

Ensure That Your Business Physical Inventory Counts

By Michael F. Ganino, CPA, CFE, Partner

Whether a business is a growing or well-established manufacturer, distributor, or retail operation, if you were to ask the owners, management or head of operations what keeps them up at night, odds are that they will respond with something involving inventory and their goal of properly managing it.

In addition to its employees, these businesses will likely find that inventory is one of their most significant assets and its management – whether in the form of raw materials, work in process (WIP) or finished goods – will contribute greatly to the success or failure of the business.

Physical Inventory: A Glimpse of Your Business in Time

As inventory is received from vendors used in the production process, moved within or between warehouses, or shipped to customers, each individual movement presents its own unique challenges. These challenges involve the proper authorization, documentation and recording, as well as storing, of the inventoried items. While every day, month-end or quarter-end presents the opportunity for a snapshot of inventory, there is arguably no date of greater significance than when the year-end physical inventory is performed.

No matter when performed, there is essentially **one** chance to get it right. Recounting comes with additional and likely significant financial costs, wasted resources and unnecessary delays in financial reporting.

Best Practices for a Successful Physical Inventory Count

1. Inventory should be organized in a logical manner, not only by type (raw material, work in process, finished goods), but also by frequency of usage and value. Warehouses, shelves, drawers, or other storage areas should be unique and clearly marked for ease of identification. Prior to a count, all parties involved should familiarize themselves with the layout through review of a warehouse map, or tour of the facilities.
2. Inventory counts should be planned with all stakeholders (internal and external) having been made aware of key dates and deadlines, procedures, and expectations. Details regarding specific processes, responsibilities and forms of reporting should be made in writing.
3. Clearly identify items of inventory that should **not** be counted. Examples include vendor-financed inventory held on consignment, customer inventory being repaired, damaged or otherwise obsolete inventory that no longer has any value. Scrap, packing material or other small items should be separately identified as eligible for counting or not. Finally, consideration should be given to inventory held at vendors or third-party locations as well.
4. Shipping and receiving of goods during the count period should be properly documented for inclusion or exclusion in counts. Items received will typically be held in a staging area until counts are completed.
5. Counts should be performed in teams by individuals familiar with the inventory. Unless specialists are engaged, the use of temporary and/or part-time workers brought in solely for the inventory count should be avoided, unless necessary.
6. Use pre-numbered tickets, tags or count sheets that are either preprinted with a part name, number and SKU or blank containing adequate space to include this information. In addition, the

location and actual physical count should be entered, and each ticket, tag or sheet should be signed or initialed by each member of the count team.

7. Tickets, tags and sheets should be matched to the inventory control records for each part number/SKU. Reconciliations should be provided of differences between the actual and expected counts. If any difference is determined to be an error, adjustments should be made in the inventory management system with an appropriate explanation for the change. All significant differences should be reviewed for possible modifications or improvements to the company's inventory management structure.

Go Forth and Count

Physical inventory counts and observations could be seen as a daunting task; easily overwhelming those who find themselves insufficiently prepared for this critical undertaking. An action plan that incorporates some or all these best practices may not necessarily guarantee a positive outcome to a physical inventory count, but it will lead to the development of more accurate financial information that will move operations in a positive direction; that you can count on.

Contact Us

If you would like to know more about this topic, please contact your PKF O'Connor Davies client engagement partner or Michael F. Ganino, CPA, CFE, Partner at mganino@pkfod.com.

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