BOOKKEEPING SYSTEMS

STOCK (INVENTORY) CONTROL

Paper 002-080

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1. Accounting For Inventory (Stock)

Accounting for inventory (stock) is a major problem in most manufacturing and merchandising concerns.

The number of transactions and dollars involved, plus the number of employees who handle the inventory from time of acquisition to time of disposal, all point to a need for good internal control over these series of activities.

Nobody doubts the need for strong controls over the movement of cash within a business (both incoming and outgoing) nor the requirement for a strong control over the debtors of the business. Unfortunately, many business people tend to consider the need for control over stock to be somewhat less important.

This attitude generally arises from the fact that stock is seen as being less susceptible to losses of the business or only of limited usefulness to others outside the business whilst cash and debtors are recognised as being highly susceptible to direct monetary loss resulting from fraud or carelessness.

2. Stock Losses

Stock is subject to a multitude of losses and excessive costs, and must therefore be properly controlled.

The following list is intended merely to suggest the wide variety of losses and excessive costs which might occur in connection with inventory.

3. Purchasing Of Stock Problems

Buying in uneconomical quantities.

Failing to obtain the best prices for appropriate stock.

Failing to give proper consideration to transportation costs and the most economic transportation.

Over buying in relation to current needs, resulting in excessive financing and storage costs and

possible losses due to obsolescence or deterioration.

Failing to order promptly or failing to follow up on orders, resulting in production delays for a manufacturer or lost sales for a merchandising operation.

4. Receiving Of Stock Problems

Inaccurate counting, permitting shortages of goods received to go undetected.

Accepting goods which are not as ordered can cause production problems in a manufacturing operation. It can also cause loss of customer goodwill in a merchandising operation, in addition to the likely cost of repackaging and returning the goods to the supplier.

5. Inspection Problems

Failing to detect material or merchandise which is defective or otherwise fails to meet your required standards.

6. Storage Problems

Careless handling, resulting in breakage or deterioration.

Failing to provide adequate protection against access to inventories by outsiders or unauthorised employees, resulting in loss or unaccounted for materials.

Overlooking inventory items and improperly reporting them as being out of stock.

7. Manufacturing Problems

Inadequate protection of goods in process, resulting in theft or damage.

Careless handling in processing, resulting in excessive scrap and re-work costs.

Inadequate control over proceeds from sale of scrap.

8. Dispatch Problems

Careless counting of quantities, resulting in delivering more goods than are billed to the customer.

9. Accounting Problems - Stock

Failing to provide adequate, current and reliable data on which to base decisions.

Failing to maintain accounting records in such a way that accountability is established so that losses

will be disclosed and reported.

Failing to exercise proper care in approving disbursements.

10. Proper Segregation Of Duties - Stock Control

A review of the above examples would suggest to a manager of a merchandising or manufacturing operation that proper segregation of duties and precise recognition of responsibilities are at least as important in the control of stock as they are in the control of other more liquid assets.

It is not always possible, in the small business environment, to achieve segregation of duties to the extent that would be desirable. Nevertheless, the importance of establishing adequate controls over the inflow and outgoing of stock cannot be over emphasised.

11. Inventory Identification And Recording

Successful inventory management and control will, to a large extent, depend upon accurate and timely records. These should include details of inventory levels and movements as well as adequate identification of inventory items.

The investment in inventory represents a big slice of working capital and has a direct bearing on liquidity and profitability of a business. Management decisions effecting inventory should only be made after careful consideration of the effect a decision will have on these two vital aspects of a business.

In some cases, simple observation and memory are enough for making these decisions. However, in many cases, confident decision making needs the support of factual data on inventory levels and movement.

This information can easily be provided by a perpetual inventory record. This simply prepared record can be used for both raw materials and finished goods. It shows movements in and movements out and quantity on hand.

12. Perpetual Inventory Record

12.1	Item:	ABC Powder	Maximum Level	50 drums
	Description:	White Powder	Minimum Level	8 drums
	Location:	Rack 6	Re-Order Level	14 drums

Date	Movement Detail	In	Out	Balance
June 4	Balance b/f			14
	Mixing 2689		4	10
June 8	Powder supplies 3372	40		50

Records of this type give both a history of inventory usage or turnover and present quantities on hand - both invaluable aids in overall inventory management and control.

13. Inventory Control Without Records

Sometimes detailed records of inventory movements and levels may not be necessary or warranted:

- In small manufacturing operations with low inventory levels.
- Where the manager/owner personally attends to all inventory matters.
- In business where inventory is mostly represented by work in progress.
- Where strict control over inventory items of low value or importance are not needed.

Even in these cases, control over inventory should not be ignored. The following systems are designed to give a measure of control without the need for individual inventory records.

14. Imprest System

An upper level is set for inventory items and, at regular review periods, orders are placed to bring inventory back up to this level. This level comprises the quantity necessary to provide supplies to cover delivery time plus the review period. (example - if delivery takes two weeks and a review is planned at the end of every four weeks, the level is set at six weeks supply.)

A disadvantage of this system is that physical count is necessary at each review date.

15. Single Bin System

In this system a mark is made inside a bin in which stock is kept. When stock in the bin has fallen low enough for the mark to be seen, the item is re-ordered in sufficient quantity to fill the bin.

16. Purchasing Procedures

Control over purchasing is an integral part of sound inventory management. Purchase of materials is often the largest item of expenditure in a small manufacturing business or a small merchandising operation. A 5% reduction in the cost of purchases can increase profits in some cases by the same amount as a 25% increase in sales.

A well thought out purchasing programme and ordering system will help achieve significant cost savings.

17. Issuing, Receiving And Dispatching Procedures

Inventory is continually moving - raw materials received from suppliers, raw materials issued into production, finished goods emerging from a production line, finished goods being dispatched to customers.

Control is essential as neglect in these areas can lead to losses through:

- Production bottlenecks.
- Acceptance of poor quality materials from suppliers.
- Accepting under filled orders while paying for full orders.
- Overfilling customer orders while invoicing ordered quantity.
- Pilferage.

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18. Stock Ordering

Stock cards indicate that the stock level is low. The stock cards would be controlled by either the office or the store person. If they are controlled by the office there would be a mechanism established whereby the office would advise the store person that the stock cards indicate that the stock level is low. If not the stockperson may have ascertained that the stock level is low by physical inspection.

The stock person would prepare a stock requisition. The stock requisition would indicate what type of stock has to be purchased, giving full details and description, catalogue numbers, size etc.

The requisition is forwarded to the office.

The person within the office responsible for purchasing would check the stock requisition, would then make inquiries of potential suppliers as to the availability of the stock and their prices for it and when he/she have found the most suitable supplier from both a delivery time point of view and price and any other considerations that may be important, would verbally confirm an order.

A written order would be prepared in the name of the preferred supplier, sending the original to the supplier, the duplicate to the store person, with the triplicate of the order being retained at the office and filed in a filing system that is maintained in supplier name order.

19. Receiving Material From Suppliers

When goods arrive at the store, the store person should check the quality and quantity of the goods against the duplicate copy of the order and if satisfied, sign the supplier's delivery docket.

The store person should then forward the duplicate copy of the order and the supplier's delivery docket to the office, having already indicated on the duplicate copy of the order whether the quantity and quality are satisfactory.

The office would then update the stock cards to record the receipt of goods whilst the duplicate order and the supplier's delivery docket are filed awaiting receipt of the supplier's invoice.

When the supplier's invoice is received it is compared with the duplicate order, the price is checked against the order, extensions and additions on the invoice are checked. Stock cards are then updated for the price of goods and all the supporting evidence, i.e. duplicate order, delivery docket and supplier's invoice, are filed awaiting the date for payment.

20. Issuing Materials For Production

The person requiring materials to be issued completes a "materials issue docket" and forwards it to the store person.

The store person checks the authority of the person requisitioning the materials and if they are authorised to requisition these particular types of materials the store person then processes the requisition.

The materials are forwarded to the person requisitioning.

At the same time, a goods issue docket is prepared and forwarded to the office for costing.

The office staff cost the goods that have been issued and charge the goods to the department or account code for which they were requisitioned.

The stock cards are updated to record the issue of the materials.

21. Finished Goods

The person producing the finished goods completes a finished goods report. The report indicates the name of the goods, the quality and any other particular information the business wants to record on the finished goods report.

The finished goods report and the finished goods are forwarded to the store person.

The store checks the quantity and quality of the finished goods and places the finished goods in the allocated area in the store.

The store person forwards the finished goods report with an indication that quantity and quality are satisfactory to the office.

The office staff completes the costing on the completed goods, comprising issued materials and labour allocation and overhead recovery, so as to determine the total cost of the finished goods.

The office staff then update the finished goods stock cards, recording the quantity of goods completed and the calculated price as determined by the office.

22. Dispatching Finished Goods

The customer's purchase order is received by the office.

The appropriate person in the office checks that the customer's credit rating is satisfactory and that the business is happy to sell to the customer.

The order is forwarded to the store person who extracts the goods ordered from stock.

The store person completes the delivery docket.

The goods and delivery docket are forwarded to the customer who signs for receipt of goods on the triplicate of the delivery docket.

The store person forwards the duplicate of the delivery docket to the office.

The office updates the stock records for goods dispatched.

The office then prepares the invoice and forwards it to the customer and files the signed delivery docket with the debtor's records so that they have proof of delivery and receipt of goods if they are required in any dispute with the customer at a later date.

23. Control Of Inventory

The procedures that are required for the control of inventory are explained in the attached addendums. The procedures shown in the addendums indicate that responsibility for control of inventory movement is vested in one person, i.e. the individual who assumes the role of store person. The store person would be responsible for:

- The store area and the way in which goods are stored.
- Initiating requisitions for replenishment of raw materials.
- The receipt of materials from suppliers including checking of quantities and quality.
- The receipt of finished goods from the production area.
- Issuing materials to production personnel.
- Dispatching finished goods to customers.
- Maintaining records of inventory movement and levels.
- Reporting on inventory levels, usage rates, etc.

24. Physical Stocktakes

Periodically, it is important to physically check inventory for three reasons:

- To determine whether inventory records are accurate.
- To confirm physical quantities so that they may be valued for financial accounting purposes.
- To determine if effective control is being maintained.

Stocktaking can be a laborious and time consuming activity, but it can be done more efficiently by:-

- Counting of items of highest value and importance on a more regular basis. i.e. every three months, and items of low value and importance, every six months.
- Counting high value and important inventory by units and low value inventory units by bulk, e.g. weight etc.
- Counting inventory when it has reached re-order levels as quantities will be low and will require less counting.
- Using experienced and responsible staff on high value and important items and less experienced staff on the other items.

002-080A Stock Ordering Flow Chart

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002-080B Receiving Materials From Supplier's Flow Chart

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002-080C Issuing Materials Flow Chart

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002-080D Finished Goods From Production Flow Chart

PERSON PRODUCING FINISHED GOODS	Completes a finished goods report
(1)	
FINISHED GOODS REPORT	Forwards finished goods and finished goods report to store person
(2)	
STORE PERSON	Checks quantity and quality of finished goods
(3)	
OFFICE	Forwards finished goods report with an indication that quantity and quality are OK to office
(4)	
COSTING	Office prepares the costing on the completed goods from issued materials and labour allocations and overhead recovery records so as to determine the total cost of the finished goods
(5)	
FINISHED GOODS STOCK CARDS	The office then updates the finished goods stock cards

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002-080E Dispatching Finished Goods Flow Chart

The customer's purchase order is received by the office

Checks that the customer's credit rating is OK and that the business is happy to sell to the customer

The order is forwarded to the store person who extracts the goods ordered from stock

The store person completes a delivery docket

Goods and delivery docket are forwarded to the customer who signs for receipt of goods

Duplicate of delivery docket is forwarded to the office

The office updates the stock records for goods dispatched

The office then prepares the invoice, forwards it to the customer and files the signed delivery docket with the debtor's records

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AN IMPORTANT MESSAGE

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