# Case Study: How inoday assisted a manufacturing unit in leveraging the right Inventory Costing Method?

## Problem Statement

The new requirement had come from one of our clients. As you may know, our client already has multiple subsidiaries configured using the average cost method. However, a new subsidiary is coming into their business and they require one weighted average cost for all locations of each item, even though they maintain the account book location-wise.

## Analysis

In NetSuite, average costing is the default inventory costing method. If inventory levels are negative, NetSuite uses the last purchase price as the inventory costing method. We understood that this new requirement may differ from the existing configuration and business practices of our client.

## Important: Once the costing method is saved on the item record during Item master creation, it cannot be changed.

The cost of the item calculated by each costing method varies, as shown in the following example: On Monday, you buy 20 calculators at ₹10 each and place them in inventory. On Tuesday, you buy 20 calculators at ₹15 each and place them in inventory. On Wednesday, you sell 5 calculators to a customer.

## The recorded cost of the calculators is calculated based on the costing method as follows:

| | |
|---|---|
| FIFO | The 5 calculators post a cost of ₹10 each because that is the cost of the first calculators added to the inventory. |
| LIFO | The 5 calculators post a cost of ₹15 each because that is the cost of the last calculators added to the inventory. |
| AVERAGE | The 5 calculators post a cost of ₹12.50 because that is the average cost of all calculators in inventory. This is calculated as [(20 x ₹10) + (20 x ₹15)] /40 = 12.5. |
| Group Average | If inventory has been added in two locations and these locations are in the same group, it is calculated as [(20 x ₹10) + (20 x ₹15)] / 40 = 12.5. |

There is a huge difference b/w Average and Group Average cost although the name is similar.

As an example, let's consider purchasing Item A from two different locations: Location X at a cost of ₹ 100 and Location Y at a cost of ₹ 200.

If we use the costing method of average cost, selling Item A from Location X will impact the inventory with ₹ 100, while selling Item A from Location Y will impact the inventory with ₹ 200.

On the other hand, if we use the costing method of group average and both locations are mapped in the same group, selling Item A from Location X will impact the inventory with ₹ 150 while selling Item A from Location Y will impact the inventory with ₹ 150.

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The above example showcases the difference between average cost and group average cost.
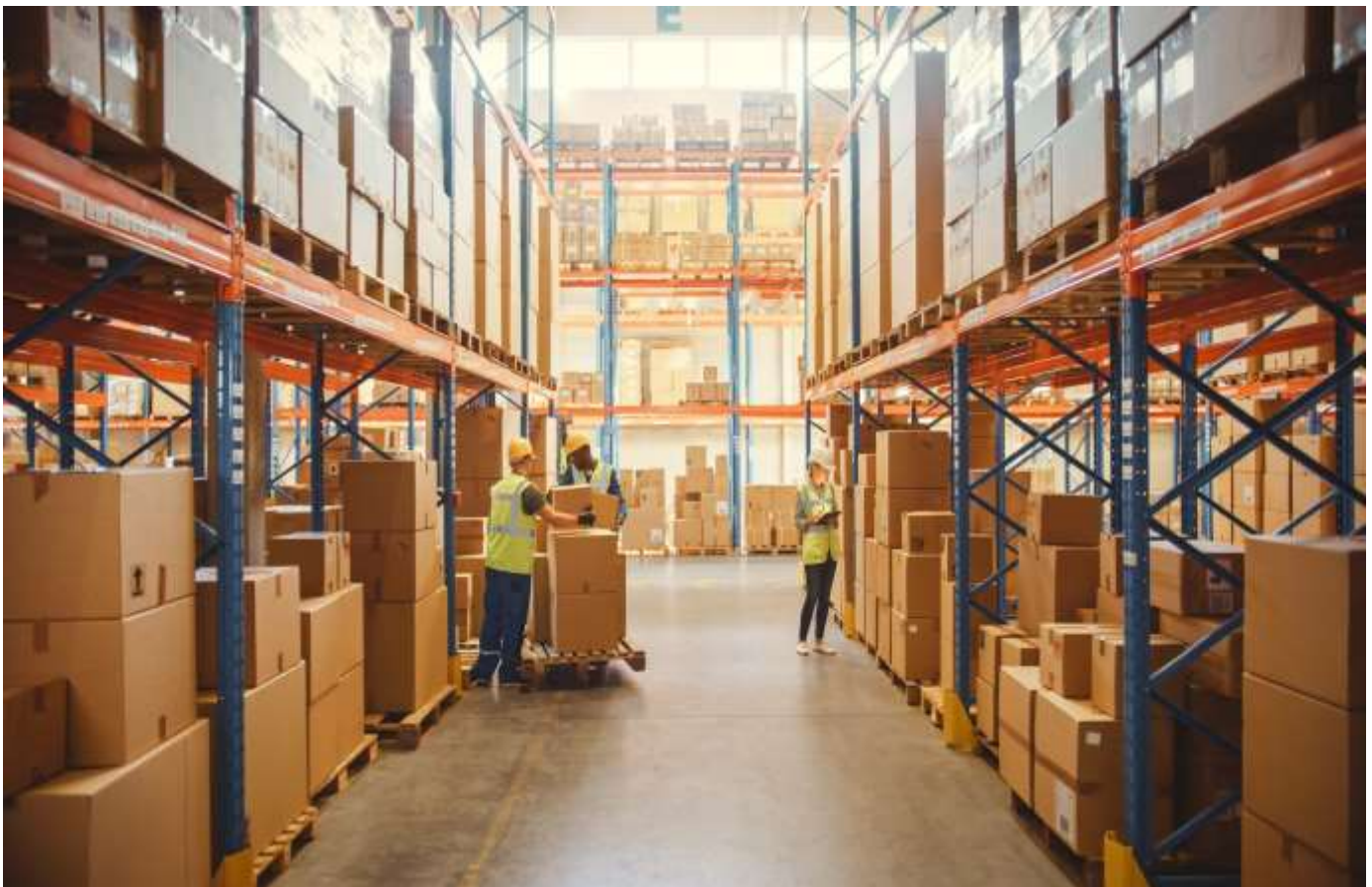
## Proposed Solution and Configuration

Group average cost configuration is captured in three parts:

1. Enabling Group Average Costing
2. Creating a Location Costing Group
3. Balance Location Costing Group Accounts.

## 1. To enable group average costing:

1) Go to Setup > Company > Setup Tasks > Enable Features..
2) Click the Items & Inventory subtab, and then check the Group Average Costing box.
3) Click Save.

## 2. To create a location costing group:

i.       Go to Setup > Accounting > Location Costing Groups.

ii.      Enter a Name for the group.

iii.     Optionally enter a Memo. Later, you can search for the text you enter.

iv.     If you use NetSuite OneWorld, in the Costing Group Currency field, select a currency to limit the subsidiaries available for the costing group.

**\*Note:** You can add locations to the costing group with restrictions. The location must be associated with a subsidiary that has the selected costing group currency as its base currency.

v.      Click the Location subtab.

vi.     In the Select column, check the box next to each location you want to be a member of this group.

**The location list on the location costing group record is filtered by your permission to access each location and subsidiary.**

vii)     Click Save.

**The location costing group you created appears in the Costing Group field on item records.**

## 3. Balance Location Costing Group Accounts

If you use the Multi-Location Inventory and Group Average Costing features, you can process account adjustments. These adjustments ensure that item costs are consistent within costing groups so that location balance sheets are accurate for group average cost items. When you balance location costing group accounts, costing adjustments update individual location inventory values to match the group average cost.

Group average costing lets you track the average cost for an item across locations using location costing groups. The Balance Location Costing Group Accounts page enables you to periodically adjust location inventory accounts for group average cost items. Doing so ensures that the inventory account balance at each location calculates accurately as (location quantity) x (group average cost).

Keep location accounts in sync. Use the Balance Location Costing Group Accounts page to examine all transactions for each location in a costing group. Transactions are examined from the point in time that the most recent previous adjustment was run. Based on these transactions, NetSuite determines the appropriate account variance and posts a cost adjustment to the general ledger. After all positive and negative adjustments post, location costing group accounts should balance close to zero, depending on rounding.

This adjustment page provides visibility into general ledger inventory account adjustments across locations. Visibility provides the impact of managing an item's cost across a company. As in the following diagram, without entering an adjustment, costs across locations might not balance.

Refer to the image above related to these details:

1. The Group Average Costing method is defined on the item record.
2. Locations are assigned on the Location Costing Group record.
3. The group average cost for an item is calculated as follows:= total inventory account value across all locations / total quantity across all locations
4. The location's average cost for an item is calculated as follows:= location inventory account value/location quantity

**\*Note:** When a transaction affects inventory costing for a Group Average cost item, NetSuite calculates an average cost across all locations in the costing group. That group's average cost is assgned as the cost for that item in all the locations.



**In the preceding diagram, each location receives the item at a specific cost:**

A. Location 1 = $6.00
B. Location 2 = $3.00
C. Location 3 = $7.00

For a specific location, the total in the inventory asset account is based on the receiving cost specific to that location. (Receiving cost x Quantity received) That inventory-specific asset cost amount might not equal the average cost calculated for the group. Therefore, the inventory value for a specific location might not equal the calculated value. (Quantity at the location x Group average cost).

**\*Note:** The average cost for each location might be different across locations and can be different from the Group Average Cost. NetSuite calculates average cost as (Account Value / Quantity).

Businesses can use the Balance Location Costing Group Accounts page, general ledger adjustments balance accounts across locations.

**Refer to the preceding diagram related to the following details:**

1.    The Group Average Costing method is defined on the item record.
2.    Locations are assigned on the Location Costing Group record.
3.    The group average cost for an item is calculated as follows:= total inventory account value across all locations / total quantity across all locations
4.    Balance Location Costing Group Accounts to post general ledger adjustments that balance accounts.
5.    The location's average cost for an item is calculated as follows:= location inventory account value/location quantity

Use the Balance Location Costing Group Accounts page to adjust inventory at the end of a period you select. You should use this page to adjust inventory when you close a period. If you choose, you can perform this more often, such as updating account balances weekly.

## Conclusion

The versatile capabilities of Oracle NetSuite regarding the calculation of weighted average cost for items, specifically, the way system calculates this cost in a location-specific manner, adds an extra layer of accuracy to the process.

The Oracle NetSuite allows for both configurations at item labels within the same or different subsidiaries, with particular location-wise weighted average cost calculation. This feature provides flexibility for businesses that have multiple subsidiaries and require customized costing methods for each location.

We understand that this feature may be of interest to many organizations. Our team has extensive experience in Oracle NetSuite ERP implementation and can help you configure the system to meet your specific needs.

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