COMPARING COSTS ENTERED IN A/P AND INVOICING

The sales figures on your P&L statement come from Customer Invoicing. Costs for inventory-related merchandise are also posted at the time the invoice is closed. However, the cost figures for non-inventory merchandise come from Accounts Payable. Problems with timing or unbilled costs can significantly affect your reported profit or loss.

For example, if the costs are billed in April, but the A/P invoice is booked to the May book period, you will see a gross profit for April that is too large (because the cost is missing from that month) and a gross profit in May that is too small (because the sales are missing from that month).

This newsletter will discuss some strategies for monitoring costs to make sure they stay in sync along with some troubleshooting advice when they don't.

Prepaid Purchases/Freight

One of the easiest ways to get your costs to be posted in the same book period as the corresponding sales is to use the Prepaid Purchases and Prepaid Freight feature. Many of you already use this feature in Lakeshore but for those who may not be familiar with it, a short explanation is in order.

First you define an account in the asset area of your Chart of Accounts called "Prepaid Purchases.

Then, when you enter the A/P invoice, instead of posting the cost to your Purchases or Cost of Goods Sold account on the P&L portion of your general ledger, you post the cost to this "Prepaid Purchases" account and use the current book period.

When you bill the related order and close the related Sales Journal, the system will automatically make a journal entry to remove the cost from the Prepaid Purchases account and make an entry in the same book period as the sales to the Purchases/CGS account. This ensures that the sales and cost go into the same book period.

That sounds great. So what can go wrong? Occasionally an order will be posted to Prepaid Purchases after it has been billed. Or an order will have costs posted to it and then cancelled. Or, an invalid order number may be used. In all of these situations, the cost would get "stuck" in Prepaid Purchases and never get pulled down to regular Purchases account.

There is a Prepaid Purchases Reconciliation procedure that compares the Prepaid Purchases detail to the G/L detail for the Prepaid Purchases account. There is also a function to check for the invalid entries described above and to clear them.

Consult the Prepaid Purchases Reconciliation help file for more information.

The Prepaid Freight works the same way and has its own reconciliation procedure. Freight costs are notorious about coming in late and are frequently entered on splits so they are more prone to the "invalid order" problem than the actual purchases are.

Entering A/P invoice along with customer invoice

Another approach to keeping things in sync is to enter the A/P invoice at the same time as you generate the invoice to the customer. Many who both enter the A/P invoices and generate the customer invoices find this to be the most efficient way of handling things. Since the A/P invoice is done at the same time as the invoice, both will be posted to the same book period.

Combination of methods

You can use these two methods in combination. For example, if you purchase blank goods from one vendor and have embroidery done by another vendor, you can enter the blank goods invoice when it is received and post it to Prepaid Purchases. Then, enter the embroider's invoice at the same time as you generate the customer's invoice.

Posting directly to the Purchase/Cost of Goods account

You can, of course, post your A/P invoice directly to the Purchases account. You will need to be very conscious of when the customer will be billed so that you can use the correct book period.

You should also be extra vigilant and monitoring and comparing your A/P and invoicing costs.

Monitoring the A/P and Invoicing Costs

Even with the best of procedures, things can sometimes go wrong. That's why we suggest that as part of your month end procedures you do a final comparison of the costs entered in A/P and the costs recorded on customer invoices. There are four reports on the A/P reports menu that are useful for this purpose.

Go to

- Accounts Payable
  - Print A/P reports
    - Compare A/P to Customer Invoice
      - Detail of Entries
      - Tie out G/L Sales/Purchases
      - Tie out all Orders Invoiced
      - Tie out All A/P entries made

Here's a short description of the four reports:

Detail of Entries - This report lists all entries to A/P and all costs on customer invoices for a single book period, matched by order number where possible.

Tie out G/L Sales/Purchases - This report is useful to see whether discrepancies are related to manual journal entries or reversals of "Prepaid Purchases". It will also give you a detailed tie out to the G/L balances in these accounts so you know exactly where each number came from. Once you determine that there is a problem, this report will give you the detail necessary to isolate whether the problem seems to be from invoicing or A/P or both.

Tie out all Orders Invoiced - This report creates a list of all order numbers for which an invoice was generated during the reporting period. It then recaps costs billed during the reporting period and in other periods for those orders as well as A/P costs entered against those numbers. This report is useful in eliminating discrepancies that are simply due to a billing correction of some type. It will also highlight problems in the assignment of book periods to A/P invoices, i.e. timing problems.

Tie out all A/P entries made - This report is similar to the one above except that it approaches the data from the A/P side---all the order numbers to which A/P entries were posted during the month are compiled, then all invoicing and A/P in the reporting period and in any other period are listed. Depending on the root cause of the problem, it may be more useful than approaching from the invoicing side.

Strategy:

Print the Tie out of Orders Invoiced and/or A/P entries made to get a quick overview.

Look for orders that have costs on one side (either A/P or Invoicing) but not on the other or that have wide variations in cost.

If you find a problem, print the two detailed reports for further analysis.

So, what kinds of problems do you look for? Here are the most common problems:

1) A/P invoices for inventory-related orders posted to your P&L CGS account instead of to your inventory account. The "Tie out all A/P entries made" report will usually bring this one to light. You will see a cost under A/P but nothing under Invoicing.

2) Costs posted directly to Purchases that used the wrong book period. The "Tie out all Orders Invoiced" report is the best one to check for this. You will see the Invoicing costs in one book period and the A/P costs in a different period.

3) Costs posted to A/P after the customer invoice has been entered. This is similar to the one above except that the extra cost will be in a later book period than the invoicing costs.

4) Customer is invoiced but no A/P costs are entered. This usually happens if you have to bill a customer ahead of receiving the vendor's invoice and it never arrives. You will see a cost in the Invoicing area but nothing in the A/P area.

5) A/P cost entered but customer is never billed. If you used the Prepaid Purchases account when you entered the invoice, the cost would stay in your Prepaid Purchases account. However, if you used the regular Purchases/CGS account, the cost would show on your P&L but with no corresponding sales amount. On the comparison reports, you will see a cost in A/P but nothing in invoicing.

   We suggest you also pull the Unbilled Cost report and/or an Open Order report to make sure that all your orders get invoiced in a timely manner.

6) <u>Bad cost on an inventory item</u>. If you have an inventory program, you should also monitor your inventory costs. For example, if an item is received at $100 per unit when it should be $1.00, your costs on the P&L will be off.