# Inventory Management & Practices Policy

## Contents of Policy

<table>
<thead>
<tr>
<th>Policy Overview</th>
<th>Physical Inventory Counts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Valuation</td>
<td>Inventory Write-offs &amp; Adjustments</td>
</tr>
<tr>
<td>Average Cost</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inventory Reserves</td>
</tr>
<tr>
<td>Inventory Management Practices</td>
<td></td>
</tr>
<tr>
<td>Controls and Security of</td>
<td>Inventory Reconciliation</td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
</tr>
<tr>
<td>Purchasing Controls</td>
<td></td>
</tr>
<tr>
<td>Receiving and Shipping Controls</td>
<td></td>
</tr>
<tr>
<td>Warehouse Security</td>
<td></td>
</tr>
<tr>
<td>Tracking Controls</td>
<td></td>
</tr>
<tr>
<td>Process Management</td>
<td></td>
</tr>
<tr>
<td>Inventory Ordering</td>
<td></td>
</tr>
<tr>
<td>Vendor Payments &amp; Returns</td>
<td></td>
</tr>
<tr>
<td>Customer Invoicing Process</td>
<td></td>
</tr>
<tr>
<td>Customer Returns</td>
<td></td>
</tr>
</tbody>
</table>

## Policy Overview

As a University Service Center, HUIT businesses purchase and distribute technology products that are maintained as inventory until they are sold or used. The following items should be included in inventory:

- Items purchased explicitly for resale
- Items purchased in quantity for subsequent use
- Materials used to produce items for resale

Items outside of these classifications are not considered inventory. Items purchased that are not resold to external parties or other University departments should be considered supplies for that department.

HUIT businesses normally accumulate inventory items such as equipment, supplies and parts in an inventory account (balance sheet object code 0400). When the item is sold, the average cost of the item is moved to a cost of goods account and matched with the associated revenue for the fiscal period.
Inventory Management and Practices Policy

Inventory Valuation
Generally Accepted Accounting Principles require that the lower of cost of market be used no matter which inventory valuation method is used. A valuation method is used to compute the cost of the inventory dollar amounts and then it is compared to the market dollar amount. The lower of the two amounts must be used when recording inventory. Regardless of which inventory accounting method is used, inventory values must be assigned. A valuation method (e.g., LIFO, FIFO, average cost and specific identification) is used to compute the cost of the inventory dollar amounts and then it is compared to the market dollar amount.

The factors that contribute to inventory valuation risks are purchasing practices, obsolescence, accuracy of sales, and product lifecycles. HUIT recommends managing risks by maintaining low safety stocks and minimum purchase lots, utilizing just in time purchasing practices, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing inventory minimization strategies such as vendor-managed inventories.

The business manager is responsible for the proper valuation of inventory and for ensuring that detailed documentation is retained of the inventory valuation. The two inventory valuation methodologies utilized in HUIT are average cost and specific identification.

Average Cost
In this valuation method, which is used by HUIT, the calculation of cost of goods is averaged among the units of inventory.

Inventory Management Practices

Controls and Security of Inventory
Carrying larger quantities of inventory often maximizes financial benefits that can be achieved. However, large inventory levels can result in greater risks to the University in the following ways:

- Inventory may become obsolete prior to sale/use.
- Inventory is subject to theft and damage.
- Maintaining inventory can be costly in terms of storage and maintenance

The business manager is responsible for establishing controls and maintaining security over the entire inventory in all locations. HUIT recommends the following guidelines to reduce risks:

- Negotiate a return allowance agreement with the vendor
- Implement and monitor internal control structure policies and procedures for staff and business systems
- Review inventory turnover rate and consider making smaller purchases

In addition to controls for managing appropriate inventory levels, the business manager must ensure the separation of duties. The separation of duties is a powerful internal control. Its objective is to ensure that duties (roles) are assigned to individuals in a manner so that no one individual can control a process from start to finish. It allows an opportunity for someone to catch an error before a transaction is fully executed and/or before a decision is made based on potentially erroneous data. In addition, having adequate separation of duties reduces the ‘opportunity’ factor that might encourage an employee to commit fraud or to embezzle.

Purchasing Controls
Proper procurement of inventory items involves planning, scheduling, policy interpretation, research, negotiation, selection and processing. It also necessitates follow-up with individuals responsible for shipping and receiving to ensure proper delivery and inspection of the merchandise for quantity and quality before acceptance and payment. It is the responsibility of
Inventory Management and Practices Policy

business management to ensure that inventory-purchasing responsibilities are only granted to qualified and properly trained staff.

Receiving and Shipping Controls
The person physically receiving and verifying purchased items must be someone other than the person who placed or approved the order. Individuals who are responsible for the receipt of inventory merchandise must verify that the goods received are the same as those that were ordered. Inspect incoming shipments for quantity, condition, and conformity with specifications and terms of purchase before they are added to inventories. The packing slip is the documentation that lists the items and quantities shipped and should accompany the shipment. The packing slip is matched to the corresponding automated order information as part of receipt confirmation process with discrepancies clearly documented including items missing, damaged or not ordered. Once items are received, a tracking number should be assigned to each item in the shipment to ensure proper tracking.

Warehouse Security
Inventory items should be housed in secure locations that are only accessible to authorized personnel. All warehouse facilities should be equipped with key/key card access systems. Access to inventory warehouses should only be granted by business management.

Tracking Controls
All inventory items should have specific item or part numbers assigned to them so that they can be tracked in the physical warehouse and in the inventory management system.

Process Management

Inventory Ordering
Inventory should be ordered by approved purchasers using the business’ procurement and inventory system. All purchases should generate a unique system identifier (e.g. a purchase order number) to facilitate order tracking. All purchases should be in compliance with the HUIT Procurement Policies and must be approved by business management and transacted through/with qualified University vendors.

Vendor Payments & Returns
Payments to vendors must be compliant with the HUIT Procurement Policies, and should only be made after satisfactory verification of the following:

- The product has been inspected and is consistent with the product and quantity ordered
- The product is deemed free of damage or defects
- The receiving report and packing slip have been verified with the original purchase order

Customer Invoicing Process
When a customer purchases an item out of inventory, an invoice is generated. In a perpetual inventory system, the invoicing process should automatically remove the item from inventory using the predetermined valuation methodology and move the appropriate expense to cost of goods sold. In a periodic inventory system, the inventory item is posted directly to the cost of goods sold and is only moved to the inventory account if it has not been invoiced to a customer by the end of the accounting period.

Customer Returns
From time to time, customers may elect to return an inventory item. If an inventory item is returned, the customer should be issued a credit and the item should be returned to inventory and/or to the vendor for credit or replacement.
Physical Inventory Counts
All inventories of goods for resale are subject to physical inventory control to assure accountability, accuracy of asset records, accuracy of cost of goods sold, and to help determine and account for any inventory shrinkage. Individuals who are independent from the day-to-day receiving or issuing of the inventory items should perform the physical inventory counts. It is also advisable to have a representative from Finance or Accounting present when physical inventories are performed. All physical items included in inventory should be verified to the inventory management system balances at least quarterly (preferably monthly). All inventory items should be counted, with any damaged or obsolete items noted. Detailed inventory sheets should include the number of units, the unit costs and their extended value (quantity times unit costs). Upon completion of the physical count, management should:

- Review the inventory sheets for damaged or obsolete items. Costs for these items should be recorded at the lower of cost or market.
- Ensure that all items have been counted.
- Verify accuracy of the quantity by recounting a sample of the items.
- Verify mathematical accuracy of the extended values and the total inventory value.

The inventory value should be provided to HUIT Accounting Office within one week after the fiscal year end. Adjustments to correct discrepancies must be adequately documented by management.

Inventory Write-offs & Adjustments
Damaged, obsolete and missing items should be written-down or written-off immediately upon discovery, to avoid overstatement of the inventory value. Material write-offs or write-downs should be researched. Unit managers must support adjustment requests with written explanations. The write-off transaction should involve crediting the inventory account (0400) directly and expensing the same amount to the Inventory Write-offs account (7764).

Inventory Reserves
In addition to maintaining inventories the business may be required to maintain an inventory reserve account (object Code 0420) to guard against over-valuation of the inventory general ledger balance. The reserve is intended to reflect the value of inventory that we may not be able to sell. An Allowance for Inventory Write-offs measures inventories on the books but not expected to be sold. These inventories may not be sold due to obsolescence, shrinkage, damage, etc. Often, it is not known which specific inventory items will be sold. An allowance is therefore established to estimate the value of those inventories that are likely to be written off.

Inventory Reconciliation
Inventory accounts should be reconciled on a monthly basis. The reconciliation should verify that the value of the inventory held in the inventory system is equal to the value in the inventory account on the general ledger, and involve adjusting either or both of the balances for transactions that may be out of sync at the end of the financial period (e.g. unpaid invoices, product returns, etc.) The business manager, working with the HUIT Accounting Services, is responsible for ensuring that the inventory accounts are reconciled.

Since some variances are always present due to the timing of transactions, business managers should recognize that the business system and the general ledger might never be exactly equal. Therefore business managers should establish a threshold for acceptable variances and manage the reconciliations with theses established parameters.