processing machines has become obsolete after 7 years of use and, unexpectedly, has no salvage value. The machine was being depreciated over a useful economic life of 10 years. Which of the following statements is *most* consistent with this discovery?

- ☐ A) Historically, economic depreciation was overstated in the financial statements.
- ☐ B) Lakeside Co. will owe back taxes.
- ☒ C) Historically, economic depreciation was understated in the financial statements.

Explanation

Historically, economic depreciation was understated. If an asset becomes obsolete and its useful life is less than expected, accounting methods for depreciation have understated the economic depreciation. In addition, if there is no salvage value when positive salvage value was expected, the understatement problem is compounded.

References

Question From: Session 8 > Reading 29 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #90 of 159

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)** weighted average because it allocates average 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)** FIFO because it allocates historical 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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #91 of 159

Question ID: 414525

Felker Inc. owns a piece of specialized machinery. The original cost of the machinery was \$500,000 and to date there is an accumulated depreciation balance of \$140,000. Which of the following will Felker recognize on its income statement if it sells the machinery for \$400,000?

- ☒ **A)** Gain of \$40,000.
- ☐ **B)** Loss of \$100,000.
- ☐ **C)** Loss of \$360,000.

Explanation

With a sale of an asset to a third party, the difference between the proceeds and carrying value is reported as a gain or loss on the income statement. The carrying value is \$360,000, which equals the original cost (\$500,000) less the accumulated depreciation (\$140,000). Therefore, the gain is equal to \$40,000 (\$400,000 proceeds less \$360,000 carrying value).

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #92 of 159

Question ID: 414529

A firm acquires investment property for 3 million and chooses the fair value model for financial reporting. In Year 1 the market value of the investment property decreases by 150,000. In Year 2 the market value of the investment property increases by 200,000. On its financial statements for Year 2, the firm will recognize a:

- ✓ **A)** 200,000 gain on its income statement.
- X **B)** 150,000 increase in shareholders' equity.
- X **C)** 150,000 gain on its income statement and a 50,000 revaluation surplus in shareholders' equity.

Explanation

Under the fair value model, all gains and losses from changes in the value of investment property are recognized on the income statement. The firm will recognize a loss of 150,000 in Year 1 and a gain of 200,000 in Year 2.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS
-

Question #93 of 159

Question ID: 498758

A company acquires an intangible asset for \$100,000 and expects it to have a value of \$20,000 at the end of its 5-year useful life. If the company amortizes the asset using the double-declining balance method, amortization expense in year 4 of the asset's useful life is *closest* to:

- X **A)** \$6,910.
- X **B)** \$8,640.
- ✓ **C)** \$1,600.

Explanation

Net book value at the end of year 3 is $\$100,000 \times 3/5 \times 3/5 \times 3/5 = \$21,600$. DDB amortization in year 4 of $2/5 \times \$21,600 = \$8,640$ would amortize the asset below its salvage value, so amortization expense is the remaining \$1,600 that will amortize net book value to \$20,000.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #94 of 159

Question ID: 414524

Spenser Inc. owns a piece of specialized machinery with a current fair value of \$400,000. The original cost of the machinery was \$500,000 and to date has generated accumulated depreciation of \$140,000. Which of the following must Spenser record on the income statement if it decides to abandon the asset?

- ☐ A) Loss of \$100,000.
- ☐ B) Gain of \$40,000.
- ☒ C) Loss of \$360,000.

Explanation

With an abandonment of an asset, the carrying value of the machinery is removed from the balance sheet and a loss of that amount is recognized in the income statement. The carrying value is \$360,000, which equals the original cost (\$500,000) less the accumulated depreciation (\$140,000).

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #95 of 159

Question ID: 550541

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) may be revalued up to 10 million.
- ☐ B) may be revalued up to 11 million.
- ☐ C) must remain valued at 9 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.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #96 of 159

Question ID: 434294

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

	<i>Units</i>	<i>Unit Price</i>
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:

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

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #97 of 159

Question ID: 683858

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?

- X **A)** Increase in finished goods inventory and corresponding decline in raw-materials and work-in-progress inventory over the last two years.
- X **B)** Finished goods inventory growing faster than sales in the last two years.
- ✓ **C)** Increase in raw-materials and work-in-progress inventory and corresponding decline in finished goods inventory over 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.

References

Question From: Session 8 > Reading 28 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #98 of 159

Question ID: 414508

Intangible assets with finite useful lives are:

- ✓ **A)** amortized over their expected useful lives.
- X **B)** not amortized, but are tested for impairment at least annually.
- X **C)** amortized over their actual lives.

Explanation

Intangible assets with finite lives are amortized over their expected useful lives, which is an estimate. Actual lives of intangible assets are often not known in advance. Intangible assets with infinite lives are not amortized, but are tested for impairment at least annually.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #99 of 159

Question ID: 414520

Under U.S. GAAP, an asset is impaired when:

- ✓ **A)** the firm can no longer fully recover the carrying amount of the asset.
- X **B)** accumulated depreciation plus salvage value exceeds acquisition costs.
- X **C)** the present value of future cash flows exceeds the carrying amount of the asset.

Explanation

An asset is impaired if its future cash flows (undiscounted) are less than its carrying value.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #100 of 159

Question ID: 414528

A building owned by a firm is *most likely* to be classified as investment property if:

- ✓ **A)** space in the building is rented to other firms.
- X **B)** the firm uses the building for its corporate headquarters.
- X **C)** the building is a manufacturing plant or distribution center.

Explanation

Under IFRS, investment property is an asset that is owned for the purpose of earning income from rentals, capital appreciation, or both.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS
-

Question #101 of 159

Question ID: 414445

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

- X **A)** specific units available for sale.
- ✓ **B)** most recent purchases.
- X **C)** earliest 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.

References

Question From: Session 8 > Reading 28 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #102 of 159

Question ID: 498760

In accounting for PP&E using the cost model, companies are required to disclose both gross asset value and accumulated depreciation under:

- ✓ **A)** both IFRS and U.S. GAAP.
- X **B)** IFRS but not U.S. GAAP.

X **C)** U.S. GAAP but not IFRS.

Explanation

Both IFRS and US GAAP require disclosure of gross asset values and accumulated depreciation.

References

Question From: Session 8 > Reading 29 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #103 of 159

Question ID: 414474

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?

- X **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.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #104 of 159

Question ID: 598958

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

- ☐ A) sales decrease during a reporting period.
- ☒ B) inventory quantity decreases during a reporting period.
- ☐ C) the firm changes to a different inventory cost method.

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.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #105 of 159

Question ID: 414492

Which of the following items is *least likely* an example of an intangible asset with an indefinite life?

- ☐ A) Trademarks that can be renewed at minimal cost.
- ☒ B) Acquired patents.
- ☐ C) Goodwill.

Explanation

Acquired patents are most likely purchased with the intent to use over a specific period of time and therefore would be an example of an intangible asset with a finite life. Goodwill, by definition, is an intangible asset with an indefinite life. Trademarks that can be renewed at minimal cost are also considered to be intangible assets with infinite lives.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #106 of 159

Question ID: 414480

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

- ✓ **A)** Low inventory turnover ratio.
- X **B)** Low inventory value compared to cost of goods sold.
- X **C)** Low number of days in inventory.

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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #107 of 159

Question ID: 598971

Which of the following is *best* estimated by the ratio of net PP&E to annual depreciation expense?

- ✓ **A)** Remaining useful life.
- X **B)** Total useful life.
- X **C)** Average age.

Explanation

Remaining useful life = ending net PP&E / annual depreciation expense.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS
-

Question #108 of 159

Question ID: 414505

This information pertains to equipment owned by Brigade Company.

- Cost of equipment: \$10,000.
- Estimated residual value: \$2,000.
- Estimated useful life: 5 years.
- Depreciation method: straight-line.

The accumulated depreciation at the end of year 3 is:

- X **A)** \$5,200.
- ✓ **B)** \$4,800.
- X **C)** \$1,600.

Explanation

Accumulated depreciation at the end of year 3 = $[(\$10,000 - \$2,000) / 5] \times 3 = \$4,800$

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #109 of 159

Question ID: 414499

On January 1, 2004, JME purchased a truck that cost \$24,000. The truck had an estimated useful life of 5 years and \$4,000 salvage value. The amount of depreciation expense recognized in 2006 assuming that JME uses the double declining balance method is:

- ✓ **A)** \$3,456.
- X **B)** \$5,760.
- X **C)** \$4,000.

Explanation

yr. 2004 = $24,000 \times 2/5 = 9,600$

yr. 2005 = $(24,000 - 9,600) \times 2/5 = 5,760$

yr. 2006 = $(24,000 - 9,600 - 5,760) \times 2/5 = 3,456$

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #110 of 159

Question ID: 414486

Which of the following statements regarding capitalizing versus expensing costs is *least* accurate?

- ✓ **A)** Total cash flow is higher with capitalization than expensing.

- X **B)** Cash flow from investing is higher with expensing than with capitalization.
- X **C)** Capitalization results in higher profitability initially.

Explanation

Total cash flow is higher with capitalization than expensing is least accurate because total cash flow would be the same under both methods, not considering tax implications.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #111 of 159

Question ID: 683845

In an inflationary environment, a company's:

- ✓ **A)** assets will be lower if it uses LIFO than if it uses FIFO.
- X **B)** net income will be larger if it uses LIFO than if it uses FIFO.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #112 of 159

Question ID: 485777

A company purchased inventory on January 1, 20X2, for 600,000. On December 31, 20X2, the inventory had a net realizable value 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 prepared under:

IFRS?

U.S. GAAP?

- X **A)** 525,000 550,000
- ✓ **B)** 550,000 525,000
- X **C)** 525,000 525,000

Explanation

Under IFRS, inventories are carried at the lower of cost or net realizable value (NRV), which in this case is 550,000. Under U.S. GAAP, inventories are carried at the lower of cost or market. In this case, the replacement cost of 525,000 would be used as it is below NRV and equal to the NRV less the normal profit margin.

References

Question From: Session 8 > Reading 28 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #113 of 159

Question ID: 414460

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:

- X **A)** \$3,780.
- ✓ **B)** \$3,760.
- X **C)** \$3,500.

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: $3 \times (\$2,800 / 5) = \$1,680$. $\text{COGS} = \$2,080 + \$1,680 = \$3,760$.

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #114 of 159

Question ID: 598976

With a finance lease, which party recognizes depreciation expense on the leased asset?

- ☐ A) Both the lessor and the lessee.
- ☒ B) The lessee.
- ☐ C) The lessor.

Explanation

On the lessee's financial statements, a finance lease is treated like a purchase with debt. The lessee adds the asset to its balance sheet along with a liability for the lease obligation and recognizes depreciation expense on the leased asset. The lessor removes the leased asset from its balance sheet and recognizes a lease receivable.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS
-

Question #115 of 159

Question ID: 434287

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) \$3,990.
- ☐ B) \$2,000.
- ☒ C) \$2,830.

Explanation

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

COGS = Units sold × weighted average cost = $848 \times 3.3363 = \$2,829.19$

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #116 of 159

Question ID: 414449

Blocher Company is evaluating the following methods of accounting for depreciation of long-lived assets and inventory:

- Depreciation: straight-line; double-declining balance (DDB)
- Inventory: first in, first out (FIFO); last in, first out (LIFO)

Assuming a deflationary environment (prices are falling), which of the following combinations will result in the highest net income in year 1?

- ☐ A) Straight-line; FIFO.
- ☐ B) DDB; FIFO.
- ☒ C) Straight-line; LIFO.

Explanation

For year 1, straight-line depreciation will be lower than DDB. During deflationary periods, LIFO will result in lower cost of goods sold and hence higher income.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #117 of 159

Question ID: 414519

Marcel Inc. is a large manufacturing company based in the U.S. but also operating in several European countries. Marcel has long-lived assets currently in use that are valued on the balance sheet at \$600 million. This includes previously recognized impairment losses of \$80 million. The original cost of the assets was \$750 million. The fair value of the assets was determined in a professional appraisal to be \$690 million. Assuming that Marcel reports under U.S. GAAP, the new appraisal of the assets' value most likely results in:

- ☐ A) an \$80 million gain on income statement and \$10 million gain in other comprehensive income.
- ☒ B) no change to Marcel's financial statements.
- ☐ C) a \$90 million gain in other comprehensive income.

Explanation

Under U.S. GAAP, long-lived assets are reported on the balance sheet at depreciated cost less any impairment losses (\$750 million original cost less \$70 million accumulated depreciation and less \$80 million impairment loss, for a net amount of \$600 million). Increases are generally prohibited with the exception of assets held for sale. Since these assets are currently in use, this exception does not apply. Therefore, Marcel may not revalue the assets upward.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #118 of 159

Question ID: 434288

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)** \$2,004.

X **B)** \$2,830.

X **C)** \$8,730.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #119 of 159

Question ID: 485775

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:

<u>Date</u>	<u>Quantity</u>	<u>Unit Cost</u>
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</u>
---------------------	---------------

inventory

- X **A)** \$1,138,000 \$279,000
- X **B)** \$1,112,000 \$279,000
- ✓ **C)** \$1,138,000 \$255,000

Explanation

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

<u>Date</u>	<u>Quantity</u>	<u>Unit Cost</u>	<u>Total Cost</u>
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.

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #120 of 159

Question ID: 683850

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?

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

Explanation

$$\begin{aligned}\text{FIFO COGS} &= \text{LIFO COGS} - \text{change in LIFO reserve} \\ &= \$16,000 - (\$4,000 - \$1,500) = \$13,500.\end{aligned}$$

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #121 of 159

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)** \$1,800.
- X **B)** \$3,100.
- X **C)** \$2,400.

Explanation

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #122 of 159

Question ID: 460646

In the early years of an asset's life, a firm that chooses an accelerated depreciation method instead of using straight-line depreciation will tend to have:

- X **A)** lower depreciation expense and lower turnover ratios.
- X **B)** higher return on equity and higher return on assets.
- ✓ **C)** lower net income and lower equity.

Explanation

These relationships are reversed in the later years of the asset's life if the firm's capital expenditures decline.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #123 of 159

Question ID: 434298

Three years ago, Ranchero Corporation purchased equipment for a process used in production, for £3 million. At the end of last year, Ranchero determined the fair value of the equipment was greater than its book value. No impairment losses have been recognized on the equipment. Assuming Ranchero follows International Financial Reporting Standards, what is the impact on its total asset turnover ratio and return on equity of reporting the value of the equipment on the balance sheet at fair value?

- X **A)** Both will increase.
- X **B)** Only one will increase.
- ✓ **C)** Both will decrease.

Explanation

Increasing the value of the equipment on the balance sheet will increase assets and thus decrease the total asset turnover ratio (higher denominator). Increasing the value of the equipment will also increase equity, otherwise, the balance sheet equation would not balance. Increasing equity will result in lower ROE (higher denominator). The increase in the value of the equipment is not recognized in the income statement unless it is reversing a previously recognized write-down.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #124 of 159

Question ID: 485778

The *most likely* result of increasing the estimated useful life of a depreciable asset is that:

- ✓ **A)** net profit margin will increase.
- X **B)** asset turnover will increase.
- X **C)** return on assets will decrease.

Explanation

The longer the estimated useful life of an asset, the lower the annual depreciation expense charged to operations. Lower depreciation expense results in higher net income, profit margins, and contributions to shareholder's equity.

References

Question From: Session 8 > Reading 29 > LOS g

Related Material:

- Key Concepts by LOS

Question #125 of 159

Question ID: 414502

Novak, Inc. owns equipment with a historical cost of \$20,000, a useful life of 5 years, and an estimated salvage value of \$5,000. Using the double declining balance method, depreciation expense in Year 3 for this equipment is:

- ✓ **A) \$2,200.**
- X **B) \$3,000.**
- X **C) \$2,880.**

Explanation

DDB depreciation in each year is $\frac{2}{5}$ of the carrying value at the beginning of the year, until the carrying value reaches the estimated salvage value.

Year 1 DDB depreciation = $\$20,000 \times \frac{2}{5} = \$8,000$

Carrying value = $\$20,000 - \$8,000 = \$12,000$

Year 2 DDB depreciation = $\$12,000 \times \frac{2}{5} = \$4,800$

Carrying value = $\$12,000 - \$4,800 = \$7,200$

Year 3 DDB depreciation = $\$7,200 \times \frac{2}{5} = \$2,880$

Because $\$7,200 - \$2,880 = \$4,320$ would depreciate the equipment below its salvage value, depreciation in Year 3 is limited to $\$7,200 - \$5,000 = \$2,200$.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #126 of 159

Question ID: 684024

Selected information from the financial statements of Salvo Company for the years ended December 31, 20X3 and 20X4 is as follows (in \$ millions):

	<u>20X3</u>	<u>20X4</u>
Sales	\$21	\$23
Cost of Goods Sold	(8)	(9)
Gross Profit	13	14
Cost of Franchise	(6)	0
Other Expenses	(6)	(6)
Net Income	\$1	\$8

Cash	\$4	\$5
Accounts Receivable	\$6	5
Inventory	9	7
Property, Plant & Equip. (net)	12	15
Total Assets	\$31	\$32

Accounts Payable	\$7	\$5
Long-term Debt	10	5
Common Stock	8	8
Retained Earnings	6	14
Total Liabilities and Equity	\$31	\$32

If Salvo had amortized the cost of the franchise acquired in 20X3 over six years instead of expensing it, Salvo's return on average total equity for 20X4 would have been *closest* to:

- X **A)** 35.6%.
- X **B)** 38.9%.
- ✓ **C)** 31.1%.

Explanation

If the franchise cost had been amortized over six years beginning in 20X3, net income in 20X3 would have been \$6 million instead of \$1 million due to the cost of franchise expense of \$6 million being eliminated and replaced by franchise amortization of \$1 million. Net income in 20X4 would have been reduced by the franchise amortization to \$7 million instead of \$8 million. On the equity side, retained earnings at the end of 20X3 would have been \$11 million (\$5 million higher), and total equity for 20X3 would have been \$8 + \$11 = \$19 million. Retained earnings for 20X4 would be the 20X3 retained earnings of \$11 million increased by 20X4 net income of \$7 million for a total of \$18 million, and total equity for 20X4 would be \$8 + \$18 = \$26 million. If the franchise cost were amortized, return on total equity for 20X4 would be $\$7 / ((19 + 26) / 2) = 31.1\%$.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #127 of 159

Question ID: 683851

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:

- X A) \$4,000.
- ✓ B) \$2,400.
- X 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)].

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

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS

Question #128 of 159

Question ID: 414526

Which set of accounting standards requires firms to disclose estimated amortization expense for the next five years on intangible assets?

- X A) Both IFRS and U.S. GAAP.
- X B) IFRS.
- ✓ C) U.S. GAAP.

Explanation

Estimated amortization expense for the next five years is required by U.S. GAAP but is not required by IFRS.

References

Question From: Session 8 > Reading 29 > LOS I

Related Material:

- Key Concepts by LOS

Question #129 of 159

Question ID: 414484

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:

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

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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #130 of 159

Question ID: 414509

Under normal circumstances, intangible assets with indefinite lives are:

- X **A)** amortized over a reasonable period but not subject to impairment.
- X **B)** amortized over a reasonable period and subject to impairment.
- ✓ **C)** not amortized but subject to impairment.

Explanation

Intangible assets with indefinite lives are not amortized but are subject to impairment charges. Under such situations, there may be in impairment in the asset value where events and circumstances indicate that the firm may not be able to recover the carrying value through future use. Examples include significant declines in market value of the asset or significant deterioration in the asset's physical condition.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #131 of 159

Question ID: 683855

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:

- X **A)** \$83,000.
- ✓ **B)** \$77,000.
- X **C)** \$91,000.

Explanation

COGS = 80,000 – (11,000 – 8,000) = 77,000.

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #132 of 159

Question ID: 598968

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.
- X **B)** Finished goods inventory increasing faster than sales.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #133 of 159

Question ID: 598975

Cash flows from an operating lease are recognized as:

- X **A)** CFF by the lessee and CFO by the lessor.
- ✓ **B)** CFO by both the lessor and the lessee.
- X **C)** CFO by the lessee and CFI by the lessor.

Explanation

Rental payments on an operating lease are an operating cash outflow for the lessee and an operating cash inflow for the lessor.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS
-

Question #134 of 159

Question ID: 414452

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

<i>Purchases</i>	<i>Sales</i>
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)** \$2,878.

X **B)** \$2,933.

X **C)** \$3,141.

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #135 of 159

Question ID: 598973

Compared to a firm that purchases a long-lived asset for cash and capitalizes the asset, a firm that leases the same asset with a finance lease will have:

- ✓ **A)** higher liabilities.
- X **B)** lower expenses in the period the asset is acquired.
- X **C)** higher long-lived assets.

Explanation

With a finance lease, the lessee recognizes both an asset and a liability on its balance sheet. When capitalizing a purchase, the buyer recognizes an asset but not a liability. In either case the firm will recognize depreciation expense on the asset, but with a finance lease the firm will also recognize interest expense on the liability.

References

Question From: Session 8 > Reading 29 > LOS o

Related Material:

- Key Concepts by LOS
-

Question #136 of 159

Question ID: 598960

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

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

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #137 of 159

Question ID: 414465

For balance sheet purposes, inventories based on:

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

References

Question From: Session 8 > Reading 28 > LOS I

Related Material:

- Key Concepts by LOS
-

Question #138 of 159

Question ID: 414511

Stannum Records obtains two intangible assets in a business acquisition: legal rights to reproduce songs, valued at \$5 million, and a trademark valued at \$1 million. The trademark expires in 10 years and can be renewed at a minimal cost. Stannum estimates a 5-year useful life for the song rights. Because much of the songs' economic value is realized in their early years, Stannum uses double-declining balance amortization. Amortization expense in the first year after the acquisition is *closest to*:

- ✓ **A)** \$2.0 million.
- X **B)** \$2.2 million.
- X **C)** \$2.1 million.

Explanation

Because the trademark can be renewed at minimal cost, it should be treated as an intangible asset with an indefinite life: the asset is not amortized but is tested for impairment at least annually. For the song rights, DDB depreciation in the first year = $2/5 \times \$5 \text{ million} = \2 million .

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #139 of 159

Question ID: 434291

Given the following data for a firm:

<i>Units</i>	<i>Unit Price</i>
--------------	-------------------

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) \$1,744.
- ☐ B) \$3,604.
- ☒ 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 $= (556 - 250) \times \$6 = \$1,836.00$.

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #140 of 159

Question ID: 414477

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

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

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS i

Related Material:

- Key Concepts by LOS

Question #141 of 159

Question ID: 414523

U.S. GAAP *least likely* requires property, plant, and equipment to be tested for impairment:

- ☐ A) when an asset is reclassified as held-for-sale.

- X **B)** when events indicate the firm may not recover the asset's carrying value.
- ✓ **C)** at least annually.

Explanation

Under U.S. GAAP, a PP&E asset is tested for impairment when events and circumstances indicate the firm may not recover its carrying value through future use, or if the asset is reclassified from held-for-use to held-for-sale. Under IFRS, firms are also required to assess at least annually whether events and circumstances indicate impairment may have occurred.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #142 of 159

Question ID: 414470

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

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

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #143 of 159

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?

<i>Purchases</i>	<i>Sales</i>
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>
X A)	\$650	\$750	\$990
X B)	\$677	\$650	\$677
✓ C)	\$650	\$750	\$677

Explanation

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

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

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

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

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

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

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS

Question #144 of 159

Question ID: 414467

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

- ✓ **A)** the same for both LIFO and FIFO.
- X **B)** higher under LIFO than FIFO or average cost.
- X **C)** higher under the average cost than LIFO or FIFO.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS

Question #145 of 159

Question ID: 414459

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 Corporation</u> | <u>Continental Incorporated</u> |
|-------------|----------------------------|---------------------------------|
| ✓ A) | Last-in, first-out | Average cost |
| X B) | Last-in, first-out | Last-in, first-out |
| X 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.

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #146 of 159

Question ID: 414503

Czernezyk Company buys a delivery vehicle for 60,000. Czernezyk expects to drive the vehicle 400,000 kilometers over 4 years, at the end of which the firm expects to be able to sell the vehicle for 10,000. At the end of Year 2, the vehicle has been driven 250,000 kilometers. If Czernezyk depreciates the vehicle by the units of production method, its carrying value at the end of Year 2 is:

- X **A)** 31,250.
X **B)** 15,000.
✓ **C)** 28,750.

Explanation

Depreciation per unit of production = $(60,000 - 10,000) / 400,000 \text{ km} = 0.125$ per kilometer. Through year 2, depreciation expense = $0.125 \times 250,000 = 31,250$. Carrying value at the end of Year 2 = $60,000 - 31,250 = 28,750$.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #147 of 159

Question ID: 434293

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

	<i>Units</i>	<i>Unit Price</i>
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) \$4,824.
- ☒ C) \$4,582.

Explanation

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #148 of 159

Question ID: 683854

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.

References

Question From: Session 8 > Reading 28 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #149 of 159

Question ID: 462071

Compared with firms that expense costs, firms that capitalize costs can be expected to report:

- X **A)** lower asset levels and higher equity levels in the early years of the asset's life.
- ✓ **B)** higher asset levels and higher equity levels in the early years of the asset's life.
- X **C)** higher asset levels and lower equity levels in the early years of the asset's life.

Explanation

The capitalized cost is recorded as an asset, which is then expensed in the form of depreciation over future years. Spreading the depreciation out over future years causes net income to increase along with retained earnings and equity in the early years of the asset's life.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #150 of 159

Question ID: 414447

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

<i>Purchases</i>	<i>Sales</i>
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)** \$3,850.
- X **B)** \$3,250.
- X **C)** \$3,200.

Explanation

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

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #151 of 159

Question ID: 652914

Davis Inc. is a large manufacturing company operating in several European countries. Davis has long-lived assets that are valued on the balance sheet at \$600 million. This includes previously recognized revaluation losses of \$80 million. In the most recent accounting period, the fair value of these assets in an active market is \$690 million. Which of the following entries will Davis record under the IFRS revaluation model?

- ☐ A) Gain on income statement only.
- ☒ B) Gain on income statement and a revaluation surplus.
- ☐ C) Revaluation surplus only.

Explanation

Under IFRS, firms may choose to report long-lived assets at fair value. Upward revaluations are permitted and will result in a gain recognized on the income statement to the extent it reverses a previously recognized loss. Any excess is reported as a revaluation surplus, a direct adjustment to equity. In this case, the carrying value of the assets is \$600 million and the fair value is \$690 million. Of the \$90 million excess of fair value over carrying value, \$80 million is recognized as a gain on the income statement to reverse the \$80 million loss that was previously recognized. The remaining \$10 million is recorded as revaluation surplus in shareholders' equity.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #152 of 159

Question ID: 414482

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

- ☒ A) Last in, first out (LIFO).
- ☐ B) Weighted average.
- ☐ C) First in, first out (FIFO).

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.

References

Question From: Session 8 > Reading 28 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #153 of 159

Question ID: 434290

Given the following data for a firm:

	<i>Units</i>	<i>Unit Price</i>
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*:

<u>Average cost</u>	<u>FIFO</u>
✓ A) \$3,600	\$2,900
X B) \$4,150	\$3,400
X C) \$3,600	\$3,400

Explanation

Average cost = cost of goods available / total units available

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

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

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

References

Question From: Session 8 > Reading 28 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #154 of 159

Question ID: 448955

Which of the following statements comparing straight-line depreciation methods to alternative depreciation methods is *least* accurate? Companies that use:

- X **A)** accelerated depreciation methods for tax purposes will decrease the amount of taxes paid in early years.
- ✓ **B)** accelerated depreciation methods will have lower asset turnover ratios than if they used straight line depreciation.
- X **C)** straight-line depreciation methods will have higher book values for the assets on the balance sheet than companies that use accelerated depreciation.

Explanation

Accelerated depreciation will lead to lower book values and hence a higher asset turnover ratio.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #155 of 159

Question ID: 652915

On January 1, 20X4, Cayman Corporation bought manufacturing equipment for \$30 million. On December 31, 20X6, Cayman determined the equipment was impaired and recognized a \$5 million impairment loss in its income statement. As of December 31, 20X7, the fair value of the equipment exceeded the book value by \$7 million. Cayman may recognize a gain in its 20X7 income statement if it reports under:

- ✓ **A)** IFRS, but not U.S. GAAP.
- X **B)** neither IFRS nor U.S. GAAP.
- X **C)** either IFRS or U.S. GAAP.

Explanation

U.S. GAAP does not permit upward valuations of plant and equipment. Under IFRS, the recovery is reported in the income statement to the extent that the previous downward adjustment (loss) was reported in net income. Any further increase in value is reported as revaluation surplus in shareholders' equity.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #156 of 159

Question ID: 683849

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

- X **A)** higher inventory.
- X **B)** lower earnings.
- ✓ **C)** higher 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.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #157 of 159

Question ID: 598959

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

- ✓ **A)** only for firms that use the LIFO inventory cost method.
- X **B)** for all firms except those that use the specific identification cost method.
- X **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.

References

Question From: Session 8 > Reading 28 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #158 of 159

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:

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

References

Question From: Session 8 > Reading 28 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #159 of 159

Question ID: 414506

Slovak Company purchased a machine that has an estimated useful life of eight years for \$7,500. Its salvage value is estimated at \$500.

What is the depreciation expense for the second year, assuming Slovak uses the double-declining balance method of depreciation?

- X **A)** \$1,875.
- ✓ **B)** \$1,406.
- X **C)** \$1,438.

Explanation

double-declining balance depreciation rate = $2 \times 1/8 = 1/4$ or 25%

first year depreciation will be $\$7,500 \times 0.25 = \$1,875$

second year depreciation will be $(\$7,500 - \$1,875) \times 0.25 = \$1,406$

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS