Computing Cost of goods sold (2)	Lesson 23

In this lesson, we will see examples on how to calculate cost of goods sold for a trading business.

First, recall from the preceding lesson that:

Beginning stock in $ + Purchases in $ - Ending stock in $ = Cost of goods sold

which we can rewrite as

	Beginning stock X Cost per unit	0	0
plus	Purchases X Cost per unit	110 X 50	5,500
less	Ending stock X Cost per unit	10 X 50	500
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equals	Cost of goods sold		$5,000

Imagine a trading company that buys and sells chairs, and that its first day of business is today. Its beginning stock is, therefore, zero. It makes a purchase of 110 units costing $50 each unit.

The end of the month comes, and it has 10 chairs left in stock. We calculate the cost of goods sold for Month 1 as follows:

	Beginning stock X Cost per unit	0	0
plus	Purchases X Cost per unit	110 X 50	5,500
less	Ending stock X Cost per unit	10 X 50	500
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equals	Cost of goods sold		$5,000

If records show that 100 chairs were in fact sold, then the cost of goods sold amounting to $5,000 as computed above represents the cost of chairs actually sold.

However, if records show that only 95 chairs were actually sold, and the inventory count at the end shows only 10 chairs, then 5 chairs were lacking . They may have been stolen or disposed of because of damages that rendered them unsaleable. The calculation of the cost of goods sold remains as shown above, which takes into consideration *the stock at the end of the month, not the stock sold.* This serves to illustrate the fact that cost of goods sold in effect takes into consideration the loss in value of the stock.

Let see another scenario. Records show that 100 chairs were in fact sold, and that 10 chairs remain in the inventory. However, prudent valuation shows that the remaining stock has deteriorated in quality, and that the value per unit has gone down to $40. We calculate the cost of goods sold as follows:

	Beginning stock X Cost per unit	0	0
plus	Purchases X Cost per unit	110 X 50	5,500
less	Ending stock X Cost per unit	10 X 40	400
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equals	Cost of goods sold		$5,100

Our latest computation showed that as a result of deterioration in quality of the remaining stock, the cost of goods sold has increased. Here we see again that a loss in the value of the ending stock is built into the cost of goods sold.

We shall have further use of this trading company as an example in the next lesson.

Until then,

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