Tracking COGS Purchases

The Problem

One major problem many MSPs face is tracking customer purchases and product profitability margins. If your goal is to sell products at a 17% markup, then every time you run a P&L from your accounting system, you should quickly see product sales are 17% higher than product costs.

However, this may not always be the case. If a product was purchased in November and billed to the customer in October, the two amounts will not align. Changing the date on a bill to appease your accounting system works only if the bill and invoice are a few days apart. In the case of projects, they may be weeks or months apart.

Additional problems include ensuring that all purchases are invoiced to customers and quickly determining which items have been overlooked with little effort.

Financial and Management Reporting

To determine true profitability on any product or service level, reports should be created on the accrual or matching basis. The object is to have Cost of Goods Sold (COGS) reported in the same period as its corresponding revenue.

The best way to do this is to create a "holding" account for COGS purchases until the customer is invoiced. By posting the COGS purchases to an "Other Current Asset" account called "Prepaid COGS," you have greater control over the date in which the purchase affects the P&L. This is true even if the customer is invoiced *prior* to the purchase.
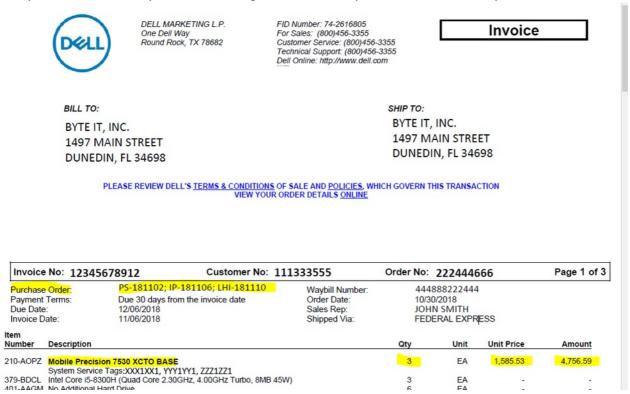
Purchase Ordering System

A key component to this procedure is an internal purchase ordering system. This can be done within your PSA or directly in your accounting system. Once an established PO system is in place complete with numbering, receiving, and tracking, the rest of the procedure becomes simple to manage.

In our example, the PO numbers are created in sections. The first section is two or three letters identifying the customer followed by a dash (PS-, IP-, LHI-). The second section is numeric and is six digits long. The first two digits indicate the year, the second two digits indicate the month of the PO, and the third two digits are chronological indicating the order in which the purchases were made (181102, 181106, 181110). All three purchase orders were created in November 2018 - PS-181102; IP-181106; LHI-181110.

Entering Purchases into Accounting System

For illustration purposes, we will use QuickBooks Online. This procedure can be used in any accounting system.

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When ordering from your supplier or distributor, be sure to label each item with the PO number to which it corresponds. This will help make receiving easier and keep track. Here is a sample invoice from Dell.

This invoice indicates that there are three different customers receiving the same product. The customers had their own purchase order.

Before we start with creating the PO in QuickBooks, let's set up our accounts and products.

Set up an "Other Current Asset" account called "Prepaid COGS."

Next, set up a Non-Inventory Product in your Products and Services List called "COGS Purchases."

CAUTION: You may *think* you want to set it up as inventory and count the items in house, but you do not. We do not want the accounting system to track the quantity or the value for these items. This is technically not inventory. It is a "Just In Time" inventory method where purchases are made only when a client orders it.

Product/Service information

Non-inventory Change type

Name*

Prepaid COGS

SKU

☐ Is sub-product/service

Enter parent product/service ▾

Class

Assign a class ▾

Sales information

☑ I sell this product/service to my customers.

Sale of hardware

Sales price/rate

Income account

Product Sales:Hardware Sales ▾

☑ Is taxable

Sales tax category

Type category ▾

What you sell

Start typing here ▾

Purchasing information

☑ I purchase this product/service from a vendor.

Purchase of hardware for customers

Cost

Expense account

Prepaid COGS ▾

Create a new Non-Inventory Item.

Name the item "Prepaid COGS"

Enter the sales information as it will appear on an invoice to a customer.

Choose an actual income account to post sales, such as Hardware Sales.

Check the box to indicate you also purchase this item.

Instead of an expense account, choose the Prepaid COGS account we just created. All purchases will now land in that account

Let's review the purchase orders.

Here is the order for Palmers Supply. Notice the product name is Prepaid COGS, but we manually entered the description of the product we are ordering.
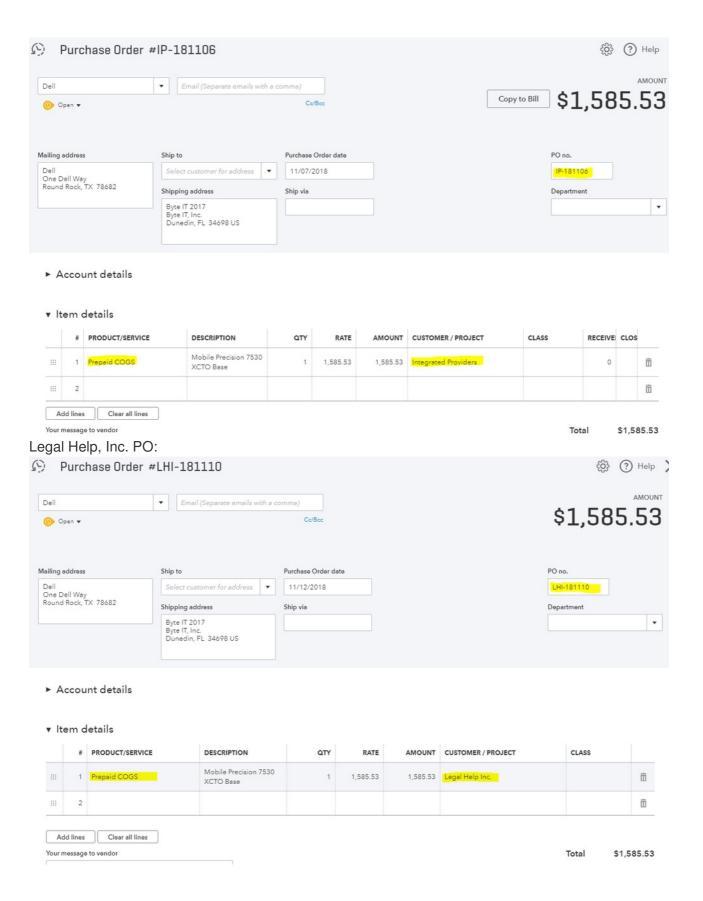

Integrated Providers PO:

Purchase Order #IP-181106

Dell ▼ | Email (Separate emails with a comma)

🕐 Open ▼   Cc/Bcc

Copy to Bill   AMOUNT **$1,585.53**

Mailing address	Ship to	Purchase Order date	PO no.
Dell One Dell Way Round Rock, TX 78682	Select customer for address ▼	11/07/2018	IP-181106
	Shipping address	**Ship via**	**Department**
	Byte IT 2017 Byte IT, Inc. Dunedin, FL 34698 US		▼

▶ Account details

▼ Item details

#	PRODUCT/SERVICE	DESCRIPTION	QTY	RATE	AMOUNT	CUSTOMER / PROJECT	CLASS	RECEIVE	CLOS
1	Prepaid COGS	Mobile Precision 7530 XCTO Base	1	1,585.53	1,585.53	Integrated Providers		0	🗑
2									🗑

Add lines   Clear all lines

Your message to vendor   Total $1,585.53

Legal Help, Inc. PO:

Purchase Order #LHI-181110

Dell ▼ | Email (Separate emails with a comma)

🕐 Open ▼   Cc/Bcc

AMOUNT **$1,585.53**

Mailing address	Ship to	Purchase Order date	PO no.
Dell One Dell Way Round Rock, TX 78682	Select customer for address ▼	11/12/2018	LHI-181110
	Shipping address	**Ship via**	**Department**
	Byte IT 2017 Byte IT, Inc. Dunedin, FL 34698 US		▼

▶ Account details

▼ Item details

#	PRODUCT/SERVICE	DESCRIPTION	QTY	RATE	AMOUNT	CUSTOMER / PROJECT	CLASS	
1	Prepaid COGS	Mobile Precision 7530 XCTO Base	1	1,585.53	1,585.53	Legal Help Inc.		🗑
2								🗑

Add lines   Clear all lines

Your message to vendor   Total $1,585.53
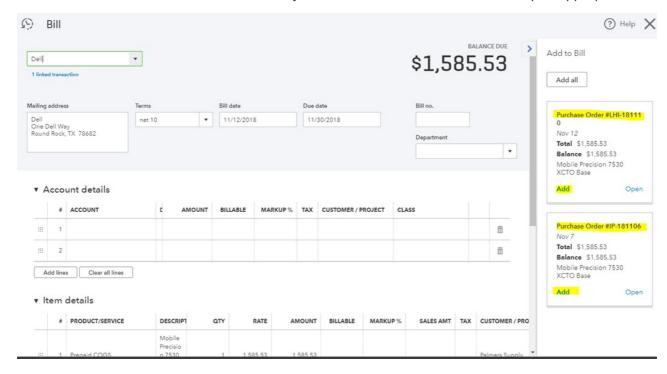
Enter the Vendor Bill

With the purchase orders in the system, we can now receive the items and enter the vendor bill. All three items were ordered from Dell at the same time and shipped at the same time. However, they are on three separate purchase orders and must be received individually.

Each accounting system has its own method of receiving items against a purchase order. We will follow the QuickBooks Online way of receiving.

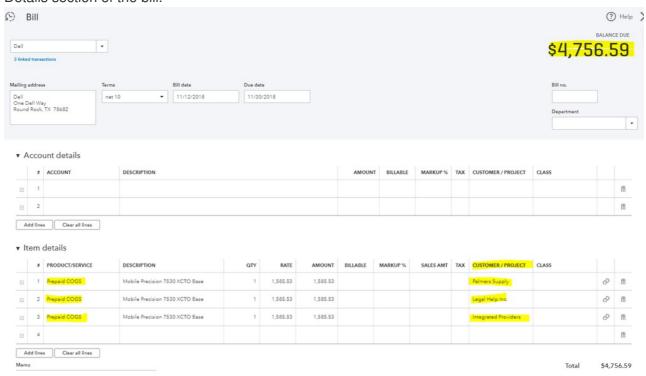1. Find the Purchase Order in the system.
2. Click the "Copy to Bill" button

3. When the bill opens, you will see other purchase orders to the same vendor available to add to this bill.
4. Add the additional items to this bill individually or check the Add All button at the top, if appropriate.

5. You will notice that there are no entries in the Account Details section. All three entries are in the Item

Details section of the bill.

Review the Reports

With the vendor invoice saved, the Prepaid COGS will now appear on the balance sheet.

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BALANCE SHEET

As of November 30, 2018

	TOTAL
▾ ASSETS	
▾ Current Assets	
▾ Bank Accounts	
Bill.com Money In Clearing	200.00
Checking Account	6,238.86
Operating Checking Account	16,067.98
Total Bank Accounts	**$22,506.84**
▾ Accounts Receivable	
Accounts Receivable	22,783.63
Total Accounts Receivable	**$22,783.63**
▾ Other Current Assets	
Inventory Asset	899.00
Prepaid COGS	4,756.59
Undeposited Funds	0.00
Total Other Current Assets	**$5,655.59**
Total Current Assets	**$50,946.06**
▾ Fixed Assets	
▾ Company Assets	
Computers and Equipment	875.00
Total Company Assets	**875.00**
▾ Hardware as a Service	
Accumulated Depreciation	-1,232.00
Desktop Computers	2,900.00
HaaS Accumulated Depreciation	-5,255.50
Servers	11,570.00
Total Hardware as a Service	**7,982.50**
Total Fixed Assets	**$8,857.50**
TOTAL ASSETS	**$59,803.56**

When you drill down onto the Prepaid COGS account, you can see the detail of the items. Here is what the default report looks like:

TRANSACTION REPORT
November 2018

DATE	TRANSACTION TYPE	NUM	ADJ	NAME	MEMO/DESCRIPTION	ACCOUNT	SPLIT	AMOUNT	BALANCE
▼ Prepaid COGS									
11/12/2018	Bill		No	Dell	Mobile Precision 7530 XCTO ...	Prepaid COGS	Accounts Payable	1,585.53	1,585.53
11/12/2018	Bill		No	Dell	Mobile Precision 7530 XCTO ...	Prepaid COGS	Accounts Payable	1,585.53	3,171.06
11/12/2018	Bill		No	Dell	Mobile Precision 7530 XCTO ...	Prepaid COGS	Accounts Payable	1,585.53	4,756.59
Total for Prepaid COGS								**$4,756.59**	
TOTAL								**$4,756.59**	

Customize the report to see the customer for whom each item is earmarked.

Customize report

▼ General

Report period

| Custom ▼ | 11/01/2018 | to | 11/30/2018 |

Accounting method

○ Cash ● Accrual

Number format

☐ Divide by 1000

☐ Without cents

Negative numbers

-100 ▼

☐ Show in red

▼ Rows/Columns

Group by

Account ▼

Change columns

▶ Filter

▶ Header/Footer

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☐ Created By	**U** ncheck the following columns:
☐ Last Modified	• Account
☐ Last Modified By	• Split
☐ **Customer**	• Amount
☐ Vendor	
☐ Employee	

Select and reorder columns

::: ✅ Date
::: ✅ Transaction Type
::: ✅ Num
::: ✅ Adj
::: ✅ Name
::: ✅ Memo/Description
::: ✅ **Account**
::: ✅ **Split**
::: ✅ **Amount**
::: ✅ Balance

☐ Employee
☐ Department
☐ Class
☐ **Product/Service**
☐ Qty
☐ Rate
☐ Invoice Date
☐ A/R Paid
☐ A/P Paid
☐ Clr
☐ Check Printed
☐ **Debit**
☐ **Credit**
☐ Online Banking
☐ Tax Name
☐ Tax Amount
☐ Taxable Amount
☐ Account
☐ Split
☐ Amount

Hide change columns

Scroll down and check the following boxes:

Select and reorder columns

::: ✅ Date
::: ✅ Transaction Type
::: ✅ Num
::: ✅ Adj
::: ✅ Name
::: ✅ Memo/Description
::: ✅ Balance
::: ✅ Customer
::: ✅ Product/Service
::: ✅ Debit
::: ✅ Credit

• **C** ustomer
• Product/Service
• Debit
• Credit

Select and reorder columns

::: ✅ Date
::: ✅ Transaction Type
::: ✅ Num
::: ✅ Name
::: ✅ Customer
::: ✅ Product/Service
::: ✅ Memo/Description
::: ✅ Debit
::: ✅ Credit
::: ✅ Balance

The dots to the left of each column title will allow you to drag and drop the columns into the order in which you
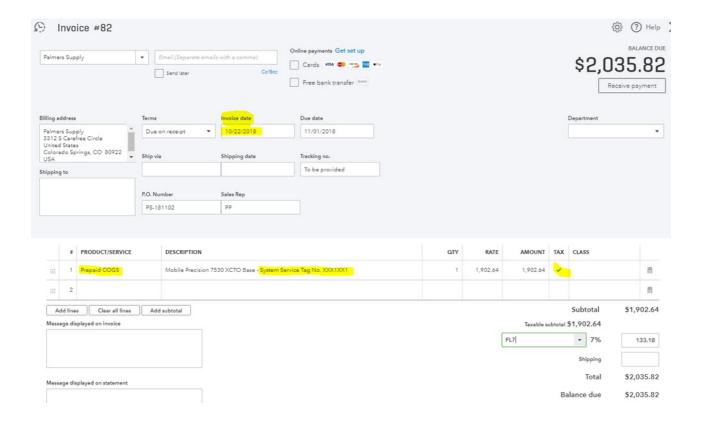
want to see them.

The updated report provides more information. The debit column shows purchases going into the Prepaid COGS account. The credit column will show sales being removed from the account.

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TRANSACTION REPORT
November 2018

DATE	TRANSACTION TYPE	NUM	NAME	CUSTOMER	PRODUCT/SERVICE	MEMO/DESCRIPTION	DEBIT	CREDIT	BALANCE
▼ Prepaid COGS									
11/12/2018	Bill	12345678912	Dell	Palmers Supply	Prepaid COGS	Mobile Precision 7530 XCTO …	$1,585.53		1,585.53
11/12/2018	Bill	12345678912	Dell	Integrated Providers	Prepaid COGS	Mobile Precision 7530 XCTO …	$1,585.53		3,171.06
11/12/2018	Bill	12345678912	Dell	Legal Help Inc.	Prepaid COGS	Mobile Precision 7530 XCTO …	$1,585.53		4,756.59
Total for Prepaid COGS							$4,756.59		
TOTAL							$4,756.59		

Invoice the Customer

In this first example, we will assume the customer was invoiced in October – prior to the purchase order being created in the system.

IMPORTANT TIP: When you receive the invoice from your vendor, go back to the customer's invoice and enter the product serial number. This will make finding product matches much easier. Also enter the serial number or service tag number on the vendor bill inside your system for easy matching.

Invoice #82

Palmers Supply ▾	Email (Separate emails with a comma)
	☐ Send later

Online payments **Get set up**

☐ Cards VISA ⬤ discover ▭ ⬤Pay

☐ Free bank transfer BANK

BALANCE DUE

$2,035.82

Receive payment

Billing address	Terms	Invoice date	Due date		Department
Palmers Supply 3312 S Carefree Circle United States Colorado Springs, CO 80922 USA	Due on receipt ▾	10/22/2018	11/01/2018		▾
Shipping to	Ship via	Shipping date	Tracking no.		
			To be provided		
	P.O. Number	Sales Rep			
	PS-181102	PP			

#	PRODUCT/SERVICE	DESCRIPTION	QTY	RATE	AMOUNT	TAX	CLASS	
1	Prepaid COGS	Mobile Precision 7530 XCTO Base - System Service Tag No. XXX1XX1	1	1,902.64	1,902.64	✔		🗑
2								🗑

Add lines   Clear all lines   Add subtotal

Message displayed on invoice

Subtotal	$1,902.64
Taxable subtotal	$1,902.64
FL7 ▾ 7%	133.18
Shipping	
Total	$2,035.82
Balance due	$2,035.82

Message displayed on statement

BALANCE SHEET
As of November 30, 2018

	TOTAL
▾ ASSETS	
▾ Current Assets	
▾ Bank Accounts	
Bill.com Money In Clearing	200.00
Checking Account	6,238.86
Operating Checking Account	16,067.98
Total Bank Accounts	$22,506.84
▾ Accounts Receivable	
Accounts Receivable	24,819.45
Total Accounts Receivable	$24,819.45
▾ Other Current Assets	
Inventory Asset	899.00
Prepaid COGS	4,756.59
Undeposited Funds	0.00
Total Other Current Assets	$5,655.59
Total Current Assets	$52,981.88

Review the Reports

There has been no change to the Prepaid COGS account on the Balance Sheet:

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PROFIT AND LOSS
October 1 - November 25, 2018

	OCT 2018	NOV 1-25, 2018	TOTAL
▾ Income			
▾ Hardware as a Service Income			$0.00
Desktop Computers	447.00	447.00	$894.00
Servers	474.00	474.00	$948.00
Total Hardware as a Service Income	921.00	921.00	$1,842.00
▾ Managed Services Revenue			$0.00
Gold Support		649.00	$649.00
Total Managed Services Revenue		649.00	$649.00
Markup		86.87	$86.87
▾ Product Sales			$0.00
Hardware Sales	1,902.64	550.00	$2,452.64
Total Product Sales	1,902.64	550.00	$2,452.64
Total Income	$2,823.64	$2,206.87	$5,030.51
▾ Cost of Goods Sold			
▾ Hardware as a Service Costs			$0.00
Desktops - Depreciation	80.54	80.54	$161.08
Servers - Depreciation	241.04	241.04	$482.08
Total Hardware as a Service Costs	321.58	321.58	$643.16
Hosted Services Costs	29.14	-29.14	$0.00
Merchant Account Fees	6.60		$6.60
▾ Product Costs			$0.00
Hardware Costs		425.00	$425.00
Total Product Costs		425.00	$425.00
Total Cost of Goods Sold	$357.32	$717.44	$1,074.76
GROSS PROFIT	$2,466.32	$1,489.43	$3,955.75

The P&L shows hardware sales in October for this purchase, but no corresponding cost. This is because the cost is still sitting in Prepaid COGS.

<u>Record the COGS in the correct period</u>

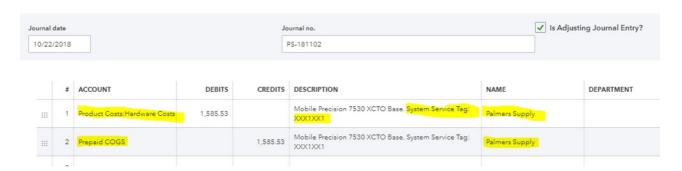Review again the report for Prepaid COGS.

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TRANSACTION REPORT
November 2018

DATE	TRANSACTION TYPE	NUM	NAME	CUSTOMER	PRODUCT/SERVICE	MEMO/DESCRIPTION	DEBIT	CREDIT	BALANCE
▾ Prepaid COGS									
11/12/2018	Bill	12345678912	Dell	Palmers Supply	Prepaid COGS	Mobile Precision 7530 XCTO ...	$1,585.53		1,585.53
11/12/2018	Bill	12345678912	Dell	Integrated Providers	Prepaid COGS	Mobile Precision 7530 XCTO ...	$1,585.53		3,171.06
11/12/2018	Bill	12345678912	Dell	Legal Help Inc.	Prepaid COGS	Mobile Precision 7530 XCTO ...	$1,585.53		4,756.59
Total for Prepaid COGS							$4,756.59		
TOTAL							$4,756.59		

The Palmers Supply purchase occurred on 11/12/18, but was sold to the customer on 10/22/18. We now need to record this purchase in the month of October.

This is why we use the Debit and Credit column on this report. If the Debit shows the product going in, a Credit will show the product going out.

Create a journal entry dated on the same day as the customer invoice. You may even want to use the Purchase Order Number as the Journal Number. Debit Hardware Costs for the exact amount of the purchase - $1,585.53. Credit Prepaid COGS for the same amount. Label the transaction with the customer name, the product and the serial number.

Journal date	Journal no.	☑ Is Adjusting Journal Entry?
10/22/2018	PS-181102	

#	ACCOUNT	DEBITS	CREDITS	DESCRIPTION	NAME	DEPARTMENT
1	Product Costs:Hardware Costs	1,585.53		Mobile Precision 7530 XCTO Base. System Service Tag: XXX1XX1	Palmers Supply	
2	Prepaid COGS		1,585.53	Mobile Precision 7530 XCTO Base. System Service Tag: XXX1XX1	Palmers Supply	

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BALANCE SHEET
As of November 25, 2018

	TOTAL
▾ ASSETS	
▾ Current Assets	
▾ Bank Accounts	
Bill.com Money In Clearing	200.00
Checking Account	6,238.86
Operating Checking Account	16,067.98
Total Bank Accounts	**$22,506.84**
▾ Accounts Receivable	
Accounts Receivable	24,819.45
Total Accounts Receivable	**$24,819.45**
▾ Other Current Assets	
Inventory Asset	474.00
Prepaid COGS	3,171.06
Undeposited Funds	0.00
Total Other Current Assets	**$3,645.06**

Review the Final Reports

Prepaid COGS on the balance has decreased:

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PROFIT AND LOSS

October 1 - November 25, 2018

	OCT 2018	NOV 1-25, 2018	TOTAL
· Income			
▾ Hardware as a Service Income			$0.00
Desktop Computers	447.00	447.00	$894.00
Servers	474.00	474.00	$948.00
Total Hardware as a Service Income	921.00	921.00	$1,842.00
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Total Product Sales	1,902.64	550.00	$2,452.64
Total Income	$2,823.64	$2,206.87	$5,030.51
· Cost of Goods Sold			
▾ Hardware as a Service Costs			$0.00
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Merchant Account Fees	6.60		$6.60
▾ Product Costs			$0.00
Hardware Costs	1,585.53	425.00	$2,010.53
Total Product Costs	1,585.53	425.00	$2,010.53
Total Cost of Goods Sold	$1,942.85	$717.44	$2,660.29
GROSS PROFIT	$880.79	$1,489.43	$2,370.22

On the P&L report, Hardware Sales and Hardware COGS appear in the same month.

If you divide Hardware Costs into Hardware Sales, you will now see your 17% profit.

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