Merchandise Inventory
Chapter 6

Learning Objective 1
Define accounting principles related to inventory

Accounting Principles & Inventories

Consistency

Disclosure

Materiality

Conservatism

Accounting Principles

- Consistency
- Disclosure
- Materiality
- Conservatism

Learning Objective 2
Define inventory costing methods

Inventory Costing Methods

Specific-unit cost

First-in, First-out

Last-in, Last out

Average-cost

Specific Unit Cost

- Each inventory item is identified by its specific cost

First-In, First-Out (FIFO)

Assumes oldest items are sold first

Therefore, newest items are on hand

Last-In, First-Out (LIFO)

Assumes newest items are sold first

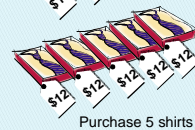Therefore, oldest items are on hand

Average Cost

Cost of Inventory on Hand ÷ **Number of Units on Hand** = **Average Cost**

Learning Objective 3

Account for perpetual inventory by the three most common costing methods

First-In, First-Out (FIFO)

Beginning Inventory

Then we sell 4 shirts for $20 each. What costs should be assigned to Cost of goods sold?

First-In, First-Out

$10 $10 $10

$12 $12 $12 $12 $12

Purchase 5 shirts

Inventory = $48

Cost of good sold = $42

First-In, First-Out (FIFO)

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable ($20 x 4)			
	Sales revenue			
	To record sales on account			
	Cost of goods sold			
	Inventory			
	To record cost of sales			

First-In, First-Out (FIFO)

Sales	**$?**
Cost of goods sold	**?**
Gross profit	**$?**

Last-In, First-Out (LIFO)

Beginning Inventory
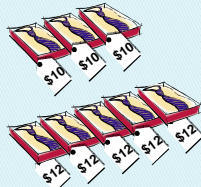
Then we sell 4 shirts for $20 each. What costs should be assigned to Cost of goods sold?

Last-In, First-Out

$10 $10 $10

$12 $12 $12 $12 $12

Purchase 5 shirts

Inventory = $42

Cost of good sold = $48

Last-In, First-Out (LIFO)

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable ($20 x 4)			
	Sales revenue			
	To record sales on account			
	Cost of goods sold			
	Inventory			
	To record cost of sales			

Last-In, First-Out (LIFO)

Sales	**$?**
Cost of goods sold	**?**
Gross profit	**$?**

Average Cost

Beginning Inventory
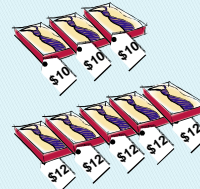
Then we sell 4 shirts for $20 each. What costs should be assigned to Cost of goods sold?

$10 $10 $10

$12 $12 $12 $12 $12

Purchase 5 shirts

Compute the Average Cost

	Units	Cost
Beginning inventory	3	$30
Purchases	5	60
Total	8	$90

Average = $90/8 = $11.25

Inventory = $11.25 x 4 = $45

Cost of good sold = $11.25 x 4 = $45

Average Cost

| GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable ($20 x 4)			
	Sales revenue			
	To record sales on account			
	Cost of goods sold			
	Inventory			
	To record cost of sales			

Average Cost

Sales	$?
Cost of goods sold	?
Gross profit	$?

Learning Objective 4

Compare the effects of the three most common costing methods

Use of Inventory Methods in Practice

LIFO 31%
FIFO 46%
Avg 20%
Other 3%
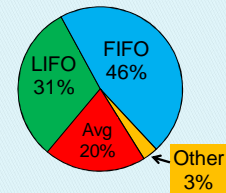
Comparison

	FIFO	LIFO	Average
Sales	$80	$80	$80
Cost of goods sold	$42	$48	$45
Gross profit	$38	$32	$35

Advantage of Each Method

First-In, First-Out	Last-In, First-Out	Average Cost

Learning Objective 5

Apply the lower-of-cost-or market rule to inventory

Lower-or-Cost-or-Market Rule

- Example of Accounting Conservatism
- Inventory is reported at lower of:
  - Historical cost or
  - Market value (current replacement cost)

Problem 6-28A

#1

GENERAL JOURNAL				
Date	Accounts	Post Ref	Debit	Credit
	Cost of goods sold		$25,000	
	Inventory			$25,000

#2

L and M Electronics
Balance Sheet
December 30, 2012

Current assets:
Inventory, (at lower-of-cost-or-market) $80,000

Problem 6-28A (continued)

#3

L and M Electronics
Income Statement
Year ended December 31, 2012
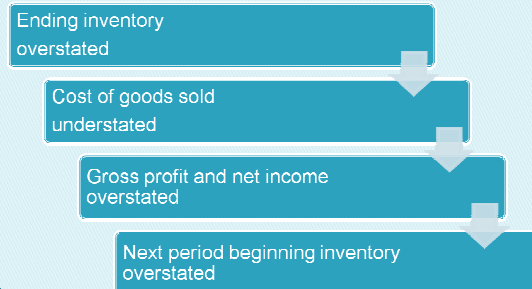
Cost of goods sold $430,000

#4

?

Learning Objective 6

Measure the effects of inventory errors

Inventory Errors- Ending inventory overstated

Ending inventory overstated

Cost of goods sold understated

Gross profit and net income overstated

Next period beginning inventory overstated

Inventory Errors-
Ending inventory understated

Ending inventory understated

Cost of goods sold overstated

Gross profit and net income understated

Next period beginning inventory understated

Learning Objective 7

Estimate ending inventory by the gross profit method

Gross Profit Method

Beginning inventory		$15,000
Net purchases		70,000
Cost of goods available		85,000
Estimated cost of goods sold:		
Sales revenue	$100,000	
Less: Estimated gross profit of 35%	(35,000)	
Estimated cost of goods sold		(65,000)
Estimated cost of ending inventory		**$20,000**

Exercise 6-27

Beginning inventory		$47,000
Net purchases		30,300
Cost of goods available		77,300
Estimated cost of goods sold:		
Sales revenue	$63,000	
Less: Estimated gross profit of 35%	(22,050)	
Estimated cost of goods sold		(40,950)
Estimated cost of ending inventory		**$36,350**

End of Chapter 6