Accounting I

OPERATING ACTIVITIES

INVENTORIES

Concept

For sale as the normal activity of the firm

Merchandise

In the production process for sale

Finished Goods

In the form of consumable materials to be used in the production process or to be used when services are provided

Raw materials

Measuring Inventories

1st recognition

Acquired Inventories

Purchase Cost

Purchase price + all the expenses directly or indirectly related to make the good arrive to the warehouse

Produced Inventories

Production Cost

Raw materials + other materials consumed as wages, industrial costs (fixed and variables) and the ones related to make the product available in the warehouse.

Measuring Inventories – after initial recognition

The lower of	
Cost (purchase/ production)	Net Realisable Value

Net Realisable Value =

Estimated selling price- Estimated cost to finish production

- Estimated cost of selling products

INVENTORIES

Inventory Valuation Methods

The purchase price of inventories is not always the same;

It varies with time (prices are not stable and are depending on the law of demand and supply)

When there is inflation the prices rise.

Because of these reasons, there is the need to adopt some **criteria** to value the inventories in the firm that are sold and the ones that are on the warehouse at the end of the year.

Inventories

Specific Identification	Inventories measured by its real price or effective price
FIFO	Inventories measured by the oldest prices. In the warehouse the inventories that remain are valued by the most recent prices
Weighted average	Inventories measured at a unit cost that result from the weighted average price of all the inventories in the warehouse

Specific Identification

- The **specific identification method** concentrates on physically linking the particular items sold with the cost of goods sold that is reported
- This method is relatively easy to use for expensive low-volume merchandise
- The use of bar codes and scanning equipment makes specific identification economically feasible for many companies

FIFO

- **FIFO** assigns the cost of the **earliest** purchased units to cost of goods sold
- The costs of the newer units is assigned to the units in ending inventory
- FIFO provides inventory valuations that closely approximate the actual market value of the inventory at the balance sheet date
- In periods of rising prices, FIFO leads to higher net income

Weighted Average

- The **weighted-average method** computes a unit cost by dividing the total purchase cost of all items available for sale by the number of units available for sale

- The weighted-average method produces gross profit somewhere between that obtained under FIFO and LIFO

Perpetual and Periodic Inventory Systems

There are two main systems for keeping inventory records:

- Perpetual system
- Periodic system

The **perpetual inventory system** keeps a continuous record of inventories and cost of goods sold

The **periodic inventory system** computes cost of goods sold and an updated inventory balance only at the end of the accounting period

Inventory systems

Perpetual inventory system

- Register all entrances of inventories

- So, at any time the firm knows
  - The quantity of products/stock in the warehouse;
  - The value of those inventories; and
  - The Margin after each sale.

Required system for Large and Medium Companies applying SNC. Only micro-companies can use the periodic inventory system.

Inventory systems

Periodic inventory system

- We do not use the inventories accounts at each entry and exit of inventories.
- The physical count of the inventories and its valuation needs to be done periodically in order to obtain the gross profit of sales.

Inventory systems

Periodic inventory system

- Inventories account (Merchandise/Raw materials) is not used after the purchase or sale of products

- The firms only knows:
  - The quantity of inventories in the warehouse.
  - The value of purchases and beginning of the year inventory

- The physical counting of inventory and respective valuation is essential to calculate the Cost of Goods Sold at the end of the year

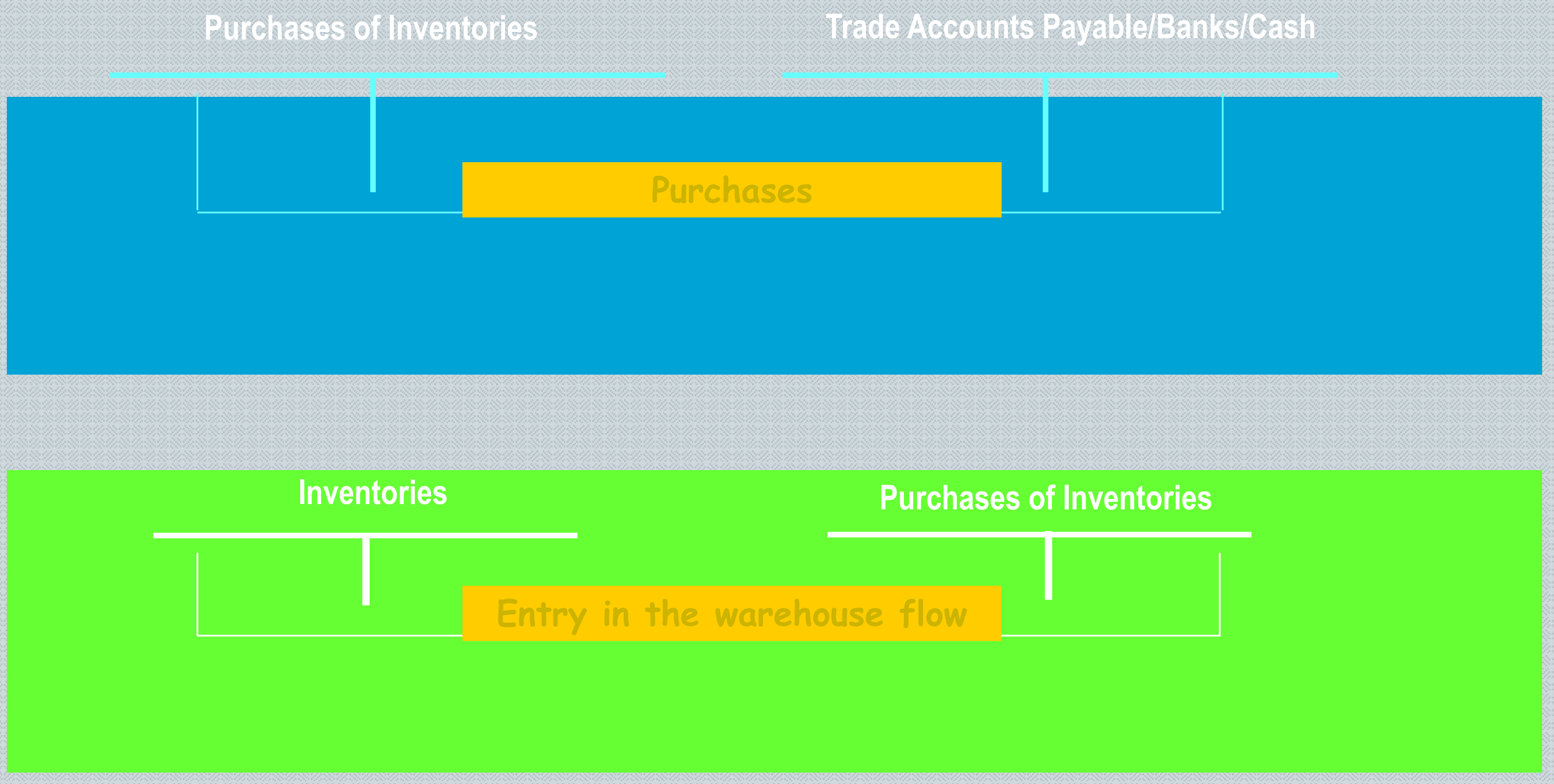
Periodic Inventory System

Under the periodic system, the calculation of Cost of Goods Sold is delayed until there is a physical count:

COGS = Beginning of the year inventories
+ Purchases of inventories
– End of the year inventories
+/- Reclassification/Regularization of inventories

Inventory systems

Perpetual inventory system



Inventory systems

Perpetual inventory system

Cash/Banks/Trade Accounts Receivable

Sales
Inventories

Sales

Cost of Goods Sold

Inventories

Exit of the warehouse flow

Inventory systems

Periodic Inventory System

Purchases of Inventories

Trade Accounts payable/Banks/Cash

Purchases of inventories

Trade Accounts receivable/Banks/Cash

Sales

Inventories

Sales

Accounting I

OPERATING ACTIVITIES

INVENTORIES

VAT

Key formulas

Net purchase = Gross Purchase - Returns to suppliers - Obtained (commercial) discounts

Key formulas

Net Sales = Gross Sales - Returns from clients - (commercial) discounts offered

Key formulas

Cost of Goods Sold = Initial Inventory + Net Purchases - Final Inventories - Inventories regularizations

Key formulas

Gross Profit from sales = Net Sales - Cost of Goods Sold

Key formulas

Sales Price = Puchase cost + Margin

% on top of sales price

or

% on top of purchase price

VAT

VAT = Value added Tax

VAT

- Indirect Tax, focused on consumption
- It is applied in all stages of the economic cycle
- Company acts as tax collector

VAT

VAT

Purchases

Deducts tax

Suppliers

Firms (Entity)

Sales

Clients

Liquidates tax

VAT

VAT

Value Added Tax Account (243) is divided into:

- VAT borne
- VAT deductible
- VAT liquidated
- VAT regularizations
- VAT calculation
- VAT to be paid
- VAT to recover
- VAT requested reimbursements

Determining VAT

How to determine VAT?

VAT liquidated - VAT deductible ± VAT regularizations = VAT calculation

VAT liquidated

- Sales of inventories;
- Services provided;
- Cash Advance from Customers;
- Internal consumption and free transactions.

VAT deductible

- Purchase of inventories;
- Purchase of fixed tangible assets;
- Purchase of External services;
- Cash Advances to suppliers.

VAT regularizations

- Errors;
- Returns and discounts;
- Annulment of cash advance received;
- Annulment of cash advance paid;
- Bad debt;
- Thefts, accidents, etc.
- Others.

VAT calculation

Sd → VAT to recover

Sc → VAT to be paid