



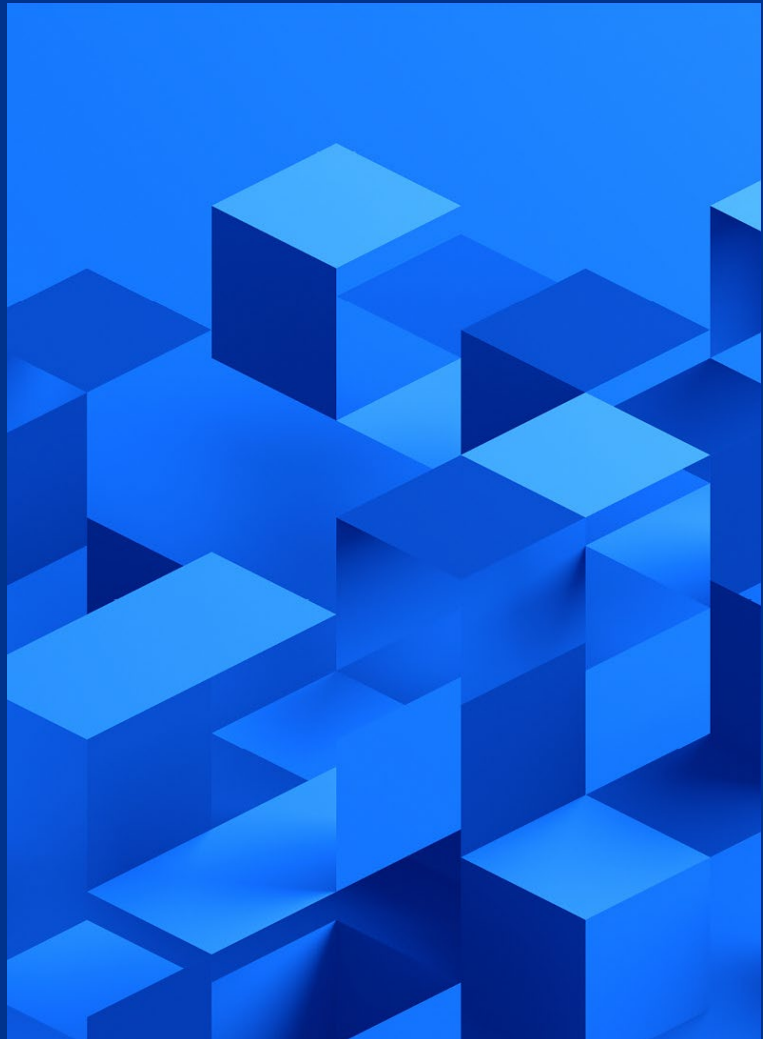
Inventory

Executive Summary

US GAAP

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Inventory in a changing economic environment

Although inventory is a key financial reporting metric for many entities, the Codification does not provide a significant amount of detailed accounting guidance. Therefore, an entity needs to apply judgment in accounting for inventory using existing principles and methods.

The accounting principles and methods for inventory are mostly unchanged over the last several decades. However, business practices have evolved in response to changes in the economic environment and competitive landscape. Many entities have shifted their distribution models to follow changes in consumer behavior – e.g. brick and mortar stores have closed as entities move to online platforms. Changes in business practices can require an entity to make critical judgments about the application of the inventory principles in today's financial reporting environment.

Our objective with this Executive Summary is to highlight those critical judgments and provide you with the inventory basics, including scope, recognition, initial and subsequent measurement and presentation and disclosure considerations.

Our related Handbook, [Inventory](#), expands beyond the basics of inventory accounting with insights, examples and perspectives based on our years of experience in this area.

Scope and recognition

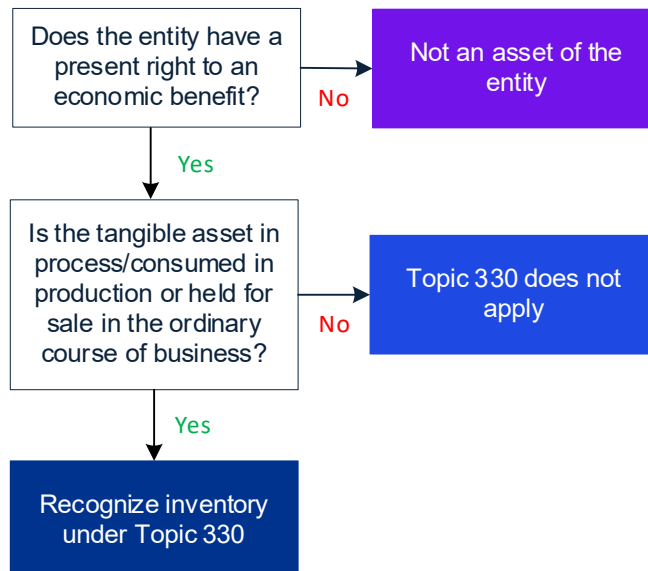
The methods and practices of accounting for inventory have been well established for many years. Accounting and reporting guidance for inventory is found in Topic 330 as well as SEC rules and regulations and AICPA publications.

A tangible asset is in the scope of Topic 330 when it meets the definitions of an asset (present right to an economic benefit) and inventory (which depends on the reasons an entity is holding the asset).

An entity generally obtains the economic benefit of a tangible asset when it obtains legal title to the asset. Further, a tangible asset meets the definition of inventory when it is:

- held for sale in the ordinary course of business (finished goods);
- in process of production for such sale (work-in-process or WIP); or
- to be currently consumed in the production of goods or services to be available for sale (raw materials).

If a tangible asset is in the scope of Topic 330, it is recognized as inventory using the initial measurement principles discussed later in this Executive Summary. The following decision tree depicts the analysis for determining whether to recognize a tangible asset as inventory.



Initial measurement

The primary basis of accounting for inventory is cost, which generally is the sum of direct and indirect expenditures and charges incurred to bring the inventory to its existing condition and location. 'Inventoriable costs' are capitalizable and fall into two broad categories.

Inventoriable costs

Acquisition costs
(e.g. price paid, sales tax, inbound delivery costs)

Production costs
(costs incurred in converting raw material to WIP and finished goods)

An entity assigns inventoriable costs to inventory using one of several cost flow assumptions.

Specific identification	Identifies inventory items by the cost of each item on hand as well as the cost of each item sold. This cost flow assumption is generally practicable when there are unique items in inventory, such as jewelry.
Average cost	Uses the average cost of a pool of assets available for sale during the period. It is often more practical than other cost flow assumptions in computing the cost of goods sold and ending inventory for similar items.
First-in, first out (FIFO)	Assumes inventories first produced or acquired are the first ones sold (i.e. the oldest inventory is sold first).
Last-in, first-out (LIFO)	Assumes inventories first produced or acquired are the last ones sold (i.e. the newest inventory is sold first).
Retail inventory method (RIM)	Calculates a retail store's total ending inventory by using the cost-to-retail price ratio (i.e. reverse markup procedure).

Certain cost flow assumptions allow different approaches or computational techniques. The primary objective is to select the assumption that most clearly reflects periodic income, matching the costs of sales with the related revenues.

Subsequent measurement

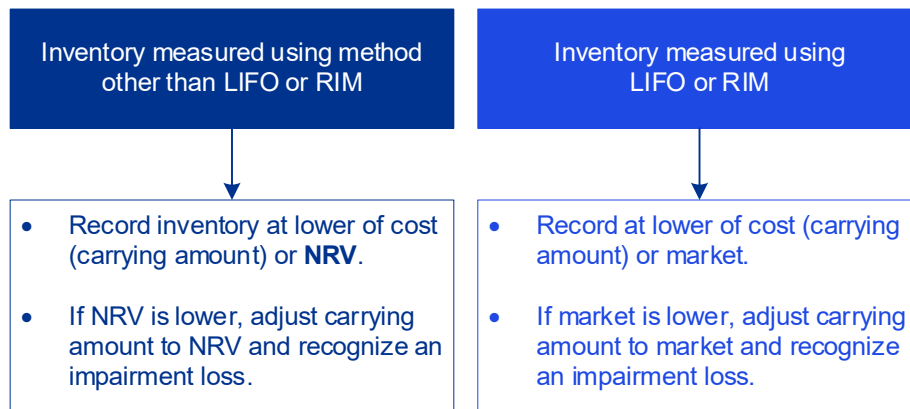
Inventory is generally measured at cost until it either becomes impaired or is sold or otherwise disposed of.

The primary accounting consideration when subsequently measuring inventory is whether the inventory has been impaired. Inventory is tested for impairment at each reporting date, at a minimum. To test for impairment, an entity chooses a unit of account based on a reasonable grouping of inventory, applied either directly to each item (i.e. an item-by-item approach) or to a grouping of items.

The following are examples of evidence that may indicate inventory is impaired:

- damage/physical deterioration;
- obsolescence;
- changes in price levels;
- market conditions; and
- customer attrition.

Inventory is impaired when its carrying amount exceeds either net realizable value (NRV) or market, depending on the cost flow assumption used.



For previously impaired inventory, it is inappropriate to restore inventory value in subsequent fiscal years. However, an entity may reverse the impairment taken during the same fiscal year if:

- the market price of that inventory recovers; and
- the gains do not exceed losses previously recognized in the same fiscal year.

Presentation and disclosure

There are several required presentation formats and disclosures relating to inventory. These requirements are not just in Topic 330, but also in other Codification Topics and SEC Reg S-X.

The major classes of inventory (e.g. finished goods, WIP, raw materials) are typically separately presented on the balance sheet or disclosed in the notes.

Inventory disclosures typically include:

- significant accounting policy for pricing,
- the basis for stating inventory and any change in that basis,
- cost elements,
- cost flow assumptions,
- significant estimates; and
- impairment losses.

Other disclosures that may be required include if inventory is measured above cost, measured at sales price, part of an inventory exchange, or included in a long-term contract or program.

An entity that uses LIFO has additional disclosure requirements, such as the requirement to disclose:

- the amount of income realized from a LIFO liquidation; and
- any material excess of replacement or current cost over the reported LIFO value.

Such an entity also may disclose non-LIFO information ('supplemental non-LIFO disclosures'), but such disclosures cannot imply that the non-LIFO earnings are the entity's 'real earnings'.

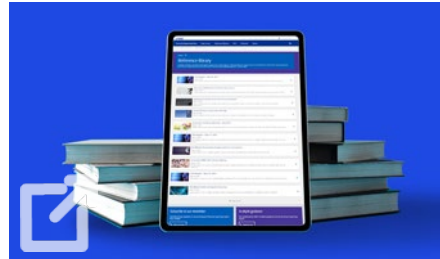
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