

Physical Inventory— The Foundation for Quality Management

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Not every company has to complete an annual physical inventory but very many do and it is a task that has few fans. Which is really too bad because from the point of view of really understanding the effectiveness of your business operations, the results of physical inventory are very telling.

It probably won't surprise you to learn that most staff members don't care for physical inventory. The initial reasons for that are pretty obvious.

- ✓ It is grueling. Whether involved only in preparation or also taking part in the count and reconciliation phases, staff expect long days and lots of time on their feet.
- ✓ It is interruptive to the business as a whole. The most obvious interruption is the halt of activities like shipping and receiving, but because staff from many departments are utilized in the inventory process it also means other functions are affected as well.

The third reason staff don't care for it might surprise you. It turns out most staff don't really understand the why's or how's of the need for the process. Sure they recognize that over the year counts or stores mistakes happen and that the physical inventory process helps gather those errors and fix them all at one time. What they don't know is how those gathered reconciliation errors are really a snapshot of how effective your people and processes are.

The dual goals of Physical Inventory

Physical inventory actually has a dual purpose and often the activities related to the second part of the purpose are simply ignored or put off for an indeterminate time. The first purpose is to verify the snapshot value of the inventory asset on the financial statements. Executing this verification occurs as a result of matching the actual to the expected stock counts. The second purpose, the part that is often overlooked, is to analyze the difference between actual and

expected counts as a form of validating the overall accuracy of the business processes that create those counts and values.

Why do so many organizations not get around to the second purpose of Physical Inventory?

We think a contributing factor to the lack of follow through is the overall sense of how interruptive the inventory process is. As mentioned earlier, time is of the essence in physical inventory. Not just because you don't want to be doing the task for ever but more importantly because until inventory has been counted and reconciled, operations halt and many other functions are slowed because staff is otherwise engaged.

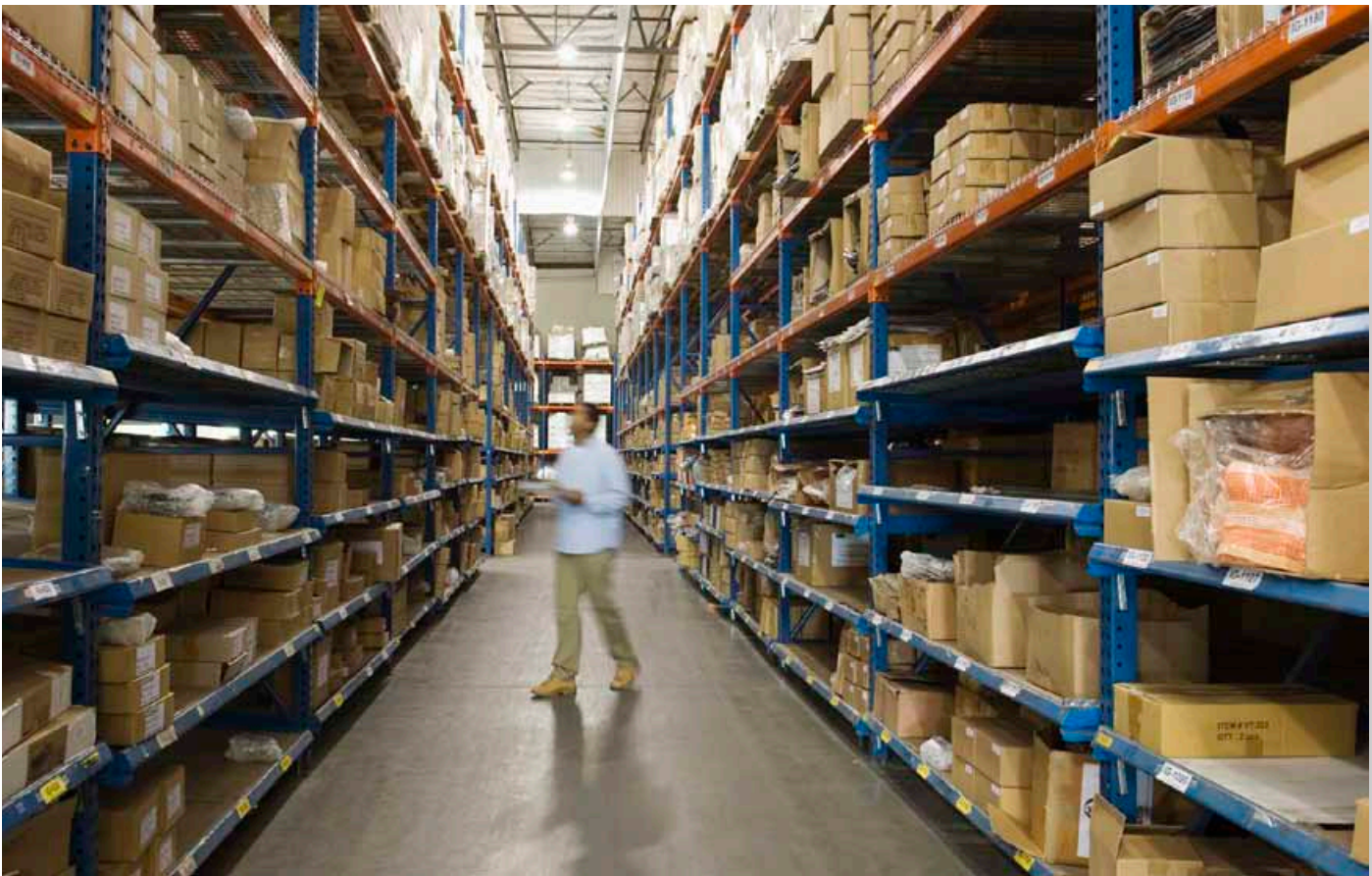
This interruptive nature means that motivation is primarily targeted to getting things moving again, not to digging in to better understand the source of discrepancies.

To combat this attitude we suggest you construct the physical inventory in four distinct phases. This approach allows staff to acknowledge the completion of each phase, while making it apparent physical inventory isn't over until all the phases are complete. It also means you can take as long as you need to properly complete the final phase of using improvement management to get to the source behaviors that created discrepancies.

We designate the phases as prepare, count, reconcile and fix. You can listen to a podcast discussing the topic here.

The prepare tasks take place before the physical count process begins. Some tasks in this phase are specific to inventory, like printing up the inventory control count sheets or providing a training session to new participants. Other tasks like cleaning up store rooms or refreshing bin labels are generally on going. Neither set of tasks require a halt to operations and are therefore not part of the interruptive aspect of inventory.

The count is of course the big interruption. All shipping and receiving activities are halted, manufacturing operations stop and no materials should move anywhere until both the



count and the most significant reconciliations are complete. Reconcile is the action of writing to the inventory the value and count adjustments that are discovered as part of the physical stock count process. We separate these activities into two phases because we know it is possible to restart operations once count is complete even if reconcile is not.

The end of reconcile is the end of the interruption.

This is when the Fix phase begins and it is where the real winning occurs. During this phase we take the reconciled transactions and begin to investigate them to identify the root cause of the discrepancies and to determine how to eliminate their reoccurrence. The good news is that because interruptions are over the Fix phase can go on for as long as is needed.

This is also where companies with strong cultures of quality will apply their improvement management processes to the task of documenting the non-conformance of the inventory counts and initiating the needed root cause investigations. You don't actually need a module like Improvement Management from [Quality Essentials Suite](#) to complete these processes but because the functionality tracks assignments, due dates and has reporting and graphing tools, it can certainly make it

easier. Centralized control of documents and events ensures consistent communication and allows everyone on the team to easily monitor progress from the same data.

From a quality management point of view, it doesn't matter how you manage your post inventory investigations it simply matters that you do. To learn more about the Improvement Management Module and conforming to the new ISO9001:2015 requirements please contact us at sales@qualityessentialsuite.com.

In our Physical Inventory Tool Chest you will find additional ideas on how you can improve your physical inventory processes to obtain greater benefits. In the tool chest we offer:

- ✓ Power Point slide deck to explain the phases of physical inventory
- ✓ Tips and Tricks for using DynamicsGP for Physical Inventory
- ✓ Physical Inventory Prepare and Execute Check List

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