Inventory and Cost of Goods Sold Accounting

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1. **Inventory**
    - Inventory refers to the goods a company holds for selling to customers.
    - There are three main types of inventory: raw materials, work in progress, and finished goods.
    - It is reported as a current asset on the balance sheet.
    - Proper inventory management is crucial for businesses to maintain sufficient stock levels without overstocking.
2. **Cost of Goods Sold (COGS)**
    - COGS represents the direct costs of producing goods sold by a company.
    - It includes costs such as raw materials, labor, and overhead expenses directly tied to production.
    - COGS is subtracted from revenue to calculate gross profit.
    - It is reported on the income statement.
3. **Inventory Valuation Methods**
    - FIFO (First In, First Out): Assumes that the oldest inventory items are sold first.
    - LIFO (Last In, First Out): Assumes that the newest inventory items are sold first.
    - Weighted Average: Calculates the average cost of all inventory items available for sale during the accounting period.
4. **Inventory Accounting Entries**
    - When inventory is purchased: Debit Inventory, Credit Accounts Payable/Cash.
    - When inventory is sold: Debit COGS, Credit Inventory.
    - Periodic inventory system: Physical count of inventory is conducted at the end of the accounting period.
    - Perpetual inventory system: Inventory balances are continuously updated with each sale and purchase.
5. **Effects on Financial Statements**

- Inventory errors can impact the balance sheet and income statement.
- Overstating inventory can inflate assets and net income.
- Understating inventory can result in lower profits and taxes.

6. **Cost Flow Assumptions**

   - The choice of inventory valuation method impacts COGS and net income.
   - FIFO tends to result in higher net income during periods of rising prices.
   - LIFO tends to result in lower taxable income due to higher COGS.

Understanding inventory and COGS accounting is essential for businesses to accurately track their costs, manage inventory levels efficiently, and make informed financial decisions.