

Tips & Tricks #28 - GL Distribution(s) from IC, PO & OE – Part 2 – Q&A Final

In the last installment (#27), we published questions submitted by a customer, and supplied background information required in order to answer those questions. Now, answering those questions is the purpose of this article. If you are not familiar with the content from the prior installment, please review as the answers here assume you have that information.

Throughout this discussion we assume that the Average Costing method has been adopted. This is the most common method for Inventory/Warehousing in a Distribution environment. Standard Cost and Layers (FIFO, LIFO) are also available as methods, but are not discussed here. Standard cost is most commonly used in manufacturing (including the PBS Manufacturing applications) and Layers methods are more complicated methods that can be used with items where expiry of the product is of concern (old product first) or where rapid changes in costs are a factor especially in pricing. All of these costing methods will give a particular price at a particular time, but calculated by different methods. So, this difference aside, the rest of the principles discussed here apply, with one exception that relates to Standard Cost and the Cost Correction/Price Variance account. We will not cover this here due to length, however, you can locate this in the PBS documentation under the “Cost Inventory Methods” and the “Standard Cost Valuation” appendices in the PBS Inventory Control manual.

Lot Control and Serialization of inventory do not affect the costing of the inventory; only the degree of detail that you use to track (or not) individual pieces or groups of pieces of inventory is affected. These are not covered here.

We are concentrating here on Average Cost. As indicated in the last T & T #27, Average Cost is the total accumulated cost of all the receiving costs for an item in stock divided by the number of pieces on hand. It therefore gives an exact, to-the-penny value for the aggregate value of an item; but can only give the average cost of the item spread across all the pieces currently in stock. In other words, we are treating all the pieces of inventory for a particular item as identical, independent of when it was received or what the actual/receiving cost was.

Here are the questions posed last time and the answers:

1. What is the accounting impact when I enter a vendor bill into Passport? In addition to AP, what will the offset account for AP be?

Each vendor has (on the 3rd, “Accounts”, tab of the master record) a set of three fields that supply the default account values used in the vouchering process. The AP (liability) account to be used for the credit side of the transaction is supplied by the first of these fields and this account is automatically used to create this side of the distribution.

To complete the vouchering process, the user is prompted to enter the offsetting GL account for the “expense”/debit side of the distribution of this voucher. There can be one or more accounts making up the debit side distribution; but the sum of the debits

must add up to the credit side (AP Liability) and these both represent gross value of the invoice. This “default distribution account” comes from the 3rd field on the vendor defaults tab and will be automatically moved into the expense account field but can be changed, i.e., overridden by the operator.

The screenshot shows a software window with a menu bar at the top containing 'New', 'Edit', 'Save', 'Save / New', 'Delete', 'Cancel', and 'Exit'. Below the menu bar is a section titled 'Select by ascending vendor #' containing a table with two columns: 'Vendor #' and 'Vendor name'. The table lists the following vendors: 1200 ACME Bike and Wagon, Inc., 600 First Bank, 800 Hanson Manufacturing Company, 100 Illinois Electric Company, 800 Jones Property Management (highlighted in blue), and 1800 Lincoln Bicycle Parts. To the right of the table is a 'Current period: July, 2018' label and a vertical scroll bar. Below the table are tabs for 'General', 'Terms', 'Accounts', 'Totals', and 'Contacts'. The 'Accounts' tab is active, showing a section titled 'Default vendor accounts' with three rows of input fields: 'A/P account no.' with value '2000-000' and label 'Accounts payable', 'Discount account no.' with value '5050-100' and label 'Purchase discounts', and 'Default dist acct no.' with value '8010-000' and label 'Rental expense'. Each row has a small icon to its right.

Vendor #	Vendor name
1200	ACME Bike and Wagon, Inc.
600	First Bank
800	Hanson Manufacturing Company
100	Illinois Electric Company
800	Jones Property Management
1800	Lincoln Bicycle Parts

Current period: July, 2018

Default vendor accounts

A/P account no. 2000-000 Accounts payable

Discount account no. 5050-100 Purchase discounts

Default dist acct no. 8010-000 Rental expense

The user needs to specify only the expense side of the transaction because, as indicated above, the credit side will automatically be generated based on the value in the 1st field of the entries on this defaults page. The PBS system allows for multiple AP Accounts to be used but only allows each vendor to have one account and it is specified here.

The second field on the defaults page allows the specification of a default discount account which will be used when the check is paid and, when a terms-based allowance is taken (e.g. an early payment allowance of 2% taken on 2/10 EOM terms).

In the specific case of vendors whom you order inventory from, using the Purchase Order system, the “expense”/debit side account used in vouchering should be the “Uninvoiced Receivings account” - the UIR account, also called the “Inventory Accrual” GL account. This account is set up in Inventory Control and, in that module, goes by the name “Balance Sheet Liability”. The same principle of using the UIR account applies if you do your receiving outside of the PO system using for example, the Receivings function built into the IC (Inventory Control) module. In both these cases, the posting of the receiving uses the UIR account as the offset to the received inventory value so that later, when vouchering the vendor invoice, you would debit the UIR account to clear it while creating the liability in the voucher in AP.

A common error is to distribute the offset to the credit of the AP liability account with a debit to the Inventory Asset account forgetting that it is the process of receiving the item in PO or IC that should be generating the Debit to inventory. (Since the receiving will generate a credit to the UIR account, the result is that the debit to the UIR account in the vouchering process clears the UIR account. The overall effect of these two steps therefore is a debit to inventory (at receiving time) and a credit to AP (at vouchering time). See examples at the end of the previous installment.

From the point of view of vouchering, the only vendors who should not be using the UIR account as the debit side transaction in AP are those for whom a receiving is not done, i.e., those vendors that are paid directly from the vendor invoice for non-inventory items or services.

In addition to AP, what will the offset account for AP be?

The credit to the AP account is automatically generated for the Gross amount of the invoice. This cannot be changed – when a vendor record is built, the AP account must be selected. Generally, this is something that applies for the life of the vendor, although it can be changed using the special “F2” override function.

(see the *Overriding Protected Changes* section of the *Use of Function Keys, Tool Bar and Windows* chapter from the *System User* documentation. Be careful, as a vendor can only have one active AP account at a time so the vendor’s liability must be zero when you make the change – this why it is a protected change.)

As discussed above, the default offset account for the liability account should be the UIR for any vendor who usually supplies inventory. For non-inventory suppliers, an actual expense account should be used appropriate to the particular product or service. If you order non-inventory supplies from an “inventory” vendor, simply replace the defaulted UIR account with the appropriate expense account.

Note: on the third defaults field, Discounts; the debit side transaction(s) selected for a voucher must agree with the *gross amount* of the vendor invoice/liability. This is because, although the discount amount and the discount account are calculated/entered at vouchering time, *they will only be used at payment time* and will typically only be invoked if the terms-type allows for an early-payment type of an allowance. At payment time the allowance (“discount”) is treated as money off the cash value of the check. In other words, Cash minus Discount = Net Vendor Payout. This means that although discounts are entered at vouchering time, they are saved for use at payment time and so they do not affect the value of the expense side distribution that was booked. They affect the cash value used to discharge the resulting liability. There is a preference for the term ‘allowance’ for these kinds of “discounts” as distinct from discounts that are applied for example, to sales and actually change the revenue value of the transaction.

2. How does Passport determine the Cost of Goods Sold (CoGS or CoS)? Is it recognized when the products are shipped out to the customers, at the time of billing, or at another time?

As stated in the background document in T & T #27, the cost of sales (when the inventory valuation method is set to Average Cost) the current value of the average cost for that item is *as of the moment* that the invoice is posted. Keep in mind that in a multi-user system, inventory receiving, sales and other inventory transactions can be going on at essentially the same time. Hence the emphasis on “at the moment”.

Each line item in a customer invoice is posted separately and as each line item is processed, the inventory record for that line item is locked so it can't be changed by someone else. The record is then read and the average cost at that moment is captured. Subsequently, the inventory record is unlocked and can be used by other applications.

Important note: Because PBS is a two-cycle Order Entry/Billing system, not a three-cycle system, there is no separate third cycle corresponding to the actual Shipping step as distinct from the invoice posting step in billing. In other words, the date/time that the Invoice is posted is also explicitly used as the data/time of shipping.

3. Can PBS be GAAP compliant and what things do we need to look at in PBS to verify this? In this context what specific steps can we take to ensure that the system will correctly calculate CoGS?

These are actually two different but related questions. The first is more general and applies to both the costing of inventory in general as well as the cost of a specific sold item. The second question is specific to the sales cycle and CoGS. They both involve the GAAP approach to accrual and use of costs.

PBS is designed to allow the system to function in a GAAP standard way. However, because of the flexibility you have in the setting up of the default accounts in the various applications that affect inventory value and revenue, you must be careful to assign these defaults. Failure to do so can result in double dipping and problems with accrual-type hand-offs, for example, with Purchase Order receiving and AP vouchering not clearing the accrual accounts and not maintaining a correct average cost.

In answer to the first question to make sure the receiving/inventory value accruals work, you will need to review the default accounts in PBS AP, PO and IC so that they properly support the accrual accounting for inventory:

- Review the receiving process so that quantities and costs are correctly reported to the IC module which can create the correct GL transactions.

The inventory account is defined separately for each item in the Item File. Make sure the Inventory Asset account number in your GL is used in the "Inventory account" field here consistently. Many companies have just one inventory account and that makes consistency easy. But it is entirely reasonable to want to use multiple inventory accounts e.g., parts inventory versus full-assembly inventory, or special-order inventory.

A single UIR account, however, is defined for all inventory in the system and it is located in the IC Control – the Balance Sheet Liability account. Ensure you have a UIR account in your Chart and that it is referenced here in the IC control file. With these in place, Inventory receiving will automatically debit the item's Inventory Account and will Credit the UIR (B/S Liability account) from the IC Control file. Also, since the PO system "sub-contracts" this posting function to the IC module, these GL distributions are created in IC as IC distributions - PO does not create distributions.

- Review the AP process (and default accounts on the third tab) so that inventory vendors use the UIR account as the default expense account. (Recall the AP account used is fixed. So, while the system supports multiple AP accounts, each vendor can only use one.)
- Be sure to interface both the AP and the IC distribution files to the GL. We have seen a number of cases where the AP was being distributed and being interfaced to the GL but the IC side was not, which will totally destroy any proper clearing of accrued values and maintenance of reasonable values in the UIR, as well as having a proper running inventory cost in the GL.
- One last point: a number of systems we come across compute inventory value in a an older somewhat cruder way. Namely for each period, one takes opening inventory and applies the following sort of equation:

Opening Inv. Balance
plus Total Receivings minus Sales/Shipments
equals Closing inv. Balance

This is normally implemented with corresponding GL accounts which frequently are manually maintained and tweaked at month end to provide some level of accrual between receivings and payment. This issue is mentioned only to say that following this regime is unnecessary and that the methods just described in this article provide a perpetual inventory down to the item level and that is fully automatic. The recommendation therefore is to consider moving to these proven methods.

The answer to the second question to ensure the CoGS are correct, involves simply that the “Expense account” field in the IC item file has the CoGS account number applicable to this item. This is where the debit for the extended cost for the line item and item being posted will be placed. The offset (the credit to inventory value) is the same field discussed above – the Inventory account also in the Item file record. This timing, the calculation of the CoGS, is done at invoice posting and is built into the system.

4. How is the gross margin determined at the customer level? For instance, can I define what is included in “Cost of Sales?”

As each line item is posted during the billing process, the cost of sales and the gross and net (discounted) selling prices are recorded for that item. This means that whether you are interested in gross margin per item code, per invoice, or per customer, this is simply a matter of subtracting cost of sales from selling price for each item and adding this up across either the invoice(s) or the sales by item or the sales by customer. Gross Margin is automatically calculated for each invoice as part of the posting process.

In addition, these numbers are provided by various reports in IC (by item code or item category), in AR (Sales by Customer or Customer Type and in Sales Analysis (by item or Customer) which can also use other KPI’s (Key Performance Indicators).

Can I define what is included in “Cost of Sales?”

Not really: Cost of Sales is defined as sales quantity times average (unit) cost at posting time. This means that there is a direct reconcilable relation between the change/decrease of inventory value due to sales and the related increase in cost of sales. Cost of sales can be adjusted for future transactions by making inventory adjustments to the costs of the item through an IC Inventory Adjustment process but normally the average cost is left at the value recalculated as of the last receiving. Physical Inventory is one time that adjustments are frequently made. Things like Customs Duties and Onboarding of freight charges into the item cost should be done at receiving time, so that the “on-the-shelf-cost” reflects the cost you feel is the actual/real cost to you.

A possible related issue though, is what if you want to send a product out for some special finishing or for a custom modification. We feel the best way of doing this is to include that process as an additional line item on the invoice. Now this may have its own selling price (and cost). But if the price of the item itself includes the finishing, the price of the finishing/customization step could also be zero and then on the description line for the finishing include “price included in the finished item” or equivalent verbiage. This line item can still have

a cost and that cost can be distributed to a separate CoGS account like “special finishing” or the same CoGS as the untreated item.

5. How can I track profitability at the Item level, in addition to at the Customer Level?

Answered in #4

General Ledger related:

6. Can I run the P&L before closing the book at the end of the month?

Yes. Keeping in mind that any distribution transactions produced by a particular module (AR, AP, IC) have to be interfaced and posted into the GL, it is most common for clients to run the interface process once a month as part of the period closing. However, since any transaction that has been interfaced to the GL has been marked as interfaced, you can run the interface process using the same cut-off date as many times per month as you want without worry of “double dipping” on the transfers. Some clients interface once a week to keep the cash account in the GL relatively up to date. (This is more typical of clients not using the PBS Check Reconciliation module that provides a running checkbook.)

Whatever the reason or whatever the cycle, once the interface is done and posted, the transactions just interfaced will be part of any Trial Balance or any Financial Statements.

The PBS accounting system was designed so that, for most businesses most of the time, interfacing more than once a month is not required. And with this goes the advice that in most cases there are reports within the sub-ledger/module that should give you the numbers you may need without the need for interfacing to the GL more than once a month or once a week.

Some clients coming from other accounting systems where distributions were automatically posted to the General Journal (automatically done as part of the posting process in the sub-ledger) think that they need to interface and post more frequently. We might recommend reviewing the procedures and reporting deadlines to determine if, for example, daily interfaces are really necessary. A GL report (Trial Balance or Financial Statement) is not necessary to capture sales on a daily basis. Reports exist with AR and OE that will satisfactorily provide this information and in some cases will allow export of this data so that cumulative totals can be kept in a separate report or spread sheet.

One additional note: The General Ledger allows two fiscal years-worth of data to be active at the same time. There is the “current year” and the “next year” with

the current year the older of the two and the expectation that the current year will be closed before the next year has run up to its closing date.

So, if you are operating in your “next” year (i.e., 2020 is still open) while waiting on auditors, and you are posting into, say, July of 2021, the PBS GL will provide full financial statements for July even though the prior year is not closed. When you run the Financial Statement processor, it determines that you are running the F/S in the “next year” and as a result, goes through all the steps of a year-end close (with a temporary set of files). This means that Retained Earnings for the current year, Balances Forward from the current year to the next year and Comparatives from 2020 are all computed. In effect ignoring any significant YE Adjustments being needed for the current year (prior to closing), there will be no difference between running the F/S in the “next” year versus closing the year and running the same period in the now “current” year.

7. How does Passport set up GL distribution accounts to each module or transaction type or item category?

The set of accounts that control the default behavior of a particular module are set up in two places in each module that produce GL transactions. These modules are called “accounting” modules (AR, AP, IC, PR, etc.) as opposed to “business” or “control” modules (PO, OE, etc.) which pass data to the accounting modules when transactions with distributions (PO transactions - Receivings, OE transactions-Sales) need to be generated. In the control file for each accounting module there are overall defaults that are fed to you as you create the master file entries for that module (Customer, Vendors, Inventory Items, etc.). These master-file based defaults will then be the defaults presented to you when entering data for most transactions. For example, all of AR, AP and IC have default accounts specified in their Control File, that will give you defaults for building customers, vendors and items respectively. In addition, during the building of these master file entries you can accept the control-file based defaults offered to you or override these and enter your own. The customer or vendor specific default values will then be presented to you when you enter a transaction against that customer, vendor or item. Again, at this level, you can alter the defaults presented to you and enter something specific to that transaction.

This means you can customize each customer, vendor or item by building into each separate master-file record the accounts that will be the default accounts presented to the data entry person during the data entry process, using that customer/vendor/item file. And you can also alter the default values at data entry time if these master-file entries don't suit the needs of the particular transaction being entered.

Bottom line, each customer, vendor and item have defaults built in, and these are what control the accounts presented to the user at the appropriate time. In many cases, the user can override these and enter a different account if appropriate, and authorized to do so.