ACC 100: INVENTORY COSTING

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Methods of Inventory Costing

- There are 3 main inventory costing methods:
  - Specific Identification
  - Average Cost
  - First-in, First-out (FIFO)

Specific Identification

- Used for low-quantity, high-cost items such as cars or jewelry
- Every item is tagged and recorded with its cost, inventory is easy to calculate because you know exactly how many items you have and their exact cost
- For example, if you are a jewelry store your inventory may look something like this:

Purchase Date	Item	Cost
March 25	Diamond Necklace	$1,500
April 2	Gold Bracelet	$250
April 15	Engagement Ring	$1,250
Total	-	$3,000

- When recording a sale, you can simply use the cost of the item as it was tagged for your cost of goods sold
- If you sold the diamond necklace on May 7th for $2,000 you would record it like this:

	Assets		Liabilities	Equity	
	Cash	Inventory		Sales	COGS
May 7	2,000	-1,500		2,000	1,500

Average Cost

- Used for high-quantity, low-cost items such as bottle caps or nails
- This method adds the value of every item and divides it by the total number of items to get the average cost value for the entire inventory, which is then used to calculate cost of goods sold
- For example, if you are a hardware store that sells nails your inventory may look something like this:

Purchase Date	Item	Cost per item	Total Cost
March 1	200 nails	$0.50	$100
March 12	500 nails	$0.25	$125
March 18	150 nails	$0.6	$90
Total	750 nails	-	$315

- To calculate the average cost of your inventory of nails, you would take the total cost of your nails ($315) and divide it by the total amount of nails you have (750).

- $Average\ Cost = \frac{\$315}{750} = \$0.42/nail$

- If you sold 50 nails on March 25th for $50, you would record it like this:

	Assets		Liabilities	Equity	
	Cash	Inventory		Sales	COGS
March 25	50	-21		50	21

- Cost of goods sold is calculated using the average cost:
- $COGS = \$0.42 \times 50 = \$21$

First-in, First-out (FIFO)

- Used for high-quantity, low-cost items, commonly used in grocery stores
- This method assumes that the oldest inventory (the item first) is the first to be sold (first out of the store)
- For example, if you are a grocery store your inventory for apples may look like this:

Purchase Date	Item	Cost per item	Total Cost
April 3	50 apples	$2.50	$125
April 18	25 apples	$3	$75
April 25	25 apples	$4	$100
Total	100 apples	-	$300

- As you sell items, you calculate the cost of goods sold based on which items you purchased first.
- For example, if you sold 60 apples on May 1st for $5 each, you would record it like this:

	Assets		Liabilities	Equity	
	Cash	Inventory		Sales	COGS
May 1	300	-155		300	155

- $Sales = Items\ sold \times selling\ price = \$60 \times 5 = \$300$
- To calculate the cost of goods sold you assume you sell your oldest item first so, of the 60 total you sold, the first 50 costs $2.5, and the remaining 10 costs $3.
- $COGS = (50 \times \$2.5) + (10 \times \$3) = \$125 + \$30 = \$155$

- Your inventory on hand now looks like this:

Purchase Date	Item	Cost per item	Total Cost
April 18	15 apples	$3	$45
April 25	25 apples	$4	$100
Total	40 apples	-	$145