

# Lecturer responsible for AUE2602: Topic 6: Inventory & Production Cycle Ms Nicolene Coetzee

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## I&P cycle

### Why is inventory important?

Inventory is a major component of:

- Income statement → CoS calculation → Gross profit & Net profit
- Balance sheet → Asset balance (inventory)

### Documents used

Warehousing	Production
<ul style="list-style-type: none"><li>• Goods received note</li><li>• Picking slip</li><li>• Delivery note</li></ul>	<ul style="list-style-type: none"><li>• Material requisitions</li><li>• Material issue note</li><li>• Manufacturing schedules</li><li>• Job cards</li><li>• Production report</li><li>• Costing schedule</li><li>• Transfer to finished goods note</li></ul>

# I&P cycle

## Risks & Internal controls

**Inventory controls** – Jackson & Stent p 12/6 – 12/7

**Production controls** – Jackson & Stent p 12/8 – 12/10

When you get a weakness / risk / internal control, ask:

- 1) What cycle are you in?
- 2) What function are you in?
- 3) What is being asked?  
(Are we asking for weaknesses, risks or internal controls?)

### Computerisation

- There are no separate section with the computerised controls for this cycle, however, the principles of the manual controls remain the same.
- Some examples to consider:
  - Re-order levels held in inventory masterfile
  - Production in manufacturing co → e.g. automatic creation of production schedules, costing schedules, etc
  - Point of Sales systems → perpetual inventory system.

# I&P cycle

## Fraud in the cycle

(J&S p 12/20 – 12/22)

Fraud in this cycle can occur through:

- Fraudulent financial reporting
- Misappropriation of assets

For this semester only, **read** through this section.

It is **very interesting** to see to what lengths people will go to manipulate the inventory balance.

# I&P cycle

## Inventory counts

(J&S p 12/11 – 12/13)

The differences between a **cycle count** and an **annual count**:

Cycle counts	Annual count
More regular – e.g. once every 3 weeks	Only at financial year end
Only some inventory is counted – e.g. high value items	<b>All</b> inventory must be counted
Comparisons to perpetual inventory records	Comparison to theoretical inventory records (not necessarily perpetual records)
Some additional procedures to take into account - p12/11	
For both counts	
Sound count controls and method of physical counting is the same (p 12/12 – 12/13)	
Discrepancies must be thoroughly investigated and followed up on	

It is very NB for you to read the question carefully – answer what was asked!!!

# I&P cycle

## Valuation of inventory

(J&S p 12/18 – 12/20)

➤ IAS 2 state that inventory should be measured at the **lower of cost and Net Realisable Value (NRV)**

➤ **Cost formulas** that can be used:

- Specific identification
- Weighted average cost
- FIFO

➤ **Cost of inventory include:**

- all costs of purchase including import duties, transport costs, etc.
- costs of conversion
- costs in bringing inventory to present location and condition
- It excludes: → storage costs, admin costs, selling costs

➤ **Cost of manufacturing of goods include:**

- allocation of overheads to cost of inventory → fixed and variable production overheads,
- @ normal capacity
- It excludes: → abnormal waste