LEVEL 1:

FINANCIAL REPORTING & ANALYSIS

Reading 21 (7th out of 12): INVENTORIES

Difficulty: **medium**

Benchmark Study Time: **3.75h**

2022

INTENTIONALLY EMPTY

THIS E-BOOK:

- is a selective summary of the corresponding Reading in your CFA® Program Curriculum,
- provides place for your own notes,
- helps you structure your study and revision time!

How to use this e-book to maximize your knowledge retention:

1. **Print** the e-book in duplex and bind it to keep all important info for this Reading **in one place.**
2. **Read** this e-book, best twice, to grasp the idea of what this Reading is about.
3. **Study** the Reading from your curriculum. **Here add** your notes, examples, formulas, definitions, etc.
4. **Review** the Reading using this e-book, e.g. write your summary of key concepts or revise the formulas at the end of this e-book (if applicable).
5. **Done?** Go to your study plan and change the Reading's status to green:
   (it will make your Chance-to-Pass-Score™ grow ☺).
6. **Come back** to this e-book from time to time to **regularly review for knowledge retention!**

NOTE: While studying or reviewing this Reading, you can use the tables at the end of this e-book and mark your study/review sessions to hold yourself accountable.

INVENTORIES – INTRODUCTION

goods available for sale = beginning inventory + purchases of inventory in the period

ending inventory = beginning inventory + purchases of inventory in the period –

– cost of goods sold (COGS) = goods available for sale - COGS

the good (or inventory) is sold → revenue is recognized → COGS is recorded as an expense

Inventories are measured at:

- the lower of cost and net realizable value (NRV) under IFRS,
- the lower of cost or market under U.S. GAAP.

cost of inventories = costs of purchase + costs of conversion + other costs incurred in bringing the inventories to their present location and condition

If the NRV or market value of inventory < inventory carrying amount →

→ write down the value of the inventory

- Under U.S. GAAP, reversals of write-downs are not allowed.
- Under IFRS, reversals of write-downs are allowed.

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Capitalizing vs Expensing

Costs that will be capitalized in inventory include:

- all costs of purchase net of trade discounts,
- cost of conversion, which includes direct labour and fixed and variable manufacturing overheads,
- other costs incurred in bringing inventories to their present location and condition,
- costs related to storage if the storage is one of the factors related to the process of manufacturing inventory.

Costs that the company will treat as **expenses in the period** in which they occurred are:

- abnormal costs due to waste of production conversion inputs (e.g. materials, labor),
- storage costs of finished inventory,
- administrative overheads,
- selling costs.

Disclosure of inventories under IFRS

IFRS require the following disclosures:

- accounting policy for inventories,
- cost formula applied,
- carrying amount of inventories,
- carrying amount of different categories of inventory (for manufacturers),
- cost of sale,
- amount of any write-downs of inventories,
- amount of any reversals of write-downs,

carrying amount of inventories pledged as security for liabilities.

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

INVENTORY VALUATION METHODS

COGS = beginning inventory – ending inventory + cost of goods acquired or produced during a certain period

Inventory vs COGS

The choice of an inventory valuation method exerts a direct impact on the items of the company's balance sheet, income statement and cash flow statement.

inventory valuation methods = cost formulas under IFRS = cost flow assumptions under U.S. GAAP

Cost formulas under IFRS:

- specific identification,
- weighted average cost,
- FIFO (first-in, first-out).

Cost flow assumptions under U.S. GAAP:

- specific identification,
- weighted average cost,
- FIFO (first-in, first-out),
- LIFO (last-in, first-out).

Specific identification is an inventory accounting method according to which cost of goods acquired or produced is reported by its purchase or production cost.

FIFO (first-in, first-out) reports inventory beginning with those units that were stored first.

LIFO (last-in, first-out) reports inventory beginning with those units that were stored last.

Weighted average cost takes into account the weighted average cost of acquired or produced inventories.

LIFO method is:

- not allowed under IFRS,
- allowed under U.S. GAAP.

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Periodic inventory system vs perpetual inventory system

Periodic inventory system assumes that inventory valuation should be conducted at the end of the accounting period.

Perpetual inventory system assumes that inventory values are continually updated (COGS is computed immediately after a given part of inventory is sold).

The choice between periodic and perpetual inventory system **is important for**:

- LIFO method,
- weighted average cost method.

The choice between periodic and perpetual inventory system **is not important for**:

- FIFO method.

sale of inventories occurred after the last inventory acquisition →

→ both systems give the same results for all valuation methods

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

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Summarizing key concepts:

☐ Inventories: COGS, ending inventory, beginning inventory, goods available for sale

My summary:

☐ Capitalizing vs Expensing

My summary:

☐ Disclosure of inventories

My summary:

☐ Inventory valuation methods: specific identification, FIFO, LIFO, weighted average cost

My summary:

☐ Periodic inventory system vs Perpetual inventory system

My summary:

Keeping myself accountable:

TABLE 1 | STUDY

When you sit down to study, you may want to **try the Pomodoro Technique** to handle your study sessions: study for 25 minutes, then take a 5-minute break. Repeat this 25+5 study-break sequence all throughout your daily study session.

✔ Tick off as you proceed.

POMODORO TIMETABLE: study-break sequences (25′ + 5′)													
date		date		date		date		date		date		date	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	
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25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	

TABLE 2 | REVIEW

Never ever neglect revision! Though it's not the most popular thing among CFA candidates, regular revision is what makes the difference. If you want to pass your exam, **schedule & do your review sessions.**

REVIEW TIMETABLE: When did I review this Reading?													
date		date		date		date		date		date		date	
date		date		date		date		date		date		date	