

Article # 1128

Technical Note: Understanding the Differences between the Actual Cost and Standard Cost Methods of Valuing Transferred Inventory

Difficulty Level: Beginner Level AccountMate User

Version(s) Affected: AccountMate 8 for SQL and Express
AccountMate 7 for SQL, Express and LAN
AccountMate 6.5 for SQL, MSDE and LAN

Module(s) Affected: IC

Posting Date: 01/19/2011

DESCRIPTION

Transfer of items between company warehouses is a common occurrence in many industries that deal heavily with inventory. AccountMate provides its users with the option to choose between actual cost and standard cost in recording these warehouse transfers. This flexibility allows users to minimize possible unit cost fluctuations caused by warehouse inventory transfers without compromising the accuracy of the cost at which the item is recorded.

Actual cost pertains to the historical, purchase or production cost of the inventory item. Depending upon the cost method used in AccountMate, this can be the average cost, FIFO cost, LIFO cost or Specific ID cost. Meanwhile, standard cost pertains to the predefined cost assigned to the inventory item. This value is computed using some generally accepted formula that combines actual prior period cost information with future period projections.

This Technical Note discusses the differences between the actual cost and standard cost methods of valuing inventory items transferred between company warehouses.

SOLUTION

The following are the differences between the actual and standard cost methods of valuing warehouse inventory transfers:

- 1. Sources of cost assigned to transferred inventory items**
When the actual cost method is used, the cost assigned to the transferred item is calculated using the cost method assigned to the inventory record (i.e., Average, LIFO, FIFO, Specific ID or Average Specific ID). For example, if the transferred item uses Average costing, and the current average unit cost is \$30, the transferred cost will be the product of the transfer quantity

multiplied by \$30.

When the standard cost method is used, the transferred cost of an item is calculated by multiplying the transfer quantity by the unit cost entered in the **Standard Cost** field of the **Settings** tab of the **Inventory Maintenance** record of the transferred inventory item. To continue the previous example, if a standard unit cost of \$29 is defined for the transferred item, the transfer cost is calculated by multiplying the transfer quantity by \$29 instead of the average unit cost of \$30.

2. Effect on inventory transfer variance

Inventory transfers between company warehouses, using the actual cost method, do not generate any inventory transfer variance. This is because there is no difference between the original cost at which the items are issued out of the source warehouse and the cost at which the same items are received in the target warehouse.

When the standard cost method is used, AccountMate calculates and records any inventory transfer variance resulting from the difference between the actual cost at which the items are issued out of the source warehouse and the standard cost at which the same items are received in the target warehouse.

The table below illustrates the foregoing concepts:

Given:

Transfer Qty = 5 units

Average Cost = \$30/unit

Standard Cost = \$29/unit

	Actual Cost Method	Standard Cost Method
Cost in source warehouse		
(AC*)	\$150	\$150
Cost in target warehouse		
AC*: \$30 x 5	\$150	
SC**: \$29 x 5		\$145
VARIANCE	0	\$5

*AC => actual cost

**SC => standard cost

3. Journal entries to record inventory transfers

The following journal entries are generated by AccountMate upon transfer of inventory items from the source warehouse. The cost information is taken from the example in the preceding section:

Actual Cost

Inventory in Transit	150	
Inventory (Stock)		150

Standard Cost ***

Inventory in Transit	145
Inventory Transfer Variance	5
Inventory (Stock)	150

*** The inventory in transit is recorded at the standard cost of the transferred item; while, the on-hand inventory (stock) amount is reduced by the actual cost of the transferred item. The inventory in transit amount becomes the inventory receipt amount in the target warehouse when the transferred items are received. The GL Account ID used to record the inventory transfer variance is from the **Inventory Transfer Variances** field of the **GL Accounts** tab of the **IC Module Setup** function.

Inventory Transfer Variances resulting from the use of standard cost for costing transferred inventory items should be properly monitored. Adjustments to standard cost may be required from time to time to ensure that the cost of inventory in each warehouse approximates actual cost as closely as possible.

Understanding the differences between the actual and standard cost methods of valuing transferred inventory may help you to easily trace and reconcile the cost of the inventory related to the transfer.

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