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BUSINESS GUIDE

# 12 Cycle Counting Best Practices

A Practical Guide to Physical Inventory Counting and Cycle Counting

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# 12 Cycle Counting Best Practices

## A Practical Guide to Physical Inventory Counting and Cycle Counting

Every company that buys, sells, and/or uses physical products deals with the pains of keeping accurate inventory records.

Inventory counts are an integral part of any organization's internal control environment and tend to be an all-hands-on-deck, manually-intensive affair that take place once a year. The process often extends a week or more, requires operational shutdowns, and interrupts fulfillment processes as employees work to count one of the business' most valuable assets: its physical inventory.

Physical inventory counts are a necessary evil. In order to make accurate budgeting, operating, and financial decisions, managers and other stakeholders need correct inventory count data to work with. Publicly-traded companies, for example, must ensure their financial reports are accurate. That means auditors and corporations must perform physical inventory checks before the last day of the company's fiscal year.

Conducted manually, physical inventory counts are both time-consuming, and error-prone. When someone has to physically touch or scan inventory during the putaway, inventory check, or pick processes, for example, errors are bound to surface. Finding, counting, and recording each item is time-consuming enough, but the fact that those items might be stored in multiple places throughout the warehouse or storeroom adds even more time to the process. Even when the physical count is completed, rectifying any discrepancies, figuring out what went wrong, and then implementing procedures to avoid repeat mistakes takes even more time.

This guide explores the key inventory count challenges businesses face; offers 12 tips for a successful physical inventory count, including how regular, scheduled cycle counting can ease these pains; and discusses how NetSuite enables you to maintain high inventory accuracy year-round.

# Table of Contents

CHAPTER 1

# Why Companies Need Physical Inventory Counts

Any company with a product-centric supply chain likely has anywhere from 20% to 30% of its assets tied up in inventory holding costs (depending on the specific industry). Those holding costs include not only the value of the products themselves, but also the cost of warehousing, controlling, and insuring those goods. Ineffective inventory control processes can inflate this percentage, but good inventory management processes can help to minimize these costs.[1]

Physical inventory counts are an essential part of keeping inventory records accurate and current. Up-to-date inventory records provide for better forecasts of sales and purchases and ensure that organizations have the right amount of product on hand to be able to fulfill customer orders, make their own products, or both.

Performing a physical inventory count ultimately benefits customers who don't want to deal with uncertain stock levels in this era of instant gratification. With updated inventory data in hand, companies can fulfill orders promptly, replenish as needed, and avoid costly overstock situations. They can also more effectively plan for losses (i.e. due to theft or breakage).

Every day that an item remains in inventory, its value decreases. Over time, the cost to stock the item begins to outweigh its actual value. By using scanners (or other stock-counting technology), immediately addressing inventory discrepancies, and using inventory management software, companies can improve their counting accuracy and significantly reduce the amount of time required to conduct this vital project.

Other important reasons to perform regular inventory counts include:

- To check and balance inventory levels. The physical inventory counts, which serve as a check and balance on cycle counting, help managers identify any discrepancies between cycle count reports and what items are actually in storage.
- For theft monitoring and management. The difference between what appears in the inventory management system and what is present can be due to missing, stolen, or broken items. Unless staff manually enter the items when these scenarios occur, the system can't recognize them.
- To develop an accurate business budget. Companies with precise inventory counts can better plan their budget for the coming year's inventory orders.
- For accurate earnings reports. Inaccurate inventory means a company will report an incorrect amount for the cost of goods sold, the gross profit, and net income. Public companies are accountable for providing correct figures in their annual reporting to their stakeholders.

[1] Benefits of Inventory Management and Inventory Management Systems, NetSuite

CHAPTER 2

# Challenges With Physical Inventory Counts

Tracking the volume of goods purchased and sold is straightforward in theory but not always easy to master. It also includes inventory turnover rates and actual product purchase costs, both of which can inflate a company's total inventory investment. Organizations must have enough inventory on hand—and in the right locations—to be able to meet demand while avoiding both stockout and overstock situations.

The biggest headaches of physical inventory counting include the need to manually count inventory—a process that typically requires paper count cards, sheets, and pencils. What's more, some businesses may have limited staff and may need to bring in temporary or part-time staff to help deal with the count, adding people unfamiliar with the business and driving up costs. While the required materials may be cheap enough, this approach takes a lot of time, introduces errors, and requires a shutdown of the physical facility. Companies can reduce some of this complexity by adding RFID, barcodes, or mobile devices to the mix, but even the electronic approach to physical inventory counting requires additional time and resources to complete and is not entirely error-free.

Businesses usually perform their annual physical inventory count before compiling their annual financial reports, but the problem is that performing an inventory count once a year doesn't always yield the most accurate results.

The best way to ease the pain of physical counts is by conducting regular, scheduled cycle counting throughout the year, and at predetermined frequencies.

These counts can be conducted manually or electronically, using cycle counting or by conducting a full inventory count.

Physical inventory counting is a labor-intensive approach that eats up time while introducing errors into the process. Once they're transferred to the company's annual financial report and other important statements, these errors can impact the organization's bottom-line profitability and cast doubt over its stated financial results.

CHAPTER 3

# What Is Cycle Counting?

Physical counts can't be avoided, but there are ways to offset the burden of this annual exercise while saving companies time and allowing them to allocate labor resources to more important tasks. One way businesses can ease the pain of physical inventory counts is by using a process known as cycle counting. Cycle counting is a systematic method for counting portions of a company's stock. It is often automated and performed at least once per quarter.

With cycle counting, staff members count sections of stock on a rotating or systematic basis and use those results to estimate the total inventory count.

With regular cycle counts, there are also fewer discrepancies to remedy at the end of the year, since the process effectively runs in the background 12 months out of the year.

Issues can be identified and addressed quickly as they surface, versus just once a year during (or after) a physical inventory count. This helps organizations significantly reduce the amount of time spent on those annual counts—a major competitive advantage in an environment where customers expect orders to ship the same day and arrive within shorter timeframes.

Businesses that automate cycle counting typically drive faster, more accurate counting. Using RFID and barcodes, for example, is much easier than jotting down stock numbers and/or scanning inventory sheets to find the right item number. Other key benefits of automation include simplified shipping and receiving processes, better visibility over on-hand inventory, better management of missing or stolen merchandise, and overall improved inventory management (i.e., less need for "just in case" overstock since your current inventory levels are always right at your fingertips).

CHAPTER 4

# Avoiding Freezes and Shutdowns?

Companies with large amounts of stock (e.g. wholesalers, distributors, and retailers) find that "freezing" stock in order to count inventory to be quite disruptive. In lieu of these full, annual inventory counts, these organizations can implement perpetual inventory systems that both appease their auditors and effectively reconcile their inventory numbers. This is important because the operation that shuts down completely for a week in order to count its inventory can find itself behind the competitive curve when it gets back up and running.

As an inventory management option, cycle counting focuses on counting items in a designated area of the warehouse without stopping operations to perform a complete physical inventory. Because of this, cycle counting has become a popular inventory management strategy for companies across all industries. Other key benefits of cycle counting include:

- Higher order fulfillment rates
- Better customer service levels
- More accurate inventory assessments
- Higher sales
- More time between physical counts
- Fewer errors
- Less inventory write-offs and obsolescent inventory
- A more efficient operation overall
- Possible elimination of annual counts
- Improvement of the closing process
- Decreased audit fees
- No employee overtime costs
- Ability to quickly detect product thefts

With cycle counting, the idea is to count small, preselected sections of inventory multiple times a year—usually quarterly, but in some cases as frequently as once a day. This approach not only saves time and enhances current inventory management systems, but it also helps businesses reliably schedule and deliver products.

CHAPTER 5

# Cycle Counting Best Practices

Even the most organized companies can run into inventory cycle counting challenges. For example, they might unknowingly introduce inventory errors when dealing with multiple locations, or run into issues like paperwork lags and outstanding transactions. When they're not updated in real time, the counts can also generate false variances that will need to be addressed. To avoid these challenges, companies should clearly define their process, track their inventory accuracy, and then aspire to a high degree of accuracy during the process.

When developing a cycle counting program, companies should factor in these three main inputs:

1. Number of SKUs. Determine how many products, or stock-keeping units, you want to count at a time. Base what you choose to count on your overall number of SKUs, the number of high-value products, and what is reasonable to count in intervals.
2. Available counting resources. Determine the number of available employees and how much time they can dedicate to counting stock. For example, some companies suggest employees use the time before shift end to count SKUs in their assigned areas. This timing takes advantage of the natural lull in employee productivity with relatively easy work. These employees should not have a stake in the accuracy of the numbers.
3. Counting frequency. How often you count inventory depends on how many SKUs you want to cycle count in the year. For example, if you wish to count

1,000 SKUs per year, then count 83 per month, 21 per week, and three per day, assuming you are only counting each SKU once annually. You may want to count high-value items more often, and don't forget to factor in the time it will take for counters to record their daily SKUs.

With these inputs in place, companies can use these best practices to create a successful cycle counting approach:

- Close all transactions for inventory items before the cycle count.
- If using the ABC method—where companies classify inventory items based on the items' consumption values—be sure to classify those items into the respective counting groups using specified, documented processes.
- Count all products for all SKUs listed.
- Decide what to count when. For example, it may make sense to count items that are of a high-value or that move quickly through the warehouse weekly. Count all other stock quarterly.
- Identify the fastest-moving items in the warehouse. Mark them as fastest to slowest to figure out how to classify items for future counts.
- Dedicate specific personnel to counting teams, and ensure that those teams count all products at least once quarterly.
- Immediately investigate any errors or discrepancies that may crop up (don't wait until the end of the year to deal with these issues).
- At least initially, perform counts twice to ensure that the numbers are correct, and have a supervisor check the counts against the inventory in the system.
- Document everything, including the process itself, the changes, and the results.

While physical counting once a year may seem like a viable option, cycle counting is less disruptive and provides more visibility into stock daily.

By combining an inventory management system and warehouse management system (WMS) with regular cycle counts, organizations benefit from more accurate inventory levels, automatic prompts for items that need to be counted, the ability to categorize items based on volumes or value, improved quality assurance, and higher customer satisfaction rates.

CHAPTER 6

# Cycle Counting Eases the Pain of the Physical Inventory Counting Process

Counting inventory is a requirement for doing business. Regardless of how effective their replenishment, tracking, and management systems are, companies must conduct regular checks of actual inventory levels for key items. Keeping an accurate item count can help reduce required safety stock, lower overhead costs, and give companies more control over their assets.

Thanks to advanced technology, physical inventory counts have become easier, less intrusive, and require less manpower. By replacing Excel spreadsheets or other manual inventory control systems with inventory control software, companies can more efficiently track their stock while reducing human error and saving time and money. Using an inventory management system also ensures that companies always have the right amount of stock at the right locations to meet customer demand.

CHAPTER 7

# Smart Count, NetSuite's Cycle Counting Solution

NetSuite Smart Count is an inventory cycle counting solution that enables organizations to improve the efficiency and accuracy of inventory management by automating inventory counts without freezing transactions in the entire location. The inventory level used for the count is taken at the time the count starts for each individual item. Smart Count keeps track of transactions that happen for the items being counted, and if there is any activity during the count, NetSuite automatically alerts counters so they can react appropriately. Preferences allow administrators to choose what happens if the on-hand quantity changes for an item during the count process. The entire cycle counting process can be done on a mobile device, saving time and increasing accuracy.

Smart Count tracking provides increased control over key assets. It also allows companies to categorize inventory based on the volume of transactions and/or value, and enter regular periodic counts of on-hand item quantities to maintain inventory accuracy.

NetSuite not only helps organizations gain better control of their inventory, but it also extends those activities to its warehouse management solution (WMS) functionality and mobile radio frequency (RF) devices. NetSuite's inventory and warehouse management solution helps inventory managers track and locate stock at a moment's notice. The system also includes features such as artificial intelligence (AI), vendor-managed inventory (VMI), and mobile device integration. With the mobile app, users can scan bins and items, automatically recording the cycle counts without leaving the floor. This makes auditing inventory less intrusive to daily work and reduces manual errors due to incorrect keying and lag time.

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