CDS
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

ACCURATE INVENTORY NUMBERS ARE CRUCIAL FOR YOUR BUSINESS

For many companies, inventory is a significant dollar amount on the company's financial statements. So it's crucial that recorded inventory balances reflect actual values. When such accounts aren't properly stated, the cost of goods sold and current ratios – numbers that often matter to decision makers – may be skewed. If banks discover that your company's inventory accounts are overstated, they may not extend credit. If, when necessary, inventories aren't "written down" (their values lowered in the accounting records), fraud may go undetected or the company's net profits may appear unrealistically rosy.

Inventories decline in value for a variety of reasons. You might be in the business of selling electronic equipment to retail customers. Over time, yesterday's "latest and greatest" gadgets become today's ho-hum commodities. Such goods still have value, but they can't be sold at last year's prices. Your inventory is experiencing "obsolescence."

Inventory "shrinkage" is another term that's often used to describe declining inventory values. Let's say you run a construction materials company. Unbeknownst to you, a dishonest supervisor is skimming goods from your shelves. A periodic inventory count that's compared to your company's general ledger might show that inventory is declining faster than it's being sold. As a result, you may decide to investigate and to reduce inventory values in your accounting records. Other examples of shrinkage might include a clothing store that loses inventory due to shoplifting or a warehouse facility that's hit by a storm. In both cases, inventories may need to be written down in the company books to more accurately reflect actual values. Under another scenario, a shady supplier might bill your company for goods that aren't actually shipped or received. If invoices are recorded in your accounting records at full cost, your inventory may end up being overstated.

For some companies, several sources feed into inventory values. A manufacturing concern, for example, might add all the expenses needed to prepare goods for sale – including factory overhead, shipping fees, and raw material costs – into inventory accounts. When those supporting costs fluctuate, inventory accounts are often affected.

To ensure that your inventory numbers remain accurate, it's a good idea to conduct regular physical counts and routinely analyze the accounts for shrinkage, obsolescence, and other evidence of diminishing value.

To set up an appointment with your tax preparer, or for additional information, contact our office at (888) 388-1040.