FA Module 8: Inventories (overview)

(The attached PDF file has better formatting.)

Reading: chapter 8

- § 2 cost of inventories
- § 3 inventory valuation methods
- § 4 the LIFO method, *excluding*
  - Example 5 (Caterpiller)
  - § 4.2 (LIFO liquidations)
- § 6 inventory adjustments,
  - *including* example 8 (Accounting for Declines and Recoveries of Inventory Value)
  - *excluding* example 9 (Effect of Inventory Write-Downs on financial ratios)
- § 7.2 Inventory ratios (but not § 7.1 or § 7.3)

[§5 (Inventory Method Changes) is not on the syllabus for this course.]

The inventory valuation method (specific identification, first-in first-out, last-in first-out, and weighted average costs) affects cost of goods sold, gross profit margin, financial ratios (inventory turnover and days of inventory on hand), and net income.

Many firms seek to minimize inventory on hand. A high-tech firm might build a computer after it is ordered and avoid carrying inventory of computers. Supermarkets seek to turn over their products daily or weekly and avoid having inventories that might spoil. Inventory activity ratios show how efficiency the firm manages operations.

When inventory costs were increasing, manufacturers were more willing to hold large inventories. Inventory unit costs are now decreasing for many industries, so more firms practice “just-in-time” inventory.