

1. Factors that can cause inventories to earn abnormal positive or negative rates of return include unexpected shifts in customers' demand, newly discovered uses for the inventory, and obsolescence.
2. A manufacturer will hold inventories of raw materials, work-in-process, and finished goods.
3. Stock-out costs relate to lost sales. Inventory may stock out because of improper ordering or production rules, because of raw materials shortages, or because of abnormally high demand.
4. The fundamental inventory balance equation is Beginning Inventory plus purchases minus cost of goods sold equals ending inventory.
5. The formula for cost of goods sold is Beginning Inventory plus purchases minus ending inventory.
6. In a periodic inventory system, the ending inventory quantity is determined by an actual physical count of goods on hand as of the balance sheet date. In a perpetual inventory system, updated values for inventories and cost of goods sold are maintained each time a sale is made.
7. A physical count will be required if a company is using a perpetual inventory system because a company needs to determine if there is any inventory shrinkage from theft, obsolescence, etc.
8. The three commonly used cost flow assumptions allowed by GAAP are FIFO (First-In, First-Out), LIFO (Last-In, First-Out) and Average Cost.
9. Sellers of high value, low volume items or items with unique identifications such as serial numbers are likely to use Specific Identification.
10. The lower of cost or market rule states that, if market values of inventory decline below cost, the company must write down the inventory value to market value.
11. The LIFO conformity rule is a tax rule requiring that companies that use LIFO calculating income taxes also use LIFO for financial reporting purposes.
12. In periods of falling prices, companies with stable or rising inventory

methods will report higher income under LIFO than FIFO. Therefore, these companies would prefer to use FIFO in these circumstances to reduce income tax liabilities.

13. To write down inventory, a company could debit cost of goods sold and credit inventory or debit loss on writedown and credit inventory.
14. In periods of rising prices, FIFO results in the highest net income. The level of inventory is assumed to be non-decreasing.
15. In periods of rising prices, FIFO, which results in the highest net income, will result in the highest income taxes paid.
16. In periods of falling prices, LIFO will result in the highest inventory valuation on the balance sheet, since the most recently acquired inventory, which would have the lowest cost, will be assumed to be sold, leaving the oldest, and most expensive inventory, still on the balance sheet.
17. Under normal circumstances, older inventory layers will be comprised of older costs. Liquidating old LIFO inventory will result in a lower cost of goods sold and a higher profit, assuming that prices have risen on average.
18. Gross profit percentage is gross profit divided by sales.
19. Organizations using LIFO are required to disclose what their inventory would have been if they had used FIFO so that financial analysts can convert the accounting results of a company using LIFO to a comparable FIFO basis for comparison with competitors.
20. With rising prices, cost of goods sold will be higher and ending inventory will be lower than if FIFO had been used. Therefore, inventory turnover will be higher under LIFO than FIFO.
21. Days inventory held are computed by dividing 365 by the inventory turnover.
22. A LIFO reserve is the excess of FIFO cost of inventory in the balance sheet over LIFO cost of inventory in the balance sheet that must be disclosed by companies using the LIFO method.