CHAPTER 6

Inventory Planning and Valuation

Bellwork

Bellwork:

Complete your terms and audits.

- 14 terms (pg. 168)
- Add the following:
  - Asset
  - Liability
  - Owner's Equity
  - Revenue
  - Expense
  - Current Asset
  - Cost

- Audits
  - Pg 175 – 3 questions
  - Pg 181 – 4 questions
  - Pg 186 – 4 questions

Concepts

1. Adequate Disclosure
2. Unit of Measurement
3. Matching Expenses with Revenue
4. Historical Cost
5. Consistent Reporting

FYI's

- Pages 171, 179, & 180

Diagrams

- 1 diagrams on page 171

Objectives

1. Define accounting terms related to planning and costing inventory.
2. Identify accounting concepts and practices related to planning and costing inventory.
3. Describe the nature of merchandise inventory.
4. Determine the cost of merchandise inventory using selected costing methods.
5. Estimate the cost of merchandise inventory using selected estimating methods.
6. Calculate merchandise inventory turnover ratio and average number of days' sales in merchandise inventory.

Nature of Merchandising Inventory

Merchandise Inventory is what type of account?

a. Asset
b. Liability
c. Owner's Equity
d. Revenue
e. Expense

Why?

Nature of Merchandising Inventory

Merchandising Businesses

- Largest asset is usually merchandise inventory
- Must maintain an adequate amount of inventory to provide good service to their customers.

Can a business fail if it keeps too much or too little merchandise on hand?

Nature of Merchandising Inventory

Can a business fail if it keeps too much or too little merchandise on hand?

YES! Visit site below for details!

https://www.inflowinventory.com/blog/pros-and-cons-of-holding-excess-inventory/

Nature of Merchandising Inventory

Business managers frequently analyze sales and inventory transactions. Why?

1. Plan for future purchases.
2. Determine which items are selling well.
3. Identify seasonal trends in sales.
4. Allows managers to order the right kind of merchandise at the right time.

Nature of Merchandising Inventory

Computerized inventory

- More accurate
- More frequent inventory information
- Make effective business decisions

Flow of Inventory Costs

- Merchandise is continually being bought and sold.
- Inventory amounts will change from day to day.

Flow of Inventory Costs

Cost of Merchandise Available for Sale consists of:

1. Cost of beginning merchandise inventory
2. Cost of net purchases added to the inventory during the fiscal period.

At the end of each fiscal period, the Cost of Merchandise Available for Sale is divided into:

1. Cost of ending merchandise inventory.
2. Cost of merchandise sold during the current fiscal period.

Flow of Inventory Costs

At the end of each fiscal period, the Cost of Merchandise Available for Sale is divided into:

1. Cost of ending merchandise inventory.
   - *The ending merchandise inventory represents a current asset that will be charged as costs in the future fiscal periods.*
2. Cost of merchandise sold during the current fiscal period.
   - *This cost materially affects the amount of net income reported for the fiscal period.*

CONCEPT: Adequate Disclosure

Effects of Errors in Costing an Inventory

When an accountant says that an amount is *understated*, it means two things:

1. The amount is not the correct amount, *and*
2. The amount is less than the true amount. In other words, the amount is too *small*.

When an accountant states that a reported amount is *overstated*, it means two things:

1. The reported amount is incorrect, *and*
2. The reported amount is *more* than the true or correct amount.

Effects of Errors in Costing an Inventory

The cost of both beginning and ending inventory affects items on:

- Income Statement
- Statement of Stockholder's Equity
- Balance sheet

Reports and Items Affected		If Ending Inventory is	
		Understated	Overstated
Income Statement			
	Cost of Merchandise Sold	overstated	understated
	Gross Profit	understated	overstated
	Net Income	understated	overstated
Statement of Stockholders' Equity			
	Net Income	understated	overstated
	Retained Earnings	understated	overstated
	Stockholder's Equity	understated	overstated
Balance Sheet			
	Merchandise Inventory	understated	overstated
	Total Assets	understated	overstated
	Stockholders' Equity	understated	overstated

Effects of Errors in Costing an Inventory

Concept:

Adequate Disclosure

Adequate merchandise inventory cost must be determined to adequately report the financial progress and condition of a merchandising business.

Reports and Items Affected		If Ending Inventory is	
		Understated	Overstated
Income Statement			
	Cost of Merchandise Sold	overstated	understated
	Gross Profit	understated	overstated
	Net Income	understated	overstated
Statement of Stockholders' Equity			
	Net Income	understated	overstated
	Retained Earnings	understated	overstated
	Stockholder's Equity	understated	overstated
Balance Sheet			
	Merchandise Inventory	understated	overstated
	Total Assets	understated	overstated
	Stockholders' Equity	understated	overstated

Effects of Errors in Costing an Inventory

If the ending inventory is understated, the financial statements will not reflect accurate information.

Concept:

Adequate Disclosure

Reports and Items Affected		If Ending Inventory is	
		Understated	Overstated
Income Statement			
	Cost of Merchandise Sold	overstated	understated
	Gross Profit	understated	overstated
	Net Income	understated	overstated
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	Net Income	understated	overstated
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Costing and Counting the Inventory

"Goods"

- *Items in the merchandise inventory of a merchandising business are frequently referred to as "goods."*

- *A business's inventory includes all goods that it legally owns.*

Cost of Goods includes:

1. Price paid to vendors for the merchandise.

   Purch. Amnt. – purch. disc. – returns – allowances granted by vendor.

2. Cost involved in getting the goods to the place of business and ready for sale (ie. transportation charges paid by the buyer).

Costing and Counting Inventory

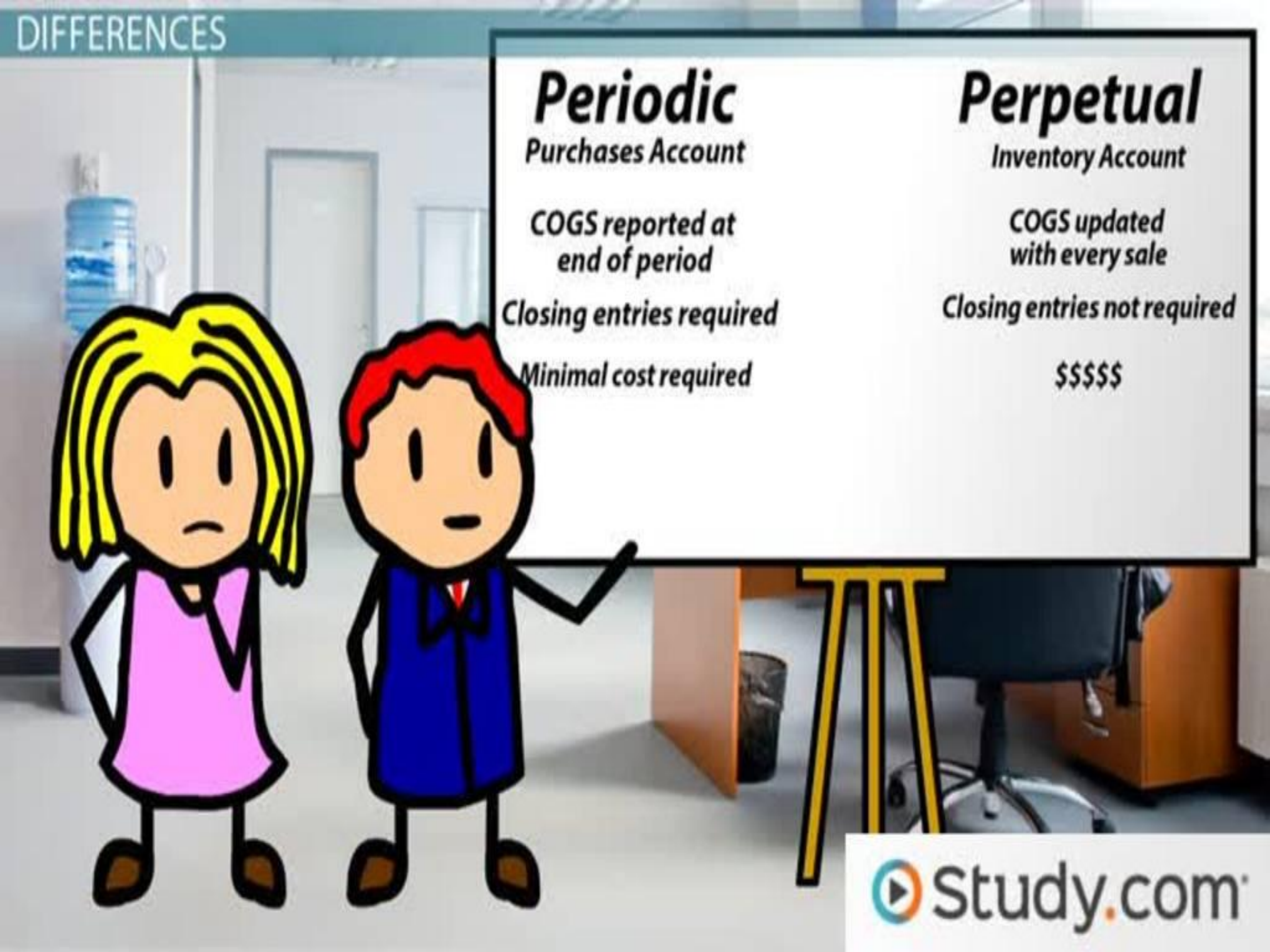
Merchandising businesses must know both:

1. Cost of the goods
2. Number of goods in inventory

Businesses use 2 methods to determine the number of goods in inventory:

1. Taking a physical count of the individual items in inventory. *What type of inventory is this?*
2. Keeping a continuous record for each merchandise item showing the number purchased and the number sold. *What type of inventory is this?*

Which one can a business determines the number of goods in inventory at any point in time?


DIFFERENCES
Periodic
Purchases Account
COGS reported at end of period
Closing entries required
Minimal cost required
Perpetual
Inventory Account
COGS updated with every sale
Closing entries not required
$$$$$
Study.com

Costing and Counting Inventory

Goods in Transit – read 172

Merchandising businesses purchase their goods from suppliers.

The suppliers ship the goods to the businesses.

At what point do the goods become part of the buyer’s inventory? When they are shipped, regardless of where they are physically located.

Costing and Counting Inventory

A vendors terms of sale may include one of the following provisions:

FOB shipping point:

- “Free on board”
- Buyer pays the transportation
- Under FOB, the title to the goods passes to the buyer as soon as the vendor delivers the goods to a transportation business.
- The goods “in transit,” but not yet received by the buyer are part of the buyer’s inventory.

FOB destination:

- “Free on board”
- Vendor pays the transportation
- Under FOB, the title to the goods passes to the buyer receives the goods.
- The goods “in transit,” but not yet received by the buyer are part of the vendor’s inventory.

Costing and Counting Inventory

Consignment

- Goods that are given to a business to sell but for which title remains with the vendor

Consignee

- The person or business that receives goods on consignment

Consignor

- The person or business that gives goods on consignment

Costing and Counting Inventory

Consignee (pg 172)

- The person or business that receives goods on consignment
- Agrees to receive, care for, and attempt to sell the consigned goods
- If goods are sold, the consignee deducts a commission from the sale. The remaining amount is sent to the consignor.

Costing and Counting Inventory

Consignee (pg 172)

- In a consignment, title to the goods DOES NOT pass to the consignee.
- The goods remain part of the consignor’s inventory.
- The consignee has implied liabilities if anything happens to the goods before they are sold.
- Balance sheet – lists cost of consigned goods as a footnote

Stock record for a perpetual inventory system.

Perpetual inventory

- Continuous record of merchandise inventory increases, decreases, and balance on hand
- Provides day-to-day records about the quantity of merchandise on hand.

What are some things perpetual inventory helps management know?

1. Inventory is low and when to reorder
2. What is selling well
3. What may be seasonal

Stock record for a perpetual inventory system.

Perpetual inventory

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Stock record for a perpetual inventory system.

For each inventory item, the records shows:

1. The number on hand
2. The number purchased
3. The number sold

Stock record – a form used to show the type of merchandise, quantity received, quantity sold, and balance on hand

Stock ledger – a file of stock records for all merchandise on hand

Steps for maintaining a stock record (pg 173)

1. Record the description information
   - Description
   - Stock No.
   - Reorder – amount to order
   - Minimum – when inventory reaches this amount, reorder
   - Location – where to find in the warehouse
2. Write the beginning quantity (balance)
3. Record all sales transactions (decreases)
4. Enter all purchase transactions (increases)

Purchase order

- A completed form authorizing a seller to deliver goods with payment to be made later

Stock record (pg 173)

- Sales are recorded when a sale is made
- Purchases are recorded when goods are received
- Unit prices are NOT recorded on the stock records

Unit prices are obtained from the purchase records.

Completing a stock record

1. Record the description information.

2. Write the beginning quantity.

3. Record all sales transactions.

4. Enter all purchase transactions.

STOCK RECORD

Description: *CDs* Stock No.: *F106*

Reorder: *1,000* Minimum: *300* Location: *Bin 26*

1	2	3	4	5	6	7
INCREASES			DECREASES			BALANCE
DATE	PURCHASE INVOICE NO.	QUANTITY	DATE	SALES INVOICE NO.	QUANTITY	QUANTITY
Jan. 1						*700*
			Jan. 16	*1761*	*120*	*580*
			Feb. 21	*1923*	*310*	*270*
			Mar. 6	*2071*	*230*	*40*
Mar. 7	*669*	*1,000*				*1,040*
			Oct. 31	*2967*	*160*	*670*

Inventory record used for the periodic inventory

Periodic Inventory

- Merchandise inventory determined by counting, weighing, or measuring items of merchandise on hand
- Referred to as “taking an inventory”
- Can be very expensive; once a fiscal period
- Cons
  1. Low quantities of inventory can be overlooked.
  2. Missed sales

Inventory record used for the periodic inventory

Periodic Inventory

- Inventory record
  - A form used during a periodic inventory to record information about each item of merchandise on hand
  - One inventory record is used for each item or category of items in inventory
  - Periodic count is compared to perpetual inventory
    - Differences are adjusted on the stock records
    - When differences are found, business should review its processes and practices to ensure inventory records are being properly maintained.

Inventory record used for the periodic inventory

Steps to complete the inventory record (pg 174)

1. Enter inventory date and item description
2. Record stock numbers and descriptions
3. Write the number of units on hand
4. Record the unit price
5. Calculate and record the total item cost
6. Total the column

Compare to Stock Record on page 173

Terms to review

- Consignment
- Consignee
- Consignor
- Stock Record
- Stock Ledger
- Purchase Order
- Inventory Record

Audit your understanding

- What two elements are included in the cost of merchandise available for sale?

1. Cost of beginning merchandise inventory
2. Cost of net purchases added to the inventory during the fiscal period

Audit your understanding

- If ending merchandise inventory is understated, will the net income be overstated or understated?

Answer: Understated

Audit your understanding

- Name two ways to determine the number of inventory items on hand.

1. Periodic
2. Perpetual

Explain each.