# Inventory Accounting in Business Central

You might get different instructions from different Business Central consultants on how to handle the setup for inventory accounting. The way that Microsoft designed the system recommends a specific setup structure. Funny thing, is the Cronus demo company setup does not follow this design.

For background, please understand that though I state these are my recommendations. I’ve consulted with multiple Microsoft MVPs who specialize in Business Central and my recommendations are approved by all.

Ok, let’s spell this out. We’ll cover two highly contested inventory related setups.

1. Should you set Inventory and Interim Inventory accounts to the same account or not
2. Should you set Purchases and Direct Cost Applied accounts to balance sheet or income statement accounts.

Inventory and Interim Inventory

Interim Inventory is only applicable if you have Expected Cost turned on in Inventory Setup. With this turned on, there are accounting entries made when sales orders are shipped, purchase orders are received and manufacturing orders have output posted.

Of note:

Sales orders shipped use the COGS interim account from General Posting Setup as the debit with Inventory from Inventory Setup being the credit. Reversed when sales order is invoiced.

Purchase orders received use the Inventory Interim account from Inventory Setup as the debit and Invt. Accrual Acc. (interim) as the credit. Reversed when purchase order is invoiced.

Manufacturing orders use the Inventory Interim account from Inventory Setup as the debit and Inventory WIP as the credit. Reversed when production order is finished.

All general ledger accounts mentioned herein should be set to Direct Posting equals No or False.

Inventory and Interim Inventory accounts are set up in Inventory Posting Setup. I recommend, as do many MVPs, that these accounts be separate accounts. To quote one MVP, also a CPA, who was very against different accounts, “when I started using the Inventory to G/L Reconciliation page, I realized that having interim inventory separated from inventory was super helpful.”

To be fair, I have seen implementations where setting both accounts works just fine. I ALWAYS recommend different accounts as it makes inventory reconciliation much, much easier.

## Purchases and Direct Cost Applied

As stated above, purchase orders received use the Inventory Interim account from Inventory Setup as the debit and Invt. Accrual Acc. (interim) as the credit when expected cost is turned on. And these account entries are reversed when purchase order is invoiced.

It has been said that monthly accounts reconcile balance sheet accounts and thus the recommended setup is incorrect to force reconciliations. Well, I think accountants should be told to compare the Purchases Account to the Direct Cost Applied Account each month. Some accountants like these two accounts in setup to be the same general ledger account, I recommend separate accounts for easier research.

Way, way back, NAV was designed to do the following when a PO was invoiced (assuming no expected cost setting):

Debit Purchases

Credit Accounts Payable

And if item quantities were still in inventory

Debit Inventory

Credit Direct Cost Applied

If quantities had been sold

Debit Cost of Goods Sold

Credit Direct Cost Applied

This has changed with the addition of Automatic Cost Posting. However, the internal process is still the same. And Adjust Cost Posting for Item Entries definitely does the above transactions.

I can promise you that if you follow my recommendations for both Inventory/Interim Inventory and Purchases/Direct Cost Applied, your inventory on the balance sheet will balance each month. Majority of the time Purchases will offset Direct Cost Applied and when it doesn’t it is typically a posting date issue.

With 29 years experience in NAV, from version 1.0, to BC version 25.1, and lots of work helping companies reconcile inventory to the general ledger. I am confident in the above recommendations and suggest that if you hear differently, to please call me.