Reconciling IC Stock Level Valuation to GL

General Topic Overview:

Reconciling GL values to inventory valuation is a double check that typically results in a variance between the figures. Variances between 1-3 percent of sales is typical for most distributors, regardless of which accounting system they use. These two figures are independently derived from different methods and departments in your organization. Each figure is one side of a balanced scale. In a perfect world where all transactions are completed and accurate the scale would balance. However, in the real world, accounting and management should expect variances and use this variance figure as a gauge to double check the accuracy of internal processes. Variance is expected due to the inaccuracies in issues similar to those touched on below, as well as some variances with moving average cost estimations. Management's goal is to monitor this variance amount periodically and adjust procedures and internal processes to minimize and control this variance. Management may choose to reconcile IC and GL inventory values monthly, quarterly, or annually. The more aggressive your company wishes to be with regard to monitoring and mitigating the variance the more frequently they may choose to audit it.

Some things to know about how STEP1 GL values and Inventory Values work:

- STEP1 uses Average Cost for GL purposes in order entry. Since same products are comingled when received and cannot be differentiated afterwards, average cost can be more accurate than other methods when monitored correctly.
- The GL value of inventory is effected by accounts payable invoices for inventory and customer billing processing.
- Any inaccurate or missing transactions that touch these areas will cause a potential increase (or possibly a decrease) in variance between IC and GL Inventory values
- Purchasing receipts has no direct effect on the general ledger value of inventory (remember it's AP invoices that effect GL inventory values). Purchasing has an indirect effect on stock levels and average costs, and therefore Cost of sales to the GL from invoicing in order entry. Correcting mistakes on purchase orders in a timely manner and avoiding modifying costs on individual orders in order entry will minimize variances, but other errors can have an effect on these variances. (See examples below).

Make sure you are doing the following procedures:

- Make sure you reconcile for Special Order Items (items without item codes) that have stock in the warehouse. Specials will not show up on the valuation report but if it has been invoiced in AP is showing up in the general ledger inventory value.
- Reconcile for PO's received but not invoiced in A/P. There is a report in "Report's Manager" under Inventory called "PO's Received not Invoiced". This report will show you what items have increased your stock levels but has not hit the GL because the AP invoice has not been entered.
- Make sure you do a General Ledger entry for all Stock Adjustments. There is a report in "Report's Manager" called "Stock Adjustment Activity Report". Make sure when you do Stock Adjustments that you give an accurate description for the stock adjustment. This will allow you to correctly adjust inventory to the correct GL Expense account.

Reconciliation Steps.

Make sure that everything that has physically left the building has been fully processed/posted and all submitted cycle counts have been approved and posted. (For more information see 'How Do I Do A Physical Inventory With STEP1 V7?') Then use the following formula for reconciling your Inventory to the General Ledger.

- **Inventory Valuation Report (Stock Level @ Ave cost) ***
- **+ Reconcile for Special Order Items In Stock***
  (Figure out how much of Special's $ Value has been invoiced in AP
  add that amount to the IC side, continue with reconciliation)
- **- PO's Received, Not Invoiced Report***
- **+/- Stock Adjustment Activity Report (Since last reconciled.)**
- **= Adjusted Inventory Valuation**

***** Complete these reconciliation steps and print/reprint these reports at the same time, typically at period end.

Examples of how stock levels can get off.

-Timing is important. If members of your staff are not completing one day's work in one day's time then you are always behind and more likely to forget the details on transactions that result in inventory errors and inaccuracies. Remember that one day's work in one days' time means accounting for everything that has left or arrived in the building before the end of the work day. Orders should be marked as shipped and purchase orders receipts should be received when they leave or arrive in the building etc. AP, Purchasing, Service and all other departments need to accurately reflect their days work for supporting information allowing the auditing of stock levels to be more accurate and up to date.

-It may be possible that the order entry staff are modifying GL average cost in order entry on a case by case basis. This would cause the cost of sales and inventory figures in the g/l to come in at different #'s then what the po's came it at and potentially get the IC value & the GL Value out of sync. Cost inaccuracies are ideally corrected at the purchasing or in rare circumstances at the item level. Costs nor commissions should not be micromanaged at the order entry level. Commission overrides are not a valid reason to change order entry GL costs, since commission costs can be modified on a case by case basis for any invoice in the Billing Module when necessary. (See modify user info under OD/BIllling Allow Modify Cost info, set to N or S to prevent staff from overriding GL Average Costs on orders)

-Inaccurate counting, often caused by disorganized warehouse with products here there and everywhere or not accounting for products that were accidently excluded from physical and or cycle counts.

-Unreported substitutions - did not tell the computer you filled with another product. Note that this happens on PO's as well as on Customer Orders. In rare cases this may be acceptable, in most it's not. Always avoid stock levels and costs from being adversely effected.

-Sample stock, internal use, R&D, demo usage not accounted for in stock adjustments and/or not g/l expensed.

-Product packaging changes, i.e. 6/1gl changes to 4/1gl and the same product # was used afterwards in order entry. Should probably setup new items when this happens.

-Inaccurate Purchasing or Payables transactions. Wrong cost on PO's not corrected. Not putting AP invoices on hold when incorrect. Not coding disputed adjustments to AP invoices to inventory or cost of sales correctly. Not using the a/p to p/o reconcile feature or not auditing and taking corrective in the AP to PO variance account in g/l when necessary.

-Wrong expense account coding on AP transactions(Technically we are only worried about ones involving inventory here).

-Inflated purchase costs (padding in for o/h, adding in internal labor to costs etc.). This should only be done in pub and or standard costs and should never be added to last or average costs.

-Special Order Items in stock. If you're stuck with it, set up products that you inadvertently end up stocking.

-Un-audited adjustments. Approved cycle count adjustments and other stock adjustments need to be journalized in GL. For those not using cycle count, use the Stock Adjustment activity report to approve adjustments. Once cycle counts or stock adjustment activity is approved enter corresponding GL entries and post prior to reconciling IC value to GL values.

-Shrinkage Adjustments - some items evaporate, spoil, and decrease with handling such as powders or cut to size mats.

-After all other issues are identified/eliminated, understood and adjusted, then management must look at ongoing patterns for the possibility of theft. It is advisable for management to avoid assuming theft as the cause of any discrepancies prior to eliminating other possibilities. Realize that a miskeyed transaction is far more common than cases where any significant theft has been proven. If the variance amount is a gauge of accuracy of internal procedures, then spikes in either direction will be seen when monitoring variances as you progress with refining better practices. If variances are unacceptable look for keying errors first, and also don't forget to check the owner's and salesreps trucks of their car for that expensive floor machine and cases of TP that were in transit and were miscounted in your physical!...If you are not entering transactions on things like this now, then you should be asking yourself some serious questions about your internal procedures right now. Such realizations, and an open mind to possibilities of where problems can exist in your company, are usually the beginning of obtaining better inventory control within your organization.