Client understanding paper assignment

University of Phoenix ACC/541 Client Understanding Paper As per your request of an analysis of the following topics: Adjusting lower of cost or market inventory on valuation, Capitalizing interest on building construction, Recording gain or loss on asset disposal, and Adjusting goodwill for impairment. The Financial Accounting Standards Board (FASB) established clear guidelines addressing the items mentioned above. I will outline that FASB generally accepted accounting standards (GAAP) affect each area, and how these improvements to the company will benefit the company's financial health (FASB, 2010).

The methods of inventory valuation are different according to companies, but at the end of the day the chosen method should be consistent each year according to the general accepted accounting principles. A manufacturing company will generate inventories for finished product, raw materials and work in progress, so lowering the cost of market inventory can be very intimidating and consuming. Inventories and prepaid expenses present some additional valuation issues.

With the emphasis on net income reporting, the inventory valuation process has become secondary to the matching of expired inventory costs to sales. The use of any of the acceptable inventory flow assumption techniques prescribes the amount that remains on the balance sheet, and it is likely that each of these flow assumptions will result in different inventory valuations in fluctuating market conditions. In addition, the accounting convention of conservatism requires that a lower of cost or market valuation be used for inventories (Schroeder, Clark, & Cathey, 2005).

Using the first-in-first out (FIFO) or the last-in-first-out (LIFO) method is the perfect way to identify the cost of each inventory item. " A valuation method (e. g. LIFO, FIFO, average cost and specific identification) is used to compute the cost of the inventory dollar amounts and then it is compared to the market dollar amount. " LIFO is not commonly used because the last goods purchased are the first to be sold. The inventory at the beginning of the year will have the earliest goods purchased acquiring a valuation of an early price.

FIFO is better used for lowering cost especially during periods of increase prices. It is also important to identify a method for valuing the items in the inventory and calculating the cost of goods sold. This can be done through the cost method, the lower of cost or market and the retail method. " A valuation method is used to compute the cost of the inventory dollar amounts and then it is compared to the market dollar amount. The lower of the two amounts must be used when recording inventory. " The cost method involves all direct and indirect costs to acquire the inventory.

The cost of the products purchased consists of the invoiced purchase price minus discounts or trade with and addition of transportation, shipping additional cost incurred for attaining the product. Lower of cost or market method " determine the market value of each item on hand as of the inventory date, compare the market value with the cost of each item, and use the lower of the two as the inventory value of that item" (Hagen, 2005). The American Institute of Certified Public Accountants (AIPCA) in conjunction with the Financial Standards Accounting Board (FASB) issued ARB No. 3 that lower of cost or market rule apply to all inventories. Lower of cost or market aspect (LCM) is also supported and defined by SFAC No. two and SFAC No. 6. The LCM rule considers the market that purchases and sells the inventory. In general, the conservatism principle applies to LCM method of accounting. Conservatism principle directs a company to choose the more " conservative" dollar amount when considering two amounts that represent inventories. This helps a Company to report accurate losses on their income statement. To determine LCM, one must also consider net realizable value (NRV).

This value represents the selling price of inventories minus the fees associated with completion of sales. The NVR is key to determining true LCM. Conclusion of market value also refers to an items current replacement cost. This cost falls between the NRV (ceiling value) and the floor value (NRV-normal profit). Inventory cost adjustments are required by accounting standards. Incorrectly reporting inventory values at higher levels is a fraudulent act (with harsher penalties under Sarbanes Ox). Inventory valued at $10 with a true value of $5 is a punishable event (FASB, 2010).

When a building asset is developed, a vast amount of time is required between the start and completion of the project. Normally the cost of should include all cost to prepare the asset for its useful life of the asset or for sale. The capitalization of interest cost on a building give a guideline on the amount of interest to be capitalized and for the financial statement disclosure. The expenditures must be qualified ahead of time, activities must be in progress and the company must be paying interest. Capitalization ends when the building fully constructed and is in use.

Interest is not capitalized on inventories manufactured on a repeated basis or if the building is acquired using gifts or grants under restriction by the donor or grantor. “ When additional financing is incurred after construction expenditures have begun, a firm may capitalize interest on construction expenditures either using an end-of-period average interest rate that includes all financing outstanding at the end of the period (general or specific, as appropriate) or using only the finance outstanding when the construction expenditure was made. Scofield, 2004) The average capitalized rate can be computed using the weighted-average or the specific method. If you were to purchase a building after it was completed, the sales price would include all costs (plus a profit to the seller). Part of the costs in building something is the interim borrowing costs… in this case, the construction loan. Adding the loan to the other costs (brick, mortar, labor) is called “ capitalizing” the interest expense. This creates a higher cost basis for the building and can be “ recovered” through the depreciation expense deduction (over the life of the building).

The three main events in the life of an asset are the acquisition, useful life, and disposal or retirement. At the end of an asset’s life, gain or loss of its disposal is recorded. A gain or loss will take place at the disposal of any assets and should be logged as journal entry along with any related incidental cost. The unrealized gains and losses are noticed according to its earnings. All changes whether upward or downward that involves investment shares are shown as income or losses with a change in market value that requires an adjustment to its carry value.

At the time disposal there can either be a gain or loss or no gain or loss. Schroeder, Clark and Cathey states that all unrealized gains and unrealized losses will be valued the same for asset valuation purposes. For trading securities, the gains and losses are noticed in those periods in which they occur; for these assets the method is consistent with other accrual accounting requirements. A consistency with the SFAC No. six definition of comprehensive income is determined because comprehensive income is determined by the changes in net assets and would include changes in the market values of assets.

For trading securities, no further masking of gains against losses that occurred under the aggregate valuation approach of SFAS No. twelve is needed. Goodwill for impairment must be assessed by companies at least once per year. If an impairment of goodwill the carried amount will be lessened and there will be recognition of impairment loss. Goodwill for impairment test must be recorded as reporting units. These could be the company's operating segments identified under SFAS 131, or a " component" of a reportable operating segment as defined in paragraph 30 of SFAS 142. (Huefner and Largay III, 2008).

Goodwill is comparing each unit's estimated fair value of the reporting unit with the unit's fair values of its identifiable net assets. This process and the process of allocating purchase price differentials of asset acquired, goodwill and liabilities assumed is very similar. The total of the tentative assignments of goodwill to reporting units can surpass the total goodwill recorded by the total entity but when this occurs, the tentative unit assignments are reduced in some reasonable fashion to make the sum equal to the total recorded goodwill (Huefner and Largay III, 2008).

Losses on impairment cannot be changed but according to Schroeder, Clark and Cathey, an impairment loss for goodwill should be reversed only if the specific external event that caused the recognition of the impairment loss reverses. A reversal of an impairment loss should be recognized as income in the income statement for assets carried at cost and treated as a revaluation increase for assets carried at revalued amount. At the end of the developing period, the annual impairment test is done on an aggregate basis, which means an increase in goodwill on some books annot offset impairments found in other units. Huefner and Largay III also states that given the potential significance of the change in the accounting treatment of a major asset, the authors expected to observe numerous large impairment write-offs due to implementing the new standard, and large increases in net income because of eliminating goodwill amortization as an expense. In conclusion assets involving current assets, long-term investments, fixed assets, and intangible assets at some point can be changed into cash.

Intangible assets except goodwill can either be determinable or indeterminable useful lives. Schroeder, Clark and Cathey explain that those with determinable useful lives are written off over the period of benefit. The cost of acquiring goodwill as well as intangible assets with indeterminate useful lives, is not amortized. References Schroeder, Richard G. , Clark, Myrtle W. , and Cathey, Jack M. (2005). Financial Accounting Theory and Analysis, The Development of Accounting Theory. Financial Accounting Standards Board. 2010). Financial Accounting Standards Board home.

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