Inventory: Special Topics
Inventory Valuation Methods

Overview

When the Cost Pack Option is registered, CounterPoint allows you to select one of several cost methods to use in costing your inventory.

This document explains the different costing methods available in CounterPoint, and describes how each method works.

Identical items are purchased for inventory at different costs during the year. When these items are sold, it’s difficult to determine exactly which item was sold and which items are still in inventory. For this reason, in order to determine the cost of inventory, assumptions must be made about the order in which items costs are relieved when items are sold.

Four generally accepted methods of costing inventory are available in CounterPoint:

- Average cost method
- Standard cost method
- First-in, first-out method (FIFO)
- Last-in, first-out method (LIFO)

If desired, you can use the serial (real) cost method for serialized items in conjunction with the average cost method.

To illustrate these four methods, the following data for the month of April will be used:

<table>
<thead>
<tr>
<th>Inventory Data, April 30</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1 On hand 10 units at $2.00 $20.00</td>
</tr>
<tr>
<td>6 Received 10 units at $2.20 $22.00</td>
</tr>
<tr>
<td>6 Received 10 units at $2.21 $22.10</td>
</tr>
<tr>
<td>17 Received 10 units at $2.30 $23.00</td>
</tr>
<tr>
<td>27 Received 10 units at $2.40 $24.00</td>
</tr>
<tr>
<td>Totals 50 units $111.10</td>
</tr>
<tr>
<td>Sales 28 units</td>
</tr>
<tr>
<td>On hand April 30 22 units</td>
</tr>
</tbody>
</table>

The following examples show how inventory is reduced by the 28 sold units. A chart is also provided that compares the value of closing inventory and the amount of profit for each of the four valuation methods.
Average cost method

Under the average cost method, the cost of inventory is the total inventory on-hand at the beginning of the period, plus all goods purchased during the period, valued at the average cost of these goods.

<table>
<thead>
<tr>
<th>Cost</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>Total cost of goods on-hand divided by total quantity</td>
</tr>
<tr>
<td>Serial</td>
<td>The “real” cost of an individual serialized item</td>
</tr>
</tbody>
</table>

CounterPoint allows you to track the actual costs of individual serialized items when using the average cost method.

Average cost is updated each time items are received into inventory. If you use serial costs, the average cost is also recalculated when a serialized item is sold, when a Move In or Move Out serial transaction is posted, and when an inventory adjustment is made (adjustment transaction), using the serial number’s serial cost.

<table>
<thead>
<tr>
<th>Inventory Data, April 30 – Average Cost Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>April  1  On hand     10 units at $2.00    $ 20.00</td>
</tr>
<tr>
<td>6     Received 10 units at $2.20    $ 22.00</td>
</tr>
<tr>
<td>6     Received 10 units at $2.21    $ 22.10</td>
</tr>
<tr>
<td>17    Received 10 units at $2.30    $ 23.00</td>
</tr>
<tr>
<td>27    Received 10 units at $2.40    $ 24.00</td>
</tr>
<tr>
<td>Totals 50 units $111.10</td>
</tr>
</tbody>
</table>

Average unit cost: $111.10/50 = $2.22
Ending Inventory: 22 units at $2.22 = $48.84
Cost of Goods Available for Sale $111.10
Less April 30 Inventory $ 48.84
Cost of Goods Sold $ 62.26

Standard cost method

In the standard cost method, the cost of each item is set and not changed by the sale or receipt of items.

<table>
<thead>
<tr>
<th>Cost</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>Cost is set by you and only changed by re-entering a new standard cost</td>
</tr>
</tbody>
</table>

Under standard costing, you set what you feel should be the cost of an item (using Inventory / Items). This becomes the target you set for the purchasing department and, with mark up, becomes the target for the sales department. Variances (positive or negative) from standard cost are tracked and printed on reports.
In CounterPoint, standard cost is an inventory valuation system that highlights price variance at time of purchase. It is designed to assist wholesalers and distributors in assigning profit responsibility between the purchasing and sales departments.

The actual cost (purchase price) of inventory is also tracked automatically at average cost.

### Last-In, First-Out (LIFO) method

LIFO is an abbreviation for last-in, first-out.

<table>
<thead>
<tr>
<th>Method</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIFO</td>
<td>Last-in, first-out method of valuing inventory, which assumes that the most recently purchased units are sold first</td>
</tr>
</tbody>
</table>

LIFO assumes that the cost of the last items purchased is assigned to the first items sold, and that the cost of ending inventory is the cost of the merchandise purchased earlier.

To understand the LIFO method, assume that for each shipment received, the quantity and unit cost of each item is input into the computer so that you can retain a cost history of all items in inventory.

The LIFO (last-in, first-out) method assumes that the most recent item put into inventory is the first sold, or “relieved” from the cost history.

LIFO layers

LIFO cost histories are retained in “layers” by location.
If there are two receivings for an item on a given date, and if the two costs vary, then the lower of the two costs is assumed to be the higher “layer.”

For LIFO, the last layer received (April 27) is referred to as the “top layer,” and the total cost history consists of five layers (to simplify, we are assuming that the April 1 on-hand amount was a single purchase).

When sales occur, the layers are relieved from the top down (last-in, first-out), and the cost of the sale is determined from the layers relieved. For example, if 28 units are sold:

<table>
<thead>
<tr>
<th>Units</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>$24.00</td>
</tr>
<tr>
<td>10</td>
<td>$23.00</td>
</tr>
<tr>
<td>8</td>
<td>$17.60</td>
</tr>
<tr>
<td></td>
<td><strong>Cost of Goods Sold: $64.60</strong></td>
</tr>
</tbody>
</table>

The remaining LIFO layers would look like this:

<table>
<thead>
<tr>
<th>April 6</th>
<th>2 at $2.20</th>
<th>$ 4.40</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>10 at $2.21</td>
<td>$22.10</td>
</tr>
<tr>
<td>1</td>
<td>10 at $2.00</td>
<td>$20.00</td>
</tr>
<tr>
<td><strong>Ending Inventory, April 30</strong></td>
<td>$46.50</td>
<td></td>
</tr>
</tbody>
</table>

The remaining layers represent ending inventory for April 30. Another method of calculating cost of goods is:

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Goods Available for Sale</td>
<td>$111.10</td>
</tr>
<tr>
<td>Less Ending Inventory April 30</td>
<td>$46.50</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>$64.60</td>
</tr>
</tbody>
</table>

First-In, First-Out (FIFO) method

FIFO is an abbreviation for first-in, first-out.

<table>
<thead>
<tr>
<th>Method</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIFO</td>
<td>First-in, first-out method of valuing inventory, which assumes that the oldest (first into inventory) items in stock are sold first</td>
</tr>
</tbody>
</table>
FIFO assumes that the cost of the first items acquired is assigned to the first items sold. The cost of ending inventory is the cost of the merchandise purchased most recently. The cost history is “relieved” of the earliest (first) items on file, rather than the latest, as in the LIFO method.

FIFO layers
FIFO cost histories are retained in “layers” by location.

<table>
<thead>
<tr>
<th>Inventory, April 30 – FIFO Cost Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>17</td>
</tr>
<tr>
<td>27</td>
</tr>
<tr>
<td>Totals</td>
</tr>
</tbody>
</table>

For FIFO, the layers develop in the reverse order of LIFO.

* If there are two receivings for an item on a given date, and if the two costs vary, then the lower of the two costs is assumed to be the higher “layer.”

The earliest purchases make up the top layers. When sales occur, the layers are relieved from the top down (first-in, first-out). The cost of goods sold is determined from the layers relieved, as follows:

10 units at $2.00 = $20.00
10 units at $2.20 = $22.00
8 units at $2.21 = $17.68
Cost of Goods Sold = $59.68

The remaining FIFO layers would look like this:

<table>
<thead>
<tr>
<th>April 6</th>
<th>2 at $2.21</th>
<th>$4.42</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>10 at $2.30</td>
<td>$23.00</td>
</tr>
<tr>
<td>27</td>
<td>10 at $2.40</td>
<td>$24.00</td>
</tr>
<tr>
<td>Ending Inventory, April 30</td>
<td>$51.42</td>
<td></td>
</tr>
</tbody>
</table>

The remaining layers represent ending inventory for April 30. Another method of calculating cost of goods is:

<table>
<thead>
<tr>
<th>Cost of Goods Available for Sale</th>
<th>$111.10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Ending Inventory April 30</td>
<td>$51.42</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>$59.68</td>
</tr>
</tbody>
</table>
Comparison of costing methods

Four methods of costing inventory have been illustrated: average cost, standard cost, LIFO, and FIFO. All four methods are based on assumptions regarding the flow of costs. Standard cost, additionally, highlights variances from management-defined standards.

This chart shows a comparison of the effects of the four methods on net income using the previous example data and assuming sales during April of $100.

<table>
<thead>
<tr>
<th></th>
<th>Average Cost</th>
<th>Standard Cost</th>
<th>LIFO</th>
<th>FIFO</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales</strong></td>
<td>$100</td>
<td>$100</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning Inventory</td>
<td>$20.00</td>
<td>$22.18 (std)</td>
<td>$20.00</td>
<td>$20.00</td>
</tr>
<tr>
<td>Purchases</td>
<td>$91.10</td>
<td>$88.72</td>
<td>$91.10</td>
<td>$91.10</td>
</tr>
<tr>
<td><strong>Cost of Goods Available for Sale</strong></td>
<td>$111.10</td>
<td>$110.90</td>
<td>$111.10</td>
<td>$111.10</td>
</tr>
<tr>
<td><strong>Less Ending Inventory</strong></td>
<td>$48.84</td>
<td>$48.80 (std)</td>
<td>$46.50</td>
<td>$51.42</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>$62.26</td>
<td>$62.16</td>
<td>$64.60</td>
<td>$59.68</td>
</tr>
<tr>
<td><strong>Gross Profit on Sales</strong></td>
<td>$37.74</td>
<td>$37.84</td>
<td>$35.40</td>
<td>$40.32</td>
</tr>
</tbody>
</table>

Assuming that costs are rising, LIFO (which charges the most recent and therefore highest cost of goods sold) results in the lowest net income (and the lowest ending inventory value).

For this example, FIFO (which charges the earliest and therefore lowest cost of goods sold) produces the highest net income (and the highest ending inventory value).

During a period of falling prices, the reverse effect would occur under LIFO and FIFO (with LIFO showing a higher net income than FIFO).

Under average cost, the net income and value of ending inventory are between those computed under LIFO and FIFO, reflecting the leveling effect of average costing.

Considerations in selecting a valuation method

**Average**

What it is
Perpetual average cost flow assumption.

Benefits
- After FIFO, the easiest to audit or review
- Saves data file space
- The cost figure obtained for ending inventory is affected by all the costs paid during the year, and tends to level out the effects of cost increases and decreases during the year
Comments
- During times of rising prices, the average cost method can cause higher profits. (See the **LIFO** section on page 7 for more information.)
- Values inventory based on a generally accepted accounting method

**Standard**

What it is
- Modified standard cost system that highlights purchase price variance at time of purchase.
  
  This method also automatically uses the perpetual average cost. (See the **Average** section on page 6 for more information.)

Benefits
- Can provide distributors and wholesalers with information to identify profit responsibility between the purchasing and sales departments.
- Purchase variance clearly identified.

Comments
- Most time and effort required to audit and review
- Requires an experienced accountant, Certified Management Accountant, or Certified Public Accountant

Although the software is easy to run, the standard cost system of inventory is difficult to monitor and interpret by most managers.

**LIFO**

What it is
- Perpetual, specific goods, LIFO cost system.

Benefits
- Cost of sales kept closest to replacement costs.
- Always keeps inventory at LIFO cost
- Prevents reporting excessive profits during times of rising prices
- Under FIFO or average cost methods, profit is overstated because inventory must be replaced at new, higher prices. Note, however, that FIFO can be manually adjusted at year end to dollar value LIFO (as discussed under FIFO, page 8), giving the operational advantages of FIFO with the lower-stated profit structure of LIFO. For a full explanation of this procedure, consult your accountant.

Comments
- Because of the perpetual updating of costs, you cannot build up significant LIFO layers as you could if you selected FIFO and made a periodic dollar value LIFO adjustment
- More is involved in audit and review because many small cost layers can be built
- Uses more storage space on the computer disk
- Values inventory based on a generally accepted accounting method
FIFO

What it is
- Perpetual, specific goods, FIFO cost system

Benefits
- Easiest to audit or review of the four methods
- Errors are easily identified and corrected
- Keeps your inventory value close to replacement value
- Easiest to use of all four methods

Comments
- The detail is sufficient for easy manual entry at year end in order to express the financial statement values at dollar value LIFO (on a periodic basis). This gives the benefit of reporting lower profit when prices are rising. For a full explanation of this, consult your accountant.
- Values inventory based on a generally accepted accounting method
- Uses more storage space on the computer disk

Using LIFO/FIFO costing

This section provides information on transaction processing under LIFO or FIFO costing.

Miscellaneous notes
- Unposted transactions don’t affect LIFO/FIFO layers until they are actually posted.
- Cost corrections occur when transactions cause on-hand inventory to increase from a negative value (even if it remains negative), if the transaction cost is different than the cost of the layer(s) being updated.
- All functions that generate transactions to increase inventory use the entered cost. If a cost is not entered and you are using LIFO, the item’s last cost is used. If a cost is not entered and you are using FIFO, the item’s average cost is used.
- All functions that create or generate transactions to decrease inventory use the item’s last cost under LIFO and average cost under FIFO for the initial transaction cost.
- Last cost is stored in both the Inventory file and the Item file. This field can be maintained by the user as a protected change field only when using Inventory / Inventory / Enter, or when maintaining inventory records from item maintenance.
- Average cost for an item is the average for locations with positive on-hand quantities. Locations with negative on-hand quantities are not included in the calculation of the item’s average cost.
- File Utilities / Special / Inventory / Recalculate item quantities allows the user to specify whether the information in the Inventory file or the Layer file should be used as the “correct” value.
- Layer activity doesn’t occur for receivings or sales of drop-ship items.
Prior to posting, the Daily Register Audit Report shows decreases in inventory using last cost (if you are using LIFO) or average cost (if you are using FIFO). During posting, if the FIFO/LIFO layers are negative or if no layers exist, the inventory last cost is used for both LIFO and FIFO. During posting, inventory increases use the entered cost.

Receivings

- Layers are maintained by location, so a receiving that is posted for an individual location creates LIFO/FIFO layers only for that location.

Sales

- When a sale is posted, LIFO/FIFO layers are relieved beginning with the top layer and progressing downward. This procedure continues until enough layers have been relieved to satisfy the sale quantity. As the layers are relieved, the exact LIFO/FIFO cost of the sale is computed from the costs stored in the layers.
- Until end of day posting is performed in Point of Sale (or invoice posting in Order Entry), Last cost is used under LIFO or Average cost is used under FIFO to determine ticket cost and gross profit. Any cost or profit figures that display or print prior to end of day posting (e.g., on daily reports printed using Point of Sale / Reports / Daily reports) will be based on this last cost under LIFO or on average cost under FIFO, not on actual layer cost. Actual layer costs are calculated during end of day posting (or invoice posting in Order Entry).

Adjustments

You can use adjustments to adjust the quantity of a specific LIFO/FIFO layer ("specific adjustment"), or you can adjust a quantity without regard to a specific LIFO/FIFO layer ("non-specific adjustment"). To alternate between entering a specific or non-specific adjustment, press F2 at field 2 on the adjustment entry screen (Inventory / Adjustments / Enter).

You can see the current LIFO/FIFO layers for any item in inventory by printing a Valuation Report. (See “Valuation Report” in Standard Inventory Reports for more information.)

Specific layer adjustments
Specific adjustments are useful when you discover that an earlier transaction was entered with an incorrect quantity.
- A specific layer downward adjustment will reduce one layer by the negative quantity you enter.
- A specific layer upward adjustment will increase one layer by the quantity you enter.

Non-specific layer adjustments
Non-specific adjustments are useful when you need to adjust inventory as the result of a physical count. In this case, you probably don’t know the exact layer(s) affected, but you are still able to adjust inventory by LIFO/FIFO cost.
- A non-specific layer downward adjustment reduces your inventory by the negative quantity you enter, but it does so without regard to any specific layer. Non-specific
downward adjustments begin with your top LIFO/FIFO layer, and relieve (eliminate) as many layers as are necessary to satisfy the quantity entered. The cost of the transaction is calculated using the costs recorded in the layer(s) relieved.

- A non-specific layer upward adjustment increases your inventory by the quantity you enter. However, it does so by inserting a new layer for the date, quantity, and cost of the transaction. If a layer already exists for the entered date and cost, the new transaction quantity is added to the existing layer.

**NOTE:** If an adjustment brings a layer to zero quantity during posting, that layer is removed. You can delete a layer by posting a specific layer adjustment that results in a layer quantity of zero.

**NOTE:** A specific adjustment cannot cause the resulting quantity of the specific layer to “pass through” zero. In other words, a negative inventory quantity cannot be made positive, and a positive inventory quantity cannot be made negative.

**Specified Layer Not Found / Invalid Transaction Quantity**

While printing an adjustment edit list or register, you might receive an error message that a specified layer has not been found, or that an invalid quantity was entered. This condition can occur because transactions are posted in date order.

While entering specific layer adjustments, the program automatically checks to ensure that the layer you specified is present and that the quantity entered is acceptable. However, during posting, it is possible that your specified layer may have already been eliminated, or its quantity altered, before your specific layer adjustment is posted. For example, if you enter a downward adjustment, then post a sale before posting this adjustment, the layer specified in the adjustment might have been eliminated, or its quantity might have been reduced by the sale transaction.

If adjusting the layer you specified is not possible, one of these two messages will appear on the edit list or register:

- Specified layer not found - trans will not be posted
- Invalid trans qty - trans will not be posted

In either case, use *Inventory / Adjustments / Enter* to change the specific adjustment so that it adjusts a valid layer (refer to your Valuation Report and edit list for valid layers).

**Using standard costing**

Standard cost is designed to assist wholesalers and distributors in assigning profit responsibility between the purchasing and sales departments.

An in-house Certified Management Accountant or Certified Public Accountant should be assigned the responsibility of monitoring and interpreting the information produced by this standard cost system.

If your company does not have a qualified person to monitor a standard cost system, we suggest that you select one of the other valuation options available (average, LIFO, or FIFO). These methods don’t require the same level of monitoring or interpretation, and they can normally be handled by a general manager on a day-to-day basis and then adjusted by a Certified Public Accountant at year end.
Standard cost in CounterPoint was designed as a modified, not a traditional, standard cost system for a manufacturing company. It isolates a material price variance at time of purchase, but doesn’t address material usage, labor cost, or overhead.

When the standard cost valuation method is selected in Setup / Inventory / Control, your inventory can be valued at both standard and actual (average) cost. This means that all your accounting transactions are made using a standard cost per unit; however, perpetual average cost is also calculated and recorded in the Item file. This allows you to identify both the standard cost of your inventory, as well as the actual cost of your inventory (per the Valuation Report with the A method selected).

Examples
The following examples illustrate the use of standard cost when processing transactions in CounterPoint.

**Receipts**

If you purchase 10 units of an item at an actual cost of $22.00 per unit, with the standard unit cost of $20.00 per unit:

<table>
<thead>
<tr>
<th>Old Qty</th>
<th>Old Avg Cost</th>
<th>New Qty</th>
<th>New Avg Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
<td>10</td>
<td>$22.00</td>
</tr>
</tbody>
</table>

*Actual entries in the Distributions file:*

- Debit Merchandise Inventory $200
- Debit Purchase Variance $20
- Credit Receivings Accrual $220

**NOTE:** Merchandise inventory is distributed at standard cost, receivings accrual is at actual cost, and the purchase variance is the difference between actual cost and standard cost.

The inventory value of this receiving at standard cost is $200. The value at actual cost is $220.

**Sales**

If you sell two units of this item at the standard cost of $20.00 per unit:

<table>
<thead>
<tr>
<th>Old Qty</th>
<th>Old Avg Cost</th>
<th>New Qty</th>
<th>New Avg Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>$22.00</td>
<td>8</td>
<td>$22.00</td>
</tr>
</tbody>
</table>

*Actual entries in the Distributions file:*

- Debit Cost of Goods Sold $40
- Credit Merchandise Inventory $40
NOTE: A sale doesn’t change the actual average cost.

Credit memos

If you issue a credit memo for two units of this item at a cost of $20.00 per unit:

<table>
<thead>
<tr>
<th>Old Qty</th>
<th>Old Avg Cost</th>
<th>New Qty</th>
<th>New Avg Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>$22.00</td>
<td>10</td>
<td>$21.60</td>
</tr>
</tbody>
</table>

Actual entries in the Distributions file:

Debit Merchandise Inventory $40
Credit Credit Memo (actual) $40

NOTE: The item will be added back to inventory at actual cost. If there was a difference between standard cost and actual cost when the unit was originally sold, then you should use an adjustment transaction to account for this difference.

Downward adjustments

The purpose of this example adjustment is to reverse the previous credit memo example. Adjustment transactions allow you to adjust your quantity on-hand to reflect the actual physical count in your inventory.

If you enter a downward adjustment for two units of this item at an actual cost of $20.00 per unit:

<table>
<thead>
<tr>
<th>Old Qty</th>
<th>Old Avg Cost</th>
<th>New Qty</th>
<th>New Avg Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>$21.60</td>
<td>8</td>
<td>$22.00</td>
</tr>
</tbody>
</table>

Actual entries in the Distributions file:

Debit Inventory Adjustments $40
Credit Merchandise Inventory $40

Upward adjustments

Adjustment transactions allow you to adjust your quantity on-hand to reflect the actual physical count in your inventory.
If you post an upward adjustment for one unit of this item using the average cost of $22.00 per unit:

<table>
<thead>
<tr>
<th>Old Qty</th>
<th>Old Avg Cost</th>
<th>New Qty</th>
<th>New Avg Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>$22.00</td>
<td>9</td>
<td>$22.00</td>
</tr>
</tbody>
</table>

Actual entries in the Distributions file:
- Debit Merchandise Inventory $22
- Credit Inventory Adjustments $22

Disposition of variances

At year end, your Balance Sheet Inventory and Cost of Goods Sold accounts will be at standard. Generally accepted accounting principles require that you present reconciled figures for inventory and cost of goods that take into account purchase variances.

Allocation of variances at year end or prior to changing any standard unit cost

In order to reconcile these figures to actual cost, you must allocate the total variances accumulated in the Purchase Variance account. The net variance should be posted (debited and credited) to the Balance Sheet Inventory and Cost of Goods Sold accounts by means of an entry in your general ledger.

Procedures for allocation of the variances and determining the adjustment amounts

The purchase variance can be allocated in either of the two following methods, or another method more appropriate to your needs. You should consult an accountant to determine the appropriate method of allocation.

Method #1
1. Determine the total goods available for the period by adding ending inventory and the cost of goods sold figures.

\[
\text{Ending inventory (std) + Cost of goods sold (std) +}
\]

\[
\text{Total goods available (std)}
\]

2. Divide ending inventory by the total goods available for the period.

\[
\frac{\text{Ending inventory (std)}}{\text{Total goods available (std)}} = \text{Ratio}
\]
3. Multiply this ratio by the net variance. The resulting figure represents the portion of the net variance that should be allocated to the ending inventory balance.

\[
\text{Ratio} \times \text{Net variance} = \text{Ending inventory portion}
\]  
\(\text{Amount needed to adjust inventory to actual cost}\)

4. The remaining amount represents the portion to be allocated to the cost of goods sold balance.

\[
\text{Net variance} - \text{Ending inventory portion} = \text{Cost of goods sold portion}
\]  
\(\text{Amount needed to adjust COGS to actual cost}\)

5. The following entry would be made to allocate the variance, assuming the net variance was a debit balance:

- Debit Balance Sheet Inventory
- Debit Cost of Goods Sold
- Credit Purchase Variance

Method #2

1. Print Valuation Reports at actual and at standard cost.

2. The difference between the two inventory figures (total at actual cost minus total at standard cost) is the net variance that is needed to adjust inventory at standard to inventory at actual (Ending inventory portion).

3. The cost of goods sold portion is calculated by subtracting the ending inventory portion from the net variance amount.

4. The following entry would be made to allocate the variance, assuming the net variance was a debit balance:

- Debit Balance Sheet Inventory
- Debit Cost of Goods Sold
- Credit Purchase Variance

Notes

Standard costs are not usually changed during the year. However, if your circumstances dictate that a change is required, and your accountant agrees, changes are allowed.

Prior to changing even one standard unit cost, though, it is necessary to allocate the net variances that have been accumulated to date. All outstanding transactions should be posted, and then the procedures outlined above for year-end allocation should be followed and the appropriate journal entries made.

After the journal entries have been made, your general ledger will have inventory at actual cost, and CounterPoint will have inventory at standard cost.

To state your general ledger inventory at standard cost, you would make the following entries:

- Debit Purchase Variance
- Credit Balance Sheet Inventory
This will allow you to continue using standard cost on a daily basis. (Note that you don't have to make any reversing journal entries for Cost of Goods Sold, because it is an expense account.)