

SPECIALIZED BOOKKEEPING TASKS

Chapter 12. End of Month Inventory Adjustments

The Importance of Taking Inventory

The purpose of this chapter is to demonstrate how to make a QuickBooks accounting entry at the end of each financial period that will account for changes in your food and beverage inventories, and which will thereby produce accurate food and beverage costs for you to assess your restaurant's financial performance.

Note: *In the interest of consistency I will assume that you use monthly accounting periods for the balance of this chapter*

First, let me explain why this procedure is so important. Along with labor, your food and beverage costs are your largest expenditures accounting for approximately 30-36% or more of every revenue dollar. Food and Beverage costs are also your single most **controllable** expense. I say this because your food and beverage costs are significantly less impacted by sales volume than labor. You need a minimum staff scheduled for every meal period irrespective of how many customers show up, while food and beverage costs can be more readily controlled independently of how many guests you have.

It is nearly impossible to make any kind informed management decision that impacts your food and beverage costs if you do not make a periodic "physical" or manual count and valuation (at cost) of your inventory. I'll take that one step further and tell you that you cannot even know what your actual food and beverage costs are without taking an accurate month end inventory.

The reason for this is simple and takes only the most basic math to demonstrate.

Defining Food & Beverage Costs

Using "food" as an example, your actual monthly "food" cost percentage can be calculated as follows:

$$\mathbf{(Beg\ Inv + Purchases - End\ Inv) / Sales = Food\ Cost\ \%}$$

Where:

Beg Inv = Beginning of the Month Food Inventory
Purchases = Total Food Purchases During the Month
End Inv = Ending Food Inventory
Sales = Total Food Sales for the Month

Most restaurants use the Profit and Loss Statement (P & L) to show them what their **food costs as a % of food sales** were for the prior month. But without adjusting for changes in inventory that occurred during the month, the P& L report will simply give them a number that represents their **food purchases** for the month (and food purchase % when divided by monthly food sales).

The distinction is the difference between “**food usage**” and “**food purchases**”.

- **Food usage is the actual amount of food (dollars) that was used to generate the food sales that you recorded for a particular time period.**
- **Food purchases (what your accounting system will give you if no inventory adjustment is made) simply let’s you how much food you purchased during the month.**

Let’s say that you take your food inventory at the close of business on March 31st and then again on April 30th. After you make sure that all your April food sales and food purchases are recorded in QuickBooks, you print your monthly Profit & Loss Statement. Here is the information that you have:

March 31st Food Inventory	\$2,500
April Food Purchases	\$20,000
April Food Sales	\$60,000
April 30th Food Inventory	\$4,500

If you do not make an inventory adjustment to your QuickBooks Food Inventory account (a Current Asset account that appears on your Balance Sheet) then your P & L will indicate that your food cost percentage for the month of April is the April food Purchases divided by the April food Sales.

$$\text{\$20,000} / \text{\$60,000} = \text{33.3\%}$$

If the inventory change from March 31 to April 30 is taken into account with a QuickBooks inventory adjustment, then your QuickBooks Profit & Loss statement will show your Food Costs percentage for the period to be:

$$(\text{\$2,500} + \text{\$20,000} - \text{\$4,500}) / \text{\$60,000} = \text{30.0 \%}$$

The food cost equation tells you that you actually spent \$18,000 (not \$20,000) to generate \$60,000 of sales. **The 3.3% variance is highly significant in a business with average profit margins in area of 4-7%.**

Alert: *The less your total monthly sales are, the larger the impact of differences between beginning and ending inventories will be. Therefore taking a complete physical inventory count, and making end of month adjustments, becomes even more important for smaller volume restaurants!*

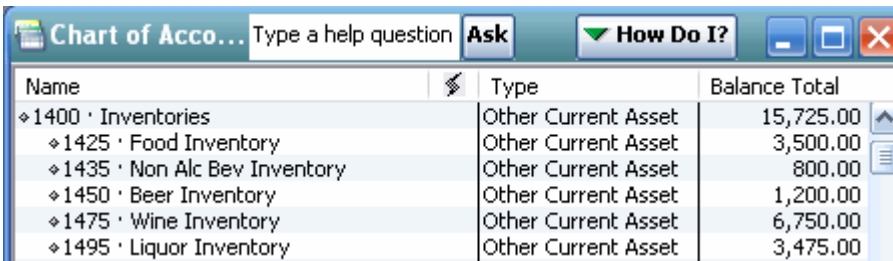
Segregating Food & Beverage Costs by Category

Now that you understand the overall importance of tracking and adjusting your inventory, let's take the process another step:

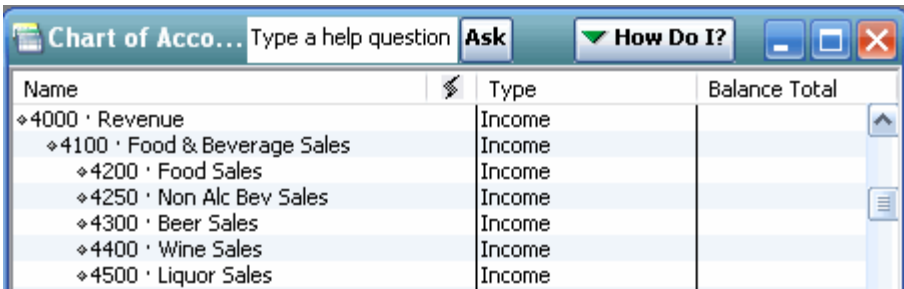
- **The extent to which you can track your Food & Beverage purchases and sales by category (Food, Beer, Wine, Liquor) dramatically improves the quality of your information because it is easier to identify where potential problems exists!**

While it is critical to know what your food and beverage costs are as a percentage of total sales, it is difficult to make effective management decisions if you can't distinguish whether an identified problem (e.g. the cost of goods sold % is too high!) is the result of your food costs, your wine costs, your liquor costs, or some combination of them all.

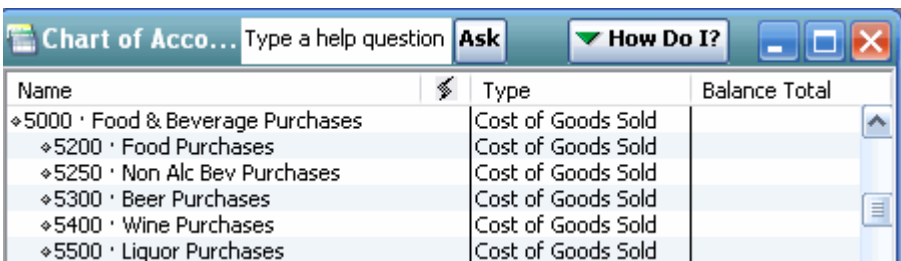
You therefore need to set up your Chart of Accounts in a way to allow you to record this critical information appropriately (the full printout is available in Appendix A). Note the way that the inventory, revenue and purchase accounts are organized below.



Name	Type	Balance Total
1400 · Inventories	Other Current Asset	15,725.00
1425 · Food Inventory	Other Current Asset	3,500.00
1435 · Non Alc Bev Inventory	Other Current Asset	800.00
1450 · Beer Inventory	Other Current Asset	1,200.00
1475 · Wine Inventory	Other Current Asset	6,750.00
1495 · Liquor Inventory	Other Current Asset	3,475.00



Name	Type	Balance Total
4000 · Revenue	Income	
4100 · Food & Beverage Sales	Income	
4200 · Food Sales	Income	
4250 · Non Alc Bev Sales	Income	
4300 · Beer Sales	Income	
4400 · Wine Sales	Income	
4500 · Liquor Sales	Income	



Name	Type	Balance Total
5000 · Food & Beverage Purchases	Cost of Goods Sold	
5200 · Food Purchases	Cost of Goods Sold	
5250 · Non Alc Bev Purchases	Cost of Goods Sold	
5300 · Beer Purchases	Cost of Goods Sold	
5400 · Wine Purchases	Cost of Goods Sold	
5500 · Liquor Purchases	Cost of Goods Sold	

Each sub-account (Food, Non Alcoholic Beverage, Beer, Wine, and Liquor) exists as an Asset, Cost of Goods Sold and Income account. This “set up” permits you to make the proper End of Month inventory adjustments to produce accurate Food & Beverage costs as a percentage of sales in each category.

Tip: *If you want to create more detail in the Food Category than illustrated above, simply add additional General Ledger accounts or subaccounts. For example you might create subaccounts for Meat, Poultry, Seafood, Dairy, Produce and Grocery under the Food Inventory, Food Purchases and Food Sales “main” accounts, to track each food component separately.*

How to Make the Inventory Adjustment in QuickBooks

It took us a while to get here but hopefully the journey was worthwhile.

I am not going to spend any time discussing how to efficiently take your End of Month inventory, but I will refer you to the Restaurant Resource Group web site www.rrgconsulting.com/spreadsheets.htm where you can purchase and download an Excel spreadsheet designed to make the job almost effortless.

Here is an overview of the procedure:

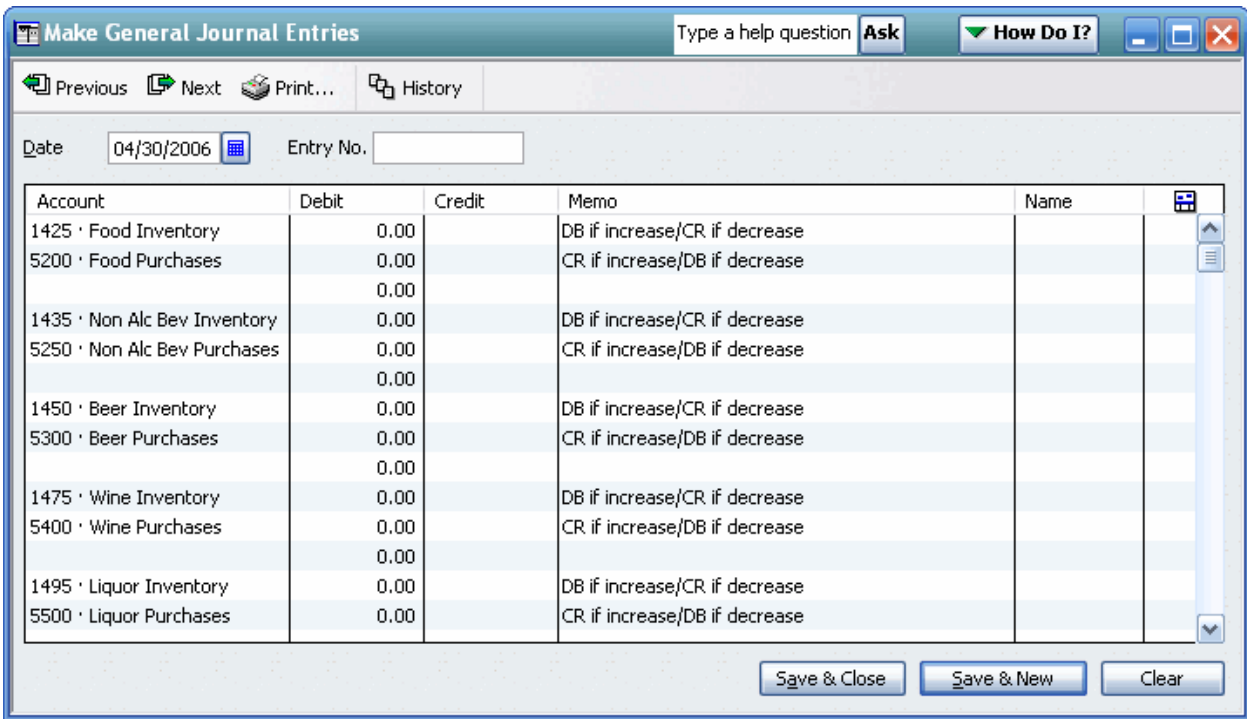
After you have completed the inventory you will have five totals; one each for food, non alcoholic beverages, beer, wine and liquor.

You will compare each amount with the preceding months inventory (as indicated on the last day of the prior month’s Balance Sheet), and **determine the amount that the current total either exceeds or has been reduced during the month.**

You will use a **MemTx General Journal** entry to record the changes as follows:

- **If the inventory of an account (e.g. food) has increased** during the period then you will **Debit** the **Inventory** account by the amount of the increase and **Credit** the **Purchases** account by an equal amount.
- **If the Inventory account in question Decreases** during the month then you will **Credit** the **Inventory** account the exact amount of the decrease and **Debit** the **Purchases** account by the same amount.
- You will repeat this process for each of the five accounts and then select Save & Close.

Here is the **MemTx General Journal** template for this entry:



Let's use some concrete examples to make the upcoming journal entry crystal clear:

INVENTORY ACCOUNT			
	31-Mar	30-Apr	Varaince
Food	\$ 2,300	\$ 3,100	\$ 800
NA Beverage	\$ 750	\$ 690	\$ (60)
Beer	\$ 900	\$ 750	\$ (150)
Wine	\$ 6,200	\$ 8,300	\$ 2,100
Liquor	\$ 3,500	\$ 2,800	\$ (700)

Using the Food Inventory account as example, the variance between the March 31 And April 30 inventory (as determined by a physical count and valuation at cost) is positive \$800. Using the rule above you would Debit the Food Inventory account by \$800 and therefore Credit the Food Purchases account by an equal amount. In plain English this means that you had \$800 more Food at the end of the month than the beginning so you will increase the Food Inventory Asset account by that amount. The offsetting entry indicates which Credits the Food Purchase account indicates that you therefore used \$800 less Food to generate April's sales than is indicated by the Food Purchases made during April.

This is how the adjustment would look in QuickBooks:

The screenshot shows the 'Make General Journal Entries' window in QuickBooks. The date is set to 04/30/2006 and the entry number is 'EOM Inv Adj'. The table below shows the journal entry details:

Account	Debit	Credit	Memo	Name
1425 · Food Inventory	800.00		DB if increase/CR if decrease	
5200 · Food Purchases		800.00	CR if increase/DB if decrease	
	0.00			
1435 · Non Alc Bev Inventory		60.00	DB if increase/CR if decrease	
5250 · Non Alc Bev Purchases	60.00		CR if increase/DB if decrease	
	0.00			
1450 · Beer Inventory		150.00	DB if increase/CR if decrease	
5300 · Beer Purchases	150.00		CR if increase/DB if decrease	
	0.00			
1475 · Wine Inventory	2,100.00		DB if increase/CR if decrease	
5400 · Wine Purchases		2,100.00	CR if increase/DB if decrease	
	0.00			
1495 · Liquor Inventory		700.00	DB if increase/CR if decrease	
5500 · Liquor Purchases	700.00		CR if increase/DB if decrease	

Alert: Make sure that the Date of the entry is the last day of the month that you are adjusting. Otherwise the adjustments will not be reflected on the proper accounting period of your P & L (the Purchases) and Balance Sheet (the Inventory).

What If You Have Not Tracked Inventory in the Past?

If you don't currently have any Inventory Asset accounts and would like to use this method, here is what to do.

First off you need to create the appropriate Inventory accounts in your Chart of Accounts. Make sure that they match your Purchase and Income accounts (which may need to be reorganized as well)

At the end of the current month you will record your first inventory, and enter the results in a General Journal entry as follows:

- **Debit** each new Inventory account by the **total amount of the inventory counted**.
- **Credit** an equal amount to the General Ledger # 3999 Opening Bal Equity account

Note: Tell your accountant what you're doing because he/she will need to reallocate this Opening Balance Equity "credit" at the end of the year to your Retained Earnings account). Now you will have an accurate starting inventory recorded in QuickBooks. Beginning with the next inventory (end of the next month) you will make the adjusting entries discussed previously.