

Using Average Cost for Inventory

Average Cost

The cost of an inventory item can be defined as “specific” or as “average.” Magaya software enables configuring your system for either costing method. It can be set system-wide or per item.

The Average Cost method calculates the average cost for inventory items (in contrast to a specific identification method). The Magaya system calculates the average of all the inventory items you have purchased. Every time you sell an item, the system will add the amount to your “Cost of Goods Sold” account and deduct from the Inventory Account for that item.

This topic explains average cost, a method that is helpful when assessing the profit of selling your inventory. Sections in this topic include:

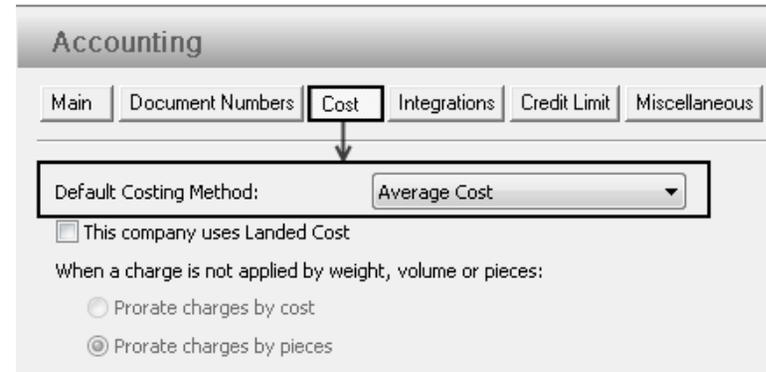
- How to configure average cost system-wide and per item
- How to create a resale item as an “average cost” method item
- Purchase items and create bills
- Sell items and invoice them
- See the purchases and sales on the Balance Sheet

Configure Average Cost System-wide

Go to Maintenance > Configuration > Accounting.

Click the “Cost” tab.

The first item is used to select the costing method. This example shows “average.”

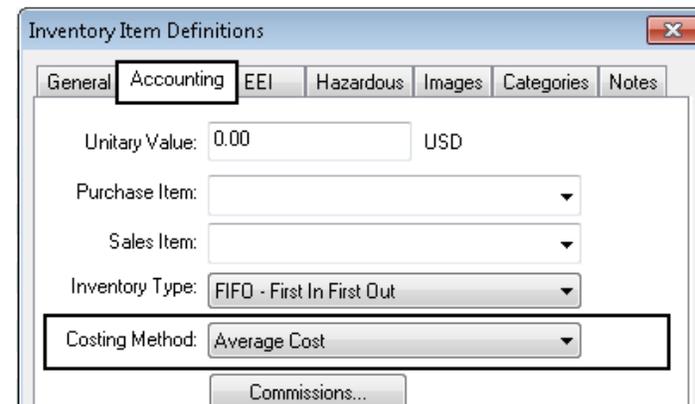


By selecting this configuration option, this costing method will apply system-wide. (If you want to set the costing method per item, see the section “Average Cost per Item.”)

Configure Average Cost per Item

This section explains how to define the costing method of an item at the Inventory Item Definition level, not system-wide.

The costing method of regular inventory items and resale inventory items can be defined. For a regular inventory item, select the costing method on the Accounting tab of the Inventory Item Definition dialog box.



For a resale item, select the costing method on the dialog box:

The screenshot shows the 'Resalable Inventory Item Wizard' dialog box. The 'Costing Method' dropdown menu is highlighted with a black box and set to 'Average Cost'. Other fields include Part Number, Description, Model, Package, L x W x H, Volume, Weight, Purchase Price, Sales Price, Manufacturer, Client, and various checkboxes for inventory management options.

Additional Configuration

Extra Info: If you want your Magaya system to create bills before items are received, set this option in Configuration > Purchasing:

The screenshot shows the 'Purchasing' configuration window. The checkbox 'Allow to create bills for purchase orders only after all inventory is received.' is highlighted with a black box and is currently unchecked. Another checkbox, 'Allow to create bills for purchase orders without commodities.', is checked.

Ensure the box is unchecked to allow the system to create bills for POs only after all inventory is received. In contrast, if this box is checked, then you will not be able to make bills until after receiving the items.

Extra Info: The system can switch between costing methods and display the average instantly when the method is changed. See the section "Changing Costing Methods" before making changes to ensure you fully understand how this will affect your system and the accounting.

Sell Items and Create Invoices

In this section, we look at how to use the items created with the average cost method by placing the items in a Sales Order (SO) and creating an invoice.

Note: When you purchased the items, the system recorded the purchase price of the items, regardless of the costing method used (average or specific method).

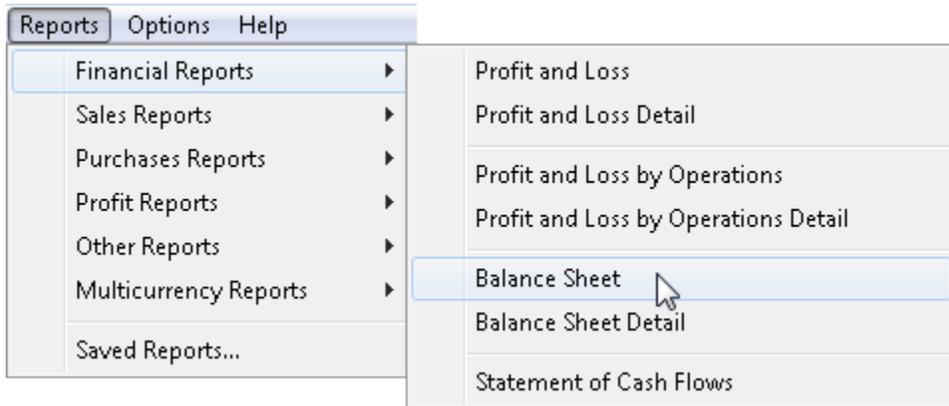
1. Create the SO and add the items to the Commodity tab.
2. Create the invoice from the Actions button. See the Adjustments tab of the invoice to see how the average amount is removed from the asset account and transferred to the account for the cost of goods sold. This invoice Adjustment tab example shows the average is \$105 for items purchased at \$100 and \$110. The two lines show the asset account and the cost account.

Average cost adjustments shown on the invoice

Internal Type	Account Name	Amount (...)	Amount	Applied to
InventoryAssetAdjustmentInvoice	Inventory Asset	105.00	USD 105.00	ABC Sporting
InventoryAssetAdjustmentInvoice	Inventory Cost	105.00	USD 105.00	ABC Sporting

The Inventory Item Definitions List and the Balance Sheet reflect the new totals.

To see the Balance Sheet, click “Reports” from the menu at the top of your Magaya Explorer screen.



The amounts are shown in the Balance Sheet's Inventory Assets section, including the bill for each vendor and the invoice for the customer:

Specific Identification

Balance Sheet average cost example

Type	Account	Amount
Inventory Asset		
Bill	Accounts Payable	100.00
Bill	Accounts Payable	110.00
Invoice	Accounts Receivable	-105.00

An alternative costing method is “Specific Identification,” which is used to keep track of the exact cost of each item of inventory that is purchased and sold for each specific item. The exact cost is subtracted from your inventory assets account for the item sold. This will be displayed on the Adjustments tab of the invoice.

Your Magaya system can be configured to the costing method of “Specific Identification”

in the Configuration > Accounting menu to apply the setting system-wide.

To apply the costing method per item, go to the Inventory Item Definition dialog box, and select the method on the Accounting tab (or in the wizard for a resale item).

If your system is set to FIFO, the system will fill an order by taking the first item and record the price for that specific item.

Changing Costing Methods

Changing the costing method affects the invoicing, the accounts for Inventory Assets, for Cost of Goods Sold, and the balance sheet. This is an advanced accounting function. We recommend that you ensure you understand how this will change your accounting system before changing from Average Cost to Specific Identification and visa versa.

If an “Average Cost” item is invoiced, there may be a balance left in the asset account when changing that item to “Specific Identification.” To correct the balance, create a Journal Entry to transfer the balance left in the asset account to the item's cost of goods sold account. For details on creating journal entries, see the section “Journal Entries” in Chapter 10 “Advanced Accounting Features” in the [Magaya Software Accounting Manual](#). 