



Whitepaper: PO Costing Principles

Inventory and jobs are costed at the PO line's *Unit Cost*

In DBA, the *Unit Cost* from the PO line is the cost that is used to update the item's *Inventory Cost* or a linked job line's *Actual Cost*. This is called "actual costing", which is the most direct way to update inventory and job costs.

Actual costing is quite different than "standard costing." In a standard costing system, inventory and jobs are updated with the item's standard cost, and any difference between actual PO cost and standard cost is captured as a variance. DBA does not work in this manner.

The *Unit Cost* comes from three possible sources

The PO line's *Unit Cost* comes from three possible sources:

- Purchase Price Table
- Last Cost
- Manual Entry

The program always looks first for a purchase price table record and, if one is found, uses it as the *Unit Cost*. If a price table record is not found, the item's *Last Cost* is used as the *Unit Cost*. The user also has the option of manually entering the *Unit Cost*.

The *Unit Cost* can be overridden at time of receipt

At time of PO receipt, you have the option of overriding the PO line's *Unit Cost*. Doing this will not change the *Unit Cost* value on the PO line, which remains as is so that it conforms with the original printed PO sent to the supplier. It will, however, be the cost that is used to update the item's *Inventory Cost* or the linked job line's *Actual Cost*.

Accurate PO costs should be your goal

Because the *Unit Cost* on the PO line is the actual cost used to update inventory and jobs, it is important that it be reasonably accurate.

Purchase prices can be maintained two ways

You can maintain accurate purchase prices two ways:

- Purchase Price Table
- Last Cost

In general, the purchase price table method is best used for critical items that are purchased in large volumes, for items that carry a high price tag, or for items with frequent price fluctuations. In such cases, the extra effort required to maintain supplier prices is worth the accuracy that they bring to your purchase orders. On the other hand, many items are not critical in terms of cost or volume and are not subject to fluctuation. These items can be safely purchased using the *Last Cost* as the PO line's *Unit Cost*.

Cost perfection is not required or desirable

In manufacturing, when it comes to costing, "close" is good enough. Absolute cost perfection is not worth the effort and is often unattainable or not practical. This is why averages are generally preferred for labor and overhead rates. So if your PO costs are off by small amounts, there will be negligible effect on the system. From an accounting standpoint, regardless if your costs are perfect or "close enough", it "all comes out in the wash" from a profit and loss standpoint and makes no difference to the bottom line.

So don't stress over thinking that DBA requires perfect PO costs to work properly. The accounting works just as well with "close enough" costs.

Price confirmation is a good practice

Confirming prices with suppliers and staying abreast of prices is a good practice because it keeps you focused on getting the best prices possible. Any savings in price goes directly to the bottom line and the effort involved will pay for itself many times over.

Maintain purchase prices during PO invoicing

An easy way to keep your purchase prices up to date is to maintain them at time of PO invoicing.

In the *Purchase Order Invoices* screen, any time you change the supplier price such that it differs from your last receipt cost, you are asked if you wish to change the item's *Last Cost*. We recommend that you always do so. By doing this each time, your last costs will remain completely accurate at all times and serve as an excellent price basis for future PO's.

In the same screen, should you wish to change the item's purchase price table record, you can click the *Links* button and be swapped to the *Purchase Prices – Items* screen where you can update the item's price relative to this supplier.

The *Last Cost* is also used for updating *Estimated Costs*

Another benefit of maintaining accurate *Last Costs* is for mass updating the *Estimated Cost* of your purchased items, which is done in the *Item Price & Cost Update* screen. In one process you can update the *Estimated Cost* of all your purchased items with their *Last Cost*.

Accurate *Estimated Costs* on your purchased items flow through to the *Cost Rollup* and to the estimated cost calculation when make jobs are created.

What happens when a significant price discrepancy occurs?

Let's continue discussing your options within the *Purchase Order Invoices* screen.

If it does so happen that your supplier price differs significantly from your PO cost of a magnitude that you feel requires a correction to inventory or job costing, you have two possible remedies.

- If the item was received into inventory, and if there is still stock on hand, you can click the *Links* button and link to the *Change Inventory Costs* screen where you can change the cost of the remaining inventory on hand.
- If the item was received to a job, and if the job is still open, you can do a reverse issue on the job line, which puts the item back in stock. You can then use the *Change Inventory Costs* screen to correct the item's *Inventory Cost*. The final step is to issue the item to the job once again, this time at the correct cost.

Be aware that there is typically a lag time between PO receipt and entry of the supplier invoice. During this interim period, the item might already be shipped or issued to jobs. When this is the case, it is difficult to correct costs after the fact. Yes, invoices and shipments and job issues and completions can be reversed and redone with corrected costs, but it's a tedious process.

To avoid having to make such corrections, follow these principles.

- Seek price confirmation on high-priced items
- Always update each item's *Last Cost* when entering supplier invoices
- Always update purchase price records, when applicable, when entering supplier invoices.
- Accept the principle that "close is good enough" when it comes to small price discrepancies.

How are price discrepancies handled, accounting-wise?

When the supplier price on the invoice differs from your PO cost, the value of your *Received not Invoiced* GL account is out of balance because you now owe more or less to the supplier than you thought you would at the time you received the item.

To keep the *Received not Invoiced* account balance accurate, when the PO line is closed (which occurs when it is fully received and matched or when you click the *Close* checkbox to manually close the line), the program compares the line's total receipt costs with total invoice amounts.

If a difference is found between the two totals, your *Received not Invoiced* account is adjusted up or down for the difference and the offsetting entry goes to your *RNI Reconciliation* account.

RNI reconciliation is not for tracking price variances

The only purpose of this GL transaction at time of line closing is to keep the overall *Received not Invoiced* account balance reconciled properly with actual supplier invoice amounts.

RNI reconciliation is not used for tracking individual price variances. The *PO RNI Reconciliation* report, for example, only lists total values for account balance reconciliation purposes and does not itemize receipt quantities and prices.