

9

Merchandise Inventory

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

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

Sale of Merchandise Inventory

Results in the recording of two journal entries:

1. Revenue is recorded:

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

2. Merchandise Inventory is reduced and Cost of Goods Sold (an expense) is increased:

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

FIFO Inventory Valuation Method

This 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

LIFO Inventory Valuation Method

This 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

Average Cost Inventory Valuation Method

This uses the average cost of all goods (total cost ÷ 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.

- Balance exceeds total inventory count:

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

- Total inventory count exceeds balance:

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

Analyzing COGS and Gross Profit

- Cost of goods sold ratio: Lower is better, as it means COGS (an expense) is being minimized.
- Gross margin ratio: Higher is better, as it means the company has funds to cover all expenses and contribute to net income.

Cost of Goods Sold Ratio = $\text{COGS} \div \text{Total Sales}$

Gross Margin Ratio = $\text{Gross Margin} \div \text{Total Sales}$