

Inventory

Suggested procedures for reviewing and testing Inventory.



Inventory

A well performed collateral examination will provide the following

- ✓ **Analytical review** of key areas that includes:
 - ✓ **Year to year comparisons and trend analysis** of key performance metrics.
 - ✓ **Explanations for fluctuations** noted in any of the above performance metrics
- ✓ **Substantive testing to verify:**
 - ✓ Authenticity, existence and valuation of balances reported
 - ✓ Existence of internal controls and proper procedures



Inventory

A well performed collateral examination will also provide the following

- ✓ **Calculation of Borrowing Availability** that includes:
 - ✓ **Suggested reserves or ineligible balances to mitigate all potential risk items** noted during the exam
 - ✓ All eligible collateral, ineligible and reserve amounts, suggested and current advance rates, overall limits and sub-limits, and all loan balances



Inventory

The analytical review portion of the an Inventory audit consists of the following procedures:

- Historical breakdown of inventory by component
- Inventory roll forward
- Turn over comparisons
- Reconciliations of reported collateral to sub ledger, general ledger and balance sheet



Inventory Summary

W/P: Inventory Summary/History														
W/P Summary		Total	RM	FG	Containers	Consgnd	Other	Trend Analysis-12 Month Mvg Avgs, Last Six Months						Notes
								Date	Total	RM	FG	Containers	Consgnd	Other
Current		1,496	530	361	28	38	539							
Prior		1,432	544	353	34	22	479	Jan-00	748	270	187	16	16	258
Difference		64	(14)	8	(6)	16	60	Jan-00	606	220	152	13	13	209
Curr 12 Mo Avg		248	90	60	5	6	88	Jan-00	487	175	122	10	11	169
Prior 12 Mo Avg		1,448	547	355	32	32	483	Jan-00	368	135	89	8	8	128
Avg Diff:		(1,200)	(457)	(295)	(27)	(26)	(395)	Jan-00	243	91	59	5	5	83
Comparison Prd:		19						Jun-97	248	90	60	5	6	88
12 Month Moving Average														
Row #	Month	Total	RM	FG	Containers	Consgnd	O/S Warehouse	Labor & OH	Charlotte	Total	RM	WIP	FG	Sppls Misc Misc-2
1	Dec-94	1,194	556	292	26	30	75		215	1,194	556	292	26	30 75 0
2	Jun-95	1,457	578	299	34	33	91	188	234	1,326	567	296	30	32 83 94
3	Dec-95	1,697	601	426	36	40	104	226	264	1,449	578	339	32	34 90 138
4	Jun-96	1,432	544	353	34	22	81	190	208	1,445	570	343	33	31 88 151
5	Dec-96	1,429	475	398	31	38	86	224	177	1,442	551	354	32	33 87 166
6	Jun-97	1,496	530	361	28	38	93	224	222	1,451	547	355	32	34 88 175
7	Jun-96	1,432	544	353	34	22	81	190	208	1,448	547	355	32	32 87 177
8		1,486	547	355	32	34	88	210	220	1,453	547	355	32	32 87 182
9		0								1,291	486	315	28	29 78 161
10		0								1,162	438	284	25	26 70 145
11		0								1,057	398	258	23	23 64 132
12		0								969	365	236	21	21 58 121
13		0								869	318	212	19	19 52 121
14		0								748	270	187	16	16 44 105
15		0								606	220	152	13	13 36 87

Inventory Summaries are analyzed to determine how the categories behave over time. Results can indicate a deteriorating performance, the impact of seasonality on inventory or an improper mix of inventory components.

Analysis includes:

- Inventory balances by category
- Trend analysis of categories/totals
- Year to year comparisons

Inventory Statistics

W/P: Inventory Roll forward/Statistics																				
W/P Summary			Cntrl Comprns		Trend Analysis- Last Six Months							Notes								
Last Phys. Date:	31-Dec	G/L:	1,468	Month	End Inv.	Prchs	DL	DOH	COGS	T/O Days	Labor and OH are booked directly to sales and cogs. June 97 includes activity for									
Beg. Balance	1,429	Date:	Nov-97	May-97	813	0	169	0	752	44.1										
Purchases	5,112	Diff:	16	Jun-97	1,449	1,016	169	0	592	57.3										
Direct Labor	1,691	Pct:	1.12%	Jul-97	1,416	530	169	0	751	57.2										
Direct OH	-	Perp:	-	Aug-97	1,462	539	169	0	682	63.3										
Misc./Phys adj	214	Date:	Nov-97	Sep-97	1,519	470	169	0	610	73.3										
Cst of Gds Sld	6,994	Diff:	-	Oct-97	1,452	510	169	0	774	58.9										
Ending Bal.	1,452	Pct:	0.00%	Avg:	1,352	511	169	-	693	58.5										
Beg Row#:	1	CurrT/O Days:	58.9																	
End Row#:	10	Prior T/O Days:	0.0																	
																	12 Month Moving Average			
Row #	Month	BOM Inv	Prchs	Dir Lab	Dir OH	Misc	Net Sales	COGS%	COGS	Phys Adj.	Pct	Inv T/O	T/O Dys	Perp Bal	Diff.	G/L Bal	Diff.	BOM Inv	Prchs	DOH
1	Jan-97	1,429	490	169		18	1,316	56%	740		0.00%	0.53	57		1,429	1,429	-	1,429	490	169
2	Feb-97	1,366	492	169		18	1,200	56%	675		0.00%	0.49	61		1,366	1,380	(14)	1,397	491	169
3	Mar-97	1,370	546	169		18	1,123	56%	632		0.00%	0.44	67		1,370	1,397	(27)	1,388	509	169
4	Apr-97	1,471	519	169		23	1,398	56%	786		0.00%	0.55	55		1,471	1,478	(7)	1,409	512	169
5	May-97	1,396	0	169		0	1,336	56%	752		0.00%	0.68	44		1,396	1,435	(39)	1,406	0	169
6	Jun-97	813	1,016	169		42	1,052	56%	592		0.00%	0.52	57		813	1,429	(616)	1,307	511	169
7	Jul-97	1,449	530	169		19	1,335	56%	751		0.00%	0.52	57		1,449	1,459	(10)	1,328	513	169
8	Aug-97	1,416	539	169		21	1,213	56%	682		0.00%	0.47	63		1,416	1,444	(28)	1,339	517	169
9	Sep-97	1,462	470	169		28	1,085	56%	610		0.00%	0.41	73		1,462	1,470	(8)	1,352	511	169
10	Oct-97	1,519	510	169		27	1,375	56%	774		0.00%	0.52	58		1,519	1,502	17	1,369	511	169
11	Nov-97	1,452							0		0.00%	0.00	0		1,452	1,468	(16)	1,377	0	0

Inventory Statistics are prepared to measure the performance of the Inventory collateral. Results of this procedure **give the lender an indication of how well this asset is performing and if that performance is improving or deteriorating.**

Analysis includes:

- Comparison of reported activity to Detail and or G/L totals
- Verification of perpetual and or G/L balances
- Year to year comparisons and trend analysis of key metrics including GP% and Inventory turnover

Inventory

The substantive testing portion of the an AR audit consists of the following procedures

- Test Counts
- Cost Test
- GP Test
- Reconciliations of reported collateral to sub ledger, general ledger and balance sheet



Inventory Test Count

W/P Test Count W/P 1													
W/P Summary			Variance Analysis				000's omitt			Net Variance Frequency Analysis			Notes
Category Tested:			Negative Variances	Items	Amount	Over -10%	Items	Amt Tst	Percent				
\$/Last Consignment:			Positive Variances	0	\$0	-5 thru -10%	0	-					
Date Last Consignment:				0	\$0	0 thru -5%	0	-					
# of Items Tested:	-		Net Variance	Amount	Percent	0 thru 5%	0	-					
\$ Amt Tested:	\$0		Absolute Variance	\$0	0.0%	5 thru 10%	0	-					
Pct Tested:	0.0%			\$0	0.0%	Over 10%	0	-					
Reserve:	\$0		Adjstmnt:		Net Res:	\$0							
Part Number	Description	Qty/Last Cons	Unit Cost	Tot. Value	Quantity Shipped	Quantity Received	Adjusted Quantity	Adjst'd Value	Quantity Auditor	Net Unts	Variance Net Amt	Net Pct	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	
				0.00			0	0		0	0	0.0%	

Test counts are completed to help determine if reported inventory quantities are accurate. **Results can indicate poor internal controls, problem inventory, overstatement of inventory quantities, bill and hold inventory and excess or obsolete inventory.**

Procedure includes:

- Physically verifying the existence of inventory reported
- Identifying conditions of inventory and storage facility
- Testing the validity of activity posted to the perpetual

Inventory Cost/Price Test

W/P Cost Test W/P 1													
W/P Summary			Variance Analysis				000's omitted			Net Variance Frequency Analysis			Notes
Category Tested: RM & FG			Items	Amount	Items	Amt Tst	Percent						
\$/Last Consignment: \$ -			Negative Variances	2	(\$1)	Over -10%	0	-	0.0%				
Date Last Consignment:			Positive Variances	0	\$0	-5 thru -10%	0	-	0.0%				
# of Items Tested: 5			Amount	Percent	<0 thru -5%	2	50.4	49.2%					
\$ Amt Tested: \$102			Net Variance	(\$1)	-0.9%	0 thru 5%	3	52.1	50.8%				
Pct Tested: 0.0%			Absolute Variance	\$1	0.9%	5 thru 10%	0	-	0.0%				
Reserve: \$0			Adjstmnt:		Net Res: \$0	Over 10%	0	-	0.0%				
Part No.	Description	Qty/Last	Unit	Cost per Auditor			Total Cost -----			Variance -----			Abs/Unit
		Cons	Cost	Tot. Value	Material	Labor	Over Head	Misc	Per Audit	Cst/Unt	Net Amt	Net Pct	
100650	ISO Octyl Alcohol	40045	0.51	20,422.95	0.51				0.51	0.00	0.00	0.0%	0.00
100880	Phosphoric Anhydride	43745	0.85	37,183.25	0.84				0.84	-0.01	-437.45	-1.2%	0.01
102000	Sodium Gluc Tech	20391	0.65	13,254.15	0.63				0.63	-0.03	-509.78	-3.8%	0.03
102620	SM-2162	7235	2.49	18,015.15	2.49				2.49	0.00	0.00	0.0%	0.00
107050	Trycol 6720	16018	0.85	13,615.30	0.85				0.85	0.00	0.00	0.0%	0.00

The cost test is completed to help determine if the reported carrying costs are accurate and/or approximate the market or replacement costs. **Results can indicate poor internal controls, problem inventory, overstatement of carrying costs, and excess or obsolete inventory.**

Procedure includes:

- Tracing carrying costs to recent vendor invoices or market costs
- Identifying components that comprise the total cost of an item
- Identifying old/excess product
- Determining methods used to value inventory items.

Gross Profit Test

W/P: Gross Profit Test

W/P Summary		Items Tested:	G/P Percentage Analysis			Notes		
G/P Per Client:		24	Sales \$ Tested:	\$318.3	Items \$ Amt Tst	Pct Tst	Cost per pound is material cost plus 12.5 cent overhead.	
G/P per Test:	44.9%		Cost \$ Tested:	\$175.4	0	-		0.0%
Less Cash Dil:			Avg Price/Unit:	\$13.3	1	14.9		4.7%
Less Misc Dil:			Avg Cost/Unit:	\$7.3	0	-		0.0%
Net G/P Per Test:	44.9%		Avg G/P per unit:	\$6.0	1	9.9		3.1%
Min G/P%:	4.6%		Fixed Costs/year:		5	73.3		23.0%
Max G/P%:	61.0%		B/E Units:	0	17	220.2		69.2%

Customer Name	Cust. #	Description	Inv #	Inv Date	Price per Item #	Unit Sold	Total Sale	Cost per Unit	Total Cost	G/P \$
Delta Plant #3	40061	Clavodene KTF	40699	11/5	1.09	9200	10,005.00	0.54	4,922.00	5,083.00
Stevcoknit-Carter	201950	Clavodene ALF Conc	40853	11/20	1.84	17840	32,825.60	0.72	12,826.96	19,998.64
Delta Plant #3	40061	Clavodene KTF	40942	11/26	1.09	13800	15,007.50	0.54	7,383.00	7,624.50
Russell Corporation	190110	Dextralube FRM	40744	11/12	0.50	40140	20,070.00	0.34	13,446.90	6,623.10
Bristol Myers Squibb Co	20840	Dextrol 230	40403	10/9	1.35	23040	30,988.80	0.58	13,390.85	17,597.95
Cross Creek Apparel	180010	Dextrol Defoamer NT-5	40674	10/31	1.53	2200	3,366.00	1.06	2,321.00	1,045.00
Delta Plant #2	41530	Dextrol DL-2	40584	10/30	5.50	1800	9,900.00	4.06	7,299.00	2,601.00
Brittany Dye & Print	20470	Dextrol FOM Soft NVSC	40895	11/24	0.99	18560	18,337.28	0.39	7,145.60	11,191.68

The gross profit test is completed to help determine if the reported gross profit is accurate and to identify individual items or classes of inventory that may be driving the GP up or down. **Results can indicate problem inventory, items sold at a loss and excess or obsolete inventory.**

Procedure includes:

- Comparing the calculated gross profit to interim and FYE income statement
- Identifying items sold at a loss or materially below normal margins
- Determining reasons for variances

Inventory Ineligibles



Throughout the review and during all procedures the examiner is on the constant lookout for items which can encroach on the liquidity of the accounts receivable. Reserves or ineligible recommendations are made for all transactions or balances which are deemed to be above average risk.

- Slow Moving
- Obsolete
- Excess
- Outside Contractors
- Public Warehouses

- Bill and Hold
- Consigned Inventory
- Contra
- Perpetual - G/L Rec.
- Test Count Variances

- Cost Test Variances
- Supplies
- Packaging
- Private Label

The logo features a stylized ECG waveform in shades of blue and white, with the company name and email address centered below it.

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Please feel free to contact ECG Enterprises to arrange for a collateral examination.

ECG is a new and young company, built on Greg Isenberg's extensive experience in the commercial finance industry,.

ECG specializes in **protecting lenders by designing and implementing audit programs** that:

- Identify collateral risk lenders may not be aware of
- Identify favorable and unfavorable trends in a borrower's financial and/or collateral performance
- Provide relationship managers with strategic information not readily available elsewhere.