

# Five Tips for Planning a Successful Physical Inventory

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Performing physical inventories are a fact of life for manufacturing, retail and distribution companies. However, many companies have vastly different processes for performing their physical inventory counts, including how often, how much inventory is counted and how the counts are recorded and reconciled back to the Company's internal records.

Best practices recommend that manufacturing, retail and distribution companies perform regular physical inventory counts, at least on an annual basis. Cycle counts can be performed on an interim basis and may alleviate: (a) the need to have a full "wall-to-wall" physical count performed at year-end, and (b) shutting down operations (for example receiving, shipping and manufacturing) if the Company's inventory controls are effective and can be relied upon.

The following are five steps can help your organization in planning a successful physical inventory counting process:

**Select a Date:** The date of the physical inventory can either be during the work week, after hours or on a weekend. In order to ensure an accurate count it is vital that the inventory movement be minimal to nil during the counting process. Factors that need to be taken into account in selecting a date include the cost-benefit of a plant shut down during normal business hours or additional payroll and benefit costs if the counts will be performed on a weekend or a holiday. Additionally, the Company's CPA should observe the counts if financial audits are going to be performed, and so it is best to discuss the timing with the CPA well in advance of the inventory date. If the inventory is not performed at month-end or year-end, a rollforward of the activity from the date of the physical to the month-end or year-end will likely be necessary to reconcile to the Company's general ledger as of the financial reporting date.

**Communicate with Team Members:** Communication with team prior to the count is another important aspect of the inventory observation. Proper planning, timing and organization are keys to an efficient and accurate count. The Company should have an internal meeting with all team members prior to the count to make sure that everyone clearly understands the counting procedures and their respective roles in the process. Further, the Company should consider documenting written inventory instructions prior to the physical inventory and distributing the instructions to all team members participating in the counts. Also provide a copy of the instructions to the CPA in advance of the physical inventory. The CPA may wish to tour the warehouse prior to the date of the physical inventory.

**Organize the Warehouse:** Prior to the counts, the warehouse personnel should make an effort to organize the warehouse. A well-organized warehouse will make the physical inventory process much more efficient. Separate loose items from bulk items. Another value-added process would be to minimize work-in-process in inventory, when possible. Consider performing pre-counts to help reduce the time commitment on the date of the physical counts for items where minimal movement is expected. Also, make sure that obsolete or damaged

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inventory is clearly marked and segregated in the warehouse. Count teams should pay special attention during the counts for inventory that may need to be deemed as damaged or obsolete. Along those lines, it is a good practice to keep supplier or customer owned inventory in the warehouse separate from Company owned inventory and clearly mark these items as “DO NOT COUNT.” In addition, the Company should make special considerations for inventory located in refrigerators, freezers and containers outside the warehouse or held at third-party locations.

**Count Sheets/Tags/Barcode Scanners:** The warehouse manager should decide if the Company will utilize count sheets, pre-numbered inventory tags, barcode scanners or another method to document the counts. Management should designate a responsible employee to control the tags and tally the results. Unused, voided or damaged tags should always be tracked. If manual count sheets are used, management should determine how they can verify that all inventory items were counted and that items were not double counted.

**Performing the Counts and Reconciling the Results:** On the day of the counts, team members should arrive on time. Supervisors can be designated for the counts performed in each area in the warehouse and those team members will report to the supervisor. Counts should be performed by at least one, if not two, team members for accuracy. Blind counts are almost always recommended. If the Company uses a perpetual inventory system, teams may wish to have a pre-count inventory listing as a guide during the counts. Once all counts have been completed, the count sheets, tags or barcode scanners should be submitted to the tag control employee to be reconciled against the pre-count inventory listing. Variances in the counts should be subject to a recount. Supervisors should tour the warehouse making sure that all items have been counted. Any final variances should be approved by management and true-up adjustments should be recorded to the general ledger to ensure the final inventory sub-ledger, and reconciliation, if applicable, agrees with the control account on the general ledger. Finally, it is a good practice to maintain a back-up of the inventory data on the Company’s information systems prior to and after the inventory date, and such data should be stored offsite.

Effective planning procedures are critical to taking a physical inventory count. When properly executed, complete and accurate inventory records can help business owners better manage their operations and make better informed financial business decisions.

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