

How to Conduct A Physical Inventory

Step-by-Step Guide

It is crucial for hospital gift shops to take an annual physical inventory at the end of each fiscal year. It should be conducted on the last day of the shop's fiscal year.

A 'physical inventory' determines the retail and cost value of your salable merchandise by counting all the items in your shop. Taking inventory is one of the most important "accounting" activities a shop can perform. It plays a significant part in determining your shop's profitability.

A physical inventory is the total dollar amount of inventory counted at the 'end of the fiscal year.' That figure becomes your 'beginning of the year' inventory.

Why Take an Annual Physical Inventory?

This important procedure provides your shop with an accurate *actual* figure for a 'beginning of the year' inventory. Actual inventory figures show inventory levels for each category. These figures will help you and your buyers plan buying levels and project inventory turn* goals.

Turns are the number of times your entire inventory sells in one year. The inventory turnover rate measures how quickly you are moving inventory through your shop. The turnover rate provides an accurate barometer of your shop's success. Your shop's inventory turns should be within range of industry standards: 3-5 times annually.

If your shop does not maintain running (perpetual) inventory figures in a ledger book, at the very least, an annual physical inventory is necessary to determine your stock position.

A ledger system (as opposed to a computerized system) requires continuous, day after day recording of all transactions. A running total must be kept by continuously recording all *merchandise data*. After your physical inventory, you will need to adjust the book figures for each category with your new physical inventory figures.

When you maintain inventory figures (whether in a ledger book or in a computerized system), the final actual physical inventory figures compared to your book inventory figures will reveal shortages due to:

- shoplifting & employee pilferage
- failure to record markdowns
- misplaced or lost merchandise
- bookkeeping errors
- broken items

If you are a new manager, it is important to immediately conduct a physical inventory to attain accurate beginning inventory figures at the onset. Then you know your shop's on hand inventory when you begin your new position. It will also allow you a chance to become familiar with the merchandise.

Setting high standards for the inventory process, establishes accountability for the physical inventory count. Some shops use an outside inventory service to take inventory.

Why Take Inventory at Retail Prices?

The money your customers pay at *point of purchase* is the retail price. The retail sales figures are the retail value of the inventory. The retail price has the profit built into it and *profit* occurs when an item is *sold* (at retail).

Maintaining inventory figures at retail forces the retailer to 'think retail'.

Physical inventories taken at retail price eliminates the costly, time-consuming job of decoding cost prices. Recording physical inventory at retail prices greatly simplifies the process and encourages a more frequent physical count of inventory.

Once inventory is counted at retail, an estimated average gross margin for each Department is subtracted ("backed out"). This margin is the "ideal" gross margin, that is, the margin applied when you price the items. To back out from retail pricing to Cost of Goods, multiply the shelf price by 100% minus the margin. For example, if a section has an average gross margin of 30%, the inventory at retail is multiplied by 70% (or 0.7).

Financial statements at retail are essential to good financial planning. Frequent calculations at both *cost and retail information* allows the retailer to adjust quickly to changing market conditions

The retail method facilitates the planning and control of a department or category. Sales, purchases, inventories, and price-change information are recorded by department or category and can be used to evaluate each department's performance.

By providing a *book figure* on what inventory should be on hand, the retail method allows you to determine shortages each time a physical inventory is taken.

Preparation

- ☐ Select your date(s) for taking inventory. Schedule on a weekend to avoid disrupting customers. Depending on the size of your shop, it will take from a half-day to two days.
- ☐ Begin looking for old, defective items. Mark them out of stock.
- ☐ Group 'like merchandise' together (e.g., all plush together) for an efficient process. The shops should be departmentalized.
- ☐ Submit a notice to the hospital newsletter announcing the shop's close date(s). If possible, send an email to all hospital employees.
- ☐ Make door signs announcing the shop's close date(s).
- ☐ Recruit volunteers to work Inventory Day(s).
- ☐ Obtain a set of clipboards, one per team member.
- ☐ Print multiple copies of the Counting Worksheet (see below) and number them in numerical order.
- ☐ Draw a floor plan or map of the shop. Number every shelf in consecutive order throughout the shop. Assign your teams by either Category or Location.
- ☐ Next, fill in the Department, Location, and Categories accordingly. Counters will use one sheet per Category, per shelf. Setup a table for the Counters to set aside items without prices.
- ☐ One or two days in advance, pre-count merchandise in your stockroom saves a lot of time on your actual inventory day.
- ☐ Ensure that stockroom areas are clean and organized.
- ☐ Count your back stock of sundries, balloons, candy or anything else in your stockroom. Tape off the area so nothing is removed.
- ☐ Items 'ready for return' to the manufacturer are counted since they are considered part of your inventory and credit has not yet been received.
- ☐ Consider opening shipments that arrived in the past week or two, assuming invoices are not paid. They don't have to be counted because they have not yet been entered into inventory. However, an inaccurate inventory can occur when merchandise has been counted but the invoice hasn't been paid - or the reverse. The shop should have a crisp bookkeeping system and be aware of potential cut-off-problems, particularly around the date of the inventory.
- ☐ Plan and order a cart of drinks and snacks for your volunteers. Consider treating them to lunch on inventory day.

Inventory Day

Gather all your volunteers together to review the inventory procedures and process.

ASSIGN TEAMS

Group volunteers in teams of two – one person is the Counter the other is the Recorder. Carefully select and assign Counters to ensure a high level of accuracy. Roles can be switched at the end of any inventory worksheet. Ideally, one team member should be the buyer for the area/category being counted.

COUNT INVENTORY

The manager assigns individuals to a team and gives each Counter a clipboard with their name on it and their Counting Worksheets. For example, Sue has worksheets 90 through 140. She is responsible for 50 worksheets.

The Counters fill out the Counting Worksheet with:

- Number on the shelf
- Category(s) to be counted (a separate sheet is needed for each category for each shelf being counted)
- Location being counted - ☐ Shop or ☐ Stockroom
- Date - if counted in advance of inventory day only
- Names of the Counter and the Recorder

STEPS

1. Teams begin recording the Quantity, Item Description, and the Retail Price (per-unit full retail price) for every item. Do not calculate the extended amount (Retail Extension) at this time.
 - Any items without a price are placed on the designated table. The manager will need to determine the price from the manufacturer's invoice.
 - It is not necessary to extend the number of items by the unit retail price at this time. That step can be done with an adding machine after inventory has been completed.
 - *Record items from different categories on separate sheets.* The number and location stay the same, but the category is different. If there is a variety of merchandise on a shelf, there could conceivably be 4-5 inventory sheets for that shelf.
2. Attach the sheets to the shelf with tape once the team completes that shelf.
3. The team then moves to the next shelf. Check the map to stay in the assigned area.
4. Once a section has been counted, mark it with a piece of tape, a 3x5 card, or any other method to ensure that everything is counted only once.

When everything in the shop appears counted, the manager carefully collects all the Counting Worksheets, including those in the stockroom.

BEST PRACTICES

The mind can play tricks on you when doing a lot of counting. If you see a quantity of 12 on the sheet you might then look at a stack of 16 items and think 12. It is easy to make mistakes and that is why it's important to have two people per team.

Hard-to-count items, such as pick-up candy, need to be weighed and will take more time.

Do not move misplaced material while counting. Do not move merchandise around while people are counting. You run the risk of counting it twice, or not at all. Record misplaced items where they lie.

The manager should periodically spot-check the thoroughness and accuracy of the counters. They may request a recount of a section if the work looks unsatisfactory.

The hospital auditor should be invited to participate in the process, especially the spot-checking. Ordering a recount probably will not make the auditor a popular person, so be sure that people charged with counting realize the importance of an accurate physical and are committed to the success of the project.

If your shop has a computerized inventory control system, a hand-held scanner can expedite the entire process quickly and reduce the time your shop is closed. You can rent or purchase hand-held scanners.

Calculate Total Shop Inventory

A. Calculate the Counting Worksheets

1. Collect all the Worksheets and sort in numerical order to ensure none are missing. Account for all sheets, whether they were used or voided.
2. Group the sheets by Category.
3. Extend the quantities (Retail Extension) by multiplying the Quantity x Retail Price on each sheet.
4. Calculate totals at the bottom of each of the Counting Worksheets.
5. Recheck the figures for accuracy.

B. Calculate the Inventory Totals by Category

1. On the Category Totals worksheet record the Sheet #, Category, and the Sheet Total, from each of the individual Counting Worksheets, per category.
2. Calculate the Category Total for each category to get the shop's inventory totals by Category (at retail).

**See below to calculate the cost value, if desired.

C. Calculate the Total Shop Inventory

1. On the Total Shop Inventory sheet record the Category, Sheet #s, and Category Total entries from the Category Totals sheet. Add all Category Totals together to get the Total Shop Inventory.
2. Buyers should receive a copy of the final inventory report showing their category's beginning inventory figures as soon as they are available.

**Calculate Cost of Goods Sold (optional)

Beginning Inventory (at cost)	\$ _____
+ Purchases (+ freight)	\$ _____
<u>Less Ending Inventory (at cost)</u>	<u>\$ _____</u>
Cost of Goods Sold	\$ _____

Converting from Retail to Cost

Inventory is taken at retail price, but you may also want to know the inventory at cost.

A precise inventory value at cost can be difficult to determine. There is a certain margin for error in the process when converting retail prices to cost because strict pricing standards are not always followed.

A savvy manager may price certain items at a higher or lower mark-up based on what they think the market will bear. This means that all gift items may not have a markup of 55%.

Determine the mark-up typically taken for each category:

Typical Mark-Up by Category

Gifts, cards, toys, baby, clothing	55%; therefore, the cost is approximately 45% of the retail
Jewelry	Pre-priced for a 60-70% profit margin
Candy and Sundries	Pre-priced for a 30-33% profit margin
Magazines	18-20% profit margin

Example

\$50,000 total gift inventory at retail
x 45%
\$22,500 Gift Inventory at Cost (approx)

A computerized inventory control system automatically "receives" merchandise into inventory at cost and subtracts items from the inventory as they are sold. Therefore, the cost of your inventory is easy to determine.

Evaluation

Evaluation is imperative to determine what went well but also where the process broke down. This is especially important if you see inaccuracies in inventory numbers.

Sit down with everyone who participated and discuss the process. What worked? What didn't? Who should perform what tasks next year? What could be changed to make things easier and produce a more accurate count? Place these suggestions in a "physical inventory file" and review them when it comes time to begin preparations for your next count.

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CATEGORY TOTALS			
Sheet #	Category	Category Total (at retail)	NOTES
13	Candles	\$897.21	
7	Candles	\$234.13	
45	Candles	\$34.09	
67	Candles	\$1184.87	
	CATEGORY TOTAL:	\$2350.30	

TOTAL SHOP INVENTORY		
Category	Sheet #s (optional)	Category Total (at Retail)
Candles	13, 7, 45, 67	\$2350.30
Sundries		\$67,340.01
	TOTAL SHOP INVENTORY:	