

# Inventory

## Accounting Guide for a Profitable Small Business



Effectively  
making use of  
your information  
is what  
brings value.

Every industry has its own jargon and methods to explain the processes at work in that particular industry. Just like a doctor reading an EKG requires an understanding of what a long QT wave means, interpreting the numbers gathered in inventory tracking software requires a framework for making use of the data. The doctor understands that no two patients are identical and present a unique set of considerations. Likewise, the idea that consignment inventory accounting would look like restaurant inventory accounting is fundamentally flawed.

The metrics for tracking goods will look vastly different for various types of inventory accounting. Poor inventory tracking can lead to undervaluing assets and cause the company to appear to be in dire financial straits. Methods that are considered “best practices” in a particular business model may hold little value if not adjusted for business following a different paradigm. These variations present the need for flexible accounting software to meet the unique needs of different business types.

It is **not enough** to have vast amounts of raw data available at the touch of a button. Effectively making use of the information to streamline operations is what brings value. Poor interpretation of the data can cost the life of a viable business venture.



Poor inventory tracking can lead to undervaluing assets and more...



## Accounting for All Types of Inventories – Best Practices

Ongoing and scheduled inventory accounting is like keeping a finger on the pulse of the patient. Some trends will show up only from a 10,000-foot view, or when looking at a full year of data. Conversely, other variations can be spotted through monthly or quarterly reviews.

Timely interpretation of data will allow the company to spot trends quickly, which allows needed changes to be implemented. Following a strict schedule for inventory accounting will yield the most cost savings for the company. Many operations are repeated several times a day, if not hundreds of times a week. Inefficiencies in these repeated operations can equate to large, needless expenses. This highlights the need for regular review of the data collected for inventory management.

The most valuable asset for many companies is their inventory. Tracking its flow can take many forms, but it must be detailed in nature to be of value. Detailed records allow a clear understanding of internal operations down to a payment on account or balance change. This kind of data is only available to companies using top of the line inventory accounting software. The correct software will allow for fast and accurate data entry ensuring that no transaction goes unrecorded.

Keeping each aspect of the business connected with a comprehensive inventory accounting program is a vital step in monitoring profitability. With technical inventory, it is imperative to call upon the expertise of others in the company to formulate a genuinely effective plan of attack. The knowledge base available within the company is a valuable asset that should not be overlooked. The technical nature of certain types of inventory may make standard metrics and methods ineffective and misleading.

Additionally, while many items can be acquired from another vendor at a cost savings, in certain specialty products suppliers are extremely limited. Knowing where to find alternate suppliers may best be determined by experts in that department of the company.

Knowledge sharing across departments can augment data collection for a better-adjusted approach. Following these best practices can revolutionize the profitability of a company through cost savings and waste management.

## Understanding Types of Inventory Accounting and Their Financial Implications

What that process looks like varies greatly depending on the nature of the business. In the wide world of accounting, there are numerous types of inventory accounting. The need for these unique types of accounting arises from **variances in costs, ownership, liability**, and many other factors across business models.



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## Consignment Inventory Accounting

Consignment inventory accounting presents its share of specific considerations in the way the merchandise inventory accounting is conducted. The ownership of the merchandise being sold on consignment remains in the hands of the consignor. Therefore, the business selling the products would not reflect the merchandise value as an asset on the balance sheet. At the time of sale, the consignee would need to calculate the consignment fee or percentage of sale value. This functionality should be included in inventory accounting software packages. Liability for returns falls solely on the consignor and would not need to be deducted from the bottom line of the store, in most cases.

The importance of tracking sales in this model becomes of extreme interest to two parties, both consignor and consignee. For this reason, exportable sales records should be generated to share with the consignor. In some cases, limited-access logins will be used to allow additional parties to view data on internal inventory accounting systems. This level of transparency is valuable in maintaining strong business relationships.

While the ownership of the consignment model looks different from businesses carrying their own inventory, both companies would be impacted by damaged goods. Responsibility for damages occurring to merchandise on the sales floor would rest with the store in both models. However, in the consignment model, compensation for damaged goods would go to the owner of the goods.

## Seasonal

One consideration for businesses with multiple store locations is that many of the items will have seasonal appeal. This means that the business will want to carry an increased inventory of the item during the season with the greatest demand. Companies with locations across the US frequently see local markets vary greatly in demand for one product or another. Because these trends will be recorded in the accounting software, using the past and current data as a guide will ensure greater efficiency in ordering and stocking protocols. An effective way to ensure this tracking takes place is through the implementation of inventory control software.

## Perishable

Suppose the business is not carrying durable goods, but rather perishable items such as food. Tracking lot numbers for food bought at one time will allow the accounting software to assist in rotating stock for freshness and to reduce loss. This capability will cut costs for a restaurant or grocery store and reduce human oversight. Scanning in barcodes as inventory arrives allows for improved tracking. Stockrooms can become overly crowded with new shipments resulting in some stock becoming less accessible. The real-time tracking model alleviates the tendency to misplace or overlook this perishable stock and mitigates loss due to spoilage.

## Tangible

Tangible goods are only some of the many types of items tracked during inventory accounting. Depreciation on tangible goods is another part of business accounting that needs to be tracked. Depreciation of items like commercial cooking equipment creates tax implications that every business should leverage.

The government views depreciation as a way to stimulate the economy and has offered greater refunds to businesses to stimulate the economy. While the laws affecting this potential source of cash flow continue to change, the need for accurate records for the agencies reviewing depreciation tax credits has not.

## Work in Progress

Many businesses will have copious expenses tied up with work in progress. While these items do not yet represent commercial value, they do incur cost in raw materials and carry potential cash flow. The key is to account for labor, material costs, machine costs, and overhead properly.

Some shops may wish to move the materials tied up in a particular item through an inventory accounting category based on which step in the production process it is in.

For example, a clay pot being formed would be in one category while one being glazed would fall into another. No matter how the inventory is accounted for, the central idea is to represent the on-hand material accurately. This holds true for businesses from small pottery shops to large manufacturing companies. The scale of materials being handled may be nothing alike, but the universal concept of reliable inventory accounting remains. Without proper tracking and record keeping, any business will lack the guidance needed to carry out daily operations in a cost-effective manner.



The key is to account for labor, material, machine cost and more...

## Inventory Control for All

Steps to increase profitability, such as selling excess inventory, can only be made if those in charge of inventory are aware of the excess. Through proper tracking and with useful reports, past trends and current inventory can be easily viewed, and these financial opportunities can be recognized and seized. Manufacturing inventory accounting can present a unique set of money-saving options for a company. Many of these cost savers capitalize on the time value of money and economies of scale. By submitting payments to vendors quickly and in cash, companies can save appreciable amounts of cost on much-needed items.

Although many businesses feel they are unable to do this because of cash flow issues, companies that are tracking internal data promptly are the ones most equipped to leverage these savings. This is because they closely manage accounts receivable to collect prior to purchasing. This is the power of cash in hand.

By understanding how materials are used in a given period through detailed record keeping, ordering can be timed to maximize the size of the order to ensure the lowest cost. While economies of scale can be leveraged frequently in a manufacturing business model, with proper inventory accounting, there are many businesses that might find it more accessible than previously thought.

Time has shown that the art of saving money can result in greater financial outcomes than increasing revenue alone. The adjusted numbers reflect the value of efficiency in daily operations.

## Harness the Power of Accounting for Inventories

In this day of electronic record keeping, inventory accounting has become an opportunity for businesses large and small to adjust internal operations to the ever-changing environment. **A business can only succeed with a clear understanding of current business conditions.**

Monetizing the data collected through detailed tracking is contingent upon the timely nature of the data as well as proper interpretation. From restaurant inventory accounting to manufacturing inventory accounting, software is making it possible to accurately do both. Simplistic and complex accounting models are easily executed through customizable inventory accounting programs. These programs have accessible data for key accounts, leveraging tax benefits, reducing spoilage, and capitalizing on the time value of money.

These are a few of the ways inventory software can reduce the cost of doing business.

Maintaining business health today involves a steady regimen of regularly scheduled inventory accounting.

As the old saying goes, **“An ounce of prevention is worth a pound of cure.”**

Businesses running state-of-the-art inventory accounting software will keep themselves in the black.

## MORE ABOUT Cougar Mountain Software

Cougar Mountain Software was founded in 1982 with a vision to develop powerful business accounting, nonprofit accounting, and point of sale software solutions. Our 30 years of success comes from two key practices; (1) employing in-house accounting and business professionals for our sales, support, training, and development teams, and (2) listening to our clients. These two practices make our accounting solutions unique to competitors who outsource their support and build fixed and un-scalable solutions to meet the general needs of the masses.

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