

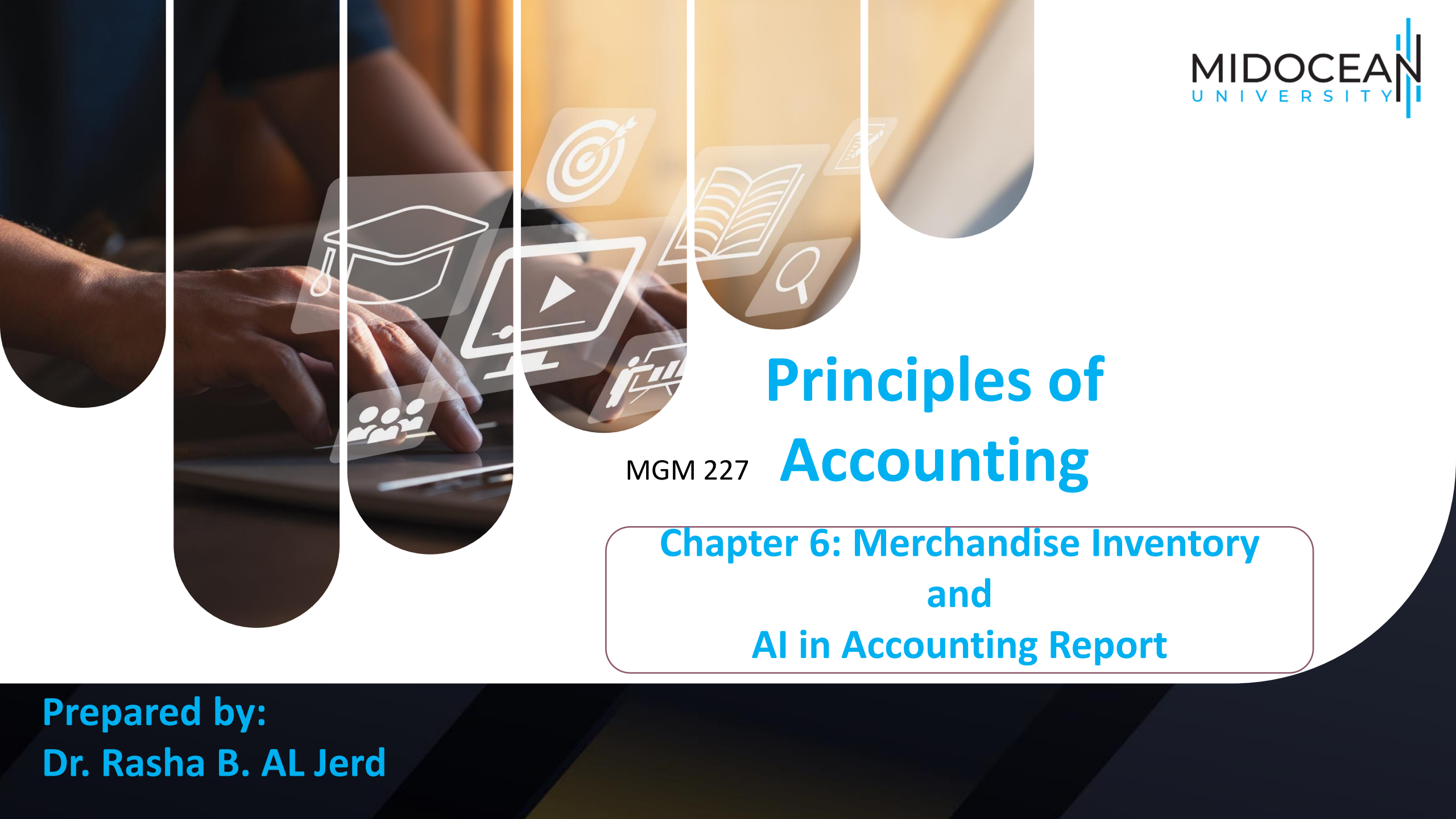
Principles of Accounting

Lecture 10

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Subject code: MGM 227



The background features a collage of educational and professional icons overlaid on a blurred image of hands typing on a laptop. The icons include a graduation cap, a target with an arrow, a play button, an open book, a magnifying glass, a group of people, and a person at a computer. The text is positioned on the right side of the slide.

Principles of Accounting

MGM 227

Chapter 6: Merchandise Inventory and AI in Accounting Report

Prepared by:
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Learning objectives:

- 1) Identify accounting principles and controls related to merchandise inventory.
- 2) Account for merchandise inventory costs under a perpetual inventory system.
- 3) AI in Accounting Report



Identify accounting principles and controls related to
merchandise inventory

Accounting Principles

Let's begin by learning about several accounting principles that affect merchandise inventories. Among them are consistency, disclosure, materiality, and accounting conservatism.

Consistency Principle

The **consistency principle** states that businesses should use the same accounting methods and procedures from period to period. Consistency helps investors and creditors compare a company's financial statements from one period to the next.

Suppose you are analyzing a company's net income over a two-year period in which there was an increase in net income from the first year to the second. Analysis of the income statement shows Net Sales Revenue was almost the same for both years, but Cost of Goods Sold decreased significantly, which resulted in increases in gross profit and operating income. Without further information, you might conclude that the company was able to purchase its inventory at a lower cost in the second year and that profits will continue to increase in future years. However, changing inventory costing methods could have caused this one-time change, in which case future profits will not be affected. Therefore, companies must be consistent in the accounting methods they use. If changes are made in accounting methods, these changes must be reported. Investors and creditors need this information to make wise decisions about the company.

Consistency Principle

A business should use the same accounting methods and procedures from period to period.

Disclosure Principle

The **disclosure principle** holds that a company should report enough information for outsiders to make knowledgeable decisions about the company. In short, the company should report information that is relevant and has faithful representation. This includes disclosing the method used to account for merchandise inventories. All major accounting methods and procedures are described in the footnotes to the financial statements. Suppose a banker is comparing two companies—one using inventory method A and the other using inventory method B. The B company reports higher net income but only because of the inventory method it selected. Without knowledge of these accounting methods, the banker could lend money to the wrong business.

Disclosure Principle

A business's financial statements must report enough information for outsiders to make knowledgeable decisions about the company.

Materiality Concept

A company must perform strictly proper accounting only for items that are significant to the business's financial situation.

Materiality Concept

The **materiality concept** states that a company must perform strictly proper accounting *only* for significant items. Information is significant—or, in accounting terms, *material* when it would cause someone to change a decision. The materiality concept frees accountants from having to report every last item in strict accordance with GAAP. For example, \$10,000 is material to a small business with annual sales of \$100,000. However, \$10,000 isn't material to a large company with annual sales of \$100,000,000. Therefore, the accounting principles followed for a \$10,000 cost in a small company may be different from the accounting principles followed for a \$10,000 cost in a large company.

Conservatism in accounting means exercising caution in reporting items in the financial statements.

Conservatism espouses the following ideas:

- Anticipate no gains, but provide for all probable losses.
- If in doubt, record an asset at the lowest reasonable amount and a liability at the highest reasonable amount.
- When there's a question, record an expense rather than an asset.
- When you are faced with a decision between two possible options, you must choose the option that undervalues, rather than overvalues, your business.

The goal of conservatism is to report realistic figures and never overstate assets or net income.

Conservatism

A business should report the least favorable figures in the financial statements when two or more possible options are presented.

Control Over Merchandise Inventory

Maintaining good controls over merchandise inventory is very important for a merchandiser. Good controls ensure that inventory purchases and sales are properly authorized and accounted for by the accounting system. This can be accomplished by taking the following measures:

- Ensure merchandise inventory is not purchased without proper authorization, including purchasing only from approved vendors and within acceptable dollar ranges.
- After inventory is purchased, the order should be tracked and properly documented when received. At time of delivery, a count of inventory received should be completed and each item should be examined for damage.
- Damaged inventory should be properly recorded and then should either be used, disposed of, or returned to the vendor.
- A physical count of inventory should be completed at least once a year to track inventory shrinkage due to theft, damage, and errors.
- When sales are made, the inventory sold should be properly recorded and removed from the inventory count. This will prevent the company from running out of inventory, often called a *stockout*.

Match the accounting terminology to the definitions.

- | | |
|--------------------------|--|
| 1. Conservatism | a. A business should report the least favorable figures in the financial statements when two or more possible options are presented. |
| 2. Materiality concept | |
| 3. Disclosure principle | b. A business's financial statements must report enough information for outsiders to make knowledgeable decisions about the company. |
| 4. Consistency principle | c. A business should use the same accounting methods and procedures from period to period. |
| | d. A company must perform strictly proper accounting only for items that are significant to the business's financial situation. |

Ward Hardware used the FIFO inventory costing method in 2018. Ward plans to continue using the FIFO method in future years. Which accounting principle is most relevant to Ward's decision?

The consistency principle is most relevant to Ward's decision.



Account for merchandise inventory costs under a perpetual
inventory system

HOW ARE MERCHANDISE INVENTORY COSTS DETERMINED UNDER A PERPETUAL INVENTORY SYSTEM?

Previously you learned about merchandise inventory and cost of goods sold. Remember these key equations:

Ending Merchandise Inventory
=
Number of units on hand
×
Unit cost

Cost of Goods Sold
=
Number of units sold
×
Unit cost

Companies determine the number of units on hand from perpetual inventory records backed up by a physical count. Exhibit 6-1 gives the inventory data for TAB0503, one model of tablets that Smart Touch Learning sells. As shown in this exhibit, Smart Touch Learning began August with 2 TAB0503s in inventory. It purchased 4 more tablets on August 5, bringing the total quantity on hand to 6 (2 + 4). On August 15, it sold 4 tablets, leaving 2 remaining on hand (6 - 4). Smart Touch Learning then purchased 12 more on August 26 and sold 10 on August 31. It had 4 TAB0503s at the end of August (2 + 12 - 10). The company sold each tablet for \$500 to its customers.

Item: TAB0503				
Date	Quantity Purchased	Quantity Sold	Cost per Unit	Quantity on Hand
Aug. 1			\$350	2
5	4		\$350	6 ← 2 + 4
15		4		2 ← 6 - 4
26	12		\$350	14
31		10		4
Totals	16	14		4

Measuring inventory cost is easy when prices do not change. For example, looking at Exhibit 6-1, you can see that Smart Touch Learning’s cost per unit remained the same at \$350. Therefore, ending inventory and cost of goods sold can be calculated easily.

Ending Merchandise Inventory
Number of units on hand
×
Unit cost

4 units
×
\$350 per unit

\$1,400

Cost of Goods Sold
Number of units sold
×
Unit cost

14 units
×
\$350 per unit

\$4,900

But what if unit cost does change? For example, what if the cost per unit increased to \$360 on August 5 and \$380 on August 26, as shown in Exhibit 6-2? When inventory is sold on August 31, how many of the tablets sold cost \$350? How many cost \$360? And how many cost \$380? To compute ending inventory and cost of goods sold, Smart Touch Learning must assign a unit cost to each inventory item. This is done by using one of four inventory costing methods: **1.** Specific identification **2.** First-in, first-out (FIFO) **3.** Last-in, first-out (LIFO) **4.** Weighted-average.

Item: TAB0503				
Date	Quantity Purchased	Quantity Sold	Cost per Unit	Quantity on Hand
Aug. 1			\$350	2
5	4		\$360	6
15		4		2
26	12		\$380	14
31		10		4
Totals	16	14		4

Each **inventory costing method** approximates the flow of inventory costs in a business (with the exception of the specific identification method) and is used to determine the amount of cost of goods sold and ending merchandise inventory.

Specific Identification Method

The **specific identification method** uses the specific cost of each unit of inventory to determine ending inventory and cost of goods sold. In the specific identification method, the company knows exactly which item was sold and exactly what the item cost. This costing method is best for businesses that sell unique, easily identified inventory items, such as automobiles (identified by the vehicle identification number [VIN]), jewels (a specific diamond ring), and real estate (identified by address). For instance, assume that of the 4 tablets sold on August 15, 1 had a cost of \$350 and 3 had a cost of \$360. As for the August 31 sale, 1 had a cost of \$350 and 9 had a cost of \$380. Cost of goods sold and ending merchandise inventory can be calculated as shown in Exhibit 6-3.

Exhibit 6-3 | Perpetual Inventory Record: Specific Identification

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Aug. 1							2 units	× \$ 350	= \$ 700 } \$ 700
5	4 units	× \$ 360	= \$ 1,440				2 units 4 units	× \$ 350 × \$ 360	= \$ 700 = \$ 1,440 } \$ 2,140
15				1 unit 3 units	× \$ 350 × \$ 360	= \$ 350 = \$ 1,080 } \$ 1,430	1 unit 1 unit	× \$ 350 × \$ 360	= \$ 350 = \$ 360 } \$ 710
26	12 units	× \$ 380	= \$ 4,560				1 unit 1 unit 12 units	× \$ 350 × \$ 360 × \$ 380	= \$ 350 = \$ 360 = \$ 4,560 } \$ 5,270
31				1 unit 9 units	× \$ 350 × \$ 380	= \$ 350 = \$ 3,420 } \$ 3,770	1 unit 3 units	× \$ 360 × \$ 380	= \$ 360 = \$ 1,140 } \$ 1,500
Totals	16 units		<u>\$ 6,000</u>	14 units		<u>\$ 5,200</u>	4 units		<u>\$ 1,500</u>

Inventory Costing Method

A method of approximating the flow of inventory costs in a business that is used to determine the amount of cost of goods sold and ending merchandise inventory.

Specific Identification Method

An inventory costing method based on the specific cost of particular units of inventory.

Notice that under the specific identification method, when inventory is sold, a specific cost is assigned to it. For example, on the August 15 sale, Smart Touch Learning knew that it had sold 1 unit costing \$350 and 3 units costing \$360. This left 1 unit (2 - 1) at \$350 and 1 unit (4 - 3) at \$360 in ending inventory. This method requires the business to keep detailed records of inventory sales and purchases and to also be able to carefully identify the inventory that is sold.

First-In, First-Out (FIFO) Method

Under the **first-in, first-out (FIFO) method**, the cost of goods sold is based on the oldest purchases—that is, the first units to come in are assumed to be the first units to go out (sold). In Exhibit 6-4, this is illustrated by the cost of goods sold coming from the *first* goods purchased, which are from the August 1 beginning inventory. FIFO costing is consistent with the physical movement of inventory (for most companies). That is, under the FIFO inventory costing method, companies sell their oldest inventory first.

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Aug. 1							2 units	× \$ 350	= \$ 700 } \$ 700
5	4 units	× \$ 360	= \$ 1,440				2 units 4 units	× \$ 350 × \$ 360	= \$ 700 = \$ 1,440 } \$ 2,140
15				2 units 2 units	× \$ 350 × \$ 360	= \$ 700 = \$ 720 } \$ 1,420	2 units	× \$ 360	= \$ 720 } \$ 720
26	12 units	× \$ 380	= \$ 4,560				2 units 12 units	× \$ 360 × \$ 380	= \$ 720 = \$ 4,560 } \$ 5,280
31				2 units 8 units	× \$ 360 × \$ 380	= \$ 720 = \$ 3,040 } \$ 3,760	4 units	× \$ 380	= \$ 1,520 } \$ 1,520
Totals	16 units		<u>\$ 6,000</u>	14 units		<u>\$ 5,180</u>	4 units		<u>\$ 1,520</u>

First-In, First-Out (FIFO) Method
An inventory costing method in which the first costs into inventory are the first costs out to cost of goods sold. Ending inventory is based on the costs of the most recent purchases.

Smart Touch Learning began August with 2 TAB0503s that cost \$350 each. After the August 5 purchase, the inventory on hand consists of 6 units (2 + 4). On August 15, the company sold 4 units. Under FIFO, the first 2 units sold had the oldest cost (\$350 per unit). The next 2 units sold cost \$360 each. That leaves 2 units in inventory on August 15 at \$360 each. The remainder of the inventory record follows the same pattern. Consider the sale on August 31 of 10 units. The oldest cost is from August 5 (2 units @ \$360). The next oldest cost is from the August 26 purchase at \$380 each (8 units @ \$380). This leaves 4 units in inventory on August 31 at \$380 each.

The FIFO monthly summary at August 31 is as follows:

- Cost of goods sold: 14 units that cost a total of \$5,180.
- Ending inventory: 4 units that cost a total of \$1,520.

Notice the total cost of goods sold of \$5,180 plus the total ending inventory of \$1,520 equals the total **cost of goods available for sale** during August of \$6,700 [(2 units @ \$350) + (4 units @ \$360) + (12 units @ \$380)]. Cost of goods available for sale represents the total cost of merchandise inventory that is available for sale during the time period. Smart Touch Learning measures cost of goods sold and ending merchandise inventory in this manner to prepare its financial statements.

Cost of Goods Available for Sale

The total cost spent on inventory that was available to be sold during a period.

Journal Entries Under FIFO

The journal entries under FIFO are presented below. We assume all purchases and sales of inventory are on account. The amounts unique to FIFO are shown in blue for emphasis. All other amounts are the same for all four inventory methods.

Date	Accounts and Explanation	Debit	Credit
Aug. 5	Merchandise Inventory (4 × \$360)	1,440	
	Accounts Payable		1,440
	<i>Purchased inventory on account.</i>		
15	Accounts Receivable (4 × \$500)	2,000	
	Sales Revenue		2,000
	<i>Sale on account.</i>		
15	Cost of Goods Sold (2 × \$350) + (2 × \$360)	1,420	
	Merchandise Inventory		1,420
	<i>Recorded the cost of goods sold.</i>		
26	Merchandise Inventory (12 × \$380)	4,560	
	Accounts Payable		4,560
	<i>Purchased inventory on account.</i>		
31	Accounts Receivable (10 × \$500)	5,000	
	Sales Revenue		5,000
	<i>Sale on account.</i>		
31	Cost of Goods Sold (2 × \$360) + (8 × \$380)	3,760	
	Merchandise Inventory		3,760
	<i>Recorded the cost of goods sold.</i>		

$$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow} - \left\{ \frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\text{}} \right\}$$

$$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow} - \left\{ \frac{L}{\text{}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow} \right\}$$

$$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow} - \left\{ \frac{L}{\text{}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow} \right\}$$

$$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow} - \left\{ \frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\text{}} \right\}$$

$$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow} - \left\{ \frac{L}{\text{}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow} \right\}$$

$$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow} - \left\{ \frac{L}{\text{}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow} \right\}$$

For example, on August 5, Smart Touch Learning purchased \$1,440 of inventory and made the first journal entry. On August 15, the company sold 4 TAB0503s for the sales price of \$500 each. Smart Touch Learning recorded the sale, \$2,000, and the cost of goods sold, \$1,420 (calculated in Exhibit 6-4 as 2 units @ \$350 plus 2 units @ \$360). The remaining journal entries (August 26 and 31) follow the inventory data in Exhibit 6-4.

Last-In, First-Out (LIFO) Method

Last-in, first-out (LIFO) is the opposite of FIFO. Under the **last-in, first-out (LIFO) method**, ending inventory comes from the oldest costs (beginning inventory and earliest purchases) of the period. The cost of goods sold is based on the most recent purchases (new costs)—that is, the last units in are assumed to be the first units sold. This is illustrated by the cost of goods sold for the August 31 sale coming from the *last* goods in the warehouse—the August 26 purchase in Exhibit 6-5. Under the LIFO inventory costing method, companies sell their newest inventory first.

Last-In, First-Out (LIFO) Method

An inventory costing method in which the last costs into inventory are the first costs out to cost of goods sold. The method leaves the oldest costs—those of beginning inventory and the earliest purchases of the period—in ending inventory.

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Aug. 1							2 units	× \$ 350	= \$ 700 } \$ 700
5	4 units	× \$ 360	= \$ 1,440				2 units	× \$ 350	= \$ 700 } \$ 2,140
							4 units	× \$ 360	= \$ 1,440 }
15				4 units	× \$ 360	= \$ 1,440 } \$ 1,440	2 units	× \$ 350	= \$ 700 } \$ 700
26	12 units	× \$ 380	= \$ 4,560				2 units	× \$ 350	= \$ 700 } \$ 5,260
							12 units	× \$ 380	= \$ 4,560 }
31				10 units	× \$ 380	= \$ 3,800 } \$ 3,800	2 units	× \$ 350	= \$ 700 } \$ 1,460
							2 units	× \$ 380	= \$ 760 }
Totals	16 units		<u>\$ 6,000</u>	14 units		<u>\$ 5,240</u>	4 units		<u>\$ 1,460</u>

Again, Smart Touch Learning had 2 TAB0503s at the beginning. After the purchase on August 5, the company holds 6 units of inventory (2 units @ \$350 plus 4 units @ \$360). On August 15, Smart Touch Learning sells 4 units. Under LIFO, the cost of goods sold always comes from the most recent purchase (4 units @ \$360). That leaves 2 TAB0503s in inventory on August 15 (2 units @ \$350).

The purchase of 12 units on August 26 adds a new \$380 layer to inventory. Now inventory holds 14 units.

Then the sale of 10 units on August 31 peels back units in LIFO order (10 units @ \$380). The LIFO monthly summary at August 31 is as follows:

- Cost of goods sold: 14 units that cost a total of \$5,240.
- Ending inventory: 4 units that cost a total of \$1,460.

Under LIFO, Smart Touch Learning could measure cost of goods sold and ending inventory in this manner to prepare its financial statements.

Journal Entries Under LIFO

The journal entries under LIFO follow. We assume all purchases and sales of inventory are on account. Amounts unique to LIFO are shown in blue.



LIFO is not permitted under International Financial Reporting Standards (IFRS). Under IFRS, companies may only use the specific identification, FIFO, and weighted-average methods to cost inventory. If LIFO were eliminated as an acceptable method under GAAP, those U.S. companies currently using the LIFO cost method would experience significant income statement and balance sheet effects. Approximately one-third of U.S. companies use the LIFO method to cost at least part of their inventory.

Date	Accounts and Explanation	Debit	Credit
Aug. 5	Merchandise Inventory (4 × \$360)	1,440	
	Accounts Payable		1,440
	<i>Purchased inventory on account.</i>		
15	Accounts Receivable (4 × \$500)	2,000	
	Sales Revenue		2,000
	<i>Sale on account.</i>		
15	Cost of Goods Sold (4 × \$360)	1,440	
	Merchandise Inventory		1,440
	<i>Recorded the cost of goods sold.</i>		
26	Merchandise Inventory (12 × \$380)	4,560	
	Accounts Payable		4,560
	<i>Purchased inventory on account.</i>		
31	Accounts Receivable (10 × \$500)	5,000	
	Sales Revenue		5,000
	<i>Sale on account.</i>		
31	Cost of Goods Sold (10 × \$380)	3,800	
	Merchandise Inventory		3,800
	<i>Recorded the cost of goods sold.</i>		

$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow}$	-	$\frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\phantom{\text{Accounts Payable} \uparrow}}$
$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow}$	-	$\frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow}$
$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow}$	-	$\frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow}$
$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow}$	-	$\frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\phantom{\text{Accounts Payable} \uparrow}}$
$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow}$	-	$\frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow}$
$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow}$	-	$\frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow}$

On August 5, Smart Touch Learning purchased inventory of \$1,440. The August 15 sale brought in sales revenue (4 units @ \$500 = \$2,000) and cost of goods sold (4 units @ \$360 = \$1,440). The August 26 and 31 entries also come from the data in Exhibit 6-5.

Weighted-Average Method

Under the **weighted-average method** (sometimes called *moving-average method*), the business computes a new weighted-average cost per unit after each purchase. Ending inventory and cost of goods sold are then based on the same weighted-average cost per unit. After the first purchase on August 5, the weighted-average cost per unit sold falls somewhere between the beginning inventory cost of \$350 and the most recent purchase cost of \$360. Exhibit 6-6 shows a perpetual inventory record for the weighted-average method. We round average unit cost to the nearest cent and total cost to the nearest dollar.

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Aug. 1							2 units	× \$ 350	= \$ 700
5	4 units	× \$ 360	= \$ 1,440				6 units	× \$ 356.67	= \$ 2,140 \$ 2,140 / 6 units = \$ 356.67
15				4 units	× \$ 356.67	= \$ 1,427	2 units	× \$ 356.67	= \$ 713
26	12 units	× \$ 380	= \$ 4,560				14 units	× \$ 376.64	= \$ 5,273 \$ 5,273 / 14 units = \$ 376.64
31				10 units	× \$ 376.64	= \$ 3,766	4 units	× \$ 376.64	= \$ 1,507
Totals	16 units		<u>\$ 6,000</u>	14 units		<u>\$ 5,193</u>	4 units		<u>\$ 1,507</u>

Weighted-Average Method

An inventory costing method based on the weighted-average cost per unit of inventory that is calculated after each purchase. Weighted-average cost per unit is determined by dividing the cost of goods available for sale by the number of units available.

As noted previously, after each purchase, Smart Touch Learning computes a new weighted-average cost per unit. For example, on August 5, the new weighted-average unit cost is as follows:

Cost of goods available for sale / Number of units available = $(\$700 + \$1,440) / (2 \text{ units} + 4 \text{ units})$
= $\$2,140 / 6 \text{ units}$
= $\$356.67 \text{ (rounded)}$



Under the weighted-average method, the cost per unit is a weighted average. You cannot take the average of the two unit costs (\$350 and \$360) to determine the new unit cost. Instead, you must use the total cost of goods available for sale (\$2,140) divided by the number of units available (6 units).

The goods sold on August 15 are then costed out at \$356.67 per unit. On August 26 when the next purchase is made, the new weighted-average unit cost is as follows:

Cost of goods available for sale / Number of units available = $(\$713 + \$4,560) / (2 \text{ units} + 12 \text{ units})$
= $\$5,273 / 14 \text{ units}$
= $\$376.64 \text{ (rounded)}$

The weighted-average cost summary at August 31 is as follows:

- Cost of goods sold: 14 units that cost a total of \$5,193.
- Ending inventory: 4 units that cost a total of \$1,507.

Under the weighted-average cost method, Smart Touch Learning could use these amounts to prepare its financial statements.

Journal Entries Under Weighted-Average

The journal entries under weighted-average costing follow. We assume all purchases and sales of inventory are on account. Amounts unique to the weighted-average method are shown in blue.

Date	Accounts and Explanation	Debit	Credit
Aug. 5	Merchandise Inventory (4 × \$360)	1,440	
	Accounts Payable		1,440
	<i>Purchased inventory on account.</i>		
15	Accounts Receivable (4 × \$500)	2,000	
	Sales Revenue		2,000
	<i>Sale on account.</i>		
15	Cost of Goods Sold (4 × \$356.67)	1,427	
	Merchandise Inventory		1,427
	<i>Recorded the cost of goods sold.</i>		
26	Merchandise Inventory (12 × \$380)	4,560	
	Accounts Payable		4,560
	<i>Purchased inventory on account.</i>		
31	Accounts Receivable (10 × \$500)	5,000	
	Sales Revenue		5,000
	<i>Sale on account.</i>		
31	Cost of Goods Sold (10 × \$376.64)	3,766	
	Merchandise Inventory		3,766
	<i>Recorded the cost of goods sold.</i>		

$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow}$	$\left\{ \begin{array}{l} \frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\phantom{\text{Accounts Payable} \uparrow}} \end{array} \right.$
$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow}$	$\left\{ \begin{array}{l} \frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow} \end{array} \right.$
$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow}$	$\left\{ \begin{array}{l} \frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow} \end{array} \right.$
$\frac{A \uparrow}{\text{Merchandise Inventory} \uparrow}$	$\left\{ \begin{array}{l} \frac{L \uparrow}{\text{Accounts Payable} \uparrow} + \frac{E}{\phantom{\text{Accounts Payable} \uparrow}} \end{array} \right.$
$\frac{A \uparrow}{\text{Accounts Receivable} \uparrow}$	$\left\{ \begin{array}{l} \frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \uparrow}{\text{Sales Revenue} \uparrow} \end{array} \right.$
$\frac{A \downarrow}{\text{Merchandise Inventory} \downarrow}$	$\left\{ \begin{array}{l} \frac{L}{\phantom{\text{Accounts Payable} \uparrow}} + \frac{E \downarrow}{\text{Cost of Goods Sold} \uparrow} \end{array} \right.$

On August 5, Smart Touch Learning purchased \$1,440 of inventory and made the first journal entry. On August 15, Smart Touch Learning sold 4 TAB0503s for \$500 each. The company recorded the sale (\$2,000) and the cost of goods sold (4 units at \$356.67 = \$1,427). The remaining journal entries (August 26 and 31) follow the same procedure.

Ward Hardware does not expect costs to change dramatically and wants to use an inventory costing method that averages cost changes.

Requirements

1. Which inventory costing method would best meet Ward's goal?
2. Assume Ward wanted to expense out the newer purchases of goods instead. Which inventory costing method would best meet that need?

The weighted-average inventory costing method would best meet Ward's goal.

The LIFO inventory costing method would best meet that need.

Boston Cycles started October with 12 bicycles that cost \$42 each. On October 16, Boston bought 40 bicycles at \$68 each. On October 31, Boston sold 34 bicycles for \$100 each.

§ Preparing a perpetual inventory record and journal entries—Specific identification

Requirements

1. Prepare Boston Cycle's perpetual inventory record assuming the company uses the specific identification inventory costing method. Assume that Boston sold 10 bicycles that cost \$42 each and 24 bicycles that cost \$68 each.
2. Journalize the October 16 purchase of merchandise inventory on account and the October 31 sale of merchandise inventory on account.

Perpetual Inventory Record: Specific Identification

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Oct. 1							12 units	× \$ 42	= \$ 504
									\$ 504
16	40 units	× \$ 68	= \$ 2,720				12 units	× \$ 42	= \$ 504
							40 units	× \$ 68	= \$ 2,720
									\$ 3,224
31				10 units	× \$ 42	= \$ 420	2 units	× \$ 42	= \$ 84
				24 units	× \$ 68	= \$ 1,632	16 units	× \$ 68	= \$ 1,088
						\$ 2,052			\$ 1,172
Totals	40 units		\$ 2,720	34 units		\$ 2,052	18 units		\$ 1,172

Requirement 2

Date	Accounts and Explanation	Debit	Credit
Oct. 16	Merchandise Inventory Accounts Payable <i>Purchased inventory on account.</i>	2,720	2,720
31	Accounts Receivable Sales Revenue <i>Sale on account.</i>	3,400 ^(a)	3,400 ^(a)
31	Cost of Goods Sold Merchandise Inventory <i>Recorded the cost of goods sold.</i>	2,052 ^(b)	2,052 ^(b)

Calculations:

$$\begin{aligned}
 \text{(a) Total sales revenue} &= \text{Number of bicycles sold} \times \text{Sales price per bicycle} \\
 &= 34 \text{ bicycles} \times \$100 \text{ per bicycle} \\
 &= \$3,400
 \end{aligned}$$

^(b) Calculated in Requirement 1.

Use the same data about Boston cycles and solve using FIFO

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Oct. 1							12 units	× \$ 42	= \$ 504 } \$ 504
16	40 units	× \$ 68	= \$ 2,720				12 units	× \$ 42	= \$ 504 } 40 units
								× \$ 68	= \$ 2,720 } \$ 3,224
31				12 units	× \$ 42	= \$ 504 } 22 units	18 units	× \$ 68	= \$ 1,224 } \$ 1,224
					× \$ 68	= \$ 1,496 } \$ 2,000			
Totals	40 units		<u>\$ 2,720</u>	34 units		<u>\$ 2,000</u>	18 units		<u>\$ 1,224</u>

Date	Accounts and Explanation	Debit	Credit
Oct. 16	Merchandise Inventory Accounts Payable <i>Purchased inventory on account.</i>	2,720	2,720
31	Accounts Receivable Sales Revenue <i>Sale on account.</i>	3,400 ^(a)	3,400 ^(a)
31	Cost of Goods Sold Merchandise Inventory <i>Recorded the cost of goods sold.</i>	2,000 ^(b)	2,000 ^(b)

(a) Total sales revenue = Number of bicycles sold x Sales price per bicycle
 = 34 bicycles x \$100 per bicycle
 = \$3,400

(b) Calculated in Requirement 1.

Use the same data about Boston cycles and solve using LIFO

	Purchases			Cost of Goods Sold			Inventory on Hand		
Date	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Oct. 1							12 units	× \$ 42	= \$ 504 } \$ 504
16	40 units	× \$ 68	= \$ 2,720				12 units	× \$ 42	= \$ 504 } 40 units
								× \$ 68	= \$ 2,720 } \$ 3,224
31				34 units	× \$ 68	= \$ 2,312 } \$ 2,312	12 units	× \$ 42	= \$ 504 } 6 units
								× \$ 68	= \$ 408 } \$ 912
Totals	40 units		<u>\$ 2,720</u>	34 units		<u>\$ 2,312</u>	18 units		<u>\$ 912</u>

Date	Accounts and Explanation	Debit	Credit
Oct. 16	Merchandise Inventory Accounts Payable <i>Purchased inventory on account.</i>	2,720	2,720
31	Accounts Receivable Sales Revenue <i>Sale on account.</i>	3,400 ^(a)	3,400 ^(a)
31	Cost of Goods Sold Merchandise Inventory <i>Recorded the cost of goods sold.</i>	2,312 ^(b)	2,312 ^(b)

$$\begin{aligned}
 \text{(a) Total sales revenue} &= \text{Number of bicycles sold} \times \text{Sales price per bicycle} \\
 &= 34 \text{ bicycles} \times \$100 \text{ per bicycle} \\
 &= \$3,400
 \end{aligned}$$

^(b) Calculated in Requirement 1.

Use the same data about Boston cycles and solve using Weighted average

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Oct. 1							12 units	× \$ 42	= \$ 504
16	40 units	× \$ 68	= \$ 2,720				52 units	× \$ 62 ^(a)	= \$ 3,224
31				34 units	× \$ 62	= \$ 2,108	18 units	× \$ 62	= \$ 1,116
Totals	40 units		<u>\$ 2,720</u>	34 units		<u>\$ 2,108</u>	18 units		<u>\$ 1,116</u>

Date	Accounts and Explanation	Debit	Credit
Oct. 16	Merchandise Inventory Accounts Payable <i>Purchased inventory on account.</i>	2,720	2,720
31	Accounts Receivable Sales Revenue <i>Sale on account.</i>	3,400 ^(b)	3,400 ^(b)
31	Cost of Goods Sold Merchandise Inventory <i>Recorded the cost of goods sold.</i>	2,108 ^(c)	2,108 ^(c)

^(c) Calculated in Requirement 1.

^(a) Weighted average cost per unit = Cost of goods available for sale / Number of units available
= (\$504 + \$2,720) / (12 units + 40 units)
= \$3,224 / 52 units
= \$62 per unit

^(b) Total sales revenue = Number of bicycles sold × Sales price per bicycle
= 34 bicycles × \$100 per bicycle
= \$3,400

1. Which principle or concept states that businesses should use the same accounting methods and procedures from period to period?
a. Disclosure b. Conservatism c. Consistency d. Materiality
2. Which inventory costing method assigns to ending merchandise inventory the newest—the most recent—costs incurred during the period?
a. First-in, first-out (FIFO) c. Specific identification
b. Weighted-average d. Last-in, first-out (LIFO)
3. Assume Nile.com began April with 14 units of inventory that cost a total of \$266. During April, Nile.com purchased and sold goods as follows:

Apr. 8	Purchase	42 units @ \$ 20
14	Sale	35 units @ \$ 40
22	Purchase	28 units @ \$ 22
27	Sale	42 units @ \$ 40

Under the FIFO inventory costing method and the perpetual inventory system, how much is Nile.com's cost of goods sold for the sale on April 14?

- a. \$1,106 b. \$686 c. \$1,400 d. \$700

1. c 2. a 3. b 4. b

4. Suppose Nile.com used the weighted-average inventory costing method and the perpetual inventory system. Use the Nile.com data in Question 3 to compute the weighted-average unit cost of the company's inventory on hand at April 8. Round weighted-average unit cost to the nearest cent.
- a. \$21.00
 - b. \$19.75
 - c. \$19.50
 - d. Cannot be determined from the data given

Watches R Us specializes in designer watches and leather goods. Watches R Us uses the perpetual inventory system. Assume Watches R Us began June holding 10 wrist-watches that cost \$50 each. During June, Watches R Us bought and sold inventory as follows:

Jun. 3	Sold 8 units for \$100 each.
16	Purchased 10 units at \$56 each.
23	Sold 8 units for \$100 each.

Requirements

1. Prepare a perpetual inventory record for Watches R Us using the FIFO, LIFO, and weighted-average inventory costing methods. (See Learning Objective 2)
2. Journalize all of Watches R Us's inventory transactions for June under all three costing methods. Assume all sales and purchases are on account. Explanations are not required. (See Learning Objective 2)
3. Show the computation of gross profit for each method. (See Learning Objective 2)

FIFO:

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Jun. 1							10 units	× \$ 50	= \$ 500 } \$ 500
3				8 units	× \$ 50	= \$ 400 } \$ 400	2 units	× \$ 50	= \$ 100 } \$ 100
16	10 units	× \$ 56	= \$ 560				2 units 10 units	× \$ 50 × \$ 56	= \$ 100 = \$ 560 } \$ 660
23				2 units 6 units	× \$ 50 × \$ 56	= \$ 100 = \$ 336 } \$ 436	4 units	× \$ 56	= \$ 224 } \$ 224
Totals	10 units		<u>\$ 560</u>	16 units		<u>\$ 836</u>	4 units		<u>\$ 224</u>

LIFO:

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Jun. 1							10 units	× \$ 50	= \$ 500 } \$ 500
3				8 units	× \$ 50	= \$ 400 } \$ 400	2 units	× \$ 50	= \$ 100 } \$ 100
16	10 units	× \$ 56	= \$ 560				2 units 10 units	× \$ 50 × \$ 56	= \$ 100 = \$ 560 } \$ 660
23				8 units	× \$ 56	= \$ 448 } \$ 448	2 units 2 units	× \$ 50 × \$ 56	= \$ 100 = \$ 112 } \$ 212
Totals	10 units		<u>\$ 560</u>	16 units		<u>\$ 848</u>	4 units		<u>\$ 212</u>

Weighted-Average:

Date	Purchases			Cost of Goods Sold			Inventory on Hand		
	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost	Quantity	Unit Cost	Total Cost
Jun. 1							10 units	× \$ 50	= \$ 500
3				8 units	× \$ 50	= \$ 400	2 units	× \$ 50	= \$ 100
16	10 units	× \$ 56	= \$ 560				12 units	× \$ 55	= \$ 660 \$ 660 / 12 units = \$ 55
23				8 units	× \$ 55	= \$ 440	4 units	× \$ 55	= \$ 220
Totals	10 units		<u>\$ 560</u>	16 units		<u>\$ 840</u>	4 units		<u>\$ 220</u>

2. Journal entries:

LIFO:

Date	Accounts and Explanation	Debit	Credit
Jun. 3	Accounts Receivable	800	
	Sales Revenue		800
3	Cost of Goods Sold	400	
	Merchandise Inventory		400
16	Merchandise Inventory	560	
	Accounts Payable		560
23	Accounts Receivable	800	
	Sales Revenue		800
23	Cost of Goods Sold	436	
	Merchandise Inventory		436

Date	Accounts and Explanation	Debit	Credit
Jun. 3	Accounts Receivable	800	
	Sales Revenue		800
3	Cost of Goods Sold	400	
	Merchandise Inventory		400
16	Merchandise Inventory	560	
	Accounts Payable		560
23	Accounts Receivable	800	
	Sales Revenue		800
23	Cost of Goods Sold	448	
	Merchandise Inventory		448

Date	Accounts and Explanation	Debit	Credit
Jun. 3	Accounts Receivable	800	
	Sales Revenue		800
3	Cost of Goods Sold	400	
	Merchandise Inventory		400
16	Merchandise Inventory	560	
	Accounts Payable		560
23	Accounts Receivable	800	
	Sales Revenue		800
23	Cost of Goods Sold	440	
	Merchandise Inventory		440

Weighted-average:

	FIFO	LIFO	Weighted-Average
Net Sales Revenue (\$800 + \$800)	\$ 1,600	\$ 1,600	\$ 1,600
Less: Cost of Goods Sold (\$400 + \$436)	<u>836</u>		
		<u>848</u>	
			<u>840</u>
Gross Profit	<u>\$ 764</u>	<u>\$ 752</u>	<u>\$ 760</u>

3. Gross profit:



AI in Accounting Report

The big shift: Current state analysis

The accounting profession is undergoing a profound transformation, driven by the rapid evolution and adoption of artificial intelligence (AI). What was once seen as a technological advancement has quickly become a strategic imperative. AI in accounting has shifted from experimental applications to essential infrastructure.

AI is not replacing practitioners; it is amplifying their potential. From workflow automation and intelligent audit assistants to generative AI for research and autonomous agents for repetitive tasks, AI's impact is expanding rapidly.

The accounting profession stands at a decisive inflection point. Firms have been balancing traditional compliance responsibilities with rapidly shifting client expectations and evolving market dynamics for several years now. Increasing demand for advisory services, talent shortages and rising complexity make old methods unsustainable.

AI is reshaping firm operations. It's not only about automating tasks—it's increasingly about rethinking entire workflows, decision structures and service offerings. While legacy systems are straining under new expectations, AI-native systems offer pathways to resilience, agility and scalability.

"AI is a catalyst that provides unprecedented opportunity for firms and finance teams to enhance their role as trusted advisors," said Erik Asgeirsson, president and CEO, CPA.com. "When harnessed the right way, it offers the potential to revolutionize the way firms of all sizes deliver value and business insights."

Key indicators

- Rapid growth in AI-assisted tax preparation tools, with some firms reporting over 80% automation of individual return preparation.
- An uptick in the use of large language model (LLM)-based research tools within audit and advisory, helping to reduce document analysis time by 50% or more.
- Increasing adoption of agentic AI to support client interactions, automate reconciliation tasks and accelerate workflow triage.

“The strategic imperative is no longer whether to adopt AI—it’s how quickly and thoughtfully firms can transition to augmented models,” noted Pascal Finette, co-founder of be radical.



Key strategic themes



AI-powered workflow automation

Firms are investing in tools that accelerate common tasks: bank reconciliations, transaction coding, month-end close and reporting. Vendors report time savings between 30–70%. These gains are allowing firms to reallocate capacity toward higher-value activities like advisory and analytics.



Regulatory compliance & risk management

Governments worldwide are racing to implement AI legislation. From the EU's AI Act to U.S. executive orders and the National Institute of Standards and Technology (NIST), firms must ensure their systems adhere to evolving standards. AI-enabled tools are integrating risk-scoring, documentation traceability and audit trails into AI workflows.



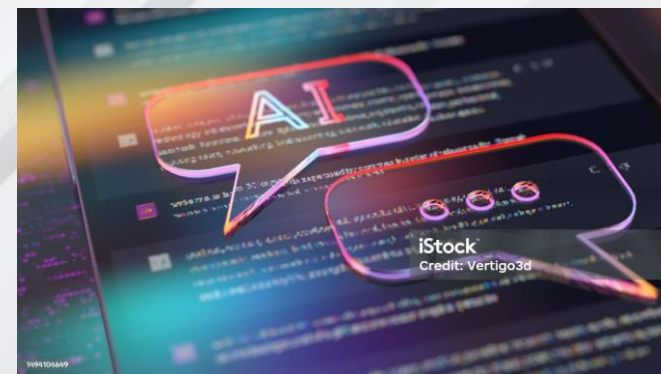
Human-in-the-loop verification

While automation is advancing, the need for human review remains paramount, especially in high-stakes environments like audit and tax. Systems increasingly flag transactions based on confidence thresholds, inviting accountants to act as reviewers, not doers. This model reduces risk and increases throughput while maintaining transparency.



Data privacy & security measures

Client trust hinges on how data is managed. As AI models rely on structured and unstructured data, vendors are emphasizing SOC 2, GDPR and opt-in training protocols. Privacy-by-design is becoming a differentiator between profession-specific solutions and general-purpose AI tools.





Generative AI for research & decision support

LLM-powered tools are transforming how firms handle knowledge work. From surfacing precedent-based tax advice to summarizing complex legislation, purpose-built systems act as research accelerators. When paired with human judgment, they reduce research time and surface nuanced insights.



AI for enhanced client experience

Clients now expect real-time dashboards, on-demand support and predictive alerts. AI is improving communication through intelligent assistants and personalized reporting. Products that embed AI into client portals, provide AI-powered analytics, can forecast cash flow, flag unusual activity and deliver up-to-date dashboards for better decision-making. This functionality offers real-time visibility and analytics for proactive financial management and, ultimately, a better client experience.



Agentic AI for autonomous task execution

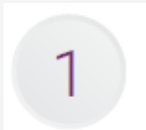
Agentic AI refers to AI systems capable of acting with autonomy across multistep workflows. Vendors within the ecosystem are deploying agents which act upon tasks. Examples of these agents' outputs are: preparing returns, reconciling books and generating variance analyses. While human oversight remains essential, the leap from recommendation to execution is underway.



It's important to recognize the growing maturity of AI adoption across the accounting profession. The next wave isn't just about smarter tools, but smarter structures: rethinking roles, redefining value and rewiring workflows for a digital-first, insight-led model. As firms integrate these technologies more deeply, early signals from the edge are already shaping what the future of accounting looks like in practice.

Six trends to watch: Signals from the edge

AI-native accounting firms are structured around automation first operations, with roles built for strategy, not process. These firms use agents to handle routine work, reducing overhead and enabling staff to focus on interpreting and advising.

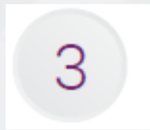
1

Domain-specific AI models for accounting. Rather than relying solely on general-purpose models like GPT-4, vendors are building fine-tuned, accounting-native LLMs. These provide better accuracy, are less prone to hallucinations and align with the vocabulary and regulatory expectations of the profession.

2

AI-powered audit transformation.

Technologies like the Dynamic Audit Solution (DAS) are enabling real-time risk assessment, pattern detection and sample stratification. Auditors are evolving into risk navigators supported by predictive tools.

3

Expansion of AI context windows.

Models are ingesting larger volumes of structured and unstructured data, allowing for better answers to complex questions. Context windows exceeding 1 million tokens (equivalent to about 2,500 pages of text) enable AI to reason across months of financial records or entire tax codes.

4

5

Shift from tax compliance to advisory. As automation is able to absorb increasingly more prep and review tasks, CPAs are reallocating time toward strategic tax planning, scenario modeling and client coaching. Firms are upskilling staff to interpret AI output and provide deeper guidance.

AI integration with financial systems. APIs and integrations with systems like QuickBooks, Sage Intacct and banking platforms allow AI agents to operate within source data, not just downstream exports. This reduces latency and improves data fidelity. However, API capabilities currently are still somewhat limited and less open; ideally, standards-based platforms will emerge.

6

Trend waves: AI in accounting & finance

- Domain-specific AI models
- Expansion of AI context windows

NOW

- AI-powered audit transformation
- Shift from tax compliance to advisory

NEXT

- AI-native accounting firms
- AI integration with financial systems

FUTURE

Five developments: Where the ground is shifting fastest

Bookkeeping
& automation



Full agentic
execution

Agentic platforms are now completing workflows from start to finish. For example, bookkeeping agents can categorize transactions, flag anomalies, generate monthly reports, and even draft client messages.

Tax preparation
& compliance



Near full
automation

New solutions reduce preparation time from hours to minutes extracting, analyzing and completing returns with high accuracy, requiring minimal human intervention except for final review.

Audit & risk
analysis



Slow but
strategic
adoption

Due to regulatory and liability complexity, audit innovation is methodical. However, new tools are making inroads, helping firms focus on higher conceptual matters that require their professional judgment.

Advisory
services



The next
frontier

AI-driven forecasting, budgeting and KPI modeling tools are emerging. Firms are blending human intuition with AI-generated what-if scenarios to deepen value-based client conversations. AI is being used to generate real-time forecasts and budgets, and helping advisors guide strategic conversations with clients. It blends machine insights with human expertise, leading to more proactive, personalized and value driven advisory services.



Workflow &
efficiency AI

Advanced &
accelerating

Email triage, scheduling assistants, document summarizers and digital QA bots are freeing up time across the firm. AI is becoming the invisible infrastructure of operational excellence. For example, intelligent workflows are being built into solutions to act like a digital assistant, routing documents, summarizing key details and ensuring accuracy, making AI the quiet engine behind a more efficient back office.

As firms navigate these shifts, it's imperative that humans stay acutely connected; not just to the tools, but to the judgment, context and ethical frameworks that underpin professional services. As Richard Jackson, EY Global Artificial Intelligence Assurance Leader, aptly put it, "As the tech continues to develop, we've put training wheels, controls and safeguards in place to help ensure that humans are in lockstep with the advancement of the technology. As we continue to gain comfort and confidence, the training wheels come off." This staged integration underscores a vital truth: Trust is not built overnight.

AI may be capable of handling tasks autonomously, but the profession must move at the speed of confidence, not just capability. "We already teach our staff to think everything could be wrong in how we consider professional skepticism.

The accounting profession is well suited to find ways to design processes for appropriate oversight and risk confidence, while critically assessing outputs," said Danielle Supkis Cheek, VP of Strategy at Caseware. It's a balance of boldness and caution, deploying agents in low-risk workflows, building in review loops, and ensuring that human expertise remains at the center of decisions. The road ahead isn't just about scaling AI; it's about scaling trust in AI.

As automation handles more of the “how,” firms must redefine the “who” and “why” behind their services. The following implications reveal how AI is influencing talent, roles, strategy and client engagement across the profession:



Skill development. AI fluency is no longer optional. Professionals must understand model strengths and limitations, develop effective prompt strategies and navigate outputs with skepticism. Firms are investing in structured AI training programs and certifications.



Competitive positioning. The AI maturity gap is widening. Firms with integrated AI strategies are already realizing efficiencies and expanding margins. For others, failure to act risks erosion of market share, talent and client trust.



Career path evolution. New roles are emerging: AI operations managers, prompt engineers and AI QA reviewers. The hybrid human+AI model demands cross-functional skills that blend domain expertise with digital literacy.



Client relationships. AI enables faster answers, richer insights and proactive recommendations. The CPA’s role as a trusted advisor is reinforced—not replaced—by intelligent systems.

These shifts are redefining what firms need from their workforce and how they deliver value. The rise of AI has accelerated the demand for mid to senior-level professionals who can interpret, strategize and advise. Entry-level, task-based roles are rapidly diminishing. Firms are challenged to rethink their talent pipeline, upskill existing teams, and reframe career trajectories around collaboration with intelligent systems. As Avani Desai, CEO of Schellman, shared during the 2025 AI Symposium, “The nature of work is changing, and so are our hiring practices. We’re building teams differently and bringing in talent at a variety of levels with a shared focus on critical thinking, adaptability and the ability to partner with AI. It’s not about reducing opportunity, it’s about redefining it.”

On the other hand, AI is a powerful enabler, especially for less experienced people:

“Our belief, and this is borne out by research, is that everybody is more productive when they have access to generative AI. But for juniors and less experienced individuals, the benefit to them is greater than the benefit to someone who is trained,” said Aaron Harris (Sage).

Understanding AI beyond the headlines

While generative AI and large language models dominate today's headlines and conversations—often becoming synonymous with artificial intelligence itself—the accounting and finance profession benefits from recognizing AI's broader landscape.

AI encompasses far more than GenAI and LLMs alone. Two particularly relevant branches include machine learning (ML) and knowledge-based systems.



Knowledge-based systems:
Solutions built on explicit, defined relationships between data points



Machine learning (ML):
Models that identify patterns in data and improve through experience

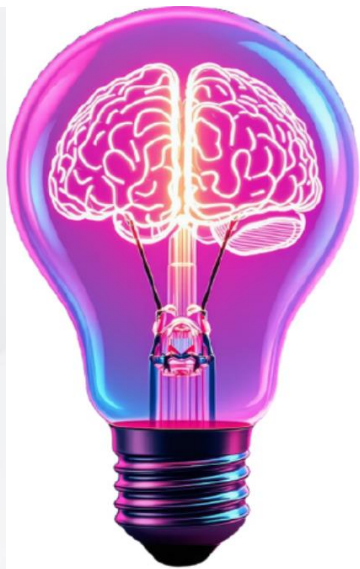
Both approaches frequently outperform LLMs in tasks common to accounting and finance, typically at substantially lower costs.

Industry vendors strategically deploy different AI modalities for specific functions:

- Machine learning for transaction classification, anomaly detection and financial forecasting
- Knowledge-based systems for rule-driven workflows with clear decision paths

LLMs demonstrate their unique value when tasks involve:

- Comprehending complex documents
- Processing unstructured information
- Generating professional communications
- Extracting and summarizing insights from extensive text



The most sophisticated solutions often integrate multiple approaches into coordinated workflows. Consider transaction classification:

- 1 A knowledge-based system applies definitive rules first (e.g., "Starbucks transactions always classify as Meals & Entertainment").
- 2 If identification fails, machine learning handles edge cases (recognizing "S*BUCKS" as Starbucks despite the truncated name).
- 3 When both previous layers cannot determine a classification, an LLM might suggest potential options to the human user.

For practitioners, understanding the diverse toolkit available matters more than technical distinctions between AI modalities, as each approach offers distinct advantages depending on the specific task at hand. Jeff Seibert, CEO of Digits, commented, "If you don't understand the tech, you can't tell which vendor is just piping your data straight into ChatGPT and printing the answer."



Thank You