Inventory Accounting Methods

by Sophia

WHAT'S COVERED

This tutorial will cover two inventory accounting methods, as well as some specific accounting procedures that are applicable to each method.

Our discussion breaks down as follows:

1. Perpetual Inventory

The first accounting method to cover today is **perpetual inventory**, which is a computerized inventory system that keeps continuous detailed records of purchase and sale of inventory, and cost of goods sold.

A perpetual inventory system is a computerized system, and can also be known as a point-of-sale system or point-of-purchase system. It utilizes scanners and barcodes that contain relevant information that can be captured immediately.

> EXAMPLE For example, as so as soon as you make a purchase or a sale, the perpetual inventory system is able to capture information about it.

So, exactly what information is captured by the perpetual inventory system? The information is gathered includes:

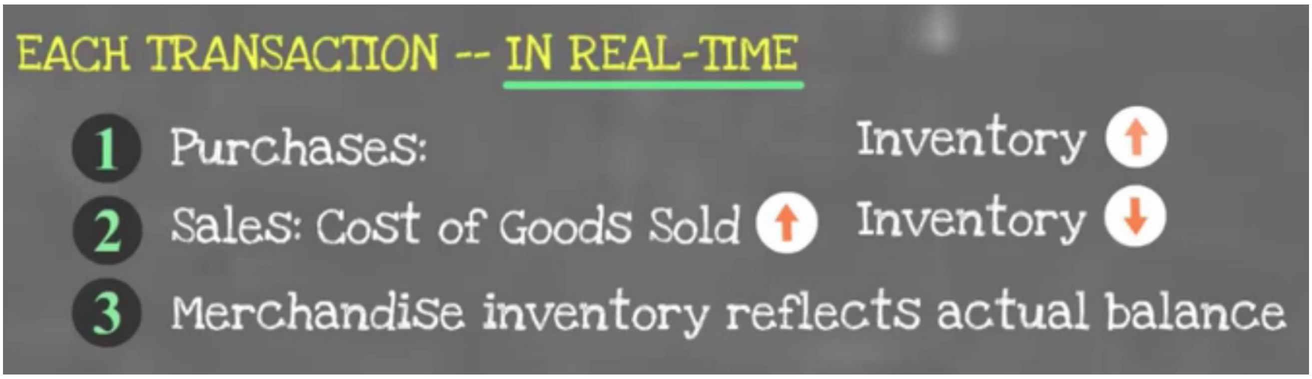
- Time of purchase or sale.
- Price, referring to how much was paid for the inventory, or how much was it sold for.
- Payment method, either cash or credit.
- Inventory, which is updated immediately.

> EXAMPLE For instance, if you make a purchase, your inventory is going to go up. If you make a sale, your inventory is going to go down.

Now, there are several accounting implications for the perpetual inventory system. Remember, each transaction in a perpetual inventory system happens in real time.

1. Every time you make a purchase or purchases, your inventory goes up immediately.
2. Every time that you make a sale or sales, your cost of goods sold goes up, recorded immediately, and your inventory goes down because of that sale.
3. Your merchandise inventory reflects your actual balance. This means that any time that you look into your

accounting system, you can see your merchandise inventory and know that it reflects the actual balance of merchandise that you have. Again, this is because your purchase/sale information updates immediately in real time as soon as that purchase or sale is made.



Now, is a physical inventory count required in a perpetual inventory system? The answer is no, it's not; however, some firms still complete a physical count of their inventory at year end because it can help to reduce inventory loss, as well as reduce theft.

TERM TO KNOW

Perpetual Inventory

Computerized inventory system that keeps continuous detailed records of purchase and sale of inventory, and cost of goods sold.

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2. Periodic Inventory

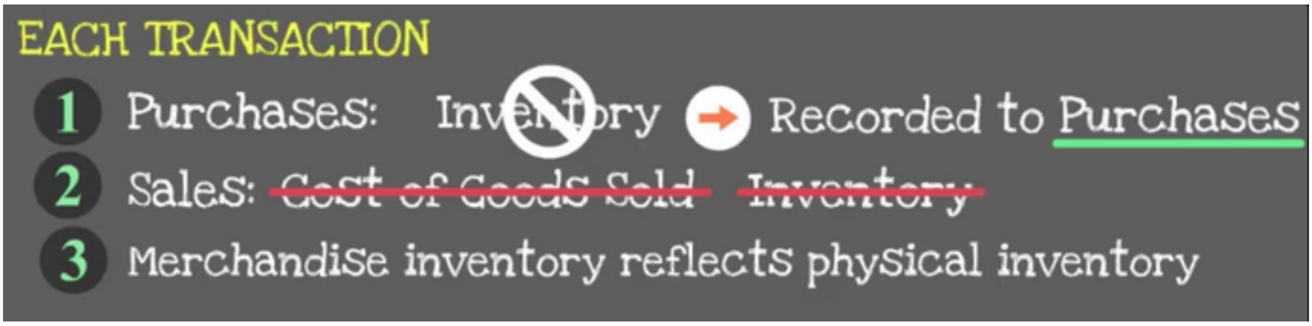
The second accounting method is **periodic inventory**, which is a physical inventory count and calculation of cost of goods sold, done at the end of the period.

The periodic inventory is an entirely manual process, done by hand through a physical inventory count and then by calculating cost of goods sold at the end of the period. Physical inventory counts need to be performed in order to know how much inventory is on hand.

Information captured in a periodic inventory system is captured periodically. A physical inventory count is done annually, quarterly, or monthly, depending on what the need might be. The important thing to note is that the information is only captured *periodically*, in terms of how much inventory is on hand and the cost of goods sold.

Here are some of the accounting implications for the periodic inventory system, for each transaction:

1. For each purchase made in a periodic inventory system, your inventory does not change. All purchases get recorded to a separate purchases account that you create.
2. For each sale made, your cost of goods sold does not get recorded, nor does your change in inventory. This is done at the end of the period.
3. Your merchandise inventory balance reflects the most recent physical inventory count, so it is not updated in real time in a periodic system.



So, is a physical inventory count required? Absolutely yes, because that is how inventory is determined, as well as the cost of goods sold. Therefore, performing that physical inventory count helps to calculate inventory, as well as the cost of goods sold.

TERM TO KNOW

Periodic Inventory

A physical inventory count and calculation of cost of goods sold, done at the end of the period.

SUMMARY

Today we learned about two inventory accounting methods. We learned about the **perpetual inventory**, which is a computerized inventory system that keeps continuous detailed records of purchase and sale of inventory, and cost of goods sold. We also learned about **periodic inventory**, a physical inventory count and calculation of cost of goods sold, done at the end of the period.

Source: Adapted from Sophia instructor Evan McLaughlin.

TERMS TO KNOW

Periodic Inventory

A physical inventory count and calculation of cost of goods sold, done at the end of the period.

Perpetual Inventory

Computerized inventory system that keeps continuous detailed records of purchase and sale of inventory, and cost of goods sold.