# Inventory Accounting, Methods, and Its Importance



One of the top ten reasons for failures in startups is the lack of efficient inventory management.

You might say well that's a known fact.
I agree, but what I ask is, do you practice efficient inventory management ? Often people know that they have better options, but still, they tend to ignore or try to take things for granted.

And, if that's not the case then

- Why do 7% of people don't track their inventory at all?
- Why do 24% of small businesses, in these times when technology is cheaper, use pen and paper to track and account inventory?

While Efficient inventory management involves managing several tasks, one of those essential tasks is proficient inventory accounting that documents the fluctuations in your inventory's performance financially. It shows whether you are showing profits or you are in loss. Isn't this the most important aspect?

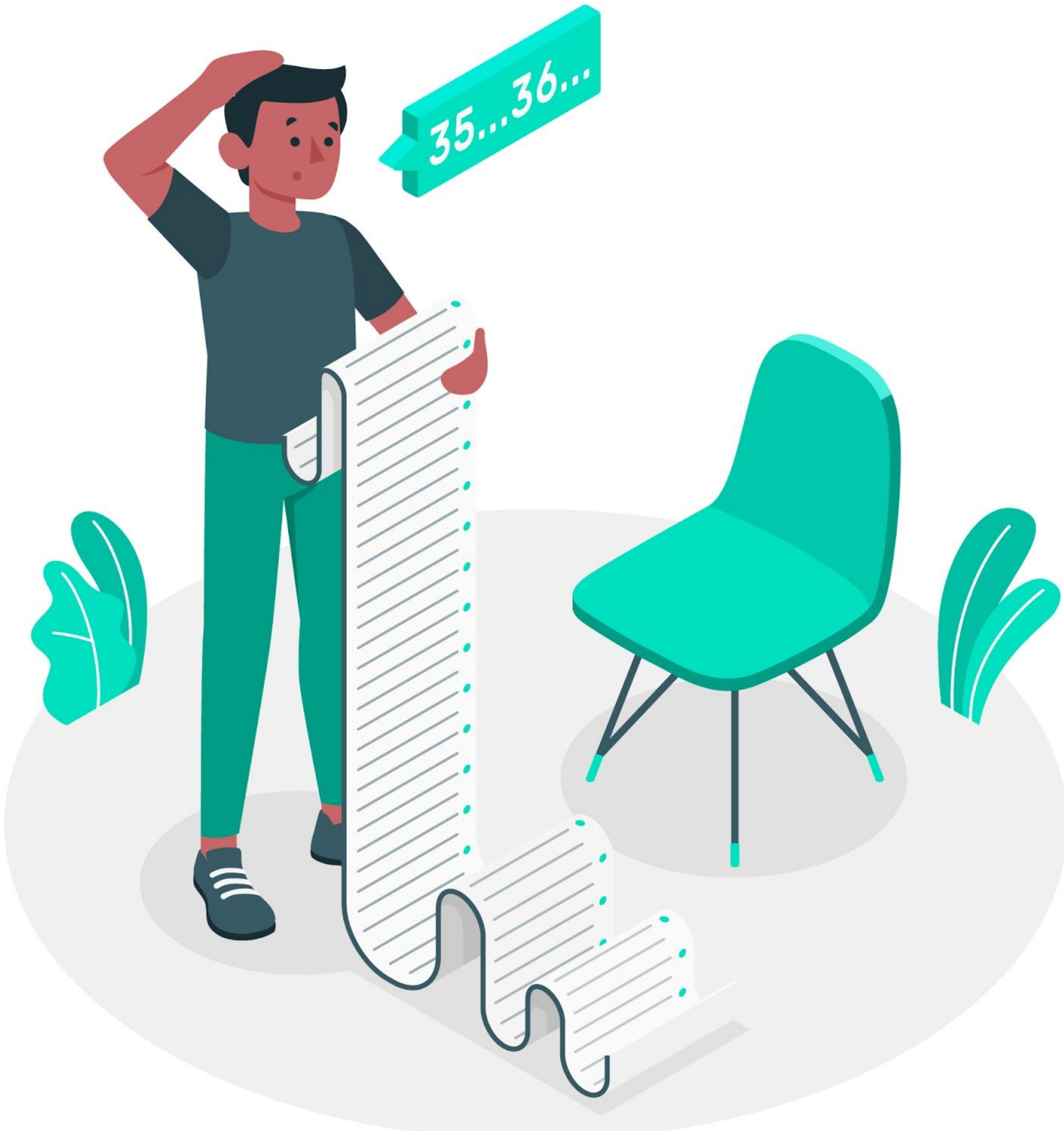
You might say,” Yeah but I do it”

You do calculate your inventory and do all the accounting tasks, but the question is, do you do it correctly?

Here, in the blog ahead, I will show you the three ways you can calculate inventory that can help you perform inventory accounting more quickly and accurately along with the advantages of Inventory Accounting

But first, let’s understand -

## What is Inventory and Inventory Accounting




The material or the merchandise kept on the racks in your warehouse is your money. Inventory is your asset; it consists of raw products, in-progress products, and the finished goods or goods bought from the manufacturer. You need to evaluate it and ensure that every inflow of inventory or outflow of the stock is accounted for.

About 7% of the US GDP is tied to the inventory, receivable accounts, and accounts payable, which is around [$1.1 trillion in assets].

Inventory Accounting is valuing your inventory to assess your company and understand how much of your asset has gone out and brought back profits for you and how much of your asset is just sitting there by assigning the values to each product of the inventory or the materials that are used to make a finished product.

Now, let’s go through the Inventory Accounting Methods.

## Inventory Accounting Methods

There are three very famous and secure methods for Inventory Accounting-

**FIFO (First In First Out)**
**LIFO(Last in First Out)**
**Weighted Average Cost (WAC)**

These inventory accounting methods are approved by GAAP(Generally Accepted Accounting Standards guidelines) of the USA. However, another international body, International Financial Reporting Standards(IFRS), restricts the LIFO method for inventory accounting.

ACCOUNTING
TAX
TAX
THIS MONTH
This month taxes
Last month taxes
ACCOUNTING BASICS
WHAT IS IT?
FINANCIAL ACCOUNTING
Taxes!
REMEMBER!
MANAGEMENT
ACCOUNTING SERVICES
SALARY
MY TAX ACCOUNT
TAX
SAVINGS
SAVINGS CACULATOR

## First In First Out (FIFO)

First in First Out Method, as the name suggests, the oldest inventory that came first into the warehouse is first sold. This means the COGS that you see on the balance sheet are in the order of the oldest product to the newest.

FIFO shows the actual cost of goods and indicates the exact or increased profit, leading to increased taxes. Thus, many businesses refrain from using FIFO in the USA, although it is used when the company's growth is to be flaunted, especially in front of investors.

This said, since LIFO is banned by IFRS internationally, companies have to use FIFO.

## LIFO (Last in First Out)

Last in First Out method is an inventory accounting method in which the most recently bought or manufactured products are sold first. LIFO shows more investments and lesser profits, thus helping the businesses to save on taxes. However, since LIFO is banned internationally by IFRS, companies apart from the USA use FIFO.

### Weighted Average Cost Method

The [Weighted Average cost method ]calculates the amount distributed into inventory and the COGS through weighted average. This method is used when the FIFO and LIFO are not applicable because the costs of different materials are tough to account for. The SKUs increase from a specific limit that it becomes tougher to note down the values of each type of product. GAAP and IFRS also accept WAC.

To know about how these inventory accounting methods will be used in Perpetual and Periodic Inventory Click here.

## Advantages of Inventory Accounting

- Inventory accounting helps you account for the assets that you have in your inventory at different stages of production and research if you are a manufacturer.
- Accounting for inventory makes sure that you have a total and accurate idea of your company's most valuable asset, i.e., the stock.
- A company can increase profits and decrease stagnancy in the product flow by carefully accounting for it's products with the help of the above-given Inventory Accounting Methods.

- Inventory accounting helps a manufacturer or an ecommerce seller understand which type of inventory or materials he/she should save and where he/she needs to invest more to increase profits and revenues.

## Conclusion

Inventory Accounting, if done most diligently, is like a regular medical check-up of a person. You get to know the person's health inside-out and the most healthy and the unhealthy or sick parts of the body. Based on this, a person decides to take care of his/her body by altering his diet, taking medication, and starting exercising. Similarly, Inventory Accounting lets you know your company's health so that you can adjust the investments, give necessary boosts, and correct the workflow if needed.

## Useful Resources

https://www.investopedia.com/terms/i/inventoryaccounting.asp
https://www.accountingformanagement.org/exercise-3-icm/
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