



***AutoPoint*[®] Evolution – Average Costing
Implementation Guide**

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AVERAGE COSTING IMPLEMENTATION GUIDE

Definition of Average Costing:

Average Costing is a method of cost accounting that measures inventory value and COGS in terms of the actual cost of the currently possessed instances of inventory items. Rather than estimate a usual or probable Replacement Cost for each item and use this cost to initially set COGS, GP amount and inventory value, with the intent of adjusting these amounts in the Financial Statements to reflect what turned out to be the actual costs, Average Costing tries to track the actual costs on an item-by-item basis as it happens. This brings about some specific procedural requirements of Average Costing and also highlights some limitations on its use and/or accuracy.

Procedural Requirements and Limitations to Average Costing:

1. Once Average Costing is implemented in AutoPoint®, all goods must be received in Merchandise Receiving on the computer before they can be put onto an invoice (open or closed) in Point-of-Sale, unless the PO Unit Cost at which they are received is always the same and the Quantity On Hand of the item never gets as low as zero. This is because of item # 4 below as well as the fact that the system gets the item's cost from the Item Branch record at the moment the item is put onto an invoice. Each time an item not yet received gets put onto an invoice (after which its receiving will take place), the average cost and/or COGS of that item is skewed, creating both COGS and inventory inaccuracies.
2. Any buyouts which are done must have the cost for this particular order of this item entered at Point-of-Sale. If this is not possible, buyouts must be phased out and all items received into stock before being sold as per item # 1 above. Each time a buyout is sold with a make-up cost or no cost at all, COGS is skewed.
3. PO Unit costs must be accurate at receiving time, whether they are keyed in at receiving time or were set before the PO was released. If, for example, you are ordering from a supplier other than the usual supplier or if a price change has not yet been done on this product line, you will need to key in the current unit costs on the PO or at receiving time. This is necessary because it is the PO Unit Cost figures that are used at receiving time to calculate the new average costs of the items received. Each time a discrepancy between PO Unit Cost (or the cost entered at receiving time) and the actual cost of the item this time is left in place, Average Cost is skewed on these items.

4. When there is no quantity on hand, Replacement Cost is used instead of Average Cost, as the average cost of zero units is zero. Each time an item is sold in POS with no quantity on hand, COGS is skewed by this order's use of Replacement Cost (unless the cost of this item does not vary and is equal to the Replacement Cost currently on the item). This can occur when items are sold before being received, as well as when an item's inventory quantity is not accurate (item is present but shows as zero on hand on the system).

Process:

- a. Average Cost is stored for each item, separately for each branch in which the item is set to Stocking. The Average Cost field is updated each time the item is received, whether the costing field in Company Maintenance is set to Average or not. This way, Average Costing in Point-of-Sale can be enabled without loss of accuracy for the most part.
- b. The following formula is used to update average cost of each item when it is received: $[(\text{Current QOH times current AVG cost}) + (\text{PO quantity Received times PO cost})] \text{ divided by } [\text{Current QOH} + \text{PO quantity Received}] \text{ equals New Average Cost}$. In other words, the total value at Average Cost of items on hand and items being received (at PO cost) is divided by the total quantity of both the items on hand and the items being received.
- c. The above calculation occurs when you key in your initials to confirm that you want the items to be received, in Merchandise Receiving.

Results:

1. If the Procedural Requirements above are followed, the above calculation results in the actual cost of the specific instances of an item currently on the shelf being shown in the Average Cost field in the Item Branch record (visible on the Inventory Adjustments and Stock Status Inquiry screens). Thus, when the items are sold, costing reflects actual dollars paid to purchase these particular units of this part and creates Gross Profit reporting figures which can be accurate to the penny, provided all the procedural requirements and limitations to average costing above have been satisfied and no other errors were made.
2. In cases where costing may vary, the AutoPoint® Purchase Order may be used to generate accurate average costs. The Purchase Order Discount feature (<Shift>-<F10> on a Pending PO) can be useful here if the source of supply being used charges a uniform percentage different from the usual replacement cost. Once the correct cost is on the PO, provided all the procedural

requirements and limitations to average costing above have been satisfied, the accuracy can be perfect.

Implementation Steps:

1. Spool an inventory valuation report using Replacement cost (usually price 0) and another using Average cost, across all product lines in Summary format.
2. Inspect the above reports for product lines with significant differences and resolve these before switching to the use of Average cost in Point-of-Sale. If there is enough discrepancy, you may need to replace average cost with replacement cost in some product lines or system-wide. In this case, please call Support for help running this process automatically.
3. When the differences between average and replacement costs have been addressed, you are ready to do the cutover to average cost. Close or void any open POS orders or Work Orders, as these will be using Replacement Cost. After closing the open orders, you should also run end-of-day in all branches, so you know on which business day average cost accounting started. Then spool the same two reports as in step 1 above. You should also spool these in detail format and print all four reports and keep them on hand, as serious accounting issues can arise from discrepancies which have been overlooked. You will want to run the detail versions of these reports showing only items with non-zero quantity on hand (IE: negative quantity or one or more units on hand).
4. Immediately after completing step 3, call Support for help turning on the Average Costing flag in the AutoPoint[®] Company Maintenance, as well as setting System Option # 42 (Transfer Using Average Cost) to Yes. No selling or receiving activity (other than closing/voiding open orders and work orders in step 3) can occur in your AutoPoint[®] system while steps 3 and 4 are in process.
5. Proceed with normal activity, following the procedural requirements and limitations to average costing outlined above. Inventory valuation reports will now be run using Average cost.