

# Playing the Matching Game

By *Michelle Wright*

Small businesses have so much to keep track of that many times tracking inventory is easily overlooked. Many small businesses use the Cost of Goods Sold account to record all purchases of merchandise and never make any adjustments for what merchandise is still on the shelves or in the stock room at the end of the year. They never play the matching game, matching the sale of goods to the purchase of those goods.

So, why is the matching game important? First, it is required by the Internal Revenue Service. Whether you use cash or accrual basis of accounting, inventory must be accounted for using the accrual system. And, you are required to take a physical count of inventory each year. Using beginning inventory, adding purchases for the year, and subtracting ending inventory will give you your Cost of Goods Sold.

A second reason for playing the matching game is to get a true picture of how the business is operating. Just imagine, you purchase a large amount of inventory on

December 28 and sell very little before the year end. If you only use Cost of Goods Sold, it may appear that your business is unprofitable because of the large inventory purchase. Then, the next year, your business may appear to be very profitable because the merchandise written off last year was sold this year. The big picture of the business may look like a roller coaster ride.

By not matching sales with the purchase of the inventory, gross profit margins cannot be calculated correctly. The owner may not have accurate figures to compare with the industry. This makes it difficult to understand the performance of the business and can cause problems when looking into financing. Banks compare businesses to the industry averages. Investors look at the performance of the business over time. When they review three to five years of financial information, you do not want to have to tell them why some years look great and others not so great. It may cause them to question other figures in your financial statements. And without having a true inventory balance, you cannot value the assets of the business. Many other ratios that are used to judge the performance of the business cannot be calculated correctly, including overhead.

Even though the IRS requires the matching of sales of merchandise to the cost of those goods, it also makes good business sense. By tracking inventory, you are able to make valuable decisions in the operation of your business, get a clear picture of how your business is operating year-to-year, and compare your business to the industry in which you operate. So, start playing the matching game and be a winner!



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