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Establishing An Inventory Management Program

PURPOSE

This chapter addresses the planning and preparation phase necessary to establish an effective Inventory Management Program within an organization using either a manual inventory process or an automated inventory process.

DEFINITIONS

Property Management Plan - An established effective and efficient internal management plan for protecting, preserving, accounting for, and controlling property from acquisition through disposition, including both application and compliance.

Property Management System – A system designed to process lifecycle management of property. These processes represent sound practice and are compliant with applicable standards, policies, regulations, and contractual requirements (DPAS is such a system).

Inventory Management Program - A process used to verify the existence, location, and quantity of property items. This process may involve verifying additional property information.

RESPONSIBILITY

Each entity issued government equipment and funds is responsible for establishing a property management plan that satisfies the definition of above. The inventory management program is a critical element of the overall property management plan. As a minimum, the program should address the following:

- ❑ **Managing Assets**
- ❑ **Conduct of Inventories**
- ❑ **Addressing Inventory Losses**
- ❑ **Using "Best Practices" in Achieving Inventory Excellence**
- ❑ **Using DPAS as the Managing System**

The remainder of this manual will assist managers in developing their internal inventory management program, which is a vital part of the overall property management plan.

Planning Effective Inventories

1. **Best Practices in Achieving Consistent, Accurate Physical Counts of Inventory and Related Property (Executive Guide GAO-02-447G, Mar 2002)**

- The United States General Accounting Office (GAO), has prepared an Executive Guide outlining best practices by leading-edge private sector companies, to identify the key factors and fundamental practices and procedures they used to achieve accurate and reliable physical counts and inventory management. Also, it explains and describes leading practices from which the Federal Government may be able to draw lessons and ideas. It is recommended that individuals responsible for developing an internal property management program, in addition to satisfying applicable regulations and policy, review the GAO guide prior to program development and implementation. The guide can be found at <http://www.gao.gov>. In the search window, enter GAO-02-447G.
- To further assist you in planning and developing an effective inventory management program utilizing the GAO Guide, Chapter 2 of this manual provides the following aids:
 - Inventory Management Implementation Checklist
 - Industry Best Practices Key Factors (1-12)

These aids were taken from the GAO Guide as the key elements to be used.

2. **Physical Inventory Requirements:** A physical inventory is an assessment or audit used to verify the existence, location, and quantity of property items. This process may also involve verifying additional information about the asset(s). Physical inventories are efforts involving significant time, resources, complexity, and personnel, appropriate management techniques should be employed such as the use of barcode scanners or other electronic devices to ensure data accuracy. Physical inventory validates the existence and location of property as well as providing:

- A positive basis for assuring completeness and accuracy of property records and financial accounts.
- Procedures for adjusting and reconciling property and financial records.
- Procedures for adjusting and reconciling the custodial records with property records.
- Assessing the accuracy and effectiveness of accountable property control procedures.
- Results as cited above are obtained when physical inventory is conducted regularly, with specific procedures and documentation that identify the exact status of property being inventoried.

3. Physical Inventory Program Functions (three distinct functions):

- **Location Validation.** A physical verification of the actual storage or custodial location to the location recorded in the master record to ensure the location of all assets is properly recorded.
- **Physical Inventory.** A physical count of items of stock in storage or in use for the purpose of verifying the recorded balance on the master records.
- **Reconciliation.** The process of aligning the actual counts with the master record's recorded on-hand quantities.

4. Physical Inventory Goal:

- The goal of physical inventories is to establish and continuously improve the inventory accuracy and accountability of property in the custody of Federal agencies. Maximum use must be made by a valid sampling method to continuously validate inventory accuracy and to identify those segments of the overall inventory most in need of inventory attention. This will ensure that maximum benefits are derived for the resources allocated to the physical inventory program. The success of the physical inventory program has a direct impact on property availability; accurate, timely procurement actions; financial accountability and accurate financial statements and reports, to include capital items; and overall supply effectiveness.
- Physical inventories are designed to assist property managers in maintaining accountability and custody of property. There are a number of ways in which this function can be enhanced. For example, improved personnel training, updating appropriate regulations and procedures, initiating computerized systems to provide quicker and more accurate data, and educating personnel on the impact of other supply/logistics functions on inventory accuracy.
- A physical inventory does not reveal why an item was not found. Generally, it can only identify those items found and those not found. Items not found may have been lost or stolen, disassembled or destroyed, legitimately disposed of (though not recorded), or may have been missed during the inventory.
- Physical inventories have several byproducts as well. During the inventory, record deficiencies, such as incorrect locations or unrecorded property items are identified; these records are corrected as part of the process. Finally, physical inventory serves as a deterrent to loss, theft, damage, and misuse as those responsible for property perceive that they will be held accountable for it and be required to produce it on a periodic basis.
- In summary, physical inventories are conducted to accomplish one or more of the following:
 - Assess the accuracy of property records
 - Update property records
 - Assess property loss experience
 - Provide the status of capital items for financial reporting purposes
 - Deter misuse, loss, damage, and theft of property

5. **Types of Inventories:** Each agency has its own internal requirements and guidelines for conducting inventories. Nonetheless, there are five basic types of physical inventories applicable:

- ❑ **Wall to Wall:** A scheduled inventory of all items, as of a given date.
- ❑ **Cyclic:** A cyclic inventory is a scheduled physical inventory conducted on a group of items within a specified period of time, according to an established plan.
- ❑ **Special:** A special inventory is a scheduled physical inventory of selected items for reasons deemed appropriate by the agency.
- ❑ **Spot:** A spot inventory is an unscheduled physical inventory usually conducted at random to determine record accuracy.
- ❑ **Selected Item:** A selected item inventory is an unscheduled physical inventory of specially targeted items.

The type of inventory required is based on several factors. Some of these are:

- Acquisition or replacement cost
- Security classification
- Sensitivity of item
- Requirements generated by the property manager to verify stock records

6. **Frequency of Inventories:**

- ❑ DoD Instruction Number 5000.64, dated 13 August 2002, states that agencies establish and maintain physical inventory schedules generally with the below listed requirements.
 - Military Equipment - Annually
 - Other Personal Property - At least every three years
 - Real Property and Stewardship Land - At least every five years
- ❑ Since various services, agencies and/or organizations may dictate a more stringent frequency; an inventory schedule should be based on applicable/local policy as long as it meets DoD Instruction as a minimum. Accountable Property Officers, Custodians, and/or Managers should schedule inventories and assist in their completion, in accordance with these policies.

7. **Scheduling Responsibilities:** The Accountable Property Officer prepares the plan and schedule for all physical inventories prior to the beginning of the fiscal year. This activity is coordinated with agency officials responsible for its financial operations and also with Property Custodial Officers or warehouse/storeroom officials responsible for physical custody of property in program areas. The schedule should identify personnel assigned to conduct a physical inventory, dates for training and orientation, plus procedures and guidelines for physical inventory teams.

Additionally, the schedule should list the personnel assigned to each custodial area, start date and completion date, number of items in the custodial area, items on loan to the custodial area and any other information regarding status of items that affects the physical count.

The Property Custodial Officers are assigned specific duties and responsibilities to get ready for a physical inventory and for providing leadership in program areas that enable team members to observe, verify and count all property under jurisdiction of custodial officers. The following results should be achieved:

- ❑ Verifying that property on record is on-hand in the physical location assigned, in the proper custodial area, and is assigned an agency property identification number.
- ❑ Identifying unrecorded property so that it can be reconciled to property and financial records and assigned to use in a custodial area or picked up for other use or disposal.
- ❑ Locating/identifying missing items.
- ❑ Custodial, accountable property, and financial records are reconciled for:
 - Items assigned but not recorded on custodial or property records.
 - Items assigned but not found.
 - Items excess to program needs and items in need of repair.

8. **Count Procedures:** Complete and correct item counts result in greater accuracy and better inventory control. To preclude recounts and unnecessary research, inventory personnel will ensure that the total quantity of each item is determined as accurately as possible in the initial circuit of a custodial/storage area. Tools such as tape measures, scales, equivalency tables, and wire/rope/cable measuring devices will be used when required. Inventory personnel are authorized to open sealed containers when necessary for item identification and/or quantity verification, except that preservation packaging should not be broken. All opened containers will be resealed after the identification and count have been completed and externally marked on each container. In conducting the inventory, inventory personnel will proceed from location to location in a predetermined sequence and will ensure that:

- ❑ Each item is legibly identified by an appropriate tracking number (National Stock Number (NSN), serial number, part number, barcode, or other unique identifier).
- ❑ Each unit of each item is inspected for material condition, and that the quantity unfit for use is recorded.
- ❑ Each item is carefully counted, weighed, or measured, as appropriate, and the quantity inventoried is legibly recorded.
- ❑ Quantities and units of issue recorded in count documents are compatible.
- ❑ A tag, label, or card annotated with the inventory quantity and date is attached to each reel and container from which an item is issued by unit of measure.
- ❑ Actual location of each item is either checked or entered on the inventory aids.

9. **Procedures for Reconciling Records:** It is important to set a date following physical inventory for all adjustment documents to be prepared, approved, and processed. Sixty days is considered a maximum time for all changes to records to be completed. A typical agency process would allow the Property Custodial Officer and the supporting team members up to 15 days for recount, research of property receipt and issue records, or documentation of all findings relative to a discrepancy, including initiation of an adjustment or Report of Survey. The Accountable Property Officer may proceed as follows with the work of reconciliation, provided authority is delegated:

- ❑ For items assigned to but not found in the custodial area, prepare a transfer document to relieve the custodial officer of responsibility and adjust the physical inventory listing of property assigned to the custodial area. Next, the Accountable Property Officer will prepare an adjustment document citing the dollar value of the loss and use this document to delete the property from the accountable property records. A copy of the document will be furnished to finance for deleting the dollar value of the loss from the financial accounts when Capital equipment or supplies.
- ❑ If the item is of sufficient value to warrant a Board of Survey and/or theft, loss, damage or destruction is indicated, the Accountable Property Officer will initiate and coordinate a Report of Survey. When the Board of Survey has decided the action to take, the Survey document will be the authority for the Accountable Property Officer to change accountable property records and forward a copy of the Survey document to finance for changing financial records. The Accountable Property Officer will take any other actions the Board of Survey may require such as, deletion, destruction, replacement, repair, as necessary to assure continued agency mission performance; and process the appropriate accountable documents to reconcile records.
- ❑ For items found, but not assigned to a custodial area, the Accountable Property Officer will issue a transfer voucher to remove the item from the custodial area and assignment to another custodial area where a need is justified, placed in a not required status for possible use by other organizations of the agency, or declare the item excess. In all of these activities the Accountable Property Officer is seeking to find an authorized, approved need for the item within the accountable property area, other accountable property areas of the agency, or to declare the item excess to agency needs thus making it available for other Government use as soon as possible.
- ❑ For any other discrepancy in physical inventory, it is the responsibility of the Accountable Property Officer (APO) to perform the necessary research, prepare documentation, and seek higher approval, if necessary. It is also the APO's responsibility to carry out the mission assigned of ensuring that reconciliation of physical inventory to property and financial records is completed in accordance with Agency requirements.

10. **Records Maintenance:** Physical inventory and reconciliation cannot take place without access to accountable documents. If the Custodial Officer does not have access to accountable documents, as a minimum the Accountable Property Officer should provide the Custodial Officer with a document identifying each property item assigned to the custodial area. Additionally, monthly, or as specified by agency policy, the Accountable Property Office should provide the Custodial Officer with an up-dated inventory listing of items assigned. These records and any other records initiated or processed by the Accountable Property Officer or the Custodial Officer, if they affect the status of property in any way, should be on file in the custodial area. Examples of such transactions include:

- ❑ Notification, and plans and schedules for physical inventory.
- ❑ Designate people to perform a physical inventory.

- ❑ Inventory listings of items currently assigned to the custodial area.
- ❑ Instructions and procedures for the Custodial Officer to perform all duties assigned.
- ❑ Copies of all adjustment documents if they are initiated as a result of a discrepancy in the custodial area.
- ❑ The official records and files covering all of the above physical inventory and reconciliation transactions must be in the Accountable Property Officer's files. Copies of any of these documents that affect dollar balances, or the status of the general and subsidiary ledgers, must be furnished to the official responsible for the agency finance records.
- ❑ After all adjustments resulting from physical inventory are processed, the custodial officer's files may be purged of all documents except those covering current year's property assigned and current physical inventory listings. However, the Accountable Property Officer's files, being the official agency files for property administration, must be retained until agency forms and reports officials authorize removal.

11. **Problem Areas:** Property managers must be able to recognize the conditions and actions which cause the major problems in the physical inventory function. Consider these:

- ❑ No property in newly established locations.
- ❑ Location changes reflecting erroneous data such as wrong row, level, room, building, etc.
- ❑ Property received but not posted to stock records.
- ❑ Duplicate or multiple posting to stock records.
- ❑ Quantity posted other than that received
- ❑ Wrong property or quantity shipped.
- ❑ Overage/shortage on receipt not posted to stock records.
- ❑ Property disposed of and not credited to account.

12. Standard Practice for Assessing Loss, Damage or Destruction of Property:

- ❑ This practice covers the assessment of loss, damage, and destruction (LDD) of property, assets or material. LDD occurs when such property is found to be missing, damaged, or destroyed. Such discoveries often are made as a result of a physical inventory, an analysis of material used, or routine audits.
- ❑ Excessive LDD can indicate weaknesses in awareness of control processes, physical security, procedures, and the like.
- ❑ LDD creates concerns regarding effectiveness and efficiency indicating a negative impact on profitability or mission. Excessive LDD increases risk, and indicates at least a potential, if not real, weakness in procedures, processes and control.
- ❑ Investigate excessive LDD, analyze the cause(s), and implement corrective action.

13. **Training and Communication:** Establish a plan to ensure that individuals involved in the physical inventory have all necessary skills and information and to ensure that all those affected by the physical inventory are familiar with the established objectives, period, population, and validation techniques.

14. **Use of Bar Code Technology (Automated Identification Technology [AIT]):**

- ❑ Bar code symbology is a method used to identify equipment and physical inventory locations. Bar codes consist of rectangular bars and spaces arranged in a predetermined pattern to represent coded elements of data that can be automatically read and interpreted by automatic bar code reading devices. The bar codes are placed on labels which are attached to the equipment and physical inventory locations. Bar coding for the equipment accounting application will greatly enhance the capability to monitor the movement of equipment and is an effective tool for use in physical inventory process.
- ❑ In accordance with DOD Instruction 5000.64, "the use of Automated Identification Technology to assist in property accountability is mandatory unless it is demonstrably proven through cost benefit or other analysis that implementation would not be practicable."
- ❑ This manual provides the responsible individual with direction and the process to schedule, generate, and record physical property inventories using AIT, to include emerging technology, and DPAS.