



VARZA SCHOOL · THE FOUNDATIONAL 100

From Stock to Cost of Goods Sold: The Accounting Life of Inventory

Chapter 56 · Track 6 — Purchasing, Suppliers, Inventory, and Assets

THE QUESTION IT ANSWERS

How does purchased or produced stock remain an asset, move through custody and production, and become expense when related revenue is recognized?

CONCEPTS DEFINED

Inventory · Cost of goods sold · Goods receipt · Landed cost · Inventory transfer · Sales return · Inventory obsolescence · Journal entry

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Varza promise: clear enough for a first-time learner, exact enough for a professional conversation, and practical enough to support a real decision.

Why this chapter matters

This track follows resources from supplier selection to purchase, receipt, storage, consumption, and long-term use. The central discipline is custody: knowing what was ordered, what arrived, what is owned, what it cost, where it is, and whether it can still create value.

Central question: How does purchased or produced stock remain an asset, move through custody and production, and become expense when related revenue is recognized?

Inventory is cost carried forward while future economic benefit remains. Receipt, landed cost, transfers, production, write-down, sale, return, and count adjustment change its quantity, location, status, or carrying amount. Cost of goods sold records the portion consumed by current sales.

Varza approaches the subject from life to ledger and from ledger to decision. We begin with what actually happened, identify the rights, obligations, resources, timing, and uncertainty, and only then choose the correct term, calculation, document, or account. This order protects the learner from a common error: learning a label without understanding the economic reality that the label is supposed to describe.

Learning outcomes

- Define and distinguish inventory in plain and professional language.
- Define and distinguish cost of goods sold in plain and professional language.
- Define and distinguish goods receipt in plain and professional language.
- Define and distinguish landed cost in plain and professional language.
- Apply the concepts to a numerical case and explain the result rather than only calculate it.
- Identify evidence, workflow, controls, and Varza entities required for reliable use.
- Recognize when jurisdiction-specific or licensed professional advice is required.

The Varza mental model

A financial concept becomes decision-ready when six questions have answers: **what, who, when, how much, based on what evidence**, and **under which assumption or rule**. A seventh question—**what should happen next**—turns knowledge into management.

This chapter uses internationally recognized terminology, but it remains jurisdiction-neutral unless explicitly stated. Accounting standards, tax rules, contract law, consumer protection, labor requirements, and investment regulation can produce different legal outcomes in different countries. The global foundation gives the learner a stable map; local collections must add the binding rules.

Core concepts

1. Inventory

Working definition. Inventory is assets held for sale, in production for sale, or in the form of materials or supplies to be consumed in production or service delivery under the applicable framework.

Inventory combines quantity, ownership, condition, location, cost, and expected recoverability. Physical presence alone does not prove ownership. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. Goods held on consignment may be physically present but owned by another party.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

2. Cost of goods sold

Working definition. Cost of goods sold is the cost assigned to inventory or directly associated resources recognized as expense when related goods are sold.

The amount depends on quantity, cost formula, allocation, cut-off, returns, and write-downs. It connects stock movement to gross margin. The concept should be measured at the smallest level that still supports a real action.

Simple example. Selling ten units at a carrying cost of CU 40 each recognizes CU 400 cost of goods sold.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

3. Goods receipt

Working definition. Goods receipt is a record confirming the quantity, condition, location, and date of goods accepted into custody.

Receipt should be independent from invoice approval where practical and should record exceptions immediately. The number alone is not enough; its definition determines whether comparisons are valid.

Simple example. Warehouse staff receive 970 of 1,000 ordered units and record thirty as short.

Decision test. What is being measured, and what has been left outside the boundary? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

4. Landed cost

Working definition. Landed cost is the total attributable cost of bringing purchased goods to their present location and condition, subject to the applicable accounting policy.

Allocate freight, duty, insurance, handling, and other eligible costs consistently. Some selling, storage, abnormal waste, or financing costs may require separate treatment. This is where operational activity and financial reporting meet.

Simple example. Imported inventory includes purchase price, customs duty, and inbound freight allocated by a rational driver.

Decision test. When did the underlying right, obligation, benefit, or sacrifice arise? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

5. Inventory transfer

Working definition. Inventory transfer is the documented movement of inventory between locations, statuses, custodians, projects, or ownership contexts.

Transfer requires dispatch and receipt evidence so goods do not disappear between two correct-looking warehouse balances. In Varza language, the concept becomes useful when it changes a decision.

Simple example. Stock moves from central warehouse to branch and remains in transit until acknowledged.

Decision test. Which document or observation would allow another person to verify it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

6. Sales return

Working definition. Sales return is the reversal or modification of a sale because goods are returned or the original transaction is otherwise unwound.

Returns affect revenue, tax, receivable or cash, inventory quantity and condition, cost of sales, commissions, and customer metrics. The professional term matters because it prevents two different realities from being recorded as though they were the same.

Simple example. A returned item is inspected before being restored to saleable inventory.

Decision test. How would a different assumption change the result? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

7. Inventory obsolescence

Working definition. Inventory obsolescence is loss of inventory usefulness or recoverable value because of technological, market, legal, design, condition, or demand change.

Slow movement is evidence, not the definition. Estimate net realizable value and develop disposition, write-down, or prevention actions. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. An old electronic component remains physically perfect but can no longer be sold at its recorded cost.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

8. Journal entry

Working definition. Journal entry is a dated and referenced set of balanced debit and credit lines recording the financial effect of an event.

A journal entry should explain the event, not merely force equality. Every line needs account, amount, currency, dimensions, evidence, and purpose where relevant. The concept should be measured at the smallest level that still supports a real action.

Simple example. A credit sale debits accounts receivable and credits revenue, with separate tax and cost entries where applicable.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

How the concepts connect

The concepts in this chapter are a system, not a vocabulary list. Inventory, Cost of goods sold, Goods receipt, Landed cost, Inventory transfer, Sales return, Inventory obsolescence, and Journal entry describe different parts of the same decision. Confusing them usually creates one of three failures: the wrong amount is measured, the right amount is assigned to the wrong period or person, or a correct report is used for a decision it was never designed to support.

A useful analysis therefore preserves both **classification** and **relationship**. Classification tells us what an item is. Relationship tells us what caused it, what it affects, and what could change it. Varza should store both. A report that shows only totals may be suitable for orientation; a controlled decision requires traceability to the underlying relationships.

Formulas and quantitative relationships

Inventory roll-forward

Closing inventory = Opening inventory + Purchases and production additions + Inbound transfers – Cost assigned to sales – Other issues – Write-downs ± Count and transfer adjustments

The roll-forward explains quantity and carrying-value movement.

Boundary: Use separate quantity and value bridges and avoid double counting internal transfers.

Gross profit

Gross profit = Net revenue – Cost of goods sold

The relation connects commercial output to inventory cost consumed.

Boundary: Returns, discounts, freight classification, manufacturing variance, and write-downs require consistent treatment.

Worked case — A sale creates two accounting stories

A retailer buys 100 units at landed cost CU 60 each and sells 40 at CU 100 each on credit.

Item	Amount or observation
Inventory acquired	100 × CU 60 = CU 6,000 asset
Sales revenue	40 × CU 100 = CU 4,000
Cost of goods sold	40 × CU 60 = CU 2,400
Gross profit	CU 1,600
Closing inventory	60 × CU 60 = CU 3,600

Calculation and reasoning

1. Receipt creates inventory and a payable or cash reduction, not immediate CU 6,000 expense under the stated accrual model.
2. Shipment and revenue recognition create a receivable and CU 4,000 revenue, subject to tax and terms.
3. The same event removes CU 2,400 inventory and recognizes cost of goods sold.
4. The remaining CU 3,600 stays as an asset, subject to count, condition, and net realizable value.

What the result means

A sales invoice alone tells only half the margin story. The inventory cost must travel with the sold quantity so performance and stock remain connected.

The case is deliberately compact. In practice, Varza would preserve the supporting documents, currency, dates, counterparty, project or cost center, approvals, and links to the resulting records. The lesson is not merely to reach a number; it is to make the path to that number reviewable.

Practical workflow

1. **Define the decision, responsible person, economic unit, period, and acceptable uncertainty.**
Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
2. **Recognize inventory when control and applicable criteria are met.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
3. **Accumulate eligible acquisition or conversion costs by item and layer.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
4. **Record every custody, status, and production movement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
5. **On sale, assign cost under policy; on return or loss, assess condition and recoverable value.**
Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
6. **Reconcile the result to source evidence and investigate exceptions rather than forcing agreement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
7. **Approve the decision or record at the authority level required by value, risk, and legal consequence.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
8. **Monitor the outcome, compare it with the original assumption, and retain the learning for the next cycle.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.

How this concept should appear in Varza

The minimum Varza data model for this chapter includes `inventory_receipt`, `cost_layer`, `landed_cost`, `warehouse_balance`, `production_issue`, `shipment`, `cost_of_sales`, `customer_return`, `write_down`, `count_adjustment`. These names are not merely interface labels.

Each entity should have a stable identifier, status history, responsible owner, applicable currency or unit, effective dates, evidence links, and access controls.

A useful Varza screen should answer four questions without forcing the user to reconstruct the story manually:

1. **What happened or is expected to happen?** Show the operational event, obligation, or decision in plain language.
2. **What changed financially?** Show cash, asset, liability, equity, income, expense, commitment, or risk effects.
3. **Why should the user trust it?** Show source documents, calculations, approvals, and revision history.
4. **What requires attention now?** Show exceptions, due dates, thresholds, and the next responsible action.

The Varza design principles most relevant here are:

- Attach every important number to a source, period, currency, entity, and responsible person.
- Prefer a traceable estimate with stated assumptions to an impressive number with hidden assumptions.
- Use automation to strengthen evidence and consistency, never to remove accountability.

Varza AI may explain, classify, compare, simulate, and prepare a proposed action. It should not silently change a legal record, post a material transaction, close a period, release a payment, or make an investment decision on the user's behalf. Material actions require visible evidence, permissions, validation rules, and an accountable human approval path.

Controls and professional boundaries

1. **Inventory subledger to general-ledger reconciliation.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
2. **Sales shipment and cost-of-sales interface control.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
3. **Negative stock and stale in-transit exception reports.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
4. **Write-down and reversal review under applicable rules.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
5. **Stable definitions, versioned assumptions, and consistent units across plans, records, and reports.** The control should be proportionate to value and risk, documented clearly, and tested

often enough to detect failure before the consequence becomes irreversible.

6. Traceability from every material total to evidence, calculation, owner, and change history. The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.

7. Access and approval rights aligned with responsibility and the possible consequence of error or misuse. The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.

A control is effective only when it operates in practice. A policy that everyone can bypass is a statement of hope, not a control. Likewise, a control that blocks ordinary work without distinguishing low-risk and high-risk cases encourages hidden workarounds.

Common mistakes and better responses

Mistake 1: Expensing all inventory purchases immediately in an accrual-reporting business

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 2: Recognizing revenue without removing the related inventory cost

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 3: Returning goods to inventory at original cost without condition assessment

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 4: Using physical quantity as proof of ownership

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 5: Using a technically correct number outside the period, entity, currency, or decision boundary for which it was calculated

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 6: Accepting an automated result without reviewing the evidence, assumptions, exceptions, and required professional judgment

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Decision checklist

- ☐ Can I explain inventory in plain language and in professional terms?
- ☐ Can I explain cost of goods sold in plain language and in professional terms?
- ☐ Can I explain goods receipt in plain language and in professional terms?
- ☐ Can I explain landed cost in plain language and in professional terms?
- ☐ Have I stated the entity, currency or unit, date or period, and decision boundary?
- ☐ Can another person reproduce the number from retained evidence?
- ☐ Have I separated actuals, estimates, commitments, and scenarios?
- ☐ Have I tested timing, liquidity, risk, and at least one adverse outcome?
- ☐ Is the required approval proportional to the possible loss or legal consequence?
- ☐ Does the final output lead to a specific action, owner, and review date?

Practice lab

1. **Explain it.** Describe Inventory to a person who has never studied finance. Then add the professional definition and identify one boundary your simple explanation omitted.
2. **Classify it.** Create five examples from your household or a small business and classify each using Cost of goods sold. State any assumptions.
3. **Calculate it.** Rebuild the worked case with amounts 20% higher. Identify which conclusions change and which remain structurally true.
4. **Challenge it.** Describe a situation in which Goods receipt could be measured correctly but still lead to a poor decision because timing, risk, or incentives were ignored.
5. **Design it.** Sketch a Varza screen or report for this chapter. Include fields, evidence links, status, owner, exceptions, and one AI-assisted action.

Answer guidance

A strong answer uses consistent definitions, reveals assumptions, distinguishes fact from estimate, and connects the result to an action. More than one conclusion may be reasonable when the learner clearly states the decision objective and uncertainty. The worked-case recalculation should preserve the method even when the numbers change.

Varza AI knowledge capsule

This capsule is intentionally explicit so that a retrieval system can distinguish canonical teaching points from examples and commentary.

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    "Cost of goods sold: the cost assigned to inventory or directly associated resources recognized as expense when related goods are sold.",
    "Goods receipt: a record confirming the quantity, condition, location, and date of goods accepted into custody.",
    "Landed cost: the total attributable cost of bringing purchased goods to their present location and condition, subject to the applicable accounting policy.",
    "Inventory transfer: the documented movement of inventory between locations, statuses, custodians, projects, or ownership contexts.",
    "Sales return: the reversal or modification of a sale because goods are returned or the original transaction is otherwise unwound.",
    "Inventory obsolescence: loss of inventory usefulness or recoverable value because of technological, market, legal, design, condition, or demand change.",
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Suggested questions for Varza AI

- Explain this chapter using an example from a household, a shop, and a service business.
- Ask me five diagnostic questions before applying this concept to my situation.
- Show the difference between cash effect, accounting effect, and decision effect.
- Recalculate the worked case using my currency and assumptions, but preserve the original definitions.
- Identify which parts require local accounting, tax, legal, labor, or investment rules.

Sources and standards horizon

This chapter is original Varza educational content. It paraphrases and synthesizes concepts; it does not reproduce a standard or third-party article. The following sources were used to establish terminology, scope, and current professional context:

- **S102 — IFRS Foundation, *IAS 2 Inventories*.** 2026 standards set. Inventory cost, lower of cost and net realisable value, and cost formulas. Source: <https://www.ifrs.org/issued-standards/list-of-standards/ias-2-inventories/>
- **S114 — IFRS Foundation, *IFRS 15 Revenue from Contracts with Customers*.** 2026 standards set. Principles for recognizing revenue from customer contracts. Source: <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/>
- **S117 — IFRS Foundation, *IFRS for SMEs Accounting Standard*.** third edition 2025; effective 2027. Simplified global reporting framework for eligible small and medium-sized entities. Source: <https://www.ifrs.org/issued-standards/ifrs-for-smes/>
- **S118 — IFRS Foundation, *IFRS Accounting Standards—Required 2026*.** 2026-01-29. Standards and amendments effective from 1 January 2026. Source: <https://www.ifrs.org/news-and-events/news/2026/01/now-available-ifrs-accounting-standards-required-2026-two-editions/>

Standards horizon. Reviewed through 2026-08-31. IFRS 18 and the third edition of the IFRS for SMEs Accounting Standard are included as transition knowledge where relevant; both have mandatory effective dates beginning in 2027, with early application permitted under their respective requirements.

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