

Inventory Best Practices

Michael J. Poirier, Partner
Feeley & Driscoll, P.C.
Manufacturers and Distributors
Services Group

www.fdcpa.com
888.875.9770



Agenda

- Physical inventories
 - Planning
 - Completeness
 - Other considerations
- Overhead allocation
 - Overhead pool
 - Methodology
- Standard costing
 - Update standards frequently
 - Bills of material
 - Variance accounts
- Common problems
 - Obsolete/slow moving inventory
 - Cut-off
 - Personnel
 - Who are you?
- Remedies
 - Cycle counting
 - ERP systems
 - Inventory reserve
 - Other

Pre-Planning Procedures

- Draft procedures memo
- Coordinate dates
- Coordinate staffing and schedule
- Break down area's of responsibility (i.e. locations and assigned areas)

Observation Procedures

- Determine that all items are tagged
- Two or three part tag
- Maintain a tag control
 - Account for all tags
 - Used
 - Not used
 - Voids
- If tags not used, need to:
 - Ascertain how completeness assertion is to be accomplished

Physical Inventory Card

Card No:

Location:

Item No:

U/M:

Description:

Beginning Count:

Date:

Initials:

Quantity	Date	Initials	Quantity	Date	Initials

PHYSICAL
COUNT ON:

Quantity:

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Work-In-Process Inventory

- Most difficult to count
- Determine the overall significance of WIP
- Need to utilize services of outside consultant (ie Engineer)
- Determine approach to counting WIP
 - Percentage completion
 - Specific identification

Other Considerations

- Book to physical adjustments
- Limit physical movement/action
- Multiple errors in one location
- Ascertain proper unit of measure used

Other Considerations continued

- Ascertain if any consigned 3rd party warehouse inventory
- Ascertain if any inventory-in-transit
- Isolate obsolescence and damaged goods

Overhead Allocation

- Overhead pool
- Methodology

Overhead Pool

- Separate labor, manufacturing and overhead
- Define overhead pool's
- Exclude sales general and administrative expenses from overhead pool's

Methodology

- Labor hours vs. labor dollars vs. equipment hours
- Weigh single factory rates vs. departmental rates
- Overhead allocation should provide meaningful information

Standard Costing

- Update standards frequently
- Bills of material
- Variance accounts

Update Standards Frequently

- Annual may not be soon enough
- Assign the task of updating to the *Right* person
- Must be using accurate information to update

Bills of materials (BOM's)

- Multi-level BOM's may be necessary
- Are time studies recent enough to accurately portray?
- Integrate with ERP systems

Variance Accounts

- Consider alternatives to tracking variances inside the general ledger
- Purchase price variance
 - Labor and overhead variances
- Must be committed to process

Common Problems

- Obsolete/slow moving inventory
- Cut-off
- Personnel
- Knowing who you are

Obsolete/Slow Moving Inventory

- Must track through ERP system
- Use data analysis (i.e. sales turnover report)
- Use projected sales (i.e. from sales group)
- Be mindful of anticipated revisions and new releases of products
- Area for external auditor's to question – have sound policies and procedures

Cut-Off

- Policies around month/year-end
- Coordination of personnel covering vacations and other absences
- Coordinate with 3rd party warehouse, customers, vendors, etc.

Personnel

- Coverage during compensated absences
- Lack of adequate training (ERP system or in general)
- Build in checks and balances

Knowing Who You Are

- Understand your business model (make to stock versus engineer to order)
- Distributors-customer service levels have to be established, measured and re-evaluated
- How extensive are your capabilities? (supply chain management, forecasting, and planning)
- Knowing your customers

Remedies to Improve Inventory

- Cycle counting
- ERP system
- Inventory reserves
- Critical success factors
- Other

Cycle Counting

- Primary function is to diagnose problems
- Key is to use cycle counting to get to root cause
- Segregate A, B and C items
- Track progress and results
- Ultimate reward = no physical inventory counts at 99% accuracy

ERP Systems

- Know how your ERP system works within the confines of inventory (GINR, IRGN)
- Reconcile to general ledger each month
- Conversion issues

Inventory Reserves

- Must be able to document procedure for determining reserve (no general reserve)
- Lower of cost or market adjustment
- Best of class is to use mostly quantitative analysis (X% over 90 days, Y% over 120 days, Z% over 150 days)
- Mechanize the process to eliminate manual errors

Other

- International subsidiaries must be coordinated with same policies and procedures
- On consolidated basis, eliminate gross profit on sales to subsidiary from parent (if remaining in inventory on subsidiaries book's)
- Incorrect LIFO reserve calculations
- Inventory not recorded properly or consistently applied using GAAP

Other

- Warranty reserves should be established
- Lean manufacturing and other process improvement strategies should be implemented
- Demand forecasting – at customer level (at least for key customers)
- Revenue recognition policies must be established and in writing

Critical Success Factors

- Establish metrics that allow you to measure productivity and profitability
- Constantly evaluate cash gap vs. plan
- Quality measurements
- Customer service levels
- Return on investment (ROI) evaluation

- Questions and Answers

Michael J. Poirier

- Mr. Poirier, CPA, CPIM, is the Director of the Manufacturers and Distributors Services Group at Feeley & Driscoll, P.C. Located in Boston, Massachusetts, Feeley & Driscoll, P.C. is one of the top 100 largest public accounting and consulting firms in the country. Michael has over twenty years of experience in public accounting with extensive experience in accounting, taxation, business planning and consulting issues for the manufacturing and distribution industry. Through innovative and actionable solutions, Michael has helped businesses build competitive advantages to succeed and most importantly, to grow profitably. Mr. Poirier is both a Certified Public Accountant and CPIM Certified (Certified in Production and Inventory Management). Mr. Poirier is active and a member of the Massachusetts Society of Certified Public Accountants, the New Hampshire Society of Certified Public Accountants, American Institute of Certified Public Accountants, the Association for Operations Management (APICS), and charter member/board member of ManuSource, a national power network of leading independent accounting and consulting firms who specialize in serving manufacturers and wholesale-distributors. Mr. Poirier has presented numerous seminars on issues affecting manufacturers and distributors at local and regional conferences.