Accounting for COGS (Cost of Goods Sold) Examples

Cost of Goods Sold, commonly referred to as COGS, is the sum of costs directly associated with producing the goods sold. Any expense incurred that (1) is necessary to generate revenue and (2) directly impacts creating a sellable product must be included in COGS calculations. These costs can include materials as well as the staff required to assemble the materials into finished sellable goods.

In an e-commerce example, Zappos, an online shoe and clothing retailer would include these expenses in COGS:

- Materials to produce shoes
- Shipping cost of materials
- Parts or equipment used to produce shoes
- Cost of labor to produce shoes
- Cost of boxes and packaging to ship shoes to customers (note: customer shipping costs are not part of COGS)

When to Record COGS

In accordance with the matching principle and accrual basis of accounting, COGS should be recorded in the same period as the revenue it generated. Doing so ensures accurate financial reporting and analysis.

However, in certain scenarios such as when sales impact multiple periods, recording COGS in the appropriate period can be difficult due to system limitations. We will dive deeper into these technology challenges and how to solve them in the next blog post.

COGS Journal Entry Examples

Suppose Zappos sold a pair of shoes in June for $100. The total cost of producing the shoes is $60. The company will record the following journal entries in June:

DR Cash 100
CR Revenue 100
To record sales revenue from shoes

DR Cost of Goods Sold 60
CR Inventory 60
To record COGS for shoe revenue

Gross Margin Calculation

Gross margin is the percentage of revenue that exceeds a company's costs of goods sold, calculated using the formula below.