

Merchandise Inventory

Pratt, Financial Accounting 7e, Chapter 7

Inventory consists of the items being held for sale in the normal course of business

Generally the items held in your physical possession at the end of the period will compromise your inventory. However you should also include items held by others on consignment and any items in transit that are still legally yours.

Freight Terms:

- FOB Shipping Point – title to the goods passes from the buyer to the seller when the item is shipped
- FOB Destination – title to the goods passes from the buyer to the seller when the good are received

Generally all costs that are necessary to prepare the item for sale should be included in the cost of inventory.

Perpetual Method vs. Period Method

Inventory Journal Entries

Inventory Costing \$200 is purchased on account, terms 2/20, n/30		
Inventory	200	
Accounts Payable		200
\$50 of the items purchased are returned for credit		
Accounts Payable	50	
Inventory		50
The balance is paid within the discount period		
Accounts Payable	150	
Inventory		3
Cash		147
Items that cost \$100 are sold on account for \$180, terms n/30		
Accounts Receivable	180	
Sales		180
Cost of Goods Sold	100	
Inventory		100
Items that cost \$50 and were sold for \$80 are returned		
Sales Returns and Allow.	80	
Accounts Receivable		80
Inventory	50	
Cost of Goods Sold		50
Payment is received when due		
Cash	100	
Accounts Receivable		100

Inventory Cost Methods and Cost Flow Assumptions

Date	Event	Quantity	\$/Unit
1/1	Beginning Inventory	1,000	4.10
1/10	Purchase	800	5.00
1/20	Purchase	1,200	6.00
1/25	Sale	1,100	

Units Available for Sale = Beginning Inventory +
Units Purchased

Units Available for Sale = 1,000 + (800 + 1,200)

Units Available for Sale = 3,000

Ending Inventory = Units Available for Sale – Units
Sold

Ending Inventory = (1,000 + 800 + 1,200) – 1,100

Ending Inventory = 3,000 – 1,100

Ending Inventory = 1,900 units

Specific Identification

The items sold on 1/25 consisted of 700 from the Beginning Inventory and 400 from the purchase on 1/10.

Ending Inventory

1,200 @ 6.00 =	7,200
400 @ 5.00 =	2,000
<u>300 @ 4.10 =</u>	<u>1,230</u>
<u>1,900</u>	<u>10,430</u>

Cost of Goods Sold

700 @ 4.10 =	2,870
400 @ 5.00 =	2,000
	<u>4,870</u>

Average Cost

$$\begin{aligned}\text{Weighted Average Cost per Unit} &= \frac{\text{Cost of Goods Available for Sale}}{\text{\# Units Available for Sale}} \\ &= \frac{15,300}{3,000} \\ &= 5.10\end{aligned}$$

$$\text{Ending Inventory} = 1,900 \times 5.10 = 9,690$$

$$\text{Cost of Goods Sold} = 1,100 \times 5.10 = 5,610$$

FIFO – First In, First Out

Ending Inventory

$$\begin{array}{r} 1,200 @ 6.00 = 7,200 \\ 700 @ 5.00 = \underline{3,500} \\ \hline 10,700 \end{array}$$

Cost of Goods Sold

$$\begin{array}{r} 1,000 @ 4.10 = 4,100 \\ 100 @ 5.00 = \underline{500} \\ \hline 4,600 \end{array}$$

LIFO – Last In, First Out

Ending Inventory

1,000 @ 4.10 =	4,100
800 @ 5.00 =	4,000
100 @ 6.00 =	<u>600</u>
	<u>8,700</u>

Cost of Goods Sold

1,100 @ 6.00 =	<u>6,600</u>
	<u>6,600</u>

Which Method to Use?

Method	EI	COGS
Average	9,690	5,610
FIFO	10,700	4,600
LIFO	8,700	6,600

Special LIFO Issues

- LIFO Conformity
- LIFO Liquidation
- LIFO Reserve

Lower of Cost or Market Rule

Just In Time Inventory Method