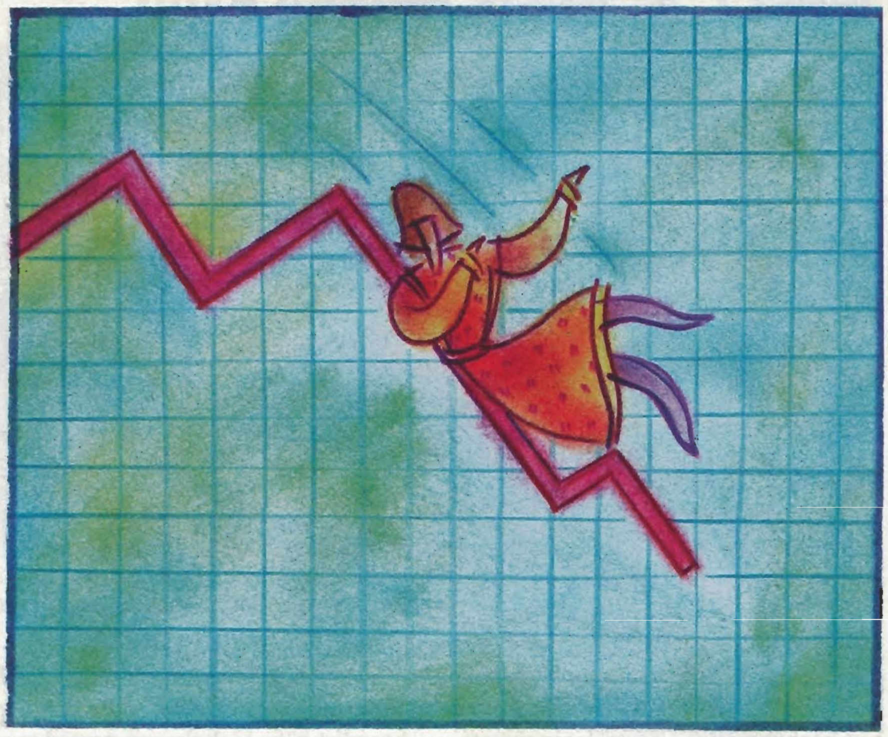

Nightmare on Physical Inventory Sheet

WITHOUT TAKING A COMPLETE PHYSICAL INVENTORY of your store, you have no way of knowing whether you're turning a profit.

It's New Year's Eve, and it's time to party like it's 1999. You've been invited to dine at midnight with friends at the new kosher Italian deli, Vel Italia. You graciously decline.

You've been offered four tickets to see The Who at the Coliseum for their 11th annual farewell tour. Once again, you decline, knowing that you have to wake up early tomorrow morning.

Your buddies invite you to sit in on lead guitar for their third set at a hot new blues club, and now you slip into a deep depression.

At home, your wife says, "Honey, let's stay up all night, watch Dick Clark's Rockin' New Year's Eve, have a couple of drinks and maybe you'll get lucky (wink, wink)."

Uggggghhh!!!! At this point, you start crying like a big baby.

The reality of having to wake up at 6:00 a.m. on New Year's Day along with a dozen of your disgruntled employees to count unending boxes of slow-moving stock and satisfy your uptight accountant and tightwad banker has now hit you square in the head like the full-arc swing of Pete Townshend's cherry-red Gibson SG (which, I need not remind you, you missed last night).

Is this torture necessary? Is it really worth it? No—unless you're interested in knowing the true status of your company's financial condition. Make no mistake about this one: *Without a true physical count and valuation of your store's inventory, you have no way of knowing if you're making money, losing money, buying properly, moving inventory fast enough, or getting ripped off by your customers, employees or even your suppliers.* You could be technically out of business and not even know it.

So, why do so many music retailers still neglect the critical need to take a physical count of their inventory? I can think of at least 758 reasons. Here's 10.

A Pain in the Assets

Here's my top 10 reasons why retailers don't take physical inventories.

1 There's always a lot of inventory to count, which is tedious, laborious and boring.

2 To do it right, you've got to spend time and plan the staffing, counting methodology and costing tasks. You have to coordinate your efforts with your accounting firm if year-end "audited" financial statements are required by your bank. And the more time your accounting firm is involved in observing the physical inventory, the more it's going to cost you in professional fees.

3 You must then spend time organizing your store's inventory in order to help assure a complete and accurate count.

4 You must verify that each inventory item is tagged or identified before it can be counted. Computer inventory reports need to be cleaned up and printed at the end of the last business day prior to the actual count.

5 You usually need to pay your employees overtime to come in after hours or close the store during normal hours in order to count the inventory in a controlled environment.

6 If you don't use a bar code system, you had better have inventory counters who really know the inventory (like the difference between a 2x12, 4x10 and 4x12 speaker cabinet, even though they all kind of look the same).

7 You need to take measures to perform a proper accounting cut-off of inventory coming in and going out. You don't want to count inventory that you haven't yet been invoiced for or miss counting inventory that's been invoiced but is still on its way to your store.

8 You need to "cost out" every inventoried item at the "lower of its cost or market value," not at its selling price and not at its cost if it's now worthless.

9 You need to hunt down and reconcile variances between what was counted and what should have been counted, according to your inventory records.

10 Because a physical inventory should be done at the end of your fiscal year, you need to expedite the completion of the inventory counting, costing and correcting process. If you delay, your bookkeeper is going to get mad because he or she won't be able to close out the accounting period.

This gives your accountant the perfect excuse to delay the financial statements and file tax return extensions. In turn, your banker won't lend you any money and suppliers won't extend credit because you don't have your year-end financial statements.

You're now pulling out what little hair you have left because cash is tight from too much inventory; you still have no clue if you're profitable or how much you owe in taxes; and vendors won't ship your vital orders.

"Is this burdensome task really worth it?" That's like asking, "Do I really need an X-ray to see if my skull is fractured?" No, it's not—unless you care to find out if something is broken.

Why Don't We Do It in the Row (of Inventory)?

For as many excuses you can make to avoid taking a physical inventory, I can find as many reasons that will make you yearn to do physical inventories. Okay, maybe not yearn, but certainly these reasons should stop the complaining and start the doing. Here's just some of the many great reasons to take a physical count of your store's inventory.

Great Reason #1 –

By knowing the absolute dollar value of your inventory, you can now properly measure the profitability and financial condition of your company. You'll be able to analyze gross profit dollars and percentages and derive meaningful inventory turns, allowing you to make decisive and educated buying and selling decisions, instead of simply guessing.

The income statement in the chart on page 22 shows the wide swing in bottom-line profitability that can occur when you don't have a proper valuation of your inventory. This retailer was led into a false sense of euphoria by his: (1) lack of "writing down to market value" the

$20,000 declined value below the cost of some old drum machines, synths and samplers, and (2) poor "cut off" of inventory—the retailer picked up $30,000 worth of goods that arrived (and were counted) on December 31, 1998, but were invoiced and dated in January, 1999. Guess what—he paid taxes on that misstated profit too.

Great Reason #2—

By going through the process of counting and checking inventory items against your books and computer records, you have a much greater chance of uncovering:

- Slow-moving or obsolete goods
- Overstocked and understocked goods
- Shrinkage in inventory from employee pilferage
- Weaknesses in your store's internal accounting controls
- Inefficient moving of goods from receiving to warehousing to the sales floor

Great Reason #3—

Behind every dark crowd there's a silver Stratocaster. You'll never know what hidden treasures you'll

> **'By knowing the absolute dollar value of your inventory, you can now properly measure the profitability and financial condition of your company.'**

find as you systematically count inventory in every corner of your store and back room. You may find missing cables, misplaced repair parts, and old (but now considered vintage) guitars and amps.

Some Final Thoughts

Physical inventories don't have to be long, burdensome and done all at once. By taking periodic counts throughout the year, you can greatly alleviate a monumental task at the end of the year. Take an inventory by department at the end of each month (guitars in January, keyboards in February, drums and percussion in March, band instruments in April, etc.).

I can't think of a simpler way to ease the task of taking inventory than to use bar code technology and good accounting software. Contact Mary Beth Connor at NAMM (800-767-6266) for the latest package of information on implementing a bar code system in your store.

Finally, don't let another year-end pass without taking a complete physical inventory of your store. Your accountant should be able to assist you, which will help prevent Freddy Krueger from turning your New Year's dreams into a nightmare on physical inventory sheets.

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Big Al's House of Rock and Overstocked Schlock Statement of Income

	in theory $	%	in reality $	%
Sales	1,000,000	100	1,000,000	100
Beginning inventory	350,000		350,000	
+ purchases	675,000		675,000	
=	1,025,000		1,025,000	
- ending inventory	325,000		275,000	
= cost of goods sold	700,000	70	750,000	75
Gross Profit	300,000	30	250,000	25
Operating Expenses	250,000	25	250,000	25
Net Income (before taxes)	50,000	5	—	—