THE PREROGATIVE OF IMPLEMENTING AN EFFECTIVE INTERNAL CONTROL OF INVENTORIES IN THE ECONOMIC ENTITIES

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ABSTRACT*: The current control for physical integrity and the rights exercised on stocks involves the application of appropriate procedures for physical inspection of inventory and reconcile inventory results with records, followed by investigating differences resulting from inventory. Checking stock assessment involves determining the cost of inventories and net realization value, as well as comparing the two values to be retained in the synthetic minimal financial statements.*

KEY WORDS*: inventories, internal control, cost of inventories*

1. INTRODUCTION

In planning for the internal control of inventory one must be aware of the high risk related to the management assertions about the existence and stock assessment. With regard to assets, the company is motivated to overstate stocks rather than underestimate them. Due to the lack of stock obtained from third parties in case of production is much easier to overstate the value of stocks than other assets such as receivables, treasury etc.

Determining when the stock rights transfer occurs from the supplier to the customer is very important. There are times when stocks are transferred with or without property rights over them. From this point of view we must appreciate the existence of effective controls on this type of transaction.

2. DISCUSSION

The financial accounts of the company stocks are classified and defined according to four criteria: physical, destination, operating cycle stage, and place to create inventories.

Corresponding to these criteria are individualized following stocks:

• raw material directly involved in the production , being found in their structure or part original state or processed;

• consumable materials include auxiliary materials, fuel , spare parts , seeds and planting material, feed and other supplies indirectly participating or helping operating activities not formally rule, the resulting product;

• products in the form of blanks, finished products and waste products ;

• animals that have not met the requirements to be listed in adult animals , animal fattening , poultry and bee colonies;

• work in progress represents raw materials that have not gone through all stages of manufacture, any non technical evidence and reception and the work and services in progress or unfinished ;

• goods , namely that the company buy goods for resale ;

• packaging , include goods necessary to protect goods during transport and storage or commercial presentation .

In Romania, the Regulation implementing the Accounting Law no. 82/1991 is given the following definition of this class of property assets, "Accounting for inventories and work in progress includes all goods and services in the economic unit, for:

• either to be sold in the same state or after processing them in the production process; • either be eaten on their first use.

The main objectives of accounting incumbent in this area are :

- tracking and monitoring the realization of the supply, the organization of groups and types of inventories and transportation costs , supply kinds of expenses .

- ensuring the integrity of property stocks in storage and permanent places of their movement by organizing material working capital management accounting , and within the course of stocks, quantity and value , accurate and timely recording of the amount of movement and differences in inventory , notification of the stocks without utility or slow moving , to take the necessary measures liquidated.

- follow the rational use of material resources supplied enforce specific consumption norms release from storage , record savings or unused materials and recoverable materials resulting from manufacturing processing stations

- providing transportation costs , supply delimitation of the value of materials supplied

- registration and control capitalization stocks of goods and other inventories to be delivered to third parties.

- record and track product inventories in the procurement and delivery at competitive prices.

- realistic assessment of stocks and determining heritage influences and outcomes , through the proper application of the rules of evaluation.

- promotion of prudence and going concern assessment and recording of inventory accounting .

International Accounting Standards Committee (IASC), through the accounting standard IAS 2 "Inventories" applied from 1/1/1976 and revised in 1993, defines the stocks as an asset and their acquisition cost includes purchase price, taxes customs and other duties sunk, transport-supply.

The objective of IAS 2 is to describe the accounting treatment for inventories. This standard deals with the cost of inventories, such stocks inventory method adopted and the allocation of costs, inventories recognized as assets and expenses and any diminution of inventories to net realizable value.

The standard covers all active stocks are:

- held to be sold in the ordinary course of business;
- in production for sale;
- in the form of raw materials and other consumables to be used in the production process;
- the provision of services.

Depending on the nature of stocks held, should be checked storage conditions and storage, as well as security.

Outside the direct control in such cases is expected to be in place restrictions on leaving the management of such property - exit management based on documents duly authorized. In addition, inventory storage conditions must be adequate to prevent damage, destruction and facilitate access and identification of stocks.

Removal from inventory control is manifested often by applying strict procedures regarding the documentation (which must be duly authorized) and evaluation (it is the case of difficult to sell stocks, waste products, etc.).

The current control for physical integrity and the rights exercised on stocks involves the application of appropriate procedures for physical inspection of inventory and reconcile inventory results with records, followed by investigating differences resulting from inventory.

Differences in inventory (pluses / minuses inventory) indicates a high control risk. In addition to the existing stocks situation inventory also determines the physical integrity and helps identify operational rights exercised on stocks.

If there is a satisfactory system of internal control in operation, the following activities should be screened:

- purchases of stocks;
- storing stock;
- exit from inventory;
- determine the existence, physical integrity and the rights exercised on the stocks;
- evaluating stocks.

A significant feature of stocks is that they go through a continuous cycle of acquisition, use in production and sales. In both cases - the company producing and traders - inventories and cost of sales are significant for both summary financial statements, and for assessing the performance achieved.

There are many risk factors that can affect stocks, including:

- transaction volume procurement , production and sales are generally high , thereby increasing the risk of errors in the accounts ;
- there are always hotspots on stock assessment and identification, sizing and allocation of indirect costs , the accounting treatment of waste products , assessing deviations from standard costs , proper allocation of costs for the manufacture of complementary products , etc.
- sometimes special procedures are required to determine the amount or value stocks, such as appreciation of stock assessment conducted by other experts ;
- often the stocks are stored in different places , thus creating difficulties both in achieving their control to prevent theft or physical degradation and in accounting for inventories in transit ;
- stocks are vulnerable to changing economic circumstances which may reduce demand , sales and , therefore, the application of different treatments in such cases for their evaluation ;
- stocks subject for return contracts (ex. packaging).

Obtaining evidence about the rights exercised on stocks is more difficult leading to the need to apply additional control procedures. The basic principle used in evaluating stocks summary financial statements is to select the minimum of cost and net realization. Thus, all the controls exercised in this sphere of activity shall ensure compliance with this principle.

Special attention should be paid to control the deviations from standard costs, and measures taken in this regard. Significant deviations backlog may indicate a higher risk of control.

To check claims management in the financial statements on the existence and completeness of information on stocks, we must have the ability to choose a control strategy based on company policy, adopted for determining the quantity of inventory held.

Control strategies identified as possible for economic entities are:

- when stocks are accounted for by inventory method intermittently, although the operation does not intend to take an inventory of the stock on or near the balance sheet date, the control strategy may allow assessment of a low control rim;
- when inventories are accounted for using the perpetual inventory method and inventory is done near the balance sheet date, the control strategy allows the assessment of control risk associated records of stocks at a relatively high level;
- if stocks are quantitatively determined by the balance sheet date inventory control strategy requires an approach based predominantly substantive procedures

by not testing the control system applied to the accounts on the stock, as it may be missing altogether.

A major focus is on verifying the existence and valuation of inventory, given the high inherent risk associated with these two statements. In general, the risk of detection is estimated at a low level for the existence and stock assessment, while for the remaining claims on stocks, detection risk can range from high to medium levels.

To check opening balances, we must ensure that all agreed adjustments last year in the checking were recorded. Moreover, especially in situations where stocks are accounted for by inventory method intermittently need to check whether all the accounts on the stock are kept properly and regularly updated.

Analytical procedures applicable to stocks are varied. Analysis of the trends at branch or sector can program your key to developing analytical procedures that will be applied to evaluation of analytical information of the society.

Checking accounts records of stocks is based on supporting documents.

When the balance sheet date, inventories are determined solely on the basis of the inventory intermittent tests relevant details are:

- verification of physical existence of inventories by inspection;

- investigate significant differences between the results of the physical inventory and accounting records relating to stocks.

If the amount of inventories is determined by counting (weighing, etc..) on a date other than the end of the financial year, as adjusted by reference to the accounts for the period went up to check quantitative tests of detail can be applied only to the remainder of the financial year of quantitative verification and closing time of the year.

Tests verifying the matching principle on purchases and sales are important for identifying transactions that occurred near the end of the financial year and to check how they have been charged year to which it relates.

When inventories are significant in the context of the company's financial statements and inventory stocks is impossible, observation of inventory counting is one of the major responsibilities of control.

When you have not obtained sufficient evidence of the existence or the opening balances could not attend the physical inventory at the end of the financial year and when i can not obtain sufficient appropriate evidence by applying alternative procedures control we should refrain from issuing an opinion that a decisive move in the inspection report.

Applying this procedure allows the establishment of evidence on the management of the financial statements relating to the existence, completeness, valuation and rights, their obligations exerted on stocks.

After the inventory, the company uses to draw the inventory lists inventory report. All items after they are counted, weighed, etc.. are then assessed and the results underlying accounting corrections. Due to the importance of present inventory lists with the book inventory, we must ensure that the inventory lists presented fairly physical inspection result both in terms of quantity and value.

To determine whether inventory lists present fairly the results of the inventory we shall:

- compare their results with those in the test application inventory lists;

- identify the lists drawn up at the time that witnessed the inventory and check their consistency with the inventory record;

- compare the survey results with the inventory accounts to identify and ask for explanations about the differences noticed;

- check the calculations on the determination of inventory items.

Checking stock assessment involves determining the cost of inventories and net realization value, as well as comparing the two values to be retained in the synthetic minimal financial statements.

Inventories of goods, raw materials, which is determined by applying one of the FIFO, CMP, or LIFO, involves examination of invoices from suppliers on amount invoiced.

If the case of output current inventory, finished goods and semi-manufactures, the cost should be checked through the records of the costing. The calculation used by the entity is evaluated in principle during the interim control when applying tests of methods for calculation of the cost of production. Where stocks are valued at standard cost production, variations to this must be considered.

International accounting standards (namely IAS 2) require coverage of stocks in the balance sheet net of realization if it is lower cost. Assessment of the net realization involves the use of accounting estimates, which implies that we must have in mind the provisions of accounting estimates involving:

- analyzing and checking of management estimation methods applied;

- use of independent estimates;

- analysis and permanent review of subsequent events.

For stocks valued at net realization, calculation and establishing value in achieving must be checked. In some cases, the starting point is the present value or selling price contract, adjusted by cost of sales / achievement. In other situations, can be used formulas that take into account age, previous changes and expected future changes on those stocks. We need to examine the data and assumptions underlying the estimates formulation to check calculations to analyze past performance of the stock in question and check if estimates are duly approved by management.

Regarding the assessment of inherent risk in terms of adjusting elements undervaluation of inventories, we must apply substantive procedures to enable us to identify needs further adjustment of inventories. IAS 2 retains the following situations where adjustment of inventories may be required:

- lowering the sale price;

- physical damage;

- obsolescence;

- the decision to sell at a loss; or

- acquisition or production errors.

Specific procedures commonly applied are:

- analyze sales made after the balance sheet date;
- declare obsolete inventory during assisting in inventory;
- analysis of stocks held against the scheduled turnover to determine excess stocks;
- discussions with company management, staff responsible for sales and production;
- process analysis reports drawn up during board meetings (Executive) etc..

If the claims made in the financial statements on the value of stocks are related to complicated technical issues, can call on the assistance of technical experts in the field.

There are situations where companies may own stock belonging to their clients, at their request, after the sale took place. Another possible situation is to purchase stocks or the obligation to return or payment, if there is a subsequent sale. The management will be required to separate common stocks recorded during the inventory. In addition, they usually require your confirmation in writing of the ownership of stocks.

Conversely, management requested confirmation on stocks belonging to the company, but are "registered" to customers. For such cases, we must consider the contracts agreed with third parties and to solicit their confirmation on the amount of stocks "recorded".

In another scenario, stocks can be used as collateral for contracting loans. In this respect we must obtain information / explanations from management about the existence of such credit agreements and check the publication of appropriate additional information in the notes to the financial statements.

By this procedure, we are able to provide evidence of management's assertions in the financial statements relating to the rights and obligations exerted on stocks as well as stocks disclosure of annual accounts.

We also need to ensure that the main categories of stocks have been identified and grouped properly in the financial statements. In addition, the notes to the balance sheet should provide information on:

- the methods used to determine costs;
- stocks used as collateral; and
- the existence of major procurement commitments.

Discussions with company management is a procedure frequently applied to determine the existence of constraints that operate on future purchases of stocks on the basis of agreements concluded with third parties. Where such restrictions exist, we must examine and evaluate the sincerity of contracts accounting and reports prepared by the company to the extent that significant losses on contracts to be recognized in the financial statements together with the publication of information notes more about the circumstances that led to this development.

Samples on disclosure in the financial statements are obtained by substantive procedures described above. Further evidence can be obtained to the extent necessary, by consulting and process analysis reports drawn up during board meetings and discussions with management. Based on evidence obtained by comparing the financial statements with the requirements of relevant standards for presentation and publication, we are able to determine the sincerity of stocks presented in the summary financial statements.

3. CONCLUSIONS:

As the main objectives of inventory control economic entities believe that it should address the following issues:

- stocks there are in good condition and are owned by the company ;
- costs to bring the inventories at the current condition and location were determined correctly;
- stocks were valued at the lower of cost and net realization and adjustments were set to reflect the current status of the stocks;
- all stocks are recorded in the accounts;
- inventory valuation policies are adequately presented in the financial statements;
- accrual principle is respected;
- expenses incurred (materials , raw materials , labor, overheads , etc. .) are included in the cost of production ;
- the cost of production (materials , raw materials , labor, overheads , etc. .) was correctly calculated ;
- production costs were properly allocated ;
- all costs involved in the production have been identified and properly recorded in the accounts ;
- cost of production is affected to the financial year accordingly.

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