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**NATIONAL ASSOCIATION
of
COST ACCOUNTANTS**

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Vol. VI August 15, 1925 No. 24

**Control of Stocks of
Merchandise**

**BUSH TERMINAL BUILDING
130 WEST 42nd STREET, NEW YORK**

NATIONAL ASSOCIATION OF COST ACCOUNTANTS

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Vol. VI, No. 24

August 15, 1925

Control of Stocks of Merchandise

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PUBLICATION DEPARTMENT NOTE

Maintenance of the currency of a stock of merchandise is a most important function of management. In the solution of the problem two elements are particularly important. The one of these has to do with the style, quality, and general salability of the merchandise, *i.e.*, the maintenance of that kind of a stock of merchandise for which there exists a real consumers' demand. The other is the quantity element. Regardless of the salability of the merchandise, there are reasonable limits as to quantity which the stock on hand at a given time should not exceed. Otherwise what should be liquid capital becomes fixed or frozen simply because the time of its conversion into cash is too far removed.

The first of these elements or considerations, *viz.*, that of style or general salability, falls within the exclusive province of the merchandise man or buyer. It rests upon his judgment of the demands of his trade, his forecast of consumers' demand. Statistical and accounting records will help but little in the formulation of such judgments. Only an experience which results in a keen appraisal of style requirements affords adequate control of this element. However, in securing a proper control of the second element, that of quantity, records are invaluable. How much of the working capital of a business should be invested in stock in trade is a matter for determination in individual cases; there are no standards available. While a minimum stock should be carried at all times sufficient to meet all reasonable demands of customers, the more rapidly the stock is sold out and replenished the greater the profit return on the capital invested in stock. The greater the number of stock turns the greater the profit possibilities.

This Official Publication deals with the quantity phase of merchandise control and describes a system of records used with excellent results in the National Cloak & Suit Company. The author, Mr. Herbert C. Freeman, was born and educated in London, England. He received his first training in accounting in the office of George A. Touche & Company, Chartered Accountants of London. Coming to this country in 1902, he entered the office of Touche, Niven & Company, and later became a partner in the firm. In January, 1921, he was made vice-president and general manager of the National Cloak & Suit Company, which position he holds today.

Mr. Freeman is a certified public accountant of the states of New York and Missouri. He is a member of the New York State Society of Certified Public Accountants, of the American Institute of Accountants, and of the National Association of Cost Accountants.

This was one of the papers given at the Eastern Regional Conference of the N. A. C. A. held in New York, February 20-21, 1925.

CONTROL OF STOCKS OF MERCHANDISE

THE PROBLEM STATED

The problem of the physical control of a stock of merchandise and of the records by which this can be rendered most effective is one which must be approached, like every problem of its kind, from the point of view of the requirements of the specific business under discussion. I shall therefore endeavor first to outline briefly

the nature of the business of our company in order that you may visualize the conditions which have to be met.

In the first place we are not manufacturers. We are purely distributors, at retail, of every kind of wearing apparel, textiles and some kindred lines, to the consumer direct by mail order. Our business is secured by means of catalogs issued at intervals to our customers and to others who write in for catalogs. The catalogs each year comprise a large Spring and Summer Catalog issued during the latter part of January and the month of February; a mid-summer booklet issued at the end of May and current until the end of August; a large Fall and Winter Catalog issued during the latter part of August and the month of September; and a sale booklet issued immediately after Christmas and current until the end of February. The Spring and Summer Catalog is current until the Fall and Winter Catalog is issued and that in turn is current until the next Spring and Summer book is issued.

The Spring and Summer Catalog contains approximately 4,100 styles or 41,000 units. When it is first issued, the January Sale Booklet, containing 1,270 styles or 12,000 units is current, and orders are still being received from the previous Fall and Winter Catalog, while before it in turn is superseded by the following Fall and Winter Catalog, the mid-summer booklet containing some 1,500 styles or 14,000 units is issued and is current up to the termination of the Spring book. The Fall and Winter Catalog contains approximately 4,100 styles or 38,000 units, and is slightly overlapped by the mid-summer booklet and almost entirely by the January Sale Booklet.

Some numbers of staple merchandise are repeated from one catalog to another, but even in the staple lines the changing seasons of the year require a substantial change in the merchandise cataloged. It will thus be seen that the number of merchandise units to be dealt with at any one time is very considerable.

The reason the number of units so largely exceeds the number of styles is that a single style may be cataloged in several sizes and colors, the merchandise unit being an individual size of an individual color of that style.

The business is divided into 44 lines of merchandise or departments. Each style number is listed in the catalog by a number representing the department, a letter indicating the particular catalog or booklet and a number standing for the style. Thus a customer ordering a man's crepe de chine silk shirt from the Spring and Summer Catalog now current would order style 38T1316 and would in addition give the color and size desired. This style, for example, is cataloged in three colors and seven sizes—twenty-one units in all.

In considering the magnitude of a problem of this character, it seems to me that the individual plant must be the basis. Something over forty per cent of our business is handled in our New York plant, and since the methods outlined in this paper are those

in force in that plant, it may be interesting to give some figures of the volume of business handled there.

The number of units of merchandise handled in the year 1924 was 23,957,724. The number of orders received amounted to 4,083,846, an average of 1,818 for each working hour throughout the year. Each order thus, on the average, called for slightly less than six units of merchandise, and the average amount of the order was \$5.58. A unit of merchandise at selling value thus averaged about \$1, though the individual units amounted to upwards of \$100. It is obvious that a system applicable to a business involving so many units of such low average value must be simple and inexpensive to operate but must provide for adequate information to serve as the basis for merchandising.

This somewhat lengthy introduction appears to be desirable to furnish the background for the necessarily brief description of the system in force.

RECEIPT OF MERCHANDISE

All incoming merchandise is received in the Receiving Department, where each shipment is recorded on a "Door Sheet" showing the Door Sheet number assigned to the shipment, the name and address of the shipper and other identifying details. The Door Sheet number is stamped on the invoice, which in most cases accompanies the merchandise. Each case or package is marked with the Door Sheet number, the Department number and floor to which the merchandise is to be delivered and the number of cases constituting the shipment.

The cases or packages are forwarded to the proper Examining Department and the invoices are delivered to the Releasing Department.

RELEASING DEPARTMENT

The Releasing Department is a very important factor in the control of merchandise receipts. Through this department is operated the system of blind check upon manufacturers' invoices.

As soon as an invoice is delivered by the Receiving Department to the Releasing Department, the latter makes out a set of listing sheets in quadruplicate for each shipment. The listing sheets show the Invoice or Door Sheet number, the name and address of the manufacturer, the Department number, date and amount of bill, case numbers, and by whom delivered.

Three copies of the listing sheets are delivered to the Examining Department. The fourth copy is sent to the buyer of the Department to serve as a memorandum of the arrival of the shipment.

The Examining Department opens up the cases or packages and enters on the listing sheets details of the contents of each case or package, showing the quantity of each style, size and color. The listing sheets are then taken to the Releasing Department and by them compared with the invoice. If the particulars do not agree

a recount is required. If the result of the recount is not the same as the original count the case is referred to a special investigator. If the recount confirms the original count and the details differ from the invoice, the manufacturer is notified. If the listing agrees with the invoice, the Releasing Department gives the Examining Department a Release number and the shipment is ready to be examined for quality and general conformity with sample and sent to stock.

In the case of out-of-town shipments, in which the invoices do not accompany the merchandise, the sets of listing sheets are made out by the Receiving Department and forwarded to the Releasing Department, who receive the Invoice in due course from the Accounting Department. The procedure otherwise is the same.

EXAMINING AND STOCKING OF MERCHANDISE

After a shipment has been released by the Releasing Department it is examined for quality and compliance with specifications. The quantity of any irregular or defective merchandise to be shipped back to the manufacturer is noted on the listing sheets with the reason for rejection. If the defect is such that it can be repaired by the manufacturer or at his expense, the listing sheet is held open until this is done and the merchandise passed. Reshipments to manufacturers are made through a special Shipping Department and the quantities are blind-checked against a charge sheet made out by the Examining Department and forwarded to the Accounting Department.

After the examination of the merchandise, the invoice, together with the original and triplicate copies of the listing sheet, is delivered to the Stock Record Department for the checking of the bill as to prices and terms and the recording of the delivery on the file copy of the order. The duplicate listing sheet is retained by the Releasing Department, the triplicate by the Stock Record Department and the original, with the invoice, is forwarded to the Accounting Department for audit and payment. If, upon the checking of the listing sheet and invoice in the Stock Record Department it is found that an overshipment has been made by the manufacturer, the matter is referred to the Buyer, who decides whether or not the excess quantity should be accepted or returned to the manufacturer. If returned, the Merchandise Floor is notified of the quantity to be reshipped for which a charge sheet is made out. The shipment is blind-checked by the Shipping Department with the Accounting Department against this charge sheet.

Once a release is given to the Examining Room on a shipment of incoming merchandise, no further control is kept as to the quantity comprised in the specific lot. When the shipment has been examined it is delivered to the merchandise floor, that is, the department responsible for the stocking of merchandise and the filling of orders; but no attempt is made to verify the fact that the quantity delivered to the floor agrees with the quantity listed. This

may at first blush appear to be an important omission but it is perfectly consistent with the theory that if a proper control is kept over the quantity of incoming merchandise and a similar control is kept (as will be seen later) over outgoing merchandise, there is nothing gained in keeping stock records as between one department of the business and another, except where a warehouse condition is involved in which the quantity and location of stock in warehouse, as distinct from open stock on the merchandise floors, is needed for convenience of operation. As a practical matter, moreover, the shipment may not be delivered to the merchandise floor in one lot. The general scheme of operation requires that it be delivered as promptly as possible, the Examining Rooms not being permitted to act as custodians of stocks of merchandise. Nevertheless, the turnover of stock is very rapid and deliveries of portions of shipments may be called for by the merchandise floors as rapidly as the examining can be completed.

It may be of interest to mention that as far as practicable merchandise is delivered by the examining rooms to the merchandise floors prepacked and sealed in boxes or envelopes ready for shipment. This obviates the further handling of the unprotected merchandise. The containers are plainly marked with style, size and color and are, of course, to be wrapped before shipment.

MERCHANDISE FLOORS

The merchandise floors or stock rooms are equipped with bins or hanging space for the various types of merchandise handled. At the beginning of each season a "lay-out" is made for each line, assigning to each style number the amount of bin space which experience and the expectation of rate of turnover indicate. The style numbers follow in regular sequence in the bins, each bin being marked with the style, color and size to which it is assigned and each aisle with the style numbers which it contains. This constitutes the active stock from which merchandise is picked to fill orders. No running record control is maintained over the quantities in open stock.

The less accessible bins above the open stock bins and all surplus bin space on the floor is utilized for reserve stock. Reserve stock space is not so definitely assigned to individual style numbers but is used to the best advantage and with a good deal of flexibility, but in a sufficiently systematic manner to render record controls by location and quantities unnecessary. Active stock can be filled in from reserve stock without any formality and without the necessity for any records being made.

When merchandise is sent to the merchandise floors from the examining rooms, therefore, the procedure is: first, to fill any orders already accumulated; second, to replenish active stock; third, to place any surplus in reserve stock if provision has been made for a reserve of that particular style; and, fourth, to send the excess to sections of the building assigned as warehouse space. Only with

respect to warehoused merchandise is any specific record kept. The department heads in charge of the floors have no jurisdiction over the warehouse which is physically under the control of the supervisor of the merchandise floors, but the records of which, in the form of individual card records for each case, are kept by the Stock Record Department.

At regular intervals—about three times each week on the average—the stock clerks go through the active stock sections of the merchandise floors and take a record of the styles, colors, and sizes of which the stock needs replenishing. The stock needed is drawn from reserve stock where any exists. If there is no reserve, the list is turned over to the warehouse record clerks in the Stock Record Department and the cards are drawn for the oldest cases of such merchandise in the warehouse. These cards are sent to the Warehouse Department, which withdraws the cases and delivers them to the Merchandise Floors. The control record by quantities ceases as soon as the card is withdrawn. If any excess merchandise in the case is re-warehoused it goes back to warehouse under a new record.

In certain departments warehouse stock is kept in bins instead of cases. Where this is so the warehouse records are kept by bin location instead of case number, and the merchandise floors are furnished with the specific quantities called for instead of the entire contents of a case. This condition still differs from that of reserve stock because specific records are kept of quantities in warehouse and the use of location cards permits of the utilization of all space available in the warehouse and this is not practicable where space has to be assigned more or less definitely to individual style numbers.

FILLING OF ORDERS

Coming now to the factor in the control of merchandise involving the greatest amount of detail, it is necessary to follow to some extent the manner in which orders are handled. Seventy per cent of the orders received call for more than one item of merchandise. After the customers' remittances have been detached and the orders recorded in the alphabetical index of customers, the original orders go to an Order Writing Department where a merchandise sheet is typed for each separate item of merchandise called for by the order. The order itself and each merchandise sheet are stamped with an assembly bin number and time, which ensures all the items on the order meeting the order itself at a certain specified time in the shipping department. The merchandise sheets can then be detached from the order and handled individually.

The merchandise sheets and the orders calling for one item only are sorted by lines of merchandise and tabulated by style, color and size. The tabulation is made on Sales Tabulation Sheets prepared in advance containing sections indexed in the left-hand column for each color of each style and indexed across the top of

the columns for each size carried. Each section consists of a small block of printed numbers from one to fifty, and the tabulation is performed by crossing off the numbers in order. When a block of fifty is entirely crossed off, a new block printed on gummed paper of a different color is stuck over it.

After being tabulated, the merchandise sheets are forwarded to the merchandise floors. The items called for are picked from active stock and the sheets attached. The packages are sorted according to the specified time for assembly stamped on the sheets and are sent by spiral chute to the shipping department in time to be handled by the hour and minute indicated.

The sales tabulation sheets are closed at stated intervals—every day at the beginning of a book, every three days in the earlier part of a season, and every week later in the season, and a summary forwarded to the Stock Record Department.

Another factor which has to be dealt with is that of returns from customers. The package openers in the Returned Goods Department prepare a returned goods sheet for each item of merchandise returned. These sheets are tabulated in the same manner as the sales merchandise sheets and a summary is forwarded to the Stock Record Department. The merchandise is returned to the merchandise floors through the examining rooms, where items unsuitable for restocking are eliminated and any items requiring it are reconditioned.

STOCK RECORD DEPARTMENT

The Stock Record Department maintains files, by merchandise line and style number, of orders placed. They are furnished with the listing sheets of merchandise received, together with the invoices, from which they record the deliveries on their file copies of orders. The method followed is to enter the balance remaining undelivered. They are thus in a position at any time to furnish a statement of merchandise dues, i.e., orders placed not yet delivered, by style, size and color.

It has already been seen that they receive tabulations of Sales and Returns by style, size and color. These summaries they transfer to a record of Calls and Returns by merchandise units, the entries in which represent the cumulative totals for the season. The totals of each month's calls and returns are summarized and furnished to the Accounting Department, which extend them at catalog selling price and at cost. The extension at selling price forms the basis for the Gross Sales and Net Sales figures by lines of merchandise, the grand totals of which are cleared through an account which serves as a reconciliation of these figures with the grand total of cash receipts. This reconciliation, which is never absolute but must be reasonably close, acts in a measure as a check upon the accuracy of the sales tabulation. The extension at cost forms the basis for the credit to merchandise inventory and charge to Cost of Sales.

Substitutions are another detail which have to be dealt with. When merchandise ordered by the customer is out of stock and it is possible to furnish similar merchandise of greater value, this may be done. No additional charge is made, of course. Transfer sheets are made out on the merchandise floors for these substitutions, copies of which are furnished to the Stock Record Department and summarized by them.

The Stock Record Department thus has all the data readily available for the determination of a book inventory, by quantities, of each merchandise unit carried. As a practical matter, however, detailed book inventories are kept in only two departments—Piece Goods and Millinery—in which the taking of accurate physical inventories is extremely difficult. In all other departments, the data in the Stock Record Department are used as a means of checking the substantial accuracy of the physical inventories taken from time to time throughout the season.

PHYSICAL INVENTORIES

The actual basis of merchandise control is the physical inventory. Every week in the fashion lines and every two weeks in other lines, a physical inventory is taken, by crews of inventory clerks who work on the various lines in rotation on predetermined schedules, in co-operation with the examining departments and merchandise floors. The latter observe the necessary cut-offs in the transfer of merchandise to permit of accurate inventories being taken. The interruption of regular activities is negligible, and orders are filled during the progress of the inventory.

The inventories are taken on sheets prepared in advance for the individual lines. One sheet is used for active and reserve stocks, which are actually counted; a second sheet is used for warehouse stocks which are transcribed from the card records; and a third sheet is used for back orders, or customers' orders for merchandise temporarily out of stock. These latter, it must be remembered, have already been tabulated as sales and hence require to be treated as merchandise "short" in the physical inventory.

Merchandise in the examining rooms is not inventoried, but is treated as being still due from manufacturers.

The summaries of the physical inventories are checked by the Stock Record Department against the data assembled in their files and records. It has been found more practical to do this in statement or memorandum form rather than to maintain complete book inventories. One reason for this is the necessity for keeping readily accessible cumulative figures of calls and returns in a convenient form for use independent of all other figures. Apart from this, however, the use of the copy of the order as a means of keeping records of deliveries and dues obviates the necessity for transcription of a vast amount of detail into stock records.

The physical inventories are rechecked if any substantial variation between them and the memorandum book inventory figure

is found. A slight variation, however, is allowed to pass, since the figures are required promptly for guidance in placing additional orders rather than for the purpose of checking the accuracy of the constituent figures. In many lines agreement is only possible as to style and color, the quantities of the individual sizes shown by the physical inventory being accepted.

The inventory figures are transcribed on to a report which serves a very important purpose in the merchandising procedure. This report shows for each style, size and color the quantity in stock, the quantity of "dues" or merchandise on order, the total "calls" or units sold for the season to date, the quantity of returns for the season to date, and the number of calls for the last series of six-day periods. The report sheet also shows for the merchandise line as a whole, or for the group of styles on the sheet, the percentage of the total business for the season represented by the business done up to the date of the report, based, of course, on the experience of previous seasons, together with the percentage of the season's business represented by the business of the last six days.

On the basis of the figures shown on this report, additional orders are placed where necessary covering the requirements up to a certain specified date, which are estimated upon the experience of past seasons applied to the actual results obtained to the date of the report.

SEMI-ANNUAL INVENTORIES

Detailed physical inventories are taken in every line each half year. It may be interesting to observe that the physical inventory at December 31st last exceeded the book inventory by a figure approximately equal to eight-tenths of one per cent of the cost of sales for the six months. This represents the net error arising from the use of latest costs rather than true average costs, from errors in tabulation, and from physical disappearance of merchandise.

CONCLUSION

Stripped of minor details, this memorandum gives a brief outline of our method of handling the control of merchandise. That it is not claimed to be ideal is evidenced by the fact that we are frequently introducing refinements of one kind or another. We shall not be completely satisfied with it until it serves to enable us, without undue expense for records, to use the last piece of merchandise on hand each season to fill the last order received from that particular catalog!

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