**GREEN TOYS**

**Inventory Policy**

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1. **Policy**

Introduction**:**

Green Toys’ Inventory Policy has been developed to document procedures and controls to ensure inventory and cost of sales transactions are accurate and properly recorded.

Scope:

This Policy’s goal is to ensure that access to inventory is properly safeguarded, purchases and usage of materials / labor are appropriately authorized and reconciled, and inventory is correctly valued and recorded according to GAAP.

Inventory Safeguards at the 3PL’s:

* 1. Physical access to the manufacturing floor and warehouse are controlled and monitored through:
* Electronic fobs and key card access.
* Use of an inventory cage at the warehouse.
* Camera security system / closed circuit video monitoring.
* Security guards posted 24/7 at entrances, who also do rounds once / hour.
  1. Electronic access is controlled by roles and groups based access control to electronic data in the ERP system.
  2. Inventory parts are numbered and revision control is activated in NetSuite.
  3. An email notification should be sent to the accounting / finance team by the R&D team when an item assembly/BOM is created and / or updated. Accounting should review the account code and update the standard cost of new purchase items. Accounting would only update the BOM if there were significant variance in a work order.
  4. Inventory counts are performed regularly:
* Cycle counts are performed each month.
* Inventory counts are performed at year end and mid year.
  1. The 3PL’s perform monthly inventory counts and are responsible for delivering reporting of on hand, received, and shipped units at month end back to Green Toys. For the period July-September 2017, the 3PL’s agree to perform inventory counts every week and deliver reporting back to Green Toys by end of day Friday each week.
  2. At mid year and year end, a full physical inventory is performed. The 3PL’s perform the first count and put the count tag on the inventory, and Green Toys production / accounting / finance teams perform the second count to ensure the first count is accurate. Accounting / finance summarize the count results in an Excel spreadsheet and compare them to the NetSuite inventory valuation report for on hand inventory, and to the NetSuite stock valuation report for received and shipped inventory. Variances are sent to production and CS for investigation and resolution. After investigation and resolution, a final count variance is established. The annual physical inventory count result is reported to the CEO, controller, and head of operations, R&D and CS.
  3. The 3PL’s commit to adhering to month end cut offs and ensuring that the reporting they provide is an accurate representation of the number of units by item / SKU for on hand, received and shipped at each period end.

Authorization and Reconciliation of Turn Key / Assembled and Packaging / Labor:

1. All goods are delivered to the 3PL’s warehouse. The receiving employees receive goods and verify the part number and quantity listed on the packing slip that matches with the information listed on the boxes and a blind copy of the authorized PO – the receiving report.
   * KS produces turn key FG and ships them to Orion FOB destination i.e. Green Toys owns the inventory once it gets to Orion. KS sends Orion an Excel spreadsheet which lists quantities and SKU’s. Orion makes sure what they actually receive ties to the spreadsheet, packing slip and blind copy of the PO, and then uploads the units by SKU to their system. A platform called Celigo then takes that and pulls it into NetSuite so it is visible to Green Toys.
   * Hansen – produces turn key FG and ships to 3PL Orion FOB shipping point, i.e. Green Toys owns the inventory once it leaves Hansen’s dock. Orion makes sure what they actually receive ties to the packing slip and blind copy of the PO, then uploads the units by SKU to their system. Orion then generates an email to Green Toys with units received by SKU from Hansen.
   * VRS / Pride / Tigers – pick up parts from KS and make sure what they actually receive ties to the packing slip and blind copy of the PO. VRS / Pride send a copy of the packing slip and accounting / finance enters this into NetSuite as a manual receipt from one vendor location to another. VRS / Pride then assemble the products and send the assembled FG products go to Orion. Orion makes sure what they actually receive ties to the spreadsheet, packing slip and blind copy of the PO, and then uploads the units by SKU to their system. A platform called Celigo then takes that and pulls it into NetSuite so it is visible to Green Toys.
   * Transfers and Rework - after goods have been received at the 3PL Orion from the vendors, rework might need to take place e.g. changing 1 case pack with 3 rockets to case packs of 10 rockets each which requires taking all the rockets out of existing case packs and repackaging them. In this case, Orion transfers the assembled FG's back to VRS / Pride / Tigers, who repackage and then transfer back to Orion once that work is complete. Accounting / Finance must record these reworks in NetSuite by making sure units are moved out of the SKU / item for the case pack to the SKU / item for the individual product. This ensures SKU / item level accuracy in NetSuite.
   * If there are any significant variances in this process, the 3PL’s reject the shipment.
   * If the shipment quantity and quality is correct, the 3PL’s sign a copy of the bill of lading to accept shipment.
   * The 3PL’s Send an electronic copy of the bill of lading, associated PO, and receiving report to Green Toys.
   1. Upon receipt of the turn key or assembled goods, Green Toys’ accounting / finance team accesses the authorized PO in NetSuite. They also ensure there is a match between the PO and the receiving report and perform the following:

* Generate a PO receipt transaction in NetSuite that automatically records inventory based on the standard cost associated with that item and an offset to a receipt clearing account based on the PO price in the system. The accrued liabilities in the receipt clearing account are automatically reclassified to AP account during the month end close process when the invoice from the vendor is received.
* Ensure that they record both the quantity received and the location where the units will be stored - Orion, VRS, Pride or Tigers.
* Upload a copy of the bill of lading into the system as documentation - this will be accessed by the accounting department.
  1. The accounting / finance team date stamps the packing slips to avoid duplicate entry.
  2. The receiving report, shipping documents / packing slip and PO is sent to the team member who processes AP, and a copy is filed with the accounting / finance team by date of transaction.
  3. Upon completion of the receiving process, the assembled goods are stored at VRS / Pride / Tigers 3PL’s warehouse for assembly and FG turn key and FG assembled products are stored at Orion 3PL warehouse until they are ready to be shipped out to customers. Note: Orion will store eCommerce turn key and assembled goods in separate bins in the warehouse.
  4. The accounting team is responsible for tracking all inventory movements through sub-inventory transfers, reworks, or work orders in NetSuite.
  5. NetSuite transfers the inventory costs among the various inventory accounts through the production process. When assembled goods are issued to a work order, the cost is moved between the raw material account and the finished good account based on the stage of completion of the work order.
  6. The BOM pulls parts needed – any scrap is reported and recorded in a separate GL account code.
  7. The inventory team records manufacturing variances in the following major pre-defined accounts:
* Purchase Price Variance: difference between PO price per unit and standard cost per unit on the BOM’s.
* Invoice Price Variance: difference between invoice price per unit and PO price per unit.
* Standard Cost Update Variance: variance arising from changing standard costs on the BOM’s based on review of actual prices from the vendor obtained from the R&D / production teams – done each quarter.
* Absorption Variance: direct labor costs and overhead costs.
* Cycle Count Adjustments: difference between the cycle count quantity and perpetual inventory quantity.
* Physical Inventory Adjustment: difference between the physical inventory count quantity and perpetual inventory quantity.
  1. If the unit standard cost is different from the PO unit price, the price differences are recorded automatically as the Purchase Price Variance (PPV) at time of goods receipt:
  + Calculation of the variance = (actuals quantity purchased \* actual rate / unit) – (actual quantity purchased \* standard rate / unit).
* If this is favorable:

dr. Inventory - raw materials / FG @ standard cost

cr. AP @ actual purchase price

cr. Inventory - raw materials / FG purchase price variance

* If this is unfavorable

dr. Inventory - raw materials / FG @ standard cost

dr. Inventory - raw materials / FG purchase price variance

cr. AP @ actual purchase price

* 1. Return merchandise authorization (RMA’s) - when inventory is shipped back to the vendor for repair or replacement under warranty a return transaction is processed in NetSuite returning the material to the original PO. The packing slip and transaction is processed based on the requirements provided by the purchasing department and the vendor. Credit memos issued by the vendor for any non-repairable goods will be offset in COGS other. Repaired inventory received from the vendor at the warehouse is checked by the receiving employees against a blind copy of the PO / receiving report. Then, the inventory team processes the receipt transaction in NetSuite which returns the material to the correct internal location for use in production.

Production Inventory Procurement:

1. Refer to the Green Toys Procure to Pay Policy.

Inventory Valuation (GAAP):

1. Green Toys uses the average cost cost flow assumption for finished goods inventory and average cost for raw materials and FG.
   1. On a monthly basis, the accounting / finance team reviews all BOM changes with the R&D department to ensure their accuracy and update for any errors found.
   2. On a weekly / monthly basis, the accounting / finance team performs inventory reconciliations for all 3PL’s:

* Obtain the end of week / month inventory reporting for on hand, received and shipped units by item # / SKU from Orion, VRS, Pride and Tigers.
* Pull reporting by 3PL from NetSuite for the end of week / month:
  + Inventory valuation report - shows on hand units.
  + Stock ledger report - shows received and shipped units.
* Using the inventory reconciliation workbooks for Orion, VRS, Pride and Tigers, the accounting / finance team compares what is on hand, received and shipped at the 3PL's (using their reports) vs what is reported as on hand, received and shipped in NetSuite.
* Record an inventory adjustment for any variances found in the inventory recon analysis.
  1. On a monthly basis, the accounting / finance team reviews the average cost of inventory items / SKU's, prioritizing the most expensive items. They assess for reasonableness and investigate / resolve any average costs that do not appear reasonable.
  2. Each month, the accounting / finance team compares units and $ on the inventory valuation report for the current period to the report from the prior period and investigate / resolve any unexplained, material variances.
  3. On a quarterly basis, Green Toys’ accounting / finance team should evaluate the valuation of inventory using lower of cost or market (LCM). The accounting / finance team pulls the inventory valuation report and sorts so that it shows the items / SKU's that comprise the top 20% inventory valuation first to focus attention here.
* Step 1 – calculate designated market which is the lower of a) net realized value (which is the selling price of the inventory less any costs to complete it / dispose of it), b) net realizable value less a normal profit margin, and c) replacement cost of the inventory. To determine a), b) and c), accounting / finance shares the inventory valuation report with the production manager and asks them to compare the unit prices of the top 20% of items / SKU's to market prices.
* Step 2 – choose the middle value in step 1 e.g. if a) = $20, b) = $25 and c) = $22 then choose c). This is designated market value.
* Step 3 – determine which is lower – designated market value or the cost of the inventory on Green Toys’ balance sheet. Once this comparison is complete, accounting / finance should meet with the production manager to go over the material variances between the cost and market prices and determine if any adjustments should be made to write inventory down to market where costs > market value by item / SKU.
* Step 4 – accounting / finance should prepare a JE for the loss to write down any items / SKU's to market value and document any adjustments in a memo that is shared with the production manager. To record a loss:
  + If immaterial:

dr. COGS

cr. Inventory

* + If material:

dr. loss from inventory write down (in other expenses and losses on the income statement)

cr. Inventory

COGS (GAAP):

1. COGS should be recorded in the period in which sales occur. According to GAAP, COGS should be matched with the revenue it generated.
   1. Inventory is released based on generation of a valid sales order.
   2. Once the inventory is shipped out and the shipping document has been recorded, the accounting team can record the following JE’s:
   * Record the sale:

dr. AR / cash

cr. Revenue

* + Record the release of FG inventory to COGS:

dr. COGS

cr. Inventory - FG

* + Consigned goods – inventory that is moved to another location where it is held for sale, but no title has passed to a 3rd party is considered to be consigned. As such it would still be part of Green Toys’ inventory and would not be considered COGS or a valid sale.