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Preparing for year-end inventory counts

How accurate is the amount reported in your company's perpetual inventory system? To best answer that question, a physical count is essential at year end. For calendar-year entities, year end is fast approaching on December 31.

Planning tips

Though physical counts may be seen as time consuming and disruptive, a well-executed count of what's on-hand can provide valuable insight into operational efficiency. Here are five tips on how to prepare for your count to maximize the benefits and minimize the hassle.

- 1. Order (or create) prenumbered inventory tags.** Most companies use two-part tags to count inventory. One tag stays with the item on the shelf; the other is returned to the manager at the end of the count. Tags are numbered sequentially to ensure the manager can account for every tag issued. Using a tagging system prevents items from being counted twice or omitted. Each tag should identify the part number, location, quantity and person who performed the count. To avoid scrambling around last minute, assign someone in your accounting department to get this task done at least a month before your count is scheduled to start.
- 2. Preview inventory.** Most companies do a dry run a few days before the count to identify any potential roadblocks and determine how many workers to schedule. This makes the count more efficient and gives warehouse personnel the opportunity to correct any foreseeable problems, such as missing part numbers, unbagged supplies and an insufficient amount of inventory tags.
- 3. Assign workers to count inventory.** Assemble two-person teams to prevent fraudulent counts. Assign each team a specific area of the warehouse to count. (A map often helps workers identify count zones.) Never give employees inventory listings to reference during the count — otherwise, they may be tempted to duplicate the amount from the listing, rather than bring attention to a possible discrepancy.
- 4. Write off any unsalable items.** All defective or obsolete items should be thrown away or recycled before the inventory count begins. There's no sense counting items that will be written off.
- 5. Pre-count and bag slow-moving items.** To make the physical count faster, some items that aren't expected to be used before year end can be counted a few days in advance. Pre-counted items should be tagged and placed in sealed containers. If a broken seal is noticed on the day of the actual physical count, the items in the container should be recounted.



Inventory values

Under U.S. Generally Accepted Accounting Principles (GAAP), inventory is recorded at the lower of cost or market value. However, estimating the market value of inventory may involve subjective judgment calls, particularly if your company converts the goods from raw materials into finished goods available for sale. The value of work-in-progress inventory can be especially hard to objectively assess, because it includes overhead allocations and, in some cases, may require percentage of completion assessments.

The value of inventory is always in flux as work is performed and items are delivered or shipped. To capture a static value at year end, it's essential that business operations "freeze" while the count takes place. Usually, it makes sense to count inventory during off-hours to minimize the disruption to business operations. For larger organizations with multiple locations, it may not be possible to count everything at once. So, larger companies often break down their counts by physical location.

Your auditor's role

If your company issues audited financial statements, one or more members of your external audit team will be present during your physical inventory count. Auditors aren't there to help you count inventory. Instead, they'll observe the procedures (including any statistical sampling methods), review written inventory processes, evaluate internal controls over inventory, and perform independent counts to compare to your inventory listing and counts made by your employees.

They'll also look for obsolete, broken or slow-moving items that need to be written off. Be ready to provide them with invoices and shipping/receiving reports. Auditors review these documents to evaluate cutoff procedures for year-end deliveries and confirm the values reported on your inventory listing.

For more information

[Contact us](#) to discuss physical inventory counting procedures. We can help you get it right and investigate any discrepancies between your count and the amount reported in your company's perpetual inventory system.