

## ACCT 101 – Chapter 5

### I. Internal Controls of Inventory

Inventory consists of the items a business has for resale to customers in the normal course of business.

#### A. Costs included in inventory

1. Cost of the merchandise
2. Transportation
3. Insurance
4. Import duties and taxes

#### B. Inventory will always be the largest Current Asset on the Balance Sheet and the Cost of Goods Sold will be the largest expense on the Income Statement.

Two primary objectives of Internal Control over inventory are

1. Safeguarding the inventory
2. Properly reporting it on the financial statements

### II. Cost of Goods Sold Calculation

### III. Inventory Cost Flow

A primary concern for inventory is properly calculating its value for the Balance Sheet and Income Statement. However, often times the inventory consists of identical units of merchandise which were acquired at different unit costs. When a unit is sold, it is impossible to determine what amount was paid for the particular unit sold.

Therefore, the company must **assume** an Inventory Cost Flow Assumption for use in assigning costs to the inventory on hand and the units sold.

- A. First-In, First-Out (FIFO)
  
- B. Last-In, First-Out (LIFO)
  
- C. Weighted Average
  
- D. Specific Identification
  
- E. Lower-of-Cost-or-Market – Accounting principles require that inventory be reported at the market of replacing inventory when the market value is lower than the purchase cost.

Example:

	<u>Unit Cost</u>	<u>Unit Market</u>
Apple Jacks	\$1.50	\$1.75
Rice Krispies	\$1.00	\$1.35
Frosted Flakes	\$1.80	\$1.42