

INVENTORY

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INVENTORY

I. PURPOSE OF CHAPTER 11

The purpose of this chapter of *The Guide* is to explain the concept of inventory and to discuss the policies, guidelines, and procedures associated with inventory on campus.

II. OVERVIEW AND OBJECTIVES

A. Overview

Each department's purchases of goods for consumption or resale *may* represent inventory. Departments that hold inventory must maintain inventory records which accurately reflect the valuation of the inventory at the end of each month. Additionally, such departments must conduct an annual inventory.

B. Objectives

The principal accounting objectives of maintaining inventories are:

1. To allow for the proper assignment of costs to an accounting period.
2. To present an accurate portrayal of the department's assets on the college's financial statements.

III. DEFINITION OF INVENTORY

The State of Colorado Fiscal Procedures Manual defines inventories as those that total \$100,000 or more per location. If inventories of lesser amounts are recorded on the Balance Sheet/Statement of Net Assets Report, they must be verified by physical count.

In order to minimize year-end workload, inventories of less than \$100,000 will not be booked in the general ledger inventory codes. These smaller inventories should be expensed to cost of goods sold as they are purchased. As a valid internal control function, departments may choose to continue their inventory records to verify and control quantities on hand. However, these smaller inventory amounts should not be booked by the department.

Some examples of inventory are:

- Merchandise or publications offered for sale
- Maintenance supplies

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- Office supplies
- Postage
- Laboratory supplies

IV. INTERNAL CONTROLS

Each department is responsible for safeguarding the college's assets, whether those assets are in the form of cash, merchandise, or supplies. A system of internal control is needed to ensure that appropriate management of these assets occurs. Good inventory internal controls will incorporate the following.

1. Adequate separation of duties between those responsible for the physical inventory (ordering, receiving, distributing/selling) and those responsible for the inventory accounting records (approving payments, charging departments/customers, maintaining the perpetual inventory balance in Finance System and reconciling The Finance System).
2. An internal inventory system that records all inventory activity, including acquisitions, sales, returns and adjustments.
3. Adjusting the Finance System inventory value for all inventory activity, including acquisitions, sales, returns, and adjustments.
4. Securing the inventory in such a manner so that inventory may not be removed or otherwise affected without a record being made of the event.
5. Conducting a periodic count and costing of the inventory. This must be done at least annually for the college's June 30 fiscal year-end. More frequent counts should be made depending upon the size and vulnerability to misappropriation of the inventory. Compare the count and costing to the inventory record system and to The Finance System. All differences should be investigated and explained.

V. ESTABLISHING AND MAINTAINING AN INVENTORY

All purchases of inventoriable goods are to be recorded by using The Finance System account codes. Selection of the specific account is determined by the type of inventory. The selection of control codes is determined by type of inventory.

Inventories - Sales External to College

This account presents the value of inventories on hand that are expected to be sold to customers *outside* of the college.

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Inventories - Internal Sales/Consumed

This account is similar to the account, above, but consumption takes place *inside* of the college, and is charged as an expenditure.

The value of a department's inventory normally fluctuates due to purchases and sales that occur during each accounting period. The Balance Sheet Transaction Statement/Statement of Net Assets Transaction Report reports the inventory value. The Summary of Budget, Revenues, Expenditures and Transfers Statement presents the amount of sales and provides the amount for cost of goods sold.

Inventories increase when purchases are made, or when goods are returned by customers. Inventories decrease as a result of sales, consumption of goods, or when goods are returned to vendors.

Each department having an inventory is required to keep inventory records. These records must clearly and accurately show the actuation inventory count and inventory valuation at any given date. Such records can be as sophisticated as an inventory software package, or as simple as a card file system.

Example

Department X has an inventory of maintenance supplies. The department purchases forty cans of floor wax at \$6.00 per can, and pays \$4.00 in freight (\$0.10 per can) on the purchase. Total cost of the purchase is \$244.00 (\$6.10 per can).

Debit	Inventory account	\$244.00
Credit	Cash (affected via PO/SPO voucher)	\$244.00

Department X now sells ten cans of floor wax to Department Y at \$7.00 per can. An IN is used to record the sale; and a journal entry is used to remove the cans sold from inventory.

The IN to record the sale (Ten cans at \$7.00 = \$70.00):

Debit	Dep't Y Expense	\$ 70.00
Credit	Dep't X Revenue	\$ 70.00

The journal entry to record the cost of goods sold and to remove the cans sold from inventory (Ten cans at \$6.10 = \$61.00):

Debit	Cost of Goods	\$ 61.00
Credit	Inventory	\$ 61.00

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Thus, Department X has \$9.00 in net revenue and has an inventory balance of \$183, 30 cans of floor wax.

Prior to the fiscal year end closing on June 30, Department X completed its annual physical inventory count, and discovered that two cans of the floor wax were defective. A journal entry is used to adjust the physical inventory for the defective cans.

The journal entry to adjust the inventory (Two cans at \$6.10 = \$12.20) is:

Debit	Physical Inventory Adjustment	\$ 12.20
Credit	Inventory	\$ 12.20

Thus, the adjusted inventory balance for Department X is \$170.80. Twenty-eight cans of floor are reported on the department's Finance System Balance Sheet/Statement of Net Assets Transaction Report.

VI. VALUING THE INVENTORY

Several methods exist for valuing the inventory on hand. The college uses 'First-In, First-Out' (FIFO). There are advantages and disadvantages to this method, but it assigns a value to the goods remaining in inventory. This method must be applied consistently from year to year. A change of method must be approved in writing by the Controller.

A brief description of this method follows.

A. FIFO

The assumption under FIFO is that the items in inventory are sold or used in the order in which they are purchased. Thus, the first items acquired are assumed to be the first ones sold or used. Therefore, the items in the inventory are assumed to be those from the most recent purchases, and would be priced at the cost of those recent purchases. Documentation showing the cost of those purchases should be maintained and easily accessible.

Example

Department X purchases 40 cans of floor wax at \$6.00 per can, and pays \$4.00 in freight (\$.10 per can) on the purchase. Total cost of this purchase is \$244.00.

Debit	Inventory	\$244.00
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Credit Cash (via PO/SPO voucher) \$244.00

A few days later, Department X makes another purchase of the same floor wax, after being notified by Department Y that a large quantity of floor wax will be needed within a few days. This time, Department X purchases 100 cans of floor wax at \$5.50 per can, and pays \$10.00 (\$.10 per can) in freight. Total cost of this purchase is \$560.00.

Debit Inventory \$560.00

Credit cash (via PO/SPO voucher) \$560.00

Total inventory now on hand is 140 cans of floor wax, for a total of \$804.00.

- The first 40 cans have a unit cost of \$6.10/can.
- The next 100 cans have a unit cost of \$5.60/can

Department X fills Department Y's order of 120 cans of floor wax, at \$7.00 per can. An IN is used to record the sale, and a journal entry is used to remove the cans sold from inventory.

The IN to record the sale (120 cans at \$7.00 = \$840.00) is:

Debit Dep't Y Expense \$840.00

Credit Dep't X Revenue \$840.00

Use a journal entry to deduct the value from the inventory account (the initial 40 cans purchased at \$6.10 per can for a total of \$244.00 and the 80 cans from the second purchase at \$5.60 per can for a total of \$448.00):

Debit Cost of Goods \$692.00

Credit Inventory \$692.00

Thus, Department X has \$148.00 (\$840.00 - \$692.00) in net revenue, and has an inventory balance of \$112.00 (20 cans of floor wax at \$5.60 a can).

VII. YEAR-END PHYSICAL INVENTORY

Each department with an inventory is required to take a physical count at least once a year to ensure that an accurate asset value is reported on the Balance Sheet/Statement of Net Assets Report and that the cost of goods sold is recorded correctly on the Summary of Budget, Revenues, Expenditures, and Transfers. This annual count should be completed within the three months prior to fiscal year-end close (June 30). Each department's responsible person needs to schedule

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the actual count, establish cutoff procedures, and supervise the physical inventory process.

Cutoff procedures are designed to ensure that inventory transactions are properly recorded and included in the current year financial statement. Inventory quantities include all items on hand or in transit. The inclusive and exclusive inventory items in transit are based on passage of title. In general, inventory items received but not paid are included in the physical inventory. Inventory items shipped to customers are deducted from the physical inventory. The responsible person must also review the inventory adjustments and amounts that will appear on the fiscal year-end Balance Sheet Statement/Statement of Net Assets Report.

The departmental inventory responsible person must complete the following:

1. Physical Inventory Summary Report (Exhibit 1 provides an Example, and Exhibit 2 is a Master Form.)
2. Physical Inventory Test Count (Exhibit 3. This serves as supporting documentation to the Physical Inventory Summary Report.)
3. One copy of the Prorate Inquiry Record (Finance System Allocation Entry), if applicable.
4. Inventory Reconciliation (Exhibit 4 provides an Example, and Exhibit 5 is a Master Form.)
5. One copy of the controlling Finance System Program Statement
6. Written departmental physical inventory instructions.
7. One copy of the final physical inventory listing extended value.
8. One copy of the adjusting journal entry.

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VIII. EXHIBITS

Examples and Master Forms for the inventory reports listed below are found on the pages that follow.

Exhibit 1	Master Form	Physical Inventory Summary Report
Exhibit 2	Master Form	Physical Inventory Test Count
Exhibit 4	Master Form	Inventory Reconciliation

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Exhibit 1

PHYSICAL INVENTORY SUMMARY REPORT - MASTER FORM
Adams State College

Department _____ Location _____
Responsible Person _____ Extension _____
Date _____ Observer _____

BUSINESS OVERVIEW

- **OPERATION** _____
- **DOCUMENT FLOW**
Purchases _____

Sales _____

Other _____

ACCOUNTING REVIEW

- **PROGRAM'S BALANCE SHEET/SNA ACCOUNT CODE** _____
- **PROGRAM'S SUMMARY ACCOUNT CODE** _____
- **OPERATION ALLOCATION JES** _____
- **COSTING METHOD** _____

- **MARKUP %** _____

PHYSICAL COUNT

- **GENERAL INSTRUCTIONS** _____

- **ENVIRONMENT** _____

CUT-OFF CONTROLS

- **PURCHASES** _____
- **SALES** _____

- **INS** _____

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COUNT CREW _____

COUNTING METHOD _____

CASH SALES _____

STORE CLOSURE _____

OBSOLETE/DAMANGED STOCK _____

SUMMARY _____

RECOMMENDATIONS _____

CONCLUSION _____

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Exhibit 3

INVENTORY RECONCILIATION - MASTER FORM

Adams State College

FISCAL YEAR ENDED JUNE 30, 20____

Finance System ACCOUNT CODE: _____

BOOK Value per Program Statement as of ____/____/____: _____

Adjustments:

Adjusted BOOK Value as of ____/____/____: _____

PHYSICAL Value as of ____/____/____: _____

Adjustments:

Adjusted PHYSICAL Value as of ____/____/____: _____

Inventory VARIANCE:

Journal Entry Date ____/____/____ **DR** _____

CR _____