Chain-store Accounting

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Perhaps one of the most important, and certainly one of the most laborious, tasks to be undertaken by a chain-store accountant concerns the physical count and valuation of the inventory. A mere glance at a number of chain-store balance-sheets will show the importance of the inventory. Such items as capital assets, accounts receivable, deferred charges, etc., are of comparative insignificance. The following tabulation prepared from recently published accounts of some of the representative chain stores throughout the country will serve to emphasize the importance of the inventory and to show its relationship to the total current assets:

	Ratio, inventory to total current assets
Sears, Roebuck & Co.	53.46%
Montgomery, Ward & Co., Inc.	45.90
The May Department Stores Co.	41.26
W. T. Grant Co.	58.02
Western Auto Supply Co.	66.57
The J. C. Penney Co.	83.47
Safeway Stores, Inc.	74.13
United Cigar Stores Company of America	53.82
S. S. Kresge Co.	73.42
F. W. Woolworth Co.	77.31

It is apparent from the foregoing figures that any discrepancy in the inventory would seriously affect the financial condition as reflected in both balance-sheet and statement of earnings.

An overstatement or understatement of earnings might easily lead a board of directors to adopt a dividend policy which would never have been considered had the correct figures been known. A misstatement of the inventory, resulting in incorrect record of earnings, might also lead to the adoption of managerial policies built upon false premises and thus to financial disaster. As income-taxes are based on earnings, any misstatement of earnings would result in incorrect taxes. The stockholders of the company would also be misinformed as to the yield and security of their investment in the company.

It is not alone a question of the possibility of overstatement of the inventory. Understatement might prove as disastrous, particularly in determining insurable values where an understatement of inventory values might lead to undercoverage, with resultant losses in case of fire. Conversely, overstatement of the inventory would lead to the payment of excessive premiums.

Taking of Physical Inventory

A great many chain stores, particularly department stores, compile their inventories under the retail-inventory method. It is not the purpose of this article to discuss that method. It is sufficient to state that it has great merit and in many instances is the only practical plan available.

The following procedure for taking an inventory was developed in a long period of time in taking the inventories of a chain of over one hundred automobile accessory stores. It may, however, be adaptable to many other kinds of chain stores.

Each store stocks approximately 4,500 different items, each item bearing its individual number. The numbering of items, of course, is uniform at all stores; i.e., No. H 445 indicates a monkey wrench in Podunk as well as in Kansas City. Uniformity in numbering similar items of stock is essential.

Briefly, the general scheme is, as follows: The home office furnishes all the stores with a uniform set of mimeographed inventory sheets having columns for the item number, description of article, total quantity, unit of weight count or measurement used for pricing, inventory price determined from purchase invoices or market, whichever is the lower, and for first and second extensions (see exhibit A). It should be mentioned that the original pricing schedule or master copy, from which the mimeograph sheets to be distributed to all stores are prepared, is compiled and completed shortly before the end of the accounting period. The independent auditors are called in at this time to verify the pricing. This is done by comparing the prices on the master copy with purchase invoices, contracts and present market prices. Any changes which the auditors find necessary are discussed with the officers of the company. The changes as finally agreed upon are made on the master copy and are initialed by the comptroller and the representative of the auditing firm. The mimeograph copies of the master copy are then printed and distributed to the various stores. This eliminates the possibility of having to correct the pricing on a hundred odd sets of inventory papers for any adjustment found necessary by the independent auditors after the inventory sheets have been returned from the various stores.

After the quantities have been inserted alongside the item number and description, the inventory sheets are returned to the home office, where calculating machine operators extend and foot the items in the column indicated "first extension," after which the column is torn from the sheet along the perforation line and the sheets are passed to a second set of operators where they are again extended—this time in the column marked "second extension." After this, a third group compares the first and second extensions for errors in extensions and footings.

The success of such an apparently simple procedure is contingent on the preparation of a complete set of inventory instructions. A copy of these instructions is sent to the manager of each store under whose direction the store inventory is taken. It is remarkable how many interpretations are placed by store managers on even the most simple, direct and, in the opinion of the comptroller of the company, "fool-proof" instructions.

These instructions usually cover in detail such topics as the arrangement of the stock for count, the method of counting, the segregation of consigned stock, the cut-off for unfilled mail orders, merchandise in transit, etc.

Preparatory to making the count, the stocks, including reserve stocks, are neatly and systematically arranged to facilitate the making of the count. To this end the coöperation of the buying department is obtained. The buying department, which is centralized at the home office and orders all shipments from factory to stores, stops all unnecessary shipments of merchandise during the week or ten days preceding the count, thus providing an opportunity of clearing out the receiving and shipping rooms. Old, obsolete and discontinued merchandise is gathered together in one suitable place and listed on blank sheets especially prepared by the home office for this class of merchandise.

It should be pointed out that, in addition to the semi-annual complete inventories, certain classes of merchandise at all the stores are counted every two weeks for the information and guidance of the buying department. Other classes are counted monthly. These records are turned over to the buying department, which makes postings in stock-control books of the quantity and date of the count by item number. These stock control books are kept by item number for each store. To the balance on hand is added the quantity shipped to the store as obtained from the buying department records, and from this total is deducted the count as taken either semi-monthly or monthly, leaving the sales for the period. These figures, of course, are not kept in money value but in quantity only. These records are carefully studied by the buying department as aids in watching the performance of any item in any particular locality. Valuable comparison can be made of the relative sales of the same item in different sections of the country. Through the controlling of merchandise, the buying department endeavors to obtain a larger turnover and better balanced stocks, with a minimum inventory.

The mechanics of determining the control figure or volume of merchandise to be kept on hand at the various stores consists of taking the average sales for three months, the year being divided into quarters, and using it as the basis for computing the requirements for the succeeding three months, taking into consideration, of course, the increase or decrease of sales possibility of the item, unit package and seasonal influences. By using the average sales for three months as a basis for establishing the control figure for each quarter, it has been found from experience that the quantity to be kept on hand is approximately two months' sales. This does not represent to any extent the amount of stock available for sale during any quarter, because should the sales be particularly heavy, the item will be re-ordered as often as necessary to keep on hand the amount indicated by the control figure. Actually, on the average, there is approximately six weeks' stock on hand. Usually, orders can be placed to restore stocks to the control figures as often as necessary, but at no time should the stocks on hand exceed the control figures.

Numerous problems arise when making factory purchases, such as agreement with the manufacturer on the size and weight of individual unit packages, the advisability of making job-lot purchases, taking advantage of quantity discounts and determination of whether or not there should be factory service. These problems give rise to other problems in distributing merchandise to the stores, such as the ordering of items directly from factory to branches in small quantities where sales do not justify ordering the quantity contained in the minimum unit package, which the buying department is under obligation to order; the possibility of being misled by freight allowances to place orders for merchandise larger than are warranted by the volume of sales or the savings effected; the shipment to branches in such a manner that transportation costs consume all profits.

The solution of these problems can be decided in the light of conditions obtaining when they arise. Proper control of the stocks raises and points out these problems as soon as they develop so that they can be dealt with at once.

Accounting Procedure

For taking the complete semi-annual inventory, each store is furnished with a large quantity of blank cards and plain envelopes. The cards are numbered serially from one as far as necessary. The cards are used to record the count. A first counter inserts on a card the stock number and the quantity of items counted. This card he seals in a blank envelope and places on the merchandise. A second counter follows and again counts the merchandise, placing his tally on the outside of each envelope. After the count of stock is presumed to be completed, the manager makes an inspection of all the merchandise in the store and warehouse and determines whether all the stock has been counted or not. Then all envelopes are collected and torn open and the count on the cards is compared with the count on the respective envelopes. Where any discrepancies are noted, the stock is recounted a third time and the correct tally placed on the card. When it is found that the cards and envelopes agree, the envelopes are destroyed. The cards are then placed in numerical order. After all the cards are accounted for, they are grouped by sections and then by stock number. Often the same item of merchandise is kept in two or three different places in the store, and in order to ascertain the total quantity of any particular item of stock, it is necessary to gather together the several cards recording the count of that article. The amounts as shown by the several cards are placed in the spaces provided for them on the uniform set of inventory sheets (see exhibit A) and the total quantity is carried out.

The arrangement of space on the inventory sheets to insert the tally of the individual cards to obtain the total quantity of any particular item is to furnish a record of every step taken in compiling the inventory, so that should the occasion arise, any item can be traced back to the original count cards. These original count cards are test-checked to the inventory sheets by the independent auditors. Finally, after all the cards are arranged by section and exact numerical order of items, as set out on the uniform set of inventory sheets, it becomes a simple operation to transcribe the quantities from the cards to the inventory sheets.

Merchandise in Transit

Store managers are instructed to prepare lists of invoices representing shipments of merchandise prior to the end of the year which were received subsequent to the end of the year. These lists are turned in to the home office with the inventory sheets. These lists constitute the "merchandise in transit" to be included in the inventory.

The home-office routine provides that all manufacturers are to make two copies of all invoices, one of which is sent to the home office and the other to the store to which the shipment is made. The stores forward to the home office their receiving tickets. In the home office the receiving tickets are matched with the invoices before payment. The invoices listed by the various store managers as in-transit items, when received by the home office, are stamped "in-transit" with a large rubber stamp and are taken up in the vouchers payable prior to the closing for the period. The voucher number is placed on the invoice in the space provided for it. To facilitate the independent auditors' verification of the in-transit inventory, the invoices representing the in-transit inventory, with their attached receiving reports, are held out of the files until examined by the independent auditors for receiving dates, comparison with lists sent in from the various stores and inclusion in the accounts payable. This procedure, with the verification of the master copy of the inventory as to pricing before release to the stores as mentioned previously, saves the independent auditors a great deal of time, and the client considerable expense in audit fees.

Accounting for Charge Sales

A rather recent development in certain types of chain stores is the extension of credit and selling on the instalment plan. This feature of the accounts necessitates a considerable number of detail records and lends itself to a variety of treatment.

Undoubtedly, one of the most difficult features of the decentralized control in operating a chain of stores is the human element. A man may be an excellent store manager for sales organization ability and still be unsatisfactory to the home-office with regard to accounting ability, rendering of correct reports and numerous other factors essential to a good all-round store manager. Moreover, it must be realized that the main business of the personnel of the chain stores is to sell merchandise and that necessarily the expense of keeping an elaborate set of bookkeeping records at each store is not always justifiable.

Perhaps one of the most satisfactory methods is to keep all stores' instalment accounts at the home office, where a small but well-trained department equipped with suitable bookkeeping machines can make postings from the daily reports submitted by the various stores and keep the detail records in agreement with the control accounts.

The copies of the managers' daily reports which are kept at the various stores are sufficient for reference purposes at those points.

Budget

Without question, the goal to be sought in keeping accurate and comprehensive records is adequate information concerning every phase of the business. It is interesting to note the amount of information that can be gained by the careful preparation of a budget. A three years' operating statement by individual stores is a good foundation from which to build a budget. In the case of any individual store, such a statement in comparative form, with perhaps some data on the physical inventories taken at June 30th and December 31st, each year, the total investment at each store at December 31st, and the percentage earned on the investment at that date supplies useful information. The total investment at each store should consist of cash, accounts receivable, inventory, deferred charges, furniture and fixtures, etc., but it should not include intangibles. The percentage earned on the investment, of course, should be before federal taxes, discounts and interest.

With this information, a budget committee, which should include the comptroller, the sales manager and the head buyer, can set about the determination of the estimated sales for each store. This is an important question, since many of the data which are contained in the budget are dependent upon an accurate estimate of the sales at each store. The estimate of the succeeding years' sales, for budget purposes, should be split by months so that ready comparison can be made monthly with the actual figures. The gross profit to be allotted to any store can be found by taking an average of the percentage of gross profit for the three preceding years at that store and applying that percentage to the estimated sales.

Incidentally, a certain amount of control over the stores can be exercised by the correct interpretation of the differences between the budget figures and the actual figures. For instance, where the sales are in line, but the gross profit is out of line, the situation should be investigated in detail. It is possible that goods are being stolen, and there may be justification for sending the company's detectives to watch that particular store. Of course, it is not always theft that causes disturbances in gross profit; other factors may be responsible, but the important thing is to single out for more detailed investigation the particular stores in which there are differences.

In building up the budget figures, catalogue and advertising expense for each store is based on the number of books to be issued and the equitable distribution of the amount to be expended on advertising over the various stores. Rent expense is determined from the lease agreement and, of course, will be the actual amount paid. The amount to be used for store salaries at any store should be found by taking the percentage of all store salaries to total sales and applying that percentage to the individual store. When the actual salaries are compared with the budget figures and the former are found in excess of the uniform percentage, the payroll and salary list at that particular store should be investigated. In like manner, other usual expenses, such as light, heat, etc., can be based on past experience and can be fairly accurately determined.

The indirect expenses and general office expenses are budgeted by departments. The total, then, of these expenses is broken down and distributed to the various stores on the basis of sales.

A notation should be placed on the budget of each store, indicating whether competition is "good," "bad" or "none," and the local tax question indicated as "good," "bad" or "fair." The period during which the lease is effective should also be noted.

With the foregoing information at hand, the comptroller should be in a position to know fairly well the situation of any store. With a history of the performance of any store, a current budget and current actual figures, the future outlook for the store should be determinable to a reasonable degree. Compilation of this information for all stores, should help to determine the policies and activities of the organization.

(EXHIBIT A)

Store........................
Section........................
Page........................
Assembled by..................
and........................

NAME OF COMPANY
MERCHANDISE INVENTORY—DECEMBER 31, 193..

Quantities checked and certified correct by ....
Mgr.

Store........
Section......
Page........

Assembly of count cards							No.	Article	Total quantity	How priced	Price $ ¢	Second extension	First extension
24	16	10					A1234D	Description of article	50	Ea. Doz. Set	1.23	$61.50	$61.50