Bookkeeping 101: The Ceterus Way

Inventory can be a significant part of a small businesses financial statement. If insignificant, most small businesses simply expense all inventory when it is purchased; however if the dollar value of inventory is material and a key component to the business (e.g. Quick Service Restaurants), then inventory is handled differently on the books. Generally, inventory can be tracked in the point-of-sale (POS) system. When inventory is purchased and received it is entered into the POS and naturally when inventory is sold it is logged in the POS as part of the sales transaction. Let's take a look at the flow of transactions.

The sample POS report shows the purchase of inventory.

Food - $1,000	Beverages - $500

These purchases would make it to the books with the following journal entry.

Account	Debit	Credit	Explanation
Food Inventory	1,000		Dollar value of food inventory purchased, which is reflected as an increase in inventory
Beverages Inventory	500		Dollar value of beverages inventory purchased, which is reflected as an increase in inventory
Inventory Payable		1,500	Total amount of inventory purchased that will be invoiced to the business owner and paid on a normal payment schedule

At the end of a given period (could be week, month, quarter, year), inventory amounts are adjusted to actual. The actual inventory amounts would either come from physical inventory counts (where you literally are counting items) or from the POS system (more typical in the franchise space). We need to make an assumption before we can finish our walkthrough. We must assume the inventory purchased above is the only inventory we have ever purchased.

The sample POS report shows the dollar value of inventory as of the end of the month. We need to post an adjustment to ensure the books are properly statement for monthly reporting purposes.

Food - $496.25	Beverages - $205.55

The journal entry to adjust inventory to the actual dollar value on hand would look like this.

Account	Debit	Credit	Explanation
Food Inventory		503.75	(1,000 - 496.25) - Reduces the dollar value of the inventory account by the dollar value of food used in the period
Beverages Inventory		294.45	(500 - 205.55) Reduces the dollar value of the inventory account by the dollar value of beverages used in the period
Cost of Goods Sold - Food	503.75		Dollar value of food used in the period. This amount is an expense and operates as a reduction in gross profit (revenue - cost of goods sold = gross profit)
Cost of Goods Sold - Beverages	294.45		Dollar value of beverages used in the period. This amount is an expense and operates as a reduction in gross profit (revenue - cost of goods sold = gross profit)

Inventory bookkeeping practices can vary greatly based on the type of industry you are in. If you have questions about what the best practice should be for your business please reach out to our support team.