

34**ANALYSIS OF INVENTORIES**

1. In a decreasing price environment, the first-in first-out (FIFO) inventory cost method results in:
 - (A) lower cost of goods sold compared to last-in first-out.
 - (B) higher inventory compared to last-in first-out.
 - (C) lower gross profit compared to last-in first-out.

2. 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.

3. A U.S. GAAP reporting firm changes its inventory cost flow assumption from average cost to LIFO. The firm must apply this change:
 - (A) prospectively, with LIFO layers calculated from past purchases and sales.
 - (B) prospectively, with the carrying value as the first LIFO layer.
 - (C) retrospectively, because it is a change in accounting principle.

4. 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) Both IFRS and U.S. GAAP.
 - (C) IFRS, but not U.S. GAAP.

5. 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.

6. 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) | \$ 100,000 write-up | No |
| (B) | \$ 50,000 write-down | No |
| (C) | \$ 50,000 write-down | Yes |
7. Using the lower of cost or market principle under U.S. GAAP, if the market value of inventory falls below its historical cost, the minimum value at which the inventory can be reported in the financial statements is the:
- (A) net realizable value.
 (B) market price minus selling costs minus normal profit margin.
 (C) net realizable value minus selling costs.
8. A company purchased inventory on January 1, 20X2, for \$600,000. On December 31, 20X2, the inventory had a net realizable value (NRV) of \$550,000 and a replacement cost of \$525,000, which is also the NRV less the normal profit margin. What would be the carrying value of the inventory on the company's December 31, 20X2, balance sheet using:
- | | lower of cost or NRV?: | lower of cost or market? |
|-----|-------------------------------|---------------------------------|
| (A) | \$525,000; | \$525,000 |
| (B) | \$525,000; | \$550,000 |
| (C) | \$550,000; | \$525,000 |
9. During periods of rising prices and stable or growing inventories, the most informative inventory accounting method for income statement purposes is:
- (A) FIFO because it allocates historical prices to cost of good sold (COGS) and provides a better measure of current income.
 (B) LIFO because it allocates current prices to cost of good sold (COGS) and provides a better measure of current income.
 (C) weighted average because it allocates average prices to cost of good sold (COGS) and provides a better measure of current income.

10. If prices and inventory quantities are increasing, the last-in first-out (LIFO) inventory cost method results in:
- (A) higher inventory compared to first-in first-out.
 - (B) lower cost of goods sold compared to first-in first-out.
 - (C) lower gross profit compared to first-in first-out.
11. If a firm pledges inventories as collateral for a loan, the firm must:
- (A) offset the pledged inventories against current liabilities.
 - (B) disclose the carrying value of the pledged inventories.
 - (C) create a contra asset account in the amount of the pledged inventories.
12. Assuming beginning inventory levels are zero, inventory levels increase during the year and prices have been stable over time, COGS would be:
- (A) higher under LIFO than FIFO or average cost.
 - (B) higher under the average cost than LIFO or FIFO.
 - (C) the same for both LIFO and FIFO.
13. In an inflationary environment, a company's:
- (A) net income will be larger if it uses LIFO than if it uses FIFO.
 - (B) Cost of goods sold will be lower if it uses LIFO than if it uses FIFO.
 - (C) assets will be lower if it uses LIFO than if it uses FIFO.
14. 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.
15. A company that reports under U.S. GAAP and changes its inventory cost assumption from weighted average cost to last-in first-out is required to apply this change in accounting principle:
- (A) prospectively, and explain the reasons for the change in the financial statement disclosures.
 - (B) retrospectively, and disclose the new cost flow method being used.
 - (C) retrospectively, and explain the reasons for the change in the financial statement disclosures.
16. If all else holds constant in periods of rising prices and inventory levels:
- (A) FIFO firms will have greater stockholder's equity than LIFO firms.
 - (B) FIFO firms have higher debt to equity ratios than LIFO firms.
 - (C) LIFO firms have higher gross profit margins than FIFO firms.

17. Judah GmbH. 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) Make no adjustments to the valuation of inventory on either date.
 - (B) Write down inventory by €30,000 on December 31, 20X8 and write up inventory by €30,000 on January 31, 20X9.
 - (C) Write down inventory by €30,000 on December 31, 20X8 and write up inventory by €70,000 on January 31, 20X9.
18. 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 lower, resulting in a higher gross profit.
 - (B) FIFO because during periods of decreasing prices, COGS will be higher, resulting in a higher gross profit.
 - (C) LIFO because during periods of decreasing prices, COGS will be lower, resulting in a higher gross profit.
19. The effect of an inventory writedown on a firm's return on assets (ROA) is most accurately described as:
- (A) higher ROA in the current period and lower ROA in later periods.
 - (B) lower ROA in the current period and higher ROA in later periods.
 - (C) lower ROA in the current period and no effect on ROA in later periods.
20. Tim Rogers is senior equity analyst with White Capital LLP. While analyzing the inventory disclosures of Drako Toys Inc., a toy manufacturer based in Cleveland, Ohio, Rogers concludes that Drako is expected to see above-average sales growth over the next three years. Which of the following disclosures would most likely support Rogers's conclusion?
- (A) Finished goods inventory growing faster than sales in the last two years.
 - (B) Increase in raw-materials and work-in-progress inventory and corresponding decline in finished goods inventory over the last two years.
 - (C) Increase in finished goods inventory and corresponding decline in raw-materials and work-in-progress inventory over the last two years.

21. Victor Electronics, a manufacturer of electronic components, reports inventory using the FIFO costing method. In the prior period, Victor wrote its inventory down from cost of \$2 million to its net realizable value of \$1 million. During the current period, net realizable value increased to \$4 million because of a shortage of computer chips. For the current period, Victor would most appropriately report an inventory value of:
- (A) \$ 2 million under both IFRS or U.S. GAAP.
 (B) \$ 2 million under IFRS and \$1 million under U.S. GAAP.
 (C) \$ 2 million under U.S. GAAP and \$ 4 million under IFRS.
22. A U.S. GAAP firm writes down inventory to net realizable value. In the period of the writedown, what is the most likely effect on cost of goods sold?
- (A) Decrease.
 (B) Increase.
 (C) No effect.
23. 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.
24. A firm determines that inventory of manufactured goods with a cost of €10 million has a net realizable value of €9 million and writes down its carrying value to this amount. One period later, the firm determines that the net realizable value of this inventory has increased to €11 million. Under IFRS, the carrying value of this inventory:
- (A) must remain valued at €9 million.
 (B) may be revalued up to €10 million.
 (C) may be revalued up to €11 million.
25. 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) a decrease.
 (C) an increase.
26. 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)	First-in, first-out	First-in, first-out
(B)	Last-in, first-out	Average cost
(C)	Last-in, first-out	Last-in, first-out

27. Which of the following circumstances is most likely indicative of an increase in a company's future earnings?
- (A) Finished goods inventory increasing faster than sales.
 - (B) Finished goods inventory increasing faster than work-in-process inventory.
 - (C) Work-in-process inventory increasing faster than finished goods inventory.
28. Which of the following statements about inventory presentation and disclosures is most accurate?
- (A) An analyst must determine which inventory cost method was used by examining the firm's current and historical inventory values.
 - (B) Changing from FIFO to LIFO is a change in accounting principle that must be applied retrospectively.
 - (C) IFRS permits reversals of inventory writedowns but the firm must disclose the circumstances of the reversal in its financial statements.
29. Snow Blower Industries operates in an increasing price environment and uses the FIFO method for inventory reporting. Compared to the weighted average cost method, Snow Blower's use of the FIFO method will most likely decrease:
- (A) ending inventory.
 - (B) cost of goods sold.
 - (C) net income.
30. Barber Inc., which uses LIFO inventory accounting under U.S. GAAP, sells DVD recorders. On October 14, it purchased a large number of recorders at a cost of \$90 each. Due to an oversupply of recorders remaining in the marketplace due to lower than anticipated demand during the Christmas season, the selling price at December 31 is \$ 80 and the replacement cost is \$73. The normal profit margin is 5 percent of the selling price and the selling costs are \$ 2 per recorder. What is the value of the recorders on December 31?
- (A) \$73.
 - (B) \$78.
 - (C) \$74.
31. During periods of declining prices, which inventory method would result in the highest net income?
- (A) Average Cost.
 - (B) FIFO.
 - (C) LIFO.

32. During periods of rising prices, which of the following is most likely to occur?
- (A) LIFO cost of sales < FIFO cost of sales, therefore LIFO net income < FIFO net income.
 - (B) LIFO cost of sales > FIFO cost of sales, therefore LIFO net income > FIFO net income.
 - (C) LIFO cost of sales > FIFO cost of sales, therefore LIFO net income < FIFO net income.
33. 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) last-in first-out (LIFO).
 - (C) specific identification.

