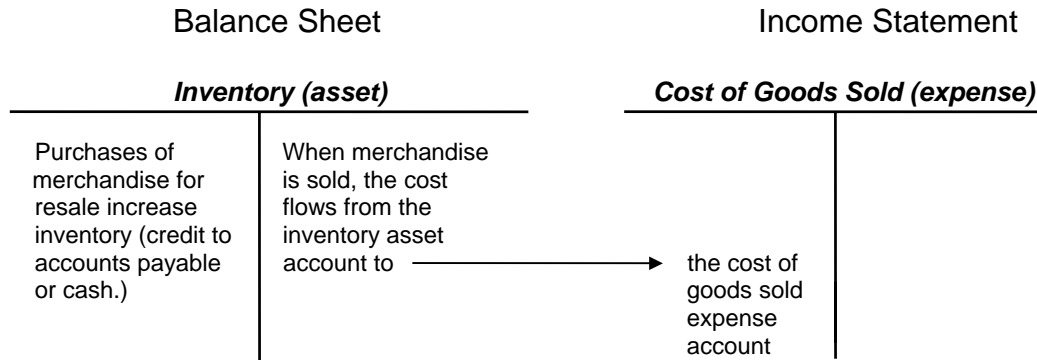


Principles of Accounting I
ACC 121

Inventory Costing Methods



Four principal alternative cost-flow assumptions:

- Specific identification
- Weighted average
- First-in, first-out (FIFO)
- Last-in, first-out (LIFO)

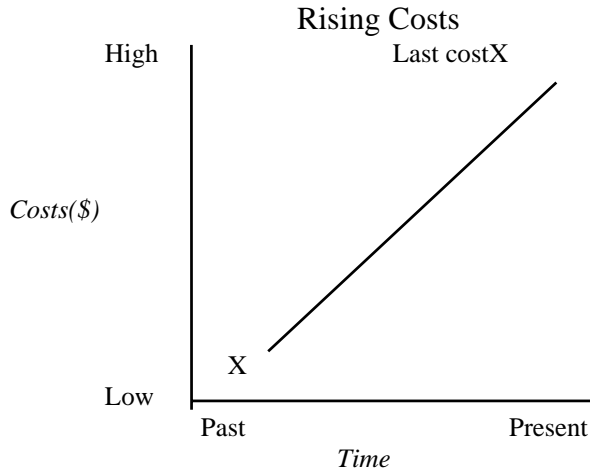
Specific identification links cost and physical flow. When an item is sold, the cost of that specific item is determined from the firm's records, and that amount is transferred from the inventory account to cost of goods sold.

Weighted-average is based on the assumption that costs should be assigned to inventory based on the *average* cost of each unit. Please note this method is not a simple average cost but a *weighted* average cost. Using the weighted average method the extremes of the highest and lowest cost is avoided. The cost is somewhere in between them.

FIFO means more than first-in, first-out; it means the first costs *to inventory* are the first costs *out to cost of goods sold*.

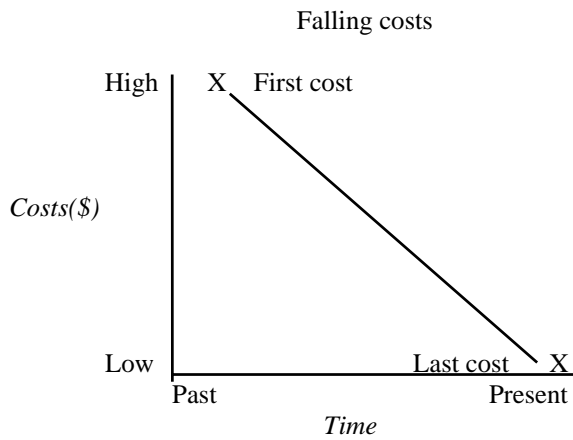
LIFO is an alternative cost-flow assumption opposite to FIFO. Under LIFO, the most recent costs incurred for merchandise purchased or manufactured are transferred to the income statement when the items are sold, and the inventory on hand at the balance sheet date is costed at the oldest costs, including those used to value the beginning inventory.

Effects of Changing Costs on Inventory and Cost of Goods Sold under FIFO and LIFO



FIFO- Lower, older costs to cost of goods sold.
Higher, more recent costs stay in inventory.

LIFO- Higher, more recent costs to cost of goods sold.
Lower, older costs stay in inventory.



FIFO- Higher, older costs to cost of goods sold.
Lower, more recent costs stay in inventory.

LIFO- Lower, more recent costs to cost of goods sold.
Higher, older costs stay in inventory.