



Lower of Cost or Market

Inventory Sales Price

- Cost to complete and transfer
= Net realizable value (**CEILING**)
- Normal profit
= Net realizable value less normal profit (**FLOOR**)

Lower of Cost or Market

- ☼ Use replacement cost as “market” if it falls between the ceiling and the floor.
- ☼ If replacement cost is above the ceiling, use the ceiling as “market.”
- ☼ If replacement cost is below the floor, use the floor as “market.”
- ☼ Value the inventory at the lower of **historical** cost or market.

Basket Allocations

- ☼ Sometimes companies buy bundles of inventory in bulk where the cost is not broken out.
- ☼ We assign a cost to the categories of inventories based on their relative sales value.
- ☼ The technique is to create a proportion using the sales values of each of the items in the inventory over the sales values of all of the items in the inventory.

Purchase Commitments

- ☼ A purchase commitment is an agreement to buy a specified quantity of inventory at a specified price at a future date.
- ☼ Under ordinary circumstances, no accounting is required for purchase commitments. Disclosures of material purchase commitments are made in footnotes.
- ☼ However, if there is a permanent price decline, a loss must be recognized and a liability accrued.

Gross Profit Method

- ☼ This estimate is used either to get a quick estimate of inventory on hand or to estimate loss when inventory has been destroyed or records have been lost.
- ☼ Historical gross margin rates are applied to known sales to estimate cost of goods sold.
- ☼ The estimate of cost of goods sold is deducted from known goods available for sale to get an estimate of ending inventory.

Retail Methods

- ⊗ Used primarily as a means of valuing inventory when there is an observable pattern between the cost and selling price
- ⊗ Estimate the cost of ending inventory by a ratio of cost to retail for goods available for sale
- ⊗ Multiply this cost ratio by ending inventory at retail to get ending inventory at cost.

Retail Methods TERMINOLOGY

Price

Markup = \$10	↑	\$40	↓	
		\$35		Markup cancellation = \$5
Original selling price		\$30		Markup cancellation = \$5
Markdown cancellation = \$5	↑	\$25	↓	
		\$20		Markdown = \$10

Retail Methods CONVENTIONAL APPROACH

Under the conventional or lower of cost or market approach include net markups but not net markdowns in the computation of the cost percentage.

Retail Methods LIFO RETAIL STABLE PRICE ASSUMPTION

- ⊗ Exclude beginning inventory in the calculation of the cost percentage.
- ⊗ Include both net markups and net markdowns in the calculation of the cost percentage.

Retail Methods LIFO RETAIL STABLE PRICE ASSUMPTION

- ⊗ The cost percentage is multiplied by the LIFO layer at retail to get the LIFO layer at cost.
- ⊗ The LIFO layer at cost is added to the beginning inventory at cost to get the LIFO ending inventory at cost.

Retail Methods LIFO RETAIL DOLLAR-VALUE

- ⊗ This method assumes fluctuating prices
- ⊗ Compute the cost percentage as under the stable price assumption

Retail Methods
**LIFO RETAIL
DOLLAR-VALUE**

- ❁ Deflate ending inventory at retail to base year prices using the applicable index
- ❁ Deflate beginning inventory at retail to base year prices using the applicable index
- ❁ The difference is the LIFO layer at retail

Retail Methods
**LIFO RETAIL
DOLLAR-VALUE**

- ❁ Inflate the LIFO layer to end of year prices using the applicable price index
- ❁ Convert the layer to cost using the cost percentage
- ❁ Add the LIFO layer at cost to the beginning inventory at cost to get ending inventory at LIFO

