

# Financial Accounting Chapter 5

## Summary: Cheat Sheet

### INVENTORY BASICS

**FOB shipping point:** Goods are included in buyer's inventory once they are shipped.

**FOB destination:** Goods are included in buyer's inventory after arrival at their destination.

**Consignee:** Never reports consigned goods in inventory; stays in consignor's inventory until sold.

**Merchandise inventory:** Includes any *necessary* costs to make an item ready for sale. Examples – shipping, storage, import fees and insurance.

### INVENTORY COSTING

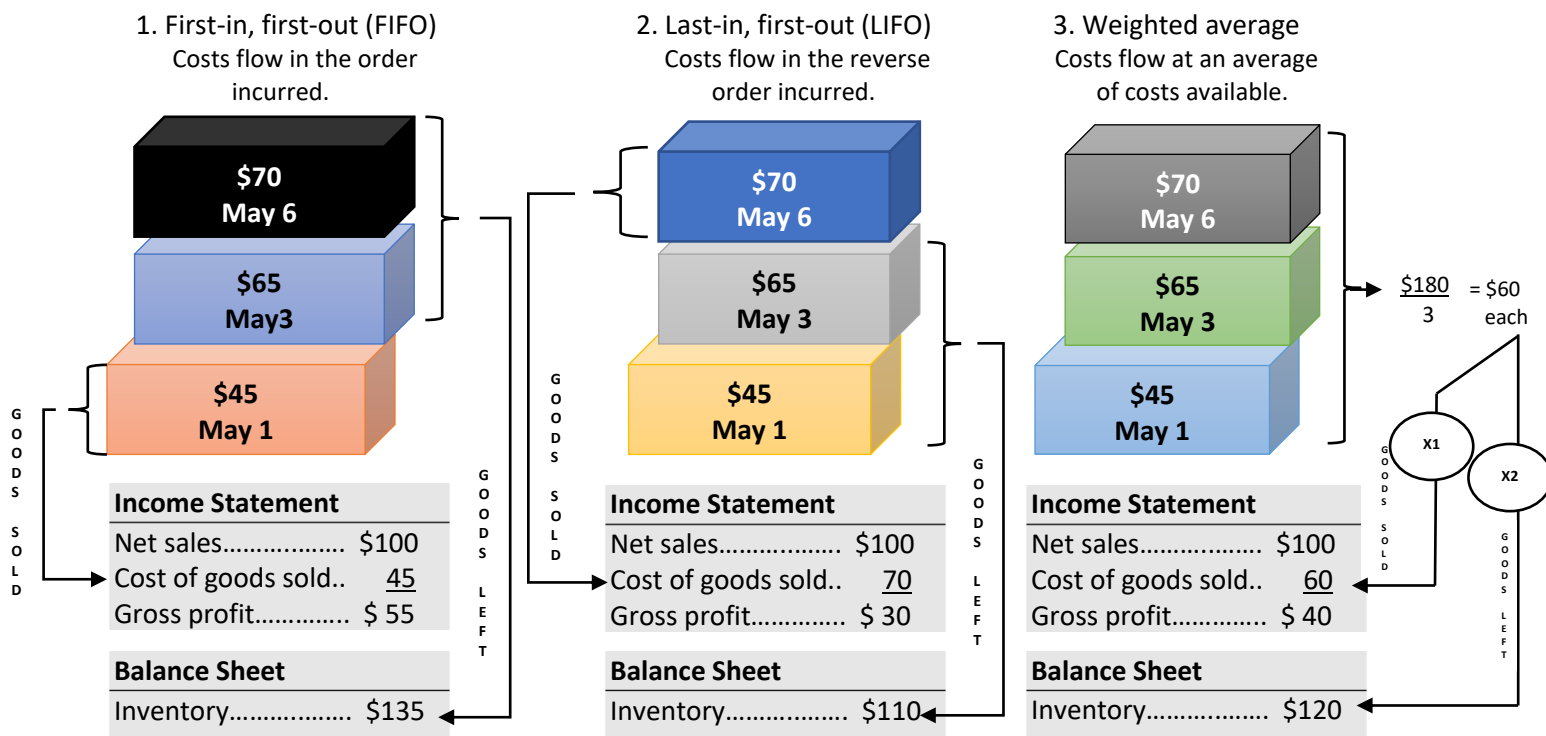
**FIFO:** Earliest units purchased are the first to be reported as cost of goods sold.

**LIFO:** Latest units purchased are the first to be reported as cost of goods sold.

**Weighted average:** Weighted average cost per unit equals the cost of goods available for sale divided by the units available.

**Specific identification:** Each unit is assigned a cost, and when that unit is sold, its cost is reported as cost of goods sold.

#### Cost Flow Assumptions Example



#### Financial Statement Effects

**Rising Costs** – FIFO reports lowest cost of goods sold and highest net income. LIFO reports highest cost of goods sold and lowest income. Weighted average reports results in between LIFO and FIFO.

**Falling Costs** – FIFO reports highest cost of goods sold and lowest net income. LIFO reports lowest cost of goods sold and highest income.

## INVENTORY VALUATION, ERRORS & ANALYSIS

**Lower of cost or market (LCM):** When market value of inventory is lower than its cost, a loss is recorded. When market value is higher than cost of inventory, no adjustment is made.

**LCM Example (applied to individual items separately)**

Inventory Items	Units	Per Unit		Total Cost	Total Market	LCM Applied to Items
		Cost	Market			
Roadster	20	\$8,500	\$7,000	\$170,000	\$140,000	\$140,000
Sprint	10	5,000	6,000	<u>50,000</u>	60,000	<u>50,000</u>
Totals				<u>\$220,000</u>		<u>\$190,000</u>

Roadster: \$140,000 is the lower of the \$170,000 cost and \$140,000 market.

Sprint: \$50,000 is the lower of the \$50,000 cost and the \$60,000 market.

LCM: Results in a \$190,000 reported inventory.

**LCM Journal Entry:** To get from \$220,000 reported inventory to the \$190,000 LCM inventory, make the following entry:

Cost of Goods Sold		30,000	
Merchandise Inventory			30,000

**Effects of Overstated or Understated Inventory for Income Statement**

Ending Inventory	Year 1		Year 2	
	Cost of Goods Sold	Net Income	Cost of Goods Sold	Net Income
Understated ↓	Overstated ↑	Understated ↓	Understated ↓	Overstated ↑
Overstated ↑	Understated ↓	Overstated ↑	Overstated ↑	Understated ↓

**Effects of Overstated or Understated Inventory for Balance Sheet**

Ending Inventory	Assets	Equity
Understated ↓ . . . .	Understated ↓	Understated ↓
Overstated ↑ . . . . .	Overstated ↑	Overstated ↑