



# **Finance**

## ***Best Practices***

**Auto Reconciliation of Cost of Goods Manufactured**

Abstract

Cost of goods manufactured (COGM) represents cost incurred for manufacturing total quantity of finished and semi finished goods over a given reporting period, It includes material cost and conversion cost for manufacturing.

**Why is reconciliation of COGM required?**

- ✓ Cost of goods manufactured (COGM) has a direct impact on strategic decisions like pricing.
- ✓ Value of goods (finished/semi finished) manufactured must reconcile with direct & indirect expenses incurred for production.
- ✓ Completeness of financial posting in COGM accounts & production variance accounts.
- ✓ Appropriate presentation of financial statements w.r.t. followings
  - Raw material consumption
  - Conversion cost
  - Overhead cost
  - Production variance

**How to reconcile COGM?**

Cost of goods manufactured =  
Closing stock of manufactured inventory  
  
+ Cost of goods delivered/consumed  
  
+ Production variance/revaluation of inventory  
  
(-) Opening stock of manufactured inventory

**What if COGM is not reconciled?**

- ✓ Reason for difference in COGM need to be worked out manually.
- ✓ Posting of manual financial entry required to reconcile COGM.
- ✓ Actual cost of goods manufactured not available from accounts.

Applicability	<p>Applicable on following process of manufacturing businesses;</p> <ul style="list-style-type: none"> <li>✓ Preparation of trial balance &amp; financial statements</li> <li>✓ MIS reporting for actual cost of goods manufactured.</li> </ul>
Business Impact / Benefits	<ul style="list-style-type: none"> <li>✓ ZERO manual financial entry for reconciliation of COGM.</li> <li>✓ Auto reconciliation of COGM account balance with Inventory difference (closing &amp; opening) cost of goods sold &amp; production variance/revaluation of inventory.</li> <li>✓ Reduce cycle time for preparation of trial balance &amp; financial statement at period end &amp; year end.</li> </ul>
Problem definition	<p><b>Why COGM account balance do not get reconciled automatically?</b></p> <ul style="list-style-type: none"> <li>✓ Posting of processed/finished inventory balance in wrong GL account</li> <li>✓ Cost of goods manufactured posted to wrong GL account, at the time of goods receipt by production confirmation.</li> <li>✓ Production variance account used for posting other than production variance &amp; revaluation of manufactured inventory.</li> <li>✓ Manual posting in inventory a/c, COGM a/c. &amp; production variance a/c.</li> <li>✓ Settlement of process order not executed as part of period end activities by costing team.</li> <li>✓ Transfer of processed stock from one profit centre to another profit centre.</li> </ul>
Process	<p><b>How to ensure auto reconciliation of COGM account balance?</b></p> <ul style="list-style-type: none"> <li>✓ <b>Process of posting in COGM &amp; Inventory accounts:</b> <ol style="list-style-type: none"> <li>a. In ERP system (SAP) posting in COGM account &amp; Inventory accounts are automatic and based on following business processes only:           <ol style="list-style-type: none"> <li>i. FG &amp; SFG Inventory: On production confirmation by production team at day/shift end.</li> </ol> </li> </ol> </li> </ul>

FG/SFG Inventory A/c. Dr.  
To COGM A/c Cr.

- ii. Production variance: On settlement of process orders by costing team at period end.

Production variance A/c. Dr/Cr  
To COGM A/c. Dr/Cr

- iii. Revaluation of inventory: On Price change of finished (FG) & semi-finished (SFG) inventory by Finance & Costing team at required interval.

Revaluation of Inventory A/c. Dr/Cr  
To FG/SFG Inventory A/c. Dr/Cr

- iv. Delivery of inventory: On dispatch of finished (FG) & semi-finished (SFG) inventory to customer by logistic & marketing team at required point.

Cost of goods sold (COGS) A/c. Dr  
To FG/SFG Inventory A/c. Cr

- v. Transfer of inventory between profit centres: On transfer of finished (FG) & semi-finished (SFG) inventory to another profit centre, by logistic team at required point.

FG/SFG Inventory A/c. Dr (Receiver Profit centre)  
To FG/SFG Inventory A/c. Cr (Sender Profit centre)

Based on above business process it is noted that posting

In COGM accounts can come only in case of

- ✚ Production confirmation of manufactured inventory
- ✚ Settlement of process order.

In Inventory accounts can come only in case of

- ✚ Production confirmation of manufactured inventory
- ✚ Revaluation of inventory
- ✚ Delivery of inventory to customer
- ✚ Inter profit centre transfer of inventory

✓ **One time “set up process” for COGM reconciliation:**

- a. Checking of posting w.r.t. following accounts for finished and semi-finished (manufactured inventory) inventory to appropriate accounts. Apart from FG and SFG inventory quantity no other inventory quantity transaction need to be posted in following accounts.
  - i. FG Inventory accounts
  - ii. SFG Inventory accounts
  - iii. Production variance accounts
  - iv. Revaluation of inventory accounts
  - v. Cost of goods sold accounts
  - vi. Cost of goods manufactured accounts
- b. Assignment of correct GL account if found any in-correct assignment of GL w.r.t inventory, GOGS, COGM, production variance, revaluation of inventory,
- c. The GL account correction process in system (SAP) should be done in association with support partner and central help desk team. As during the correction time span (ranging from 1-2 hour) there should not be any business transaction for respective inventory codes which are under correction.
- d. If we are changing the FG/SFG inventory GL account for some inventory codes then the existing stock of those inventory codes must be removed from system before change in GL accounts, Afterwards on completion of GL account change in system the stock quantity need to be uploaded in system to avoid any inconsistency.
- e. Blocking of above mentioned accounts for any manual postings in system (SAP) by any business users.

✓ **Regular process for COGM reconciliation:**

- a. Execution of process order settlement and other period end activities for costing process.

Example of these activities are

- i. Allocation of cost centre cost
- ii. Actual activity type rate computation
- iii. Revaluation of process order
- iv. Variance calculation of process order
- v. Settlement of process order

- b. Identify the transaction of inter profit centre transfer of inventory. Consider this transaction value as reconciliation item of COGM for both profit centres. As inventory accounts are debited and credited without the use of COGM accounts in this inter profit centre transfer of inventory transaction.
  
- c. Periodic reconciliation of COGM: Business users must ensure that balance of COGM should match with sum of following:
  - i. Delta of inventory balance (Closing & Opening)
  - ii. Cost of goods sold FG & SFG /Consumption of SFG
  - iii. Production variance & Revaluation of inventory

Key words

Finance best practice, Auto reconciliation of Cost of goods manufactured (COGM).