FA Module 8: Inventories (overview 4th edition)

(The attached PDF file has better formatting.)

(Readings from the fourth 4th edition of the Robinson text.)

Reading: chapter 7

- § 2 cost of inventories
- § 3 inventory valuation methods, *excluding*
    - 3.6. Periodic versus Perpetual Inventory Systems
- § 4 the LIFO method, *excluding*
    - Example 5 (Caterpiller)
    - Example 6 LIFO Liquidation Illustration
    - § 4.2 (LIFO liquidations)
- § 6 inventory adjustments, *excluding*
    - example 7 (Accounting for Declines and Recoveries of Inventory Value)
    - example 8 (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 efficiently the firm manages operations.

The final exam does not test the details of which costs are excluded from inventory (discussed in §2 cost of inventories and Example 1 Treatment of Inventory-Related Costs).

Know Example 2 Inventory Cost Flow Illustration for the Specific Identification, Weighted Average Cost, FIFO, and LIFO Methods. The inventory costing method affects cost of goods sold, profit margins, turnover ratios, and profitability ratios. Be sure you can compute the 16 figures at the bottom of this example for any inputs.

Take heed: Examples 5, 6, 7, 8 are not themselves tested on the final exam, but they illustrate many computations that are tested on the exam. For example, the examples compute inventory turnover ratios, number of days of inventory (days of inventory on hand), current ratios, gross profit margins, return on assets. The final exam problems will require you to compute these figures using simpler input figures. Reviewing the examples helps you master the computations.

Manufacturing firms often hold large inventories, so inventory management is critical to profitability. Insurers generally hold little inventory; this course places more emphasis on financial accounting specific to insurers.

The final exam problems are most like end of chapter questions 4, 13, and 14. Most of this chapter deals with the effects of various inventory adjustments on financial ratios; these are not covered in this course.