

# Accounting for inventory

## Why is accounting for inventory so important?

For many merchandising companies, inventory is the largest asset on the balance sheet, and cost of goods sold is the largest expense on the income statement.

Amounts reported for inventory and cost of goods sold generally have a material impact on a company's financial statements.

# What is an inventory cost flow assumption?

A company may purchase identical units of inventory at different unit costs. When this happens, the company must determine a consistent method for assigning these costs to both the units sold during the period and to the units left on hand at the end of the period. This is an inventory cost flow assumption.

As an example, assume a company sells tennis rackets. At the beginning of the period, the company had one racket which cost \$30 on hand. During the period, the company purchased another identical tennis racket; this racket cost the company \$38. At the end of the period, the company determined that one racket was left on hand, and therefore one racket had been sold. A cost flow assumption is needed to determine which cost, \$30 or \$38, will be assigned to the racket sold, and which will be assigned to the racket left on hand.