Purpose of Inventory Valuation
At the end of the accounting period, the inventory that was held by a merchandising company during the period will fall into one of two groups. The inventory will either have been SOLD (accounted for in the COST OF GOODS SOLD account) or NOT SOLD (accounted for in the MERCHANDISE INVENTORY account). The value assigned to each of these categories must be accurately determined so that the amounts reflected in the financial statements are accurate and reliable.

How Much Has Sold
Even though a company may use a perpetual inventory system in which the Merchandise Inventory account is continually updated, a physical count of ending inventory should be performed to determine the exact amount of inventory remaining. The amount of inventory that was sold is determined by subtracting the ending inventory (as determined by the physical count) from the beginning inventory balance (as found in the Merchandise Inventory account).

When to Count Inventory
A cutoff period is determined for performing the physical inventory. This is usually the end of the last day of the fiscal period.

What to Count
All inventory owned by the merchandiser as of the cutoff date should be included in the inventory count. This includes
- Goods owned by the merchandiser held on a showroom floor or in a warehouse
- Goods sold and shipped FOB Destination
- Goods purchased and shipped FOB Shipping Point
- Goods consigned out at other locations

How to Assign a Value to Cost of Goods Sold and Ending Inventory
Four Inventory costing methods may be used for assigning value to cost of goods sold and ending inventory.
- Specific Identification
- LIFO
- FIFO
- Weighted Average

Comparison of LIFO and FIFO Inventory Valuation Methods
LIFO and FIFO are two cost flow assumptions for assigning a value to cost of goods sold. The following comparisons assume a period of rising prices.

LIFO – Last-In-First-Out
Cost of goods sold is made up of the last or latest inventory purchased.
Cost of goods sold will be higher under LIFO than FIFO.
Ending inventory consists of the earliest inventory purchased.
Ending inventory will be valued lower under LIFO than FIFO.

FIFO – First-In-First-Out
Cost of goods sold is made up of the first inventory purchased.
Cost of goods sold will be lower under FIFO than LIFO.
Ending inventory consists of the last or latest inventory purchased.
Ending inventory will be valued higher under FIFO than LIFO.