

# Seradex White Paper

*A Discussion of Issues in the Manufacturing OrderStream*

## ***Physical Inventory – ERP Best Practices***

### **GAAP and Inventory**

GAAP does require an annual physical count. Often cycle counting is accepted by outside auditors but an annual physical count is still the most common scenario.

While GAAP is not overly prescriptive on the methods of conducting a physical inventory this paper will outline general procedures which have been accepted by many outside auditors. You can modify the procedure to suit your particular requirements

### **Why Is a Physical Inventory Necessary?**

If the people counting don't realize the importance of accurate stock balances to them, your chances for obtaining errorless counts are slim. So it is critical to explain to everyone who will participate, why a physical inventory is necessary.

### **Accurate Physical Counts = Better Customer Service**

Everyone in your organization must realize that the primary purpose of a physical inventory is not to please your accountant or the tax authorities. It is to verify that the on-hand quantity of each item in your computer reflects what is actually on the shelf. Customer service personnel need to be able to trust the accuracy of the stock quantities in your computer.

### **Accurate Physical Counts Are Necessary for Effective Replenishment**

Most computer systems produce very impressive buying reports. These reports show you how much of each item the computer thinks is in each warehouse, how much will be demanded by customers in the near future, and how much should be ordered from a vendor or central warehouse. What happens if the quantities in the computer are wrong? Disaster! No matter how sophisticated the software, the wrong quantities, of the wrong products, will be ordered.

### **The Key to a Good Physical Inventory Is Planning**

A physical inventory is a very expensive process. It usually involves a considerable labor expense and lost production time. If the resulting count isn't accurate, the money spent on the physical is wasted.

What can you do to ensure that your physical inventory is successful? Set the count date. Do this as early as possible so that everyone has plenty of notice. Avoid dates when people are preoccupied and may not be focused on the task at hand.

### **Planning**

The key to a successful inventory is the quality of the planning effort. Your planning should include when and who will conduct the inventory and how the counts will be taken. The complete process should be documented for future inventories. Provide instructions

to the count team in advance of the inventory. Some activities to do prior to the count include:

1) Clean up your warehouse. Clean, straighten and organize all areas. Physically arrange items to be counted to facilitate counting. If all the items are in proper bin locations, you will be able to conduct a faster, more accurate physical inventory. The cleanup should be completed no less than two weeks prior to the count.

2) If it isn't in your warehouse, you don't have to count it. It is in everyone's interest to reduce the inventory to the lowest possible level prior to the physical inventory. This is the perfect time to clean out the cobwebs and tackle the work that everyone has put aside. Some things to consider:

- Ship everything you can before the physical begins
- Order items to arrive after the count
- Dispose of obsolete and damaged items prior to the count or at least:
- Isolate obsolete and slow moving stock in a separate location
- Return slow moving product to the vendor
- Clean out the return goods area
- Rework items where possible and use them in production
- Sell off overstocks at a discount
- Label all consignment items
- Label all non inventory items that do not need to be counted e.g. - office and plant supplies, furniture and equipment
- Consolidate rack locations. Make sure the same item is not stored in multiple racks within one location - this can lead to incorrect adjustments.

### 3) Pre-Counting

Consider counting surplus areas and slow-moving products before the scheduled physical inventory – Most companies try to count all of their products in just one day. That's a lot of work. If some items can be counted in advance, the pressure is reduced. The possibility is small that significant amounts of your dead stock, slow moving inventory, and surplus material will move during the week preceding your physical. So why not count the bins containing these items before the day of the actual physical?

Be sure to mark bins and shelves that are pre-counted. And, keep in mind that you must have some mechanism for adjusting these quantities if some amount of a product is sold or received after the bin has been counted

### 4) In Seradex ERP

- Approve and post all receiving, shipping, adjustments, and transfers
- Process all completed work orders
- Run inventory by location reports for all inventory held off premises – provide to vendors to approve or inspect yourself
- Adjust all items with negative quantities to 0. Negatives can occur for several reasons including:
  - Un-posted receipts
  - Items listed on a bill of material that is not actually used on the bill.
  - Items that have been scrapped and replaced without recording it in Seradex

5) Order the necessary supplies. Supplies may include count cards, clipboards, and computer paper

6) Create a zoned map of your warehouse. Include every cabinet; shelving unit, rack, and any place where material is stored. Be sure to include the receiving dock, rework and vendor return areas. Remember that all material in your warehouse at the time of the physical inventory must be counted.

7) Assign teams to each zone identified on the map. This will avoid overlapping or failure to cover an area. When establishing count zones, remember that a counter should normally be able to count between 50 and 120 items in an hour. Hard-to-count products, such as those that need to be weighed or closely examined, take more time. On the other hand, boxed items with just a few pieces on hand can be counted in a few seconds.

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