

ILLUMINATING INVENTORY ISSUES

Is your company left in the dark on why inventory issues persist?

LGT sheds some light on inventory problems and offers key tools to brighten up your supply chain initiative.



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INSIDE: INTERNAL CONTROLS, TURNOVER ANALYSIS, AND
INVENTORY MANAGEMENT, TO HELP YOU **THRIVE**

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STRENGTHENING INTERNAL CONTROLS

Jack Udomsilp provides six tips for strengthening warehouse controls that can pay off with smoother manufacturing operations.

BY JACK UDOMSILP

Whether you are a manufacturer or a distributor, operate in the United States or all across the globe, manufacture vehicle parts or distribute furniture – there is at least one common denominator – the warehouse. The warehouse is where the inventory comes in and where it goes out, where the sales orders are packed and where they are shipped – it is the heart of a manufacturing and distribution (M&D) company. Making improvements in warehouse controls can go a long way in increasing efficiencies and adding value to manufacturing operations. The following tips can help you improve your warehouse management operations:

Hire a qualified warehouse manager

First, hiring a qualified operations or warehouse manager is a great place to start to ensure your warehouse is being run efficiently and has proper oversight on a day-to-day basis. The warehouse manager sees all, and is the perfect person to identify what's working well and what needs improvement. If you don't identify what's wrong, then improvements can't be made, right? As such, someone needs to take control of identifying the inefficiencies and malpractices within the warehouse in order to set your company on the right path to improving the control environment.

Use an inventory management system

Do you have an inventory management system (IMS) that does everything you need it to? An IMS is a critical element of the supply chain and ensuring your warehouse is functioning properly. These systems can track inventory movement in real time using handheld scanners, including receiving, stocking, packing, and shipping. Integration of your IMS and accounting system is a must and eliminates lengthy reconciliations. Robust systems can even forecast demand or inventory shortages by tracking the items which sell most often and



utilizing on-hand quantities to determine when you might run out. Lastly, always ensure your IMS comes with a dedicated support team to work out any kinks you may experience to keep your operations running smoothly.

Implement perpetual counts

If you're currently only performing periodic physical counts, challenge your company to stretch the process to perpetual inventory counts. If you are using cycle counts, where only a certain number of inventory items are counted per day or per week, be sure your process ensures that all items are counted at least once within a year. A typical process for cycle counts, or even a full physical count of inventory, is to have warehouse personnel count a determined listing of items or SKUs using tags to identify the counted items and count sheets to record the results. Supervisors or the warehouse manager should then review and verify any discrepancies in the counts and appropriate adjustments should be made to the

IMS to adjust the counts to actual.

Be clean and organized

Take the time and use the necessary resources to keep the warehouse as clean and organized as possible, not just for regulatory reasons, but because an organized warehouse facilitates faster customer orders with decreased lead times. Most time spent by warehouse workers comes in the form of transporting the inventory from place to place. From the loading dock to the shelves, from the shelves to the loading dock. As such, it is best to ensure that the inventory is organized in the most logical way to facilitate this transportation. For example, many M&D companies place the inventory with the highest demand closest to the loading bays and on the lower shelves, allowing warehouse personnel to pick it quicker and decrease the transport time. Inventory that is slow-moving or has less demand is stocked on the upper shelves farthest from the loading bays.

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Write it down

Document processes and keep documentation updated each year based on positive and negative results of your warehouse management. A narrative documenting your processes helps not only with consistency, but smooths any transition of personnel by documenting the expectations for proper warehouse management.

Think SOX

Even if you're a private company or small business that isn't subject to the Sarbanes-Oxley (SOX) Act that applies to public companies, implementing a controls environment with SOX in mind not only mitigates the risks of material misstatement of your financial statements but enhances the

value of the company for bottom-line impact or potential exit planning (selling the company or gaining investors).

Think of it this way—a warehouse should not only run efficiently, but also in a self-sufficient manner. As a business owner or manager, you want to be able to focus on strategies and forecasts, and not worry about the organization of your warehouse. After all, you'll want to know you can leave for a vacation and know that processes are in place to mitigate the risk that something can go wrong. The value of your company will increase, and you'll be able to sleep better at night. It's all about having the right people and the right processes in place to ensure your business thrives!



NEED HELP? Questions about how you can improve your manufacturing operations? Contact us today!

- 1 Hire a qualified warehouse manager**
- 2 Use an inventory management system**
- 3 Implement perpetual counts**
- 4 Be clean and organized**
- 5 Document processes**
- 6 Think SOX**

**STRUGGLING TO ACHIEVE TIP # 1
HIRING A QUALIFIED WAREHOUSE MANAGER?**

Check out our second installment in the THRIVE informational series, all about Human Resources & Employee Retention.

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THE INVENTORY TURNOVER RATIO

Anna Flobeck provides insights on how your manufacturing business can effectively manage inventory.

BY ANNA FLOBECK, CPA

If you run a manufacturing and distribution (M&D) company, inventory is most likely your largest asset, as well as being your revenue generator. Because inventory is the backbone of every M&D company, it is critical that you have systems and processes in place to manage your inventory effectively. Having too much or too little stock will put a drag on your bottom line and hurt your cash flow. How can you make sure you are effectively managing your inventory? There is actually one simple ratio that can help you evaluate the health of your inventory management—the inventory turnover ratio.

Understanding the Inventory Turnover Ratio

Determining your inventory turnover ratio will help you identify your business' sweet spot in inventory management. The ratio is calculated in one of two ways:

1. **Inventory Turnover = Cost of Goods Sold / Average Inventory***
2. **Inventory Turnover = Sales / Inventory**

*Average inventory can be calculated as $(\text{Beginning Inventory} + \text{Ending Inventory}) / 2$.

Both calculations are used frequently. However, the second is a less accurate representation of

how long your inventory is truly on hand, since it includes the markup from cost.

What Does the Ratio Signify?

As a general rule of thumb, a higher ratio indicates more efficient inventory management (i.e., keeping less inventory in stock). This generally implies that you are paying lower storage fees and have fewer dollars tied up in your stock, which, in turn, could free up cash for investing or reducing borrowing needs. A higher inventory ratio also indicates that your risk of slow-moving or obsolete inventory is lower, which is especially important for technology, fashion, or other goods that are either fast-changing or lose consumer appeal quickly. Understanding your inventory turnover will also enable you to maintain tighter control on your supply chain, helping you inch closer to a “just-in-time” inventory system.

That said, be wary of turnover ratios that are too high; this indicates that very little inventory is on hand. If you receive a large, sudden order, you may have to incur additional costs to fulfill the order—or, you may not be able to fill it at all, especially considering today's supply chain issues that many M&D companies are experiencing. Amidst the COVID-19 pandemic, we saw several inventory turnover ratios increase for many of our M&D clients, which initially appeared to be favorable. However,



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upon further review, this increase in the inventory turnover ratio was actually due to unfavorable decreases in inventory as companies sold out of their stock (fast!) and were unable to replenish the inventory levels due to supply chain issues. As such, the rule of thumb that “the higher the inventory turnover ratio, the better” can generally be followed; however, additional analysis should be performed to ensure the increase in the turnover ratio is due to favorable circumstances.

Using the Inventory Turnover Ratio as a Comparability Tool

Using industry data to benchmark your inventory turnover ratio is a great way to understand what is normal for your business. However, your business is unique and, in turn, your most efficient ratio will also be unique, but industry trends can serve as a guideline. Calculate your inventory turnover ratio each month to create a trend analysis for budgeting and forecasting needs. The more history you have, the better you will be able to understand what is normal for your business and to identify changes in trends that signify changes in inventory management are necessary.

The inventory turnover ratio can also be performed on a disaggregated level, such as on different product lines of inventory, to further assess any areas for improvement or to identify underperforming product lines.

HOW CAN YOU IMPROVE YOUR INVENTORY TURNOVER RATIO?

Now that you know just how valuable a tool the inventory turnover ratio can be, you might be wondering how you can improve yours. First thing's first – calculate your current inventory turnover ratio. If you don't have historical turnover ratios to compare to, let today be your starting point to improve the way your inventory is managed going forward. After you know your ratio, there are a multitude of ways to improve it. Here are some practical strategies.

- Order smaller quantities from suppliers more frequently
- Forecast your sales demands and order only what you expect to sell to meet expectations
- Reduce lead time from vendors and suppliers
- Use automated systems to track inventory and sales demands
- Research more affordable distributors
- Create a marketing campaign to increase sales
- Eliminate old or underperforming inventory and focus on top selling products

Need help thriving? LGT is here.

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INVENTORY MANAGEMENT FOR SUPPLY CHAIN ISSUES

When your manufacturing company can't meet a customer's needs due to issues in the supply chain, it can cost you that customer and your company's good reputation. Sara Godecke discusses business processes for proper inventory management you should have in place to mitigate the impact of these situations.

BY SARA GODECKE, CPA

Your manufacturing or distribution (M&D) company's lifeblood is often focused strongly on supply chain management. It's all too common these days to go to a restaurant to get your favorite dish and the server tells you that due to supply issues that item is not currently available and they are not sure when it will be back on the menu. Not only is that sale lost, but future business may be impacted due to the long wait and uncertainty. This type of interaction would affect your trust in that company to deliver what they promise in a timely manner.

In the same way, your customer base expects that you'll have what they want when they want it. This may be especially true if you are a distributor and your customers are working to meet the needs of their customers. Failing to meet that need can seriously shake their faith in your company, and may cost you their business down the road. To help mitigate effects of supply chain issues, you need to better control the things you can by putting processes in place to improve your inventory management.

Forecast Your Demand

Many companies view the supply chain as starting with the supplier or vendor – try viewing the supply chain as starting with you. *You* are telling the supplier what *you* need. With situations such as the one mentioned above, it's possible that poor inventory management processes, such as inaccurate demand forecasting, had an impact on the supply chain issue at hand. Popular dishes in a restaurant should have their ingredients on the top of the order list and in sufficient quantities, just like the most in-demand products should be on the top of an M&D company's order list.

When your company is not able to immediately fill orders due to an out-of-stock item, it's fairly common for the customer to use another company to meet their needs. This opens the door for that other company to take over a part of your market share, putting your company at risk of losing that customer to the other company not only for the current purchase but for future purchases. For this reason, it's vital that you use demand forecasting techniques in order to keep sufficient stock of your products, and not diminish your brand. You don't want to get a reputation for being a business that runs short of stock or cannot consistently deliver.

Demand forecasting involves a number of considerations, including historical trends, current trends, and seasonality factors. Accurately forecasting your demand allows you to order inventory ahead of time and avoid any last-minute supply chain bottleneck.

Stock the Items Customers Want

If you're in M&D, you already know about the fine line between having too much stock and potentially not being able to sell it all, or too little stock and risking losing customers over not meeting fulfillment needs. Unfortunately, simply having an abundance of stock on hand for all possible orders doesn't solve the supply chain issue. Inventory that doesn't sell ties up money that you could be putting to better use in your cash flow. It takes up warehouse and production space that could be better used. If it's been a while since you took a good look at your product offering and identified slow moving or obsolete items, now is the time. Identify which inventory items are in high demand, and fill your supply chain with orders of those items.

Use a Strong Inventory Management System

With a goal to keep optimal inventory levels through effective forecasting of demand, you'll need a solid inventory management system, preferably that operates from portable devices in today's environment, with pervasive communications. Among these options are a range of Enterprise Resource Planning solutions which allow you to optimize IT, accounting, order management, and procurement while eliminating manual reporting systems and improving employee productivity.

You'll also need to make sure your inventory management process is being updated and reviewed for improvement opportunities.

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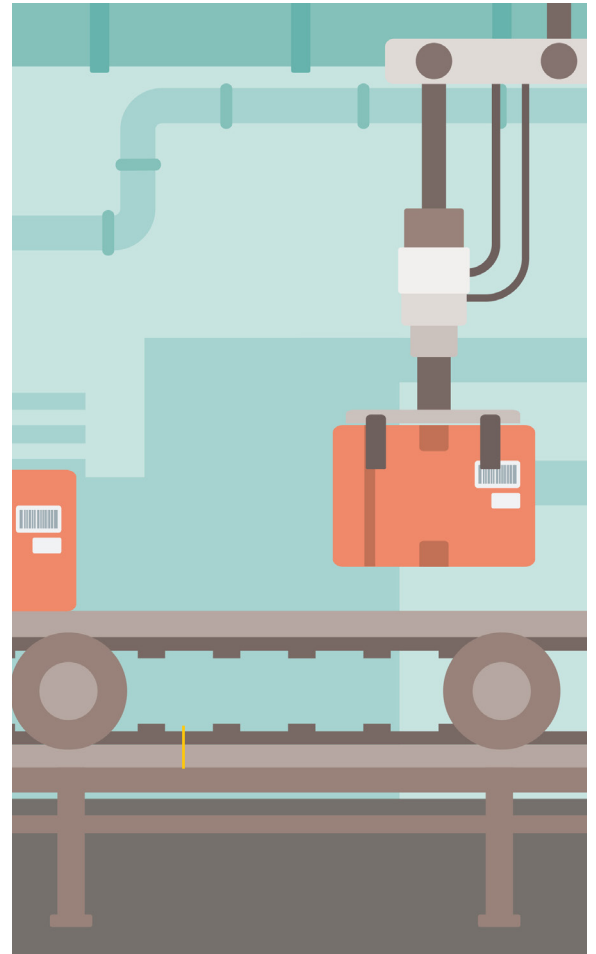
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Make sure to utilize bin or specific location level receiving and reporting so you know exactly what you have on hand and where it is. Make sure your reports identify the inventory by when it was received to make sure you are using the oldest inventory first when spoilage or obsolescence is a factor.

Foster Strong Vendor Relationships

Creating strong relationships with your vendors can also help to relieve supply chain stress by ensuring your vendors can meet your needs and process your orders timely and in the quantities desired. Many vendors require minimum quantities for orders. But what if your company's demand forecasting shows 100 units are needed for the next six months, but the minimum order quantity is 500? Having good working relationships with your vendors gives you the leverage to push back on those minimum orders and try to work out more favorable ordering conditions for your company.

Investment in solid inventory management resources, processes, and relationships will help keep your customers satisfied and coming back for more.



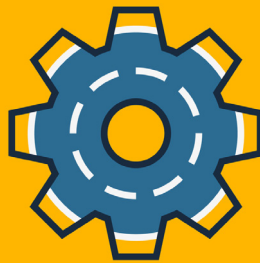
IF YOU HAVE ANY QUESTIONS...

...or need help establishing new inventory business processes or controls for your manufacturing or distribution company, we can help!



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