1. GENERAL POLICIES - Each agency must adopt and follow the following internal control policies for inventory.

   a. Segregation of duties must exist between record keeping and custodial functions.

   b. Adequate accounting control over inventory must be established and maintained.

   c. Inventories should be stored where loss from fire, theft, temperature, humidity or other elements is minimized.

   d. Storekeepers must compare quantities received against receiving reports.

   e. Materials may be released from storerooms only on the basis of approved requisitions.

   f. All inventory items must be necessary for the operations of the organization.

   g. Access to the storeroom must be controlled.

   h. If the value of the inventory is $25,000 or more, then a perpetual inventory system should be used. Otherwise, either a periodic or perpetual inventory system may be used.

   i. An annual physical inventory must be performed regardless of which inventory system is used.

   j. If a perpetual inventory system is used, then periodic testing of items in the inventory must be performed to verify the accuracy of the perpetual inventory records.

   k. Any discrepancies between the records and the physical count must be investigated and resolved.

2. TYPES OF INVENTORY - There are two main types of inventory: 1) Supplies Inventory; and 2) Items for Resale.

   a. Supplies Inventory is the most common type of inventory used in the State. This inventory usually consists of office supplies, small tools, etc.

   b. Items for Resale is the inventory that is used by Proprietary Fund Types i.e., Enterprise Funds and Internal Service Funds. In addition, some manufacturing functions (i.e., Arizona Correctional Industries and Arizona Industries for the Blind) may subdivide Items for Resale into three additional categories: 1) Raw Materials; 2) Work in Process; and 3) Finished Goods.

3. PROCEDURES - These procedures apply primarily to Supplies Inventory. Specific procedures for Items for Resale is the responsibility of the specific agency(ies).

   a. As appropriate, a central warehouse or supply storeroom for commonly used items (e.g., small tools and office supplies) should be established.This would permit purchases of large quantities at lower prices and provide access to commonly needed items.

   b. Supplies inventory may be recorded by either of two accounting methods: 1) the Purchase method; or 2) the Consumption method. The Purchase method requires recording the full amount of purchases as an expenditure when goods are purchased. When the purchase method is used, the agency must record as an asset significant inventories at year end with an offset to the Reserve for Inventory of Supplies Account (GL Account Number 3010). The Consumption method requires recording amounts purchased as assets. Assets are reduced and expenditures are recorded as goods are used. At fiscal year end (i.e., June 30) a reserve for inventory account is not established because the goods have not been recorded as expenditures. The Purchase method is the preferred method for State Agencies.

   c. Supplies may be accounted for using either the Perpetual inventory or the Periodic inventory system. In the Perpetual Supplies Inventory System, a moving average price is recommended to value the inventory. This method facilitates the costing of inventories issued to users on a current basis rather than at the end of the period. The moving average procedure involves a calculation of a new cost after each purchase. The total average cost for items remaining in the inventory, plus the costs of items purchased, is divided by the total number of units on hand to determine the unit cost of items to be issued. The inventory control card (Exhibit 1) may be used to account for supplies on the perpetual inventory system.

   d. In a Periodic Supplies Inventory System (i.e., an annual inventory is taken), the value of the inventory should be calculated by the weighted average method.

      The weighted average method is illustrated in the following example:

      (1) Assumption:

| Quantity Purchased | Cost | Extended Cost |
|---|---|---|
| 10 | $1.00 | $10.00 |
| 20 | $1.50 | $30.00 |
| 30 | | $40.00 |

      (2) Computation:

$$\frac{\text{Extended Cost}}{\text{Quantity Purchased}} = \frac{40.00}{30} = \$1.33$$

e. The following are sample procedures which could be used for issuing items stored in a central supply storeroom:

(1) Requisitioning Section:
(a) Prepares at least a two-part prenumbered requisition (See Exhibit 2),
(b) Signs and dates the requisition, and
(c) Submits original to central supply storeroom and retains duplicate copy on file.

(2) Central Supply Storeroom:
(a) Processes the requisition and prepares items for delivery, and
(b) Obtains signature on duplicate copy of the requisition when the supply items are delivered by the central supply storeroom or picked up by the section.

(3) Requisitioning Section:
Upon receipt of goods, verifies that all items are received by signing and dating the duplicate copy of the requisition.

The central supply storeroom employee will record the cost of items issued, by section, and furnish the accounting/finance section with a monthly summary of all charges. The accounting/ finance section will record these charges to the appropriate section monthly.

4. PHYSICAL INVENTORY - A physical inventory of supplies provides accurate accounting records and financial statements by substantiating the quantities of supplies inventory on hand. The valuation of items counted during the physical inventory becomes the amount recorded as supplies inventory in the financial statements. State agencies should perform a complete physical inventory annually if a periodic inventory system is used and at least once every three years if a perpetual inventory system is used.

When the agency performs a physical inventory, it should be done as close to fiscal year-end as possible and adjusted for issues, receipts or other changes between the date of the physical inventory and fiscal year-end.

Preparing for the Physical Inventory - Efficient and accurate inventory taking requires careful planning. Each State agency should develop written instructions that clearly indicate the procedures for taking the physical inventory. Such instructions should be distributed to and reviewed with all employees participating in the physical inventory so the instructions are clearly understood and uniformly followed by all employees. The State agency should take a physical inventory at each location where inventory is stored. Inventory items in individual departments that have been issued from the warehouse should not be counted in the physical inventory unless material in amount.

The agency should choose the date for taking the physical inventory sufficiently in advance to allow adequate planning and preparation for the inventory. Ideally, operations, receipts and issues at the inventory storage area should be stopped to provide a proper cutoff and accurate counts of inventory items. If this is not practicable, activity should be minimized as much as possible.

If tags are used, they should be prenumbered and in two parts. The agency should assign an employee not involved in counting the inventory to be responsible for custody of the tags and maintaining a log to account for tags issued. Tags should be issued to inventory count teams in numerical sequence.

One member of the inventory count team should count the inventory on hand for each item, and call the location, item stock number, description, quantity and unit of measure for that item. The second team member should record this information on an inventory tag. The stub of the tag should be attached to the stack or batch of items counted to indicate that the inventory item was counted. The second part of the tag should be used as a source document for preparing an inventory listing. Unused tags should be returned to the employee maintaining the log so all tags are accounted for. An advantage to the use of a tag system is the reduced risk of an inventory item being counted twice or not counted at all, since the stub clearly indicates that an item has been counted.

If inventory count sheets are used, they should also be prenumbered. As with a tag system, an employee not involved in the inventory count should maintain a log, and the numerical sequence of inventory count sheets should be accounted for. Two-member count teams should complete inventory count sheets in the same manner as described for inventory tags. The persons who count and record the inventory should initial and date the inventory count sheet to document their responsibilities. Since inventory count sheets do not provide a means of identifying which items have been counted, the agency may want to employ other means to verify that all items have been counted. For example, a colored sticker may be attached to each stack or batch of items counted. Count teams should return unused inventory count sheets to the employee maintaining the log to account for all inventory sheets (See Exhibit 3).

After the inventory has been counted, an employee not involved in the first count should make second counts on a test basis to help ensure the accuracy of the physical inventory counts. All differences should be investigated and resolved. An employee responsible for supervising the physical inventory process should initial adjustments to inventory tags and inventory count sheets.

If a perpetual inventory system is used, the agency should compare the quantities from the physical inventory with balances on the perpetual inventory cards and resolve any differences. If differences are significant, a second count and review of description should be performed. A responsible state employee should fully document and approve all adjustments to the detailed accounting records resulting from the physical inventory. Additionally, if a perpetual inventory system is used, the inventory control department should make periodic test counts throughout the year to verify the quantity on hand.

Preparing The Inventory Listing - The agency should use the inventory count sheets or tags to compile a year-end inventory listing to support the amount presented in the financial statements. The listing should include item description, quantity, unit cost, extended cost, purchase document number, page totals and a grand total.

If inventory count sheets are used, the count sheets may also serve as the inventory listing. After the inventory has been counted, an employee independent of the custodial function should record the unit costs, compute extended cost for each item, determine the total value of the inventory on each page and in total, and sign and date the count sheets to document responsibility for the valuation of the items.

Agencies should retain all inventory tags, inventory count sheets, control logs, written instructions and other documentation relating to the physical inventory to support the inventory listing.

5. YEAR-END CUTOFF

Agencies should establish procedures so that inventory transactions are recorded in the proper fiscal year. Proper cutoff is an important step in determining the valuation of supplies inventory at year-end.

Agencies should sufficiently plan year-end cutoff of inventory issues, receipts, returns and transfers. Additionally, the agencies should establish procedures for the clearance of all unprocessed receiving reports, inventory issue requisitions and other documents relating to movement of inventory.

The cut-off of inventory documents is essential so comparisons of physical inventory counts to inventory accounting records are meaningful. The agencies should bring the inventory accounting up to date as of the time operations cease for the purpose of taking physical inventory.

STATE OF ARIZONA

EXHIBIT 1

INVENTORY CONTROL CARD

Location______________ Description_______________ Max. Stock_______________

Stock Number_________ Unit of Measure___________ Min. Stock_______________

| | PURCHASES | | | | ISSUES | | | | BALANCE | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | P.O. No. | Qty | Unit Cost | Total Cost | Req. No. | Qty | Unit Cost | Total Cost | Qty | Unit Cost | Total Cost |
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STATE OF ARIZONA

EXHIBIT 2

INVENTORY REQUISITION

Department________________________ Requisition Number__________________

Ordered by________________________ Order Date__________________________

Phone_____________________________ Date Required_______________________

Location__________________________ Account Code________________________

| Quantity | Description | Unit of Measure | Unit Cost | Total Cost |
|---|---|---|---|---|
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| | | | Total Amount | |

Comments:_____________________________________________________________

______________________________________________________________________

Approved:_________________________ Received by:______________________

Title:____________________________ Title:____________________________

Date:_____________________________ Date:_____________________________

STATE OF ARIZONA

EXHIBIT 3

INVENTORY COUNT SHEET

SHEET No.

(Prenumbered)

INVENTORY ______________19___

Department ________________________ Priced by __________________________

Location __________________________ Extended by ________________________

Counted by ___________________________

Recorded by __________________________ Reviewed by ______________________

| Item Stock No. | Description | Quantity | Unit of Measure | Unit Cost | Total Cost |
|---|---|---|---|---|---|
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