Inventory Terms
Inventory is what a business purchases or manufactures that is intended for sale.

Classification
- **Merchandise inventory**: in form ready for sale
- **Manufacturing inventory**: three classifications
  - Raw materials: on hand but not placed into production
  - Work in process: materials, labor and a ratable share of overhead
  - Finished goods: completed but unsold units

Control
- Have enough inventory without overstocking; use purchase requisition; purchase order addressed to vendor (with price, terms and shipping date); shipper ships goods and sends an invoice (with quantity and description, price and terms); receiving report with description goes to accounting department
- **Perpetual**: involves continuous record of changes in the inventory account
  - Purchases, freight-in, returns, allowances, discounts, sales → affect the inventory account directly after every transaction
  - Used for high-value, low volume goods
- **Periodic**: uses a purchases account to account period purchases, added to beginning inventory to get “goods available for sale”
  - A physical count of ending inventory is subtracted from goods available for sale to know cost of goods sold
  - Inventory can either be sold or remain on the shelf
  - Used for low-value, high volume goods

Ownership or Title
Legal title passes to buyer according to the terms of sale
- **FOB shipping point**: goods belong to buyer at time of delivery to carrier
- **FOB destination**: title and risk of loss transfers to buyer when received
- **Consignment**: goods always belong to seller (consignor); consignee has a duty of due care and reasonable protection, and is selling agent for a fee.

Costs of Inventory
- **Product costs**: costs that “attach” to inventory
  - All costs necessary to bring goods to buyer in salable condition
  - Includes freight in (freight out is a selling expense)
- **Period costs**: selling, general and administrative, unrelated to product
- **Purchase discounts**: like sales discounts; net method has discount included in purchase; gross method recognizes discounts when taken
  - Ex. of terms: 2/10, n/30 (2% disc. paid in 10 days, full amount due in 30)

Cost Flow Assumption
Different methods exist to assign costs to Goods Sold and Ending Inventory
- **Specific Identification**: for small quantities of costly, unique items
- **FIFO**: First in, First Out. The first items purchased go to Goods Sold
- **LIFO**: Last in, First Out. The first items purchased remain in inventory
  - The last items go into Cost of Goods Sold in layers
  - Dollar value LIFO uses price indices to increase or decrease layers of inventory purchased and sold in times of inflation/deflation
- **Average Cost**: Total costs/Total units give average applied to CGS and EI

Lower of Cost or Market
- Inventories are recorded at original cost, but if obsolescence, price-level changes, or damage brings the value of the inventory below cost, there is a write down. Historical cost is abandoned when future utility or revenue producing ability of the asset is no longer as great as the original cost. It is better to undervalue assets than overvalue (conservatism).
- The replacement cost is the cost to reproduce the goods.
- Net realizable value is the estimated selling price less costs for completion and disposal.
- The rule for evaluating inventory at lower of cost or market:
  - If replacement cost is greater than the NRV, use the replacement cost.
- The market has a floor, which is the NRV less a normal profit margin, and a ceiling which is the NRV. Anything within this range uses the replacement cost. The historical cost is used if it is below the market floor.