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Merchandise Inventory

LABYRINTH
LEARNING®

LEARNING OBJECTIVES

- Record journal entries for merchandise inventory
- Apply valuation methods to merchandise inventory
- Adjust merchandise inventory
- Analyze the Cost of Goods Sold account and gross margin

Merchandise Inventory

- Represents the cost of goods a business intends to sell
- A current asset account

12/2	Merchandise Inventory	2,400	
	Cash		2,400
	Purchase of merchandise inventory for cash		

Sale of Merchandise Inventory

Results in the recording of two journal entries:
- First, revenue is recorded:

12/22	Accounts Receivable	1,000	
	Sales Revenue		1,000
	Sale of merchandise inventory on account		

- Second, Merchandise Inventory is reduced and Cost of Goods Sold, an expense, is increased:

12/22	Cost of Goods Sold	600	
	Merchandise Inventory		600
	Sale of merchandise inventory on account		

Inventory Valuation—FIFO Method

This method assumes the first goods to enter the warehouse are the first goods to be sold.

Date	Purchases			Sales			Merchandise Inventory Balance		
	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total
3/1							100	$ 40	$ 4,000
3/5	160	$ 42	$ 6,720				100	$ 40	$ 4,000
							160	$ 42	$ 6,720
3/13				100	$ 40	$ 4,000	70	$ 42	$ 2,940
				90	$ 42	$ 3,780			
3/17	80	$ 43	$ 3,440				70	$ 42	$ 2,940
							80	$ 43	$ 3,440

Inventory Valuation—LIFO Method

This method assumes the last goods to enter the warehouse are the first goods to be sold.

Date	Purchases			Sales			Merchandise Inventory Balance		
	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total
3/1							100	$ 40	$ 4,000
3/5	160	$ 42	$ 6,720				100	$ 40	$ 4,000
							160	$ 42	$ 6,720
3/13				160	$ 42	$ 6,720	70	$ 40	$ 2,800
				30	$ 40	$ 1,200			
3/17	80	$ 43	$ 3,440				70	$ 40	$ 2,800
							80	$ 43	$ 3,440

Inventory Valuation—Average Cost Method

This method uses the average cost of all goods—calculated by dividing the total cost by the total number of goods—to value inventory.

Date	Purchases			Sales			Merchandise Inventory Balance		
	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total	Quantity	Unit Cost	Total
3/1							100	$ 40.00	$ 4,000
3/5	160	$ 42.00	$ 6,720				260	$ 41.23	$10,720
3/13				190	$ 41.23	$ 7,834	70	$ 41.23	$ 2,886
3/17	80	$ 43.00	$ 3,440				150	$ 42.17	$ 6,326

Adjusting Merchandise Inventory

- A physical count of merchandise inventory is performed at year end.

- If the balance exceeds the total inventory count:

12/31	Cost of Goods Sold	800	
	Merchandise Inventory		800
	Adjusting entry for merchandise inventory		

- If the total inventory count exceeds the balance:

12/31	Merchandise Inventory	500	
	Cost of Goods Sold		500
	Adjusting entry for merchandise inventory		

Analyzing COGS and Gross Profit

Additional profitability ratios may be used for merchandising businesses.

- Cost of goods sold ratio
- Gross margin ratio

Cost of Goods Sold Ratio = Cost of Goods Sold ÷ Total Sales
Gross Margin Ratio = Gross Margin ÷ Total Sales