



Definition

Inventory is the term used to describe the assets of a company that are intended for sale in the ordinary course of business, are in the process of being produced for sale, or are to be used currently in producing goods to be sold.

Kinds of Inventory


<p>Wholesaler or Retailer Typically has only one kind of inventory--merchandise</p>	<p>Manufacturer Typically has three kinds of inventory</p> <ul style="list-style-type: none"> • Raw materials • Work-in-process • Finished goods
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Inventory Systems

- A perpetual inventory system keeps a running record of the amount in inventory--both dollars and units.
- A periodic inventory system keeps a dollars only record of the amount of inventory purchases.


Basic Inventory Issues

- What physical goods are included in inventory?
- What costs are included in inventory?
- What cost flow assumption is used?



Physical Goods

- Goods in transit
- Consignments
- Special sales arrangements



Costs included

- Product Costs.
- Period Costs.



Purchase Discounts

- Gross method
- Net method



Goods Available for Sale

Goods available for sale represents the aggregate historical cost of beginning inventory and inventory purchases during the period.

Goods Available for Sale

The amount of goods available for sale must be allocated between ending inventory and cost of goods sold.

Goods Available for Sale

The choice of method of making this allocation - called the cost flow assumption - represents the third major issue in accounting for inventories.

Cost Flow Assumptions

- Specific identification
- Average cost
- First-in, first-out (FIFO)
- Last-in, first-out (LIFO)



Steps to Solve Inventory Problems

- Calculate goods available for sale
- Calculate ending inventory
- Cost of goods sold = goods available for sale less ending inventory



LIFO Layer Liquidation

- When a firm dips into LIFO layers, a profit distortion occurs as inventory holding gains ignored in previous years are shifted to the income statement.
- The SEC requires disclosure of material LIFO layer liquidations.

LIFO Conformity Rule

- U. S. tax laws specify that if a company uses LIFO for tax purposes, it must also use LIFO for financial reporting purposes.
- Because of the short term cash flow tax benefits of LIFO, managers may be motivated into undesirable purchasing decisions in order to avoid LIFO layer liquidations.

Dollar-Value LIFO STEPS

Determine inventory value at year end prices.

Dollar-Value LIFO STEPS

Determine the price index.

- **Published indexes are available**
- **Calculate:**

Dollar-Value LIFO STEPS

Determine the price index.

- **Published indexes are available**
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Ending Inventory at current cost


Ending inventory at base year cost

Dollar-Value LIFO
STEPS
Determine inventory at base year price.

Dollar-Value LIFO
STEPS
Determine Inventory at base year price.


$$\frac{\text{Inventory at year end price}}{\text{Price Index}}$$

Dollar-Value LIFO
STEPS
Determine Layers.



Dollar-Value LIFO
STEPS
Multiply each layer by respective index to find year end dollar-value ending inventory.

Dollar-Value LIFO
STEPS
The sum of the layers (now at LIFO cost) equals year end dollar-value ending inventory.



Inventories