Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)

AC201
Fundamental Accounting

Semester 2/2013

Course Materials

Topic:

Chapter 7 Reporting and Interpreting
Cost of Goods Sold and Inventory

Session:

Sessions #7

Instructor:

Ajarn Santana Singhasaneh

Introduction to Financial Statements

FINANCIAL STATEMENTS	ASSETS	LIABILITIES	EQUITY
✓ • Statement of Financial Position ✓ • Statement of Comprehensive Income ✓ • Statement of Changes in Equity ✓ • Statement of Cash Flows	✓ • Cash • Investments in debt and equity securities ✓ • Accounts receivable ✓ • Notes receivable • Inventory ✓ • Prepaid expenses • Property, plant, and equipment • Intangible assets • Natural resources	✓ • Accounts payable ✓ • Accrued liabilities ✓ • Unc[illegible]ed revenues • [illegible]yable • [illegible]nds payable	• Share capital • Preferred share • Ordinary share • Retained earnings • Appropriated R/E • Unappropriated R/E • Treasury share

We are here

✓ Accounting Cycle

Financial Statement Items

FINANCIAL STATEMENT ANALYSIS

AC201 Fundamental Accounting

CHAPTER 7: REPORTING AND INTERPRETING COST OF GOODS SOLD AND INVENTORY

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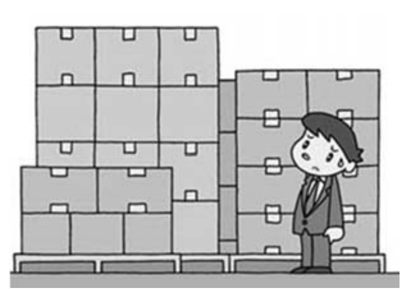
Understanding the Business

Primary Goals of Inventory Management

- Provide sufficient quantities of high-quality inventory.
- Minimize the costs of carrying inventory.

Nature of Inventory and Cost of Good Sold



Items Included in Inventory

Inventory

- Tangible
- Held for Sale
- Used to Produce Goods or Services

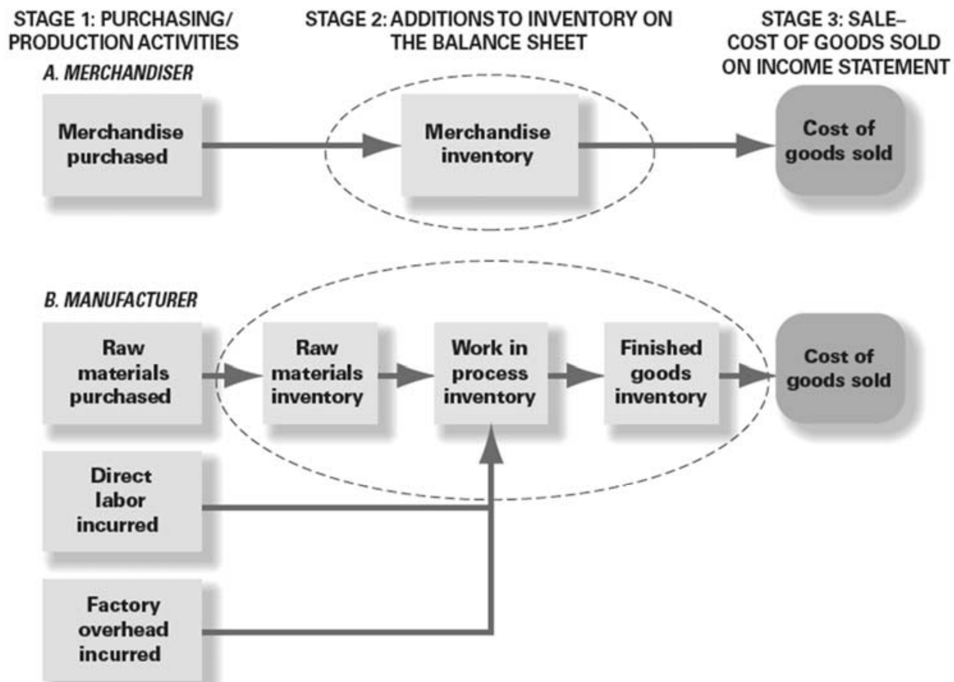
Merchandise Inventory
Raw Materials Inventory
Work in Process Inventory
Finished Goods Inventory

Costs Included in Inventory Purchases

The **cost principle** requires that inventory be recorded at the price paid or the consideration given.

- Invoice Price
- Freight
- Inspection Costs
- Preparation Costs

Flow of Inventory Costs



Nature of Cost of Goods Sold

Beginning Inventory

Purchases for the Period

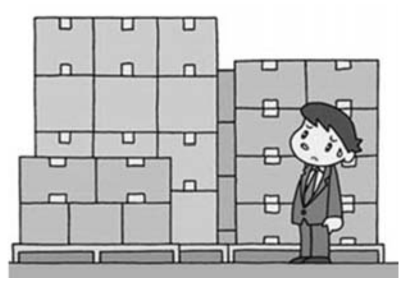
Goods Available for Sale

Ending Inventory
(Balance Sheet)

Cost of Goods Sold
(Income Statement)

Beginning inventory + Purchases = Goods Available for Sale
Goods Available for Sale – Ending inventory = Cost of goods sold

Inventory Costing Method



Inventory Costing Methods

Goods Available for Sale

Inventory Costing Methods
1. Specific Identification
2. First-in, First-out
3. Last-in, First-out
4. Weighted Average

To determine how much is to be recorded as “cost” of goods sold.

Ending Inventory (Balance Sheet)

Cost of Goods Sold (Income Statement)

Specific Identification

When units are sold,
the **specific cost** of the unit sold
is added to cost of goods sold.

Cost Flow Assumptions

The choice of an inventory costing method is **NOT based on the physical flow of goods** on and off the shelves.

- FIFO
- LIFO
- Weighted Average

Example – Inventory Costing

We will use this data throughout our inventory examples.

Computers, Inc.
Mouse Pad Inventory
As of December 31, 2011

Date	Units	$ per Unit	Total $
Beginning Inventory	1,000	5.25	5,250.00
Purchases:			
Jan 3	500	5.30	2,650.00
Jun 20	300	5.60	1,680.00
Sep 15	250	5.80	1,450.00
Nov 29	200	5.90	1,180.00
Goods Available for Sale	2,250		12,210.00
Ending Inventory	1,200		?
Cost of Goods Sold	1,050		?

FIFO: First-In, First-Out Method

FIFO assumes that
the first goods purchased are the first goods sold.

Oldest Unit Costs → Cost of Goods Sold

Recent Unit Costs → Ending Inventory

FIFO: First-In, First-Out Method

The costs of the **most recent purchases** are in **ending inventory**.
Start with 200 units from Nov 29 and add units purchased
until you reach 1,200 units in ending inventory.

Given Information				Ending Inventory				Cost of Goods Sold			
Beg. Inv.	1,000	@	5.25								
Jan 3	500	@	5.30		450	@	5.30				
Jun 20	300	@	5.60		300	@	5.60				
Sep 15	250	@	5.80		250	@	5.80				
Nov 29	200	@	5.90		200	@	5.90				
	2,250	Units			1,200	Units				Units	
				$	6,695	Cost				Cost	

Now we have allocated the cost to all 1,200 units in ending inventory.

FIFO: First-In, First-Out Method

The costs of the **oldest purchases** are allocated to **cost of goods sold**.
Start with 1,000 units from beginning inventory
and add units purchased until you reach 1,050 units sold.

Given Information				Ending Inventory				Cost of Goods Sold			
Beg. Inv.	1,000	@	5.25						1,000	@	5.25
Jan 3	500	@	5.30		450	@	5.30		50	@	5.30
Jun 20	300	@	5.60		300	@	5.60				
Sep 15	250	@	5.80		250	@	5.80				
Nov 29	200	@	5.90		200	@	5.90				
	2,250	Units			1,200	Units			1,050	Units	
				$	6,695	Cost		$	5,515	Cost	

Now we have allocated the cost to all 1,050 units sold.

FIFO: First-In, First-Out Method

Here is the cost of ending inventory and cost of goods sold using FIFO.

Computers, Inc.
Mouse Pad Inventory
As of December 31, 2011

Date	Units	$ per Unit	Total $
Beginning Inventory	1,000	5.25	5,250.00
Purchases:			
Jan 3	500	5.30	2,650.00
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Sep 15	250	5.80	1,450.00
Nov 29	200	5.90	1,180.00
Goods Available for Sale	2,250		12,210.00
Ending Inventory	1,200		6,695.00
Cost of Goods Sold	1,050		5,515.00

LIFO: Last-In, First-Out Method

LIFO assumes that
the most recently purchased units are sold first.

Oldest Unit Costs → Ending Inventory

Recent Unit Costs → Cost of Goods Sold