Chapter 8: Part 1
Valuation of Inventories
The Basics

Dr. Chula King
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Student Learning Outcomes

- Perpetual versus periodic inventory system
- Items to include in inventory
- Expenditures to include in inventory
- Part 2
  - Cost flow assumptions
  - Dollar-value LIFO
  - Advantages and disadvantages of LIFO

Inventory

- Items that a company holds for sale in the ordinary course of business, or goods that it will use or consume in the production of goods to be sold.
  - Merchandising – purchases goods in a form ready for sale, e.g., Wal-Mart
  - Manufacturing – produces goods to sell to merchandising firms, e.g., Ford

The Inventory Equation: Merchandiser

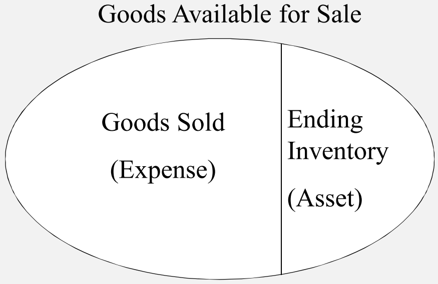
Beginning Inventory
+ Additions (Purchases)
Goods Available for Sale
- Ending Inventory
Cost of Goods Sold

Manufacturer: Cost of Goods Sold

Beginning finished goods inventory
+ Cost of goods manufactured
= Cost of goods available
- Ending finished goods inventory
= Cost of goods sold

Another View

Goods Available for Sale



Inventory Systems

- Perpetual – continuously tracks changes in the Inventory account and Cost of Goods Sold (COGS)
  - Purchases – recorded as increase in inventory
  - Sales – inventory reduced for Cost of Goods Sold
- Periodic – inventory balance determined periodically
  - Purchases – recorded in Purchases account (I/S)
  - Sales – COGS not recorded at time of sale
  - Closing – beginning inventory closed to COGS; purchases closed to COGS; ending inventory established with credit to COGS.

Issues in Inventory Valuation

- What goods should be included in inventory
- Costs to include in inventory
- Cost flow assumption (Part 2)

Goods to Include in Inventory

- Goods in Transit
  - Company Purchases Goods
    - FOB Shipping Point – Include at point of shipment
    - FOB Destination – Include when company receives goods
  - Company Sells Goods
    - FOB Shipping Point – Exclude at the time of shipment
    - FOB Destination – Include until goods reach destination
- Goods on Consignment
  - Remain property of consignor
    - Include in consignor's inventory
    - Exclude from consignee's inventory

Inventory Costs

- Costs directly involved in bring the goods to the buyer's place of business and converting the goods to a salable condition, e.g., freight, should be included
- Costs indirectly related to the acquisition or production are generally treated as period costs and expensed
- Purchase Discounts
  - Gross Method
  - Net Method

Example

- May 1, Apex, Inc., purchased goods for $10,000, subject to cash discount terms of 2/10, n/60. Apex paid for the goods on May 8, and uses the periodic inventory method.
- Gross Method

May 1	Purchases	10,000	
	Accounts Payable		10,000
May 8	Accounts Payable	10,000	
	Purchase Discounts		200
	Cash		9,800

Example (continued)

- Net Method

May 1	Purchases	9,800	
	Accounts Payable		9,800
May 8	Accounts Payable	9,800	
	Cash		9,800

- What if Apex made payment on May 15, after the discount period?

Example (continued)

- Gross Method:

May 1	Purchases	10,000	
	Accounts Payable		10,000
May 15	Accounts Payable	10,000	
	Cash		10,000

- Net Method

May 1	Purchases	9,800	
	Accounts Payable		9,800
May 15	Accounts Payable	9,800	
	Interest Expense	200	
	Cash		10,000

Financial Reporting Issues

- Determine the total product cost for a period
- Apportion the cost between goods sold during the period and goods in inventory at the period end
- Value the ending inventory

Part 2: Inventory Valuation Issues

- What should be included in the acquisition cost of inventory? (Part 1)
- How should changes in the market value of inventories subsequent to acquisition be handled?
- What cost flow assumption should be used?

The Next Step

- Part 2
- Exercises related to Part 1 material: 8-1, 8-2, 8-3, 8-4, 8-6, 8-8, 8-9, 8-10
- Problem related to Part 1 material: 8-1

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