

The retail inventory- level planning

Business



Retail Inventory-Level Planning consists of retail inventory method (RIM) which is an accounting procedure whose objectives are to maintain a perpetual. It also can book inventory in retail dollars amounts and to maintain records that make it possible to determine the cost value of the inventory at any time without taking a physical inventory. Also known as book inventory system or perpetual book inventory. Retailers also have another important choice to make the stock to sales ratio. The stock to sales ratio is derived directly from the planned inventory to determine monthly additions to stock in the merchandise budget plan.

Retailers generally think of their inventory at retail price levels rather than at cost. Retailers use their initial markups, additional markups, and markdowns, and so forth as percentages of retail. When retailers compare their prices to competitors", they use retail prices. The problem is that when retailers to design their financial plans, evaluate performance, and prepare financial statements, they need to know the cost value of their inventory. Retailers use physical inventories. This process is time consuming and costly. Retailers take physical inventories once or twice a year.

Many retailers use point of sale terminals that keep track of every item sold its original cost, and its final selling price. The rest of the retailers face a problem of not knowing the cost value of their inventory at one time. These retailers with either computerized or manual systems can use retail inventory method.

There are five advantages for using RIM over a system of inventory at cost. It does not have to "cost" each time. When retailers have many SKUs,

keeping track of each item becomes difficult and expensive. It is easier to determine the value of inventory with the retail prices marked on the merchandise than unmarked or at coded cost prices.

The second advantage for using RIM is that it follows the accepted accounting principal of valuing assets at cost or market value, which is lower. This system lowers the value of inventory when markdowns are taken but does not allow inventory's value increase with additional markups.

When using RIM, the amounts and percentages of initial markups, markdowns, and shrinkage can be identified. This information can then be compared with historical records or industry norms.

RIM is useful for determining shrinkage. The difference between the book inventory and the physical inventory can be attributed to shrinkage.

The book inventory determined by RIM can be used in an insurance claim in case of a loss.

The disadvantages of RIM are system that uses average markup. When markup percentages change during a period or when the inventory on hand at a particular time is not representative of the total goods handled in terms of markup, the resulting cost may be distorted. The inventory turnover, merchandise budget planning, open to buy, all these should be applied to the RIM category basis to avoid the problem.

There are four steps in when calculating RIM. Calculate total goods handled at cost and retail, calculate retail reductions, calculate the cumulative markup and cost multiplier, and determine ending book inventory.

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Calculating the total goods handled in at cost and retail to determine the total goods handled at cost and retail:

1. Record beginning inventory at cost and at retail. The initial markup is reflected in the retail inventory.
2. Calculate net purchases by recording gross purchases and adjusting for merchandise returned to vendor.
3. Calculate net additional markups by adjusting gross additional markup cancellations. Note: These are recorded only at retail because markups affect only the retail value of inventory.
4. Record transportation expenses. Here transportation is recorded at cost because it affects only the cost of the inventory.
5. Calculate net transfers by recording the transfers in and out. A transfer can be from one department to another or from one store to the next. Transfers are generally made to help adjust inventory to fit demand. A transfer is, in effect, just like a purchase (transfer in) or a return (transfer out). Thus, it is recorded at both cost and retail.
6. The sum is the total goods handled.

Calculating retail reductions are the transactions that reduce the value inventory at retail (except additional markup cancellations, which were included as part of the total goods handled). Reductions are calculated as follows:

1. The largest reduction in inventory is sales. Gross sales are reduced to net sales by deducting customer returns and allowances.
2. Calculate markdowns, are derived by subtracting any markdowns from gross markdowns.
3. Record discounts to employees and customers.
4. Record estimated shrinkage is used to determine the ending book inventory if the buyer has prepared an interim financial statement. Estimate shrinkage would not be included if a physical inventory were taken at the same time. The difference between physical inventory and book inventory would be the amount due to loss.

Next, a retailer has to calculate the cumulative markup and the cost multiplier. The cumulative markup is the average percentage markup for the period. It is calculated like this:

Cumulative markup total retail

The cumulative markup can be used as a measuring stick against the planned initial markup. If the cumulative markup is higher than the planned initial markup, then the

Category is doing better than expected.

Cost multiplier = $(\$100 - \text{cumulative markup \%})$

The cost multiplier is used in the next step to determine the ending book inventory at retail price.

The final step in the process is determining the ending book inventory at cost and retail.

Ending book inventory at retail = total goods handled at retail - total reductions

The ending book inventory at cost is determined the same way that retail has changed to cost.

Ending book inventory at cost = ending book inventory at retail * cost multiplier

When using the RIM retailers generally use the average beginning of month (BOM) stock to sales ratio. This is taken from the planned inventory which was taken from the RIM. This is used to determine monthly additions to stock in the merchandise budget plan. The BOM is broken down into three different methods week" s supply method, basic stock method, and percentage variation method.

The week" s supply method is the inventory management method is the most similar to the stock to sales method. The difference between the two is that everything is expressed in weeks rather than months. The average BOM stock to sales ratio is equal to months in the period divided by the planned inventory for the period. " If the plan is for 12 months and planned turnover is 6, the average BOM stock to sales ratio = $12/6 = 2$.

Using the week" s supply method, 52 weeks are substituted for 12 months. Thus, $52 \text{ weeks} / 6 \text{ turns} = 8.66$ weeks of supply. This means the buyer is

planning to have 8.66 weeks of supply at the beginning of the month. (Of course, 8.66 weeks is equivalent to two months.)"

The basic stock method is the inventory management method used to determine the BOM inventory by considering both the sales forecast for the month and the back-up stock.