

Accounting for Inventory

5th Edition

Steven M. Bragg

Table of Contents

Chapter 1 – Overview of Inventory	1
Learning Objectives	1
Introduction.....	1
The Definition of Inventory	1
Accounting for Inventory	2
Inventory Transactions.....	4
Inventory Flow in a Push Environment	5
Inventory Flow in a Pull Environment	6
Summary.....	7
Review Questions.....	8
Review Answers	9
 Chapter 2 – Periodic and Perpetual Inventory Systems	 11
Learning Objectives	11
Introduction.....	11
The Periodic Inventory System.....	11
The Perpetual Inventory System	12
Summary.....	13
Review Questions.....	14
Review Answers	15
 Chapter 3 – Inventory Record Accuracy.....	 17
Learning Objectives	17
Introduction.....	17
Inventory Record Errors	17
Environmental Factors Impacting Record Accuracy.....	18
Employee Factors Impacting Record Accuracy	19
Labeling Issues Impacting Record Accuracy	19
Inventory Naming Conventions Impacting Record Accuracy	20
Excessive Data Recordation	20
Inventory Data Collection Methods.....	21
The Data Entry Backlog Problem	22
Backflushing	23
Controls over Record Accuracy.....	24
Inventory Review Reports	24
The Negative Inventory Balance	25
Inventory Auditing.....	25
The Corrective Action System	26
Summary.....	27
Review Questions.....	28
Review Answers	29
 Chapter 4 – Inventory Counting and Reconciliation.....	 31
Learning Objectives	31
Introduction.....	31
How to Set Up Inventory Record Keeping	31
The Physical Inventory Count	32
Concerns about the Physical Inventory Count	33
Physical Count Improvements.....	34
Cycle Counting	34
Control Group Analysis	37
100% Count Analysis.....	38
Inventory Reconciliation	38
Summary.....	40
Review Questions.....	41
Review Answers	42

Table of Contents

Chapter 5 – Estimating Ending Inventory.....	43
Learning Objectives	43
Introduction.....	43
The Gross Profit Method	43
The Retail Inventory Method	44
The Effect of Overstated Ending Inventory	45
Summary.....	45
Review Questions.....	46
Review Answers	47
Chapter 6 – Inventory Cost Layering.....	49
Learning Objectives	49
Introduction.....	49
Inventory Cost Layering Overview.....	49
The First in, First Out Method.....	50
Periodic FIFO	51
Perpetual FIFO	51
The Last in, First Out Method.....	51
Perpetual LIFO and Periodic LIFO	53
The Dollar-Value LIFO Method.....	53
The Link-Chain Method.....	55
The Weighted Average Method.....	56
The Specific Identification Method.....	57
The Next In, First Out Method	58
Summary.....	58
Review Questions.....	59
Review Answers	60
Chapter 7 – Standard Costing of Inventory.....	61
Learning Objectives	61
Introduction.....	61
Overview of Standard Costing.....	61
How to Create a Standard Cost.....	61
Historical, Attainable, and Theoretical Standards	62
How to Account for Standard Costs.....	62
Overview of Variances	63
The Purchase Price Variance.....	64
Material Yield Variance	65
Labor Rate Variance	65
Labor Efficiency Variance	66
Variable Overhead Spending Variance.....	66
Variable Overhead Efficiency Variance	67
Fixed Overhead Spending Variance	68
Problems with Variance Analysis	68
The Controllable Variance.....	69
The Favorable or Unfavorable Variance	69
Where to Record a Variance	69
Which Variances to Report	70
How to Report Variances	71
Summary.....	71
Review Questions.....	72
Review Answers	73
Chapter 8 – Job Costing.....	75
Learning Objectives	75
Introduction.....	75
Overview of Job Costing	75
When Not to Use Job Costing	76
Accounting for Direct Materials in Job Costing.....	76

Table of Contents

Accounting for Labor in Job Costing	77
Accounting for Actual Overhead Costs in Job Costing	78
Accounting for Standard Overhead Costs in Job Costing.....	79
The Importance of Closing a Job.....	80
The Role of the Subsidiary Ledger in Job Costing	80
Summary.....	81
Review Questions.....	82
Review Answers	83
Chapter 9 – Process Costing	85
Learning Objectives	85
Introduction.....	85
Overview of Process Costing	85
The Weighted Average Method.....	86
The Standard Costing Method	87
The First In, First Out Method	88
The Hybrid Costing System.....	89
Process Costing Journal Entries	90
Problems with Process Costing.....	91
Summary.....	92
Review Questions.....	93
Review Answers	94
Chapter 10 – Overhead Allocation.....	95
Learning Objectives	95
Introduction.....	95
Overhead Allocation.....	95
Averaging of Overhead Rates	98
Summary.....	98
Review Questions.....	99
Review Answers	100
Chapter 11 – Obsolete Inventory	101
Learning Objectives	101
Introduction.....	101
Expected Dispositions Method	101
Reserve Method	102
Expensing Method	104
Issues with Obsolete Inventory Recognition	104
Summary.....	105
Review Questions.....	106
Review Answers	107
Chapter 12 – The Lower of Cost or Market Rule	109
Learning Objectives	109
Introduction.....	109
Lower of Cost or Market Rule.....	109
Inventory Translation Adjustment.....	111
Practical Application.....	111
Summary.....	112
Review Questions.....	113
Review Answers	114
Chapter 13 – Inventory Spoilage, Rework, and Scrap.....	115
Learning Objectives	115
Introduction.....	115
Definition of Spoilage	115
Accounting for Normal Spoilage	115
Accounting for Abnormal Spoilage	116

Table of Contents

Accounting for the Sale of Spoilage.....	117
Cost Allocation to Spoilage	117
Definition of Rework.....	117
Reporting Rework	117
Accounting for Rework.....	118
Definition of Scrap	118
Accounting for Scrap.....	118
Summary.....	120
Review Questions.....	121
Review Answers	122
Chapter 14 – Joint and By-Product Costing.....	123
Learning Objectives	123
Introduction.....	123
Split-Off Points and By-Products	123
Why We Allocate Joint Costs	124
Joint Cost Allocation	124
Joint Product and By-Product Pricing	125
Special Concerns with By-Product Costing.....	125
Summary.....	125
Review Questions.....	126
Review Answers	127
Chapter 15 – Inventory Disclosures	129
Learning Objectives	129
Introduction.....	129
Inventory Disclosures.....	129
Summary.....	130
Review Questions.....	131
Review Answers	132
Chapter 16 – Inventory Transactions.....	133
Learning Objectives	133
Introduction.....	133
Initial Cost Recognition	133
Acquired Inventory Transactions	134
Backflushing Transactions	134
Bill and Hold Transactions	134
Consignment Transactions	135
Cross Docking Transactions	135
Drop Shipping Transactions	136
Engineering Change Order Transactions	136
Goods in Transit Transactions	136
Kitting Transactions	137
Lower of Cost or Market Adjustments.....	138
Obsolete Inventory Adjustments.....	138
Overhead Allocation Transactions.....	138
Physical Count Adjustments.....	139
Receiving Transactions.....	139
Sale Transactions	140
Scrap and Spoilage Adjustments	140
Summary.....	140
Review Questions.....	141
Review Answers	142
Chapter 17 – Internal Revenue Code for Inventory.....	143
Learning Objectives	143
Introduction.....	143
IRC Section 471 – General Rule for Inventories	143

Table of Contents

IRC Section 472 – Last In, First Out Inventories	143
IRC Section 473 – Qualified Liquidations of LIFO Inventories	145
IRC Section 474 – Simplified Dollar-Value LIFO Method	147
IRC Section 1504(a) – Affiliated Group.....	148
Summary.....	149
Review Questions.....	151
Review Answers	152
Chapter 18 – Inventory Transfer Pricing.....	153
Learning Objectives	153
Introduction.....	153
Overview of Transfer Pricing	153
Market Price Basis for Transfer Pricing	154
Adjusted Market Price Basis for Transfer Pricing.....	155
Negotiated Basis for Transfer Pricing	155
Contribution Margin Basis for Transfer Pricing.....	155
Cost-Plus Basis for Transfer Pricing	156
Cost Anomalies in a Cost-Based Transfer Price	156
Pricing Problems Caused by Transfer Pricing.....	157
The Tax Impact of Transfer Prices	158
Summary.....	159
Review Questions.....	160
Review Answers	161
Chapter 19 – Inventory Controls.....	163
Learning Objectives	163
Introduction.....	163
Purchasing Process Overview	163
In-Process Purchasing Controls	164
Additional Purchasing Controls – Fraud Related	166
Additional Purchasing Controls – Periodic Actions.....	167
Receiving Process Overview.....	167
In-Process Receiving Controls	168
Additional Receiving Controls – Fraud Related.....	170
Additional Receiving Controls – Periodic Actions	170
Shipping Process Overview	171
In-Process Shipping Controls.....	172
Additional Shipping Controls – Fraud Related	173
Additional Shipping Controls – Periodic Actions	174
Intercompany Controls.....	175
Inventory Valuation Controls	175
Warehouse Controls	177
Production Controls	177
Summary.....	178
Review Questions.....	179
Review Answers	180
Chapter 20 – Fraudulent Inventory Transactions.....	181
Learning Objectives	181
Introduction.....	181
Those Who Commit Fraud	181
Financial Statement Fraud – Labor Component	181
Financial Statement Fraud – Materials Component	182
Financial Statement Fraud – Overhead Component	184
Revenue Fraud	185
Inventory Theft.....	186
Common Fraud Risk Factors	187
Fraud Prevention Tactics	188
Pressures	188

Table of Contents

Detection	188
Centralization.....	189
Summary	189
Review Questions.....	190
Review Answers	191
Chapter 21 – Inventory Policies	193
Learning Objectives	193
Introduction.....	193
Inventory Policies.....	193
Receiving Policy	193
Point of Ownership Policy	193
Responsibility for Inventory Policy	194
Inventory Access Policy	194
Inventory Owned by Third Parties Policy	194
Consigned Inventory Identification Policy	194
Physical Count Policy	195
Cycle Counting Policy	195
Inventory Record Access Policy	195
Bill of Material Updates Policy.....	195
Standard Costing Updates Policy.....	195
Lower of Cost or Market Updates.....	195
Obsolete Inventory Updates	196
Bill and Hold Policy	196
Collections Take-Back Policy	196
Summary	196
Review Questions.....	197
Review Answers	198
Chapter 22 – Inventory Budgeting	199
Learning Objectives	199
Introduction.....	199
The Production Budget	199
Other Production Budget Issues.....	200
Budgeting for Multiple Products.....	201
Ending Inventory Concepts	202
Impact of Changes in Ending Inventory.....	203
The Ending Finished Goods Inventory Budget.....	203
Direct Materials Budgeting Overview.....	204
The Direct Materials Budget (Roll Up Method).....	205
The Direct Materials Budget (Historical Method).....	206
The Direct Materials Budget (80/20 Method)	207
Anomalies in the Direct Materials Budget	208
The Role of the Direct Materials Budget	209
Summary	209
Review Questions.....	210
Review Answers	211
Chapter 23 – Inventory Measurements	213
Learning Objectives	213
Introduction.....	213
Overview of Inventory Measurements	213
Average Inventory Calculation	213
Inventory Turnover Measurements.....	214
Inventory Turnover Ratio.....	215
Raw Materials Turnover	215
Work-in-Process Turnover	216
Finished Goods Turnover	216
Inventory Accuracy Percentage.....	217

Table of Contents

Excess Inventory Measurements	218
Obsolete Inventory Percentage	218
Percent of Inventory Greater than XX Days.....	219
Returnable Inventory Valuation	220
Opportunity Cost of Excess Inventory	220
Summary.....	221
Review Questions.....	222
Review Answers	223
Glossary.....	225
Index	229