Inventories and Long-Lived Assets

Test ID: 7694097

Question #1 of 107

Question ID: 414504

Component depreciation is required under:

✗ **A) U.S. GAAP, but not IFRS.**

✓ **B)** IFRS, but not U.S. GAAP.

✗ **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.

Question #2 of 107

Question ID: 414479

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

✗ **A) Neither IFRS nor U.S. GAAP.**

✓ **B)** IFRS, but not U.S. GAAP.

✗ **C)** Both IFRS and 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.

Question #3 of 107

Question ID: 414489

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

✓ **A) investing.**

✗ **B)** financing.

✗ **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.

Question #4 of 107

Question ID: 414508

Intangible assets with finite useful lives are:

✓ **A) amortized over their expected useful lives.**

✗ **B)** not amortized, but are tested for impairment at least annually.

✗ **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.

Question #5 of 107

Question ID: 414448

Given the following inventory data about a firm:

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

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

✗ **A) $3,100.**

✗ **B)** $3,475.

✓ **C)** $1,575.

Explanation

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

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

Question #6 of 107

Question ID: 414445

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

✗ **A) specific units available for sale.**

✗ **B)** earliest purchases.

✓ **C)** most recent purchases.

Explanation

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

Question #7 of 107

Question ID: 414457

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

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

✓ **B)** lower gross profit compared to last-in first-out.

✗ **C)** higher inventory 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.

Question #8 of 107

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) Freight costs on inputs.**

✓ **B)** Selling cost.

✗ **C)** Conversion cost.

Explanation

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

Question #9 of 107

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

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

✗ **C)** LIFO or FIFO, but not weighted average cost.

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.

Question #10 of 107

Question ID: 434296

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

✗ **A) Debt-to-equity ratio.**

✗ **B)** Operating profit margin.

✓ **C)** Total asset turnover.

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.

Question #11 of 107

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)** Loss of $360,000.

✗ **C)** Gain of $40,000.

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).

Question #12 of 107

Question ID: 414485

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

✗ **A) Expensing costs creates lower cash flows from operations and lower cash flows from investing.**

✓ **B)** Capitalizing costs creates higher cash flows from operations and lower cash flows from investing.

✗ **C)** Capitalizing costs creates lower cash flows from operations and higher 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.

Question #13 of 107

Question ID: 414507

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

✓ **A) amortization.**

✗ **B)** depreciation.

✗ **C)** depletion.

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.

Question #14 of 107

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:

✗ **A) capitalize all costs of this project.**

✓ **B)** expense all costs of this project until technological feasibility has been established.

✗ **C)** expense all costs of this project in the periods incurred.

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.

Question #15 of 107

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:

✗ **A) $3,780.**

✓ **B)** $3,760.

✗ **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 × ($2,600 / 5) = $2,080. Cost of goods sold for the July 21 sale uses 3 of the units purchased on July 15: 3 × ($2,800 / 5) = $1,680. COGS = $2,080 + $1,680 = $3,760.

Question #16 of 107

Question ID: 414492

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

✗ **A) Goodwill.**

✗ **B)** Trademarks that can be renewed at minimal cost.

✓ **C)** Acquired patents.

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.

Question #17 of 107

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?
✗ **A)**	**525,000**	**525,000**
✓ **B)**	550,000	525,000
✗ **C)**	525,000	550,000

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.

Question #18 of 107

Question ID: 414493

During 2007, Big 4 Company's warehouse was totally destroyed by a tornado. Tornados are very rare in the region where Big 4 is located. The book value of the warehouse at the time of the tornado was 10 million and Big 4 is self-insured. In addition, on June 30, 2007, Big 4 acquired one of its major suppliers. The fair value of the net assets acquired by Big 4 was greater than the purchase price. According to International Financial Reporting Standards, should Big 4 recognize an extraordinary item for tornado damage and should Big 4 recognize negative goodwill on its balance sheet due to the acquisition?

	Extraordinary loss	Negative goodwill
✗ **A)**	**Yes**	**No**
✓ **B)**	No	No
✗ **C)**	No	Yes

Explanation

IFRS does not permit income statement items to be recognized as "extraordinary" in the income statement. Negative goodwill is not reported on the balance sheet; rather, the excess of fair value over the price paid in an acquisition is recognized as a gain in the income statement.

Question #19 of 107

Question ID: 414475

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

✗ **A) must remain valued at 9 million.**

✗ **B)** may be revalued up to 11 million.

✓ **C)** may be revalued up to 10 million.

Explanation

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

Question #20 of 107

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.

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

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

✓ **A) $4,351.**

✗ **B)** $5,248.

✗ **C)** $4,133.

Explanation

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

Question #21 of 107

Question ID: 485776

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

	Purchases	Units Total Cost
3/1/X6	400	$14,800
7/1/X6	450	$14,850
7/1/X6	30 units	8,100
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.**

✗ **B)** higher net income; lower working capital.

✗ **C)** lower net income; lower working capital.

Explanation

The first step is to determine the direction of prices:

Purchase	Total Cost	Units	Per-unit Cost
Begin inv.	$9,500	÷ 250	= $38
3/1/X6	14,800	÷ 400	= $37
7/1/X6	14,850	÷ 450	= $33
9/1/X6	15,950	÷ 550	= $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.

Question #22 of 107

Question ID: 414444

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

✓ **A) cost of sales near current cost and inventory below replacement cost.**

✗ **B)** cost of sales below current cost and inventory above replacement cost.

✗ **C)** inventory near replacement cost and cost of sales below current cost.

Explanation

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

Question #23 of 107

Question ID: 414446

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

✗ **A) $2,400.**

✓ **B)** $1,800.

✗ **C)** $3,100.

Explanation

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

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

Question #24 of 107

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.

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

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

✗ **A) $6,160.**

✗ **B)** $4,824.

✓ **C)** $3,015.

Explanation

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

Question #25 of 107

Question ID: 485778

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

✗ **A) return on assets will decrease.**

✗ **B)** asset turnover will increase.

✓ **C)** net profit margin will increase.

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.

Question #26 of 107

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) Neither of these items is required to be disclosed.**

✓ **B)** Both of these items are required to be disclosed.

✗ **C)** Only one 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.

Question #27 of 107

Question ID: 434291

Given the following data for a firm:

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

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

✗ **A) $1,744.**

✓ **B)** $1,836.

✗ **C)** $3,604.

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) × $6 = $1,836.00.

Question #28 of 107

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) $2,356.**

✓ **B)** $2,480.

✗ **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 × $5 = $2,480.

Question #29 of 107

Question ID: 414480

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

✗ **A) Low inventory value compared to cost of goods sold.**

✓ **B)** Low inventory turnover ratio.

✗ **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.

Question #30 of 107

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:

✗ **A) first-in first-out (FIFO).**

✗ **B)** specific identification.

✓ **C)** last-in first-out (LIFO).

Explanation

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

Question #31 of 107

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.**

✗ **B)** $2.2 million.

✗ **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 × $5 million = $2 million.

Question #32 of 107

Question ID: 414451

Given the following inventory data about a firm:

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

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

✓ **A) $1,225.**

✗ **B)** $1,575.

✗ **C)** $3,450.

Explanation

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

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

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

Question #33 of 107

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:

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

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

	Gross profit	Ending inventory
✓ **A)**	**$1,138,000**	**$255,000**
✗ **B)**	$1,138,000	$279,000
✗ **C)**	$1,112,000	$279,000

Explanation

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

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

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

COGS = $350,000 + $600,000 + (20 × $8,100) = $1,112,000

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

Ending inventory under FIFO will include the most recently purchased inventory.
ending inventory = $174,000 + (10 × $8,100) = $255,000.

Question #34 of 107

Question ID: 414453

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

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

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

Explanation

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

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

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

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

Question #35 of 107

Question ID: 414514

On January 1, 2004, Cayman Corporation bought manufacturing equipment for $30 million. On December 31, 2006, Cayman determined the equipment was impaired and recognized a $5 million impairment loss in its income statement. As of December 31, 2007, the fair value of the equipment exceeded the book value by $7 million. What amount of the recovery in value can Cayman recognize in its 2007 income statement under U.S. Generally Accepted Accounting Principles (U.S. GAAP) and under International Financial Reporting Standards (IFRS)?

	U.S. GAAP	IFRS

✓	**A)**	**$0**	**$5 million**
✗	**B)**	$0	$7 million
✗	**C)**	$5 million	$7 million

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. Otherwise, the increase in value is reported as an adjustment to equity. Thus, under IFRS, $5 million will be reported in 2007 net income and $2 million will be directly added to to equity (as an adjustment to equity).

Question #36 of 107

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?

✗ **A) Selling cost.**

✓ **B)** Allocation of fixed production overhead.

✗ **C)** Administrative 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.

Question #37 of 107

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) use the FIFO method, but must disclose a LIFO reserve.**

✓ **B)** only use the LIFO method.

✗ **C)** use any other inventory method under generally accepted accounting principles (GAAP).

Explanation

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

Question #38 of 107

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:

✗ **A) lower depreciation expense and lower turnover ratios.**

✗ **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.

Question #39 of 107

Question ID: 467386

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

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

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

Question #40 of 107

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.

Question #41 of 107

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) $800,000.**

✓ **B)** $400,000.

✗ **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.

Question #42 of 107

Question ID: 414490

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

✗ **A) lower asset levels and lower liability levels.**

✓ **B)** lower asset levels and lower equity levels.

✗ **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.

Question #43 of 107

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) $8,730.**

✓ **B)** $2,004.

✗ **C)** $2,830.

Explanation

COGS = 559 × $1 + (848 - 559) × $5 = $2,004.

Question #44 of 107

Question ID: 414469

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

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

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

✓ **C)** 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.

Question #45 of 107

Question ID: 414494

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

✓ **A) developed internally.**

✗ **B)** purchased from another firm.

✗ **C)** obtained in the acquisition of another firm.

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.

Question #46 of 107

Question ID: 414454

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

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

✗ **A) $3,600.**

✓ **B)** $3,250.

✗ **C)** $3,200.

Explanation

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

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

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

Question #47 of 107

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?

✗ **A) Only one will increase.**

✗ **B)** Both 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.

Question #48 of 107

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:

✓ **A) 28,750.**

✗ **B)** 15,000.

✗ **C)** 31,250.

Explanation

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

Question #49 of 107

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) $5,760.**

✗ **B)** $4,000.

✓ **C)** $3,456.

Explanation

yr. 2004 = 24,000 × 2/5 = 9,600

yr. 2005 = (24,000 − 9,600) × 2/5 = 5,760

yr. 2006 = (24,000 − 9,600 − 5,760) × 2/5 = 3,456

Question #50 of 107

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

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

Explanation

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

Question #51 of 107

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?

	Lincoln Corporation	Continental Incorporated
✗ **A)**	**Last-in, first-out**	**Last-in, first-out**
✓ **B)**	Last-in, first-out	Average cost
✗ **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.

Question #52 of 107

Question ID: 414450

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

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

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

✓ **A) $382,500.**

✗ **B)** $434,583.

✗ **C)** $485,000.

Explanation

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

Question #53 of 107

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

✗ **B)** net realizable value.

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

Explanation

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

Question #54 of 107

Question ID: 414526

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

✗ **A) IFRS.**

✗ **B)** Both IFRS and U.S. GAAP.

✓ **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.

Question #55 of 107

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

✗ **B)** prospectively, with LIFO layers calculated from past purchases and sales.

✓ **C)** prospectively, with the carrying value as the first LIFO layer.

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.

Question #56 of 107

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) 150,000 gain on its income statement and a 50,000 revaluation surplus in shareholders' equity.**

✓ **B)** 200,000 gain on its income statement.

✗ **C)** 150,000 increase 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.

Question #57 of 107

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?

✓ **A) $15,000.**

✗ **B)** $6,000.

✗ **C)** $12,000.

Explanation

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

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

Question #58 of 107

Question ID: 414509

Under normal circumstances, intangible assets with indefinite lives are:

✗ **A) amortized over a reasonable period but not subject to impairment.**

✗ **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.

Question #59 of 107

Question ID: 414512

Davis Inc. is a large manufacturing company operating in several European countries. Davis 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 by in independent appraisal to be $690 million. Which of the following entries may Davis record under IFRS?

✗ **A) $90 million revaluation surplus.**

✓ **B)** $80 million gain on income statement and a $10 million revaluation surplus.

✗ **C)** $90 million gain on income statement.

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 ($750 million original cost less $70 million accumulated depreciation and less $80 million impairment loss). 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 impairment loss that was previously recognized. The remaining $10 million is recorded as a revaluation surplus in shareholders' equity.

Question #60 of 107

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)** $78.

✗ **C)** $73.

Explanation

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

Question #61 of 107

Question ID: 434290

Given the following data for a firm:

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

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

	Average cost	FIFO
✗ **A)**	**$4,150**	**$3,400**
✓ **B)**	$3,600	$2,900
✗ **C)**	$3,600	$3,400

Explanation

Average cost = cost of goods available / total units available
= (709 × $2 + 556 × $6) / (709 + 556) = $3.7581
COGS using average cost = Units sold × average cost = 959 × $3.7581 = $3,604.02

FIFO COGS = (709 × $2) + [(959 - 709) × $6] = $2,918.00

Question #62 of 107

Question ID: 414470

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

✓ **A) lower gross profit compared to first-in first-out.**

✗ **B)** higher inventory compared to first-in first-out.

✗ **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.

Question #63 of 107

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
✗ **A)**	**Yes**	**No**
✓ **B)**	No	No
✗ **C)**	No	Yes

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).

Question #64 of 107

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) $58,750.**

✗ **B)** $71,430.

✓ **C)** $51,020.

Explanation

Year	*2 / Depreciable Life*	*× Book Value at Beginning of the Year*	*= Depreciation*
1	0.2857	250,000	71,429

2	0.2857	178,571	51,020

Question #65 of 107

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:

✓ **A) $4,300.**

✗ **B)** $4,400.

✗ **C)** $4,200.

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.

Question #66 of 107

Question ID: 414520

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

✗ **A) accumulated depreciation plus salvage value exceeds acquisition costs.**

✗ **B)** the present value of future cash flows exceeds the carrying amount of the asset.

✓ **C)** the firm can no longer fully recover the carrying amount of the asset.

Explanation

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

Question #67 of 107

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?

	Adjustment	Quick ratio
✗ **A)**	**$50,000 write-down**	**Yes**

✓ **B)** $50,000 write-down No

✗ **C)** $100,000 write-up No

Explanation

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

Question #68 of 107

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) $2,880.**

✗ **B)** $3,000.

✓ **C)** $2,200.

Explanation

DDB depreciation in each year is 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 × 2/5 = $8,000
Carrying value = $20,000 - $8,000 = $12,000

Year 2 DDB depreciation = $12,000 × 2/5 = $4,800
Carrying value = $12,000 - $4,800 = $7,200

Year 3 DDB depreciation = $7,200 × 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.

Question #69 of 107

Question ID: 485779

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 the lease?

✗ **A) Lower current ratio.**

✗ **B)** Lower debt-to-equity ratio.

✓ **C)** Higher asset turnover 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.

Question #70 of 107

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:

✗ **A) net income/sales ratio.**

✓ **B)** fixed asset turnover ratio.

✗ **C)** total assets on the balance sheet.

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.

Question #71 of 107

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:

✓ **A) impaired because its carrying value exceeds expected future cash flows.**

✗ **B)** impaired because expected salvage value has declined.

✗ **C)** not impaired.

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 × 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 × $1,500,000) + $1,000,000 = $8,500,000, the stamping machine is impaired.

Question #72 of 107

Question ID: 414515

Which of the following statements about accounting treatments under IFRS and U.S. GAAP are *most* accurate regarding the periodic valuation of identifiable intangible assets and marketable securities classified as available for sale, respectively?

	Identifiable intangible assets	Available-for-sale securities
✗ **A)**	**U.S. GAAP permits upward revaluation**	**Carried at market value**
✗ **B)**	U.S. GAAP permits upward revaluation	Carried at amortized cost

✓ **C)** IFRS permits upward revaluation — Carried at market value

Explanation

Under IFRS and U.S. GAAP, identifiable intangible assets are reported on the balance sheet at their cost less accumulated amortization. However, a significant difference is that U.S. GAAP does not permit upward revaluations of intangible assets.

The accounting treatment for available-for-sale securities is the same under IFRS and U.S. GAAP. These securities are carried on the balance sheet at their fair market values. Unrealized gains and losses are not recognized on the income statement, but are included in other comprehensive income.

Question #73 of 107

Question ID: 414452

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

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

✗ **A) $3,141.**

✓ **B)** $2,878.

✗ **C)** $2,933.

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

Question #74 of 107

Question ID: 414465

For balance sheet purposes, inventories based on:

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

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

✗ **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.

Question #75 of 107

Question ID: 414491

A firm that capitalizes rather than expensing costs will have:

✗ **A) lower cash flows from operations.**

✗ **B)** lower profitability in the earlier years.

✓ **C)** lower cash flows from investing.

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.

Question #76 of 107

Question ID: 485780

On December 31, Year 1, an entity adopted the IFRS revaluation model for reporting its long-term assets and revalued a patent with a carrying value of $85,000 and a 10-year life to its fair value of $75,000. On December 31, Year 2, before recording any amortization, the entity determined that the patent had a fair value of $90,000. In its December 31, Year 2, financial statements, the entity will report a revaluation gain of:

✗ **A) $5,000 on the income statement and $10,000 in other comprehensive income.**

✓ **B)** $10,000 on the income statement and $5,000 in other comprehensive income.

✗ **C)** $15,000 in other comprehensive income.

Explanation

The total Year 2 revaluation gain is $15,000 ($90,000 fair value on 12/31/Y2 - $75,000 fair value on 12/31/Y1). $10,000 of the revaluation gain will be recognized on the income statement to reverse the revaluation loss of $10,000 ($75,000 fair value - $85,000 carrying value) reported on the income statement in Year 1. The remaining $5,000 will be recognized as a revaluation surplus in Year 2 other comprehensive income.

Question #77 of 107

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.**

✗ **B)** the building is a manufacturing plant or distribution center.

✗ **C)** the firm uses the building for its corporate headquarters.

Explanation

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

Question #78 of 107

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)** offset the pledged inventories against current liabilities.

✗ **C)** create a contra asset account in the amount of the pledged inventories.

Explanation

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

Question #79 of 107

Question ID: 414447

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

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

✗ **A) $3,200.**

✗ **B)** $3,250.

✓ **C)** $3,850.

Explanation

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

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

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

Question #80 of 107

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.

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

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

✓ **A) $5,250.**

✗ **B)** $4,350.

✗ **C)** $4,980.

Explanation

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

[(699 × 5) + (710 × 8)] / (699 + 710) = 6.51171

COGS = Units sold × Weighted average cost = 806 × 6.51171 = $5,248.44.

Question #81 of 107

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) no change to Marcel's financial statements.**

✗ **B)** a $90 million gain in other comprehensive income.

✗ **C)** an $80 million gain on income statement and $10 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.

Question #82 of 107

Question ID: 414521

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

✓ **A) debt-to-equity ratio.**

✗ **B)** assets.

✗ **C)** future depreciation expense.

Explanation

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

Question #83 of 107

Question ID: 448955

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

✗ **A) accelerated depreciation methods for tax purposes will decrease the amount of taxes paid in early years.**

✗ **B)** straight-line depreciation methods will have higher book values for the assets on the balance sheet than companies that use accelerated depreciation.

✓ **C)** accelerated depreciation methods will have lower asset turnover ratios than if they used straight line depreciation.

Explanation

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

Question #84 of 107

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.

Question #85 of 107

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.**

✗ **B)** effectiveness of a firm's inventory management.

✗ **C)** age of a firm's inventory.

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.

Question #86 of 107

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.

Question #87 of 107

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 profitability in the periods after revaluation.**

✗ **B)** Lower solvency ratios.

✗ **C)** Higher earnings in the revaluation period.

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.

Question #88 of 107

Question ID: 414482

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

✗ **A) Weighted average.**

✓ **B)** Last in, first out (LIFO).

✗ **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.

Question #89 of 107

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)** Historically, economic depreciation was understated in the financial statements.

✗ **C)** Lakeside Co. will owe back taxes.

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.

Question #90 of 107

Question ID: 414487

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

✗ **A) Capitalized expenses increases equity.**

✓ **B)** Capitalizing an expense lowers current period net income.

✗ **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.

Question #91 of 107

Question ID: 414523

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

✓ **A) at least annually.**

✗ **B)** when an asset is reclassified as held-for-sale.

✗ **C)** when events indicate the firm may not recover the asset's carrying value.

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.

Question #92 of 107

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?

✗ **A) The write-downs are reported as a component of income from continuing operations.**

✗ **B)** During the year of the write-downs, retained earnings and deferred taxes will decrease.

✓ **C)** Write-downs taken on asset values can be reversed in later years if market conditions improve.

Explanation

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

Question #93 of 107

Question ID: 414456

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

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

✗ **A) $5,676.00.**

✓ **B)** $6,213.98.

✗ **C)** $6,027.56.

Explanation

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

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

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

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

Question #94 of 107

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 × 3.3363 = $2,829.19

Question #95 of 107

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.

Question #96 of 107

Question ID: 414486

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

✗ **A) Cash flow from investing is higher with expensing than with capitalization.**
✓ **B)** Total cash flow is higher with capitalization than expensing.
✗ **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.

Question #97 of 107

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:

✗ **A) gross profit margin.**
✗ **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.

Question #98 of 107

Question ID: 414506

Slovac 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 Slovac uses the double-declining balance method of depreciation?

✗ **A) $1,438.**

✗ **B)** $1,875.

✓ **C)** $1,406.

Explanation

double-declining balance depreciation rate = 2 × 1/8 = ¼ or 25%

first year deprecation will be $7,500 × 0.25 = $1,875

second year deprecation will be ($7,500 − $1,875) × 0.25 = $1,406

Question #99 of 107

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.**

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

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

Explanation

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

Question #100 of 107

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.**

✗ **B)** An analyst must determine which inventory cost method was used by examining the firm's current and historical inventory values.

✗ **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.

Question #101 of 107

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:

✗ **A) $5,200.**

✓ **B)** $4,800.

✗ **C)** $1,600.

Explanation

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

Question #102 of 107

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) LIFO inventory and FIFO cost of goods sold.**

✗ **B)** FIFO inventory and FIFO cost of goods sold.

✓ **C)** FIFO inventory and LIFO 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.

Question #103 of 107

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?

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

✗ **B)** Make no adjustments to the valuation of inventory on either date.

✗ **C)** Write down inventory by $30,000 on December 31, 20X8 and write up inventory by $70,000 on January 31, 20X9.

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, 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, 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.

Question #104 of 107

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.

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

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

✗ **A) $6,160.**

✓ **B)** $4,824.

✗ **C)** $4,582.

Explanation

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

Question #105 of 107

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) Loss of $100,000.**

✗ **B)** Loss of $360,000.

✓ **C)** Gain of $40,000.

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).

Question #106 of 107

Question ID: 414464

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

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

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

✗ **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.

Question #107 of 107

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.