

**Possible Reasons for Inventory Shrinkage**  
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Many managers jump to the conclusion that if inventory is missing, it is due to theft or fraud. We have all read or heard stories where this is true, but theft or fraud are not the most common reasons for inventory shrinkage. Some of the more common reasons are:

1. Changes in a product's design or manufacturing method effect cost. If the cost to manufacture a product is lowered, but the appropriate bookkeeping changes are not made, the item is over valued, which will turn up as shrinkage at some time in the future.
2. Unbilled shipments of salesperson samples, warranty replacements, other no-charge shipments and customer samples are another overlooked cause of shrinkage. The invoice will remove the item and the item's cost from inventory even though the selling price is zero.
3. Confirm that the total inventory you counted is accounted for by obtaining pre-numbered tags to be passed out during the physical count. Verify that you can account for all the tags handed out for the inventory count before finalizing the count. Ruined and unused tags should be returned as part of the control process.
4. If you start looking at historical gross margin percentages and they are increasing, this may lead you to find accounting errors in the costing of your finished goods.
5. An increase in the number of sales orders not shipped could mean that some shipments are not being invoiced. Possibly, due to flaws in your paper flow procedures.
6. If you notice that the scrap percentage rate is decreasing abnormally and your scrap income is staying the same, it could mean that not all defective production or scrap is being recorded correctly.
7. During production, a more expensive material was substituted for the standard material and the standard material was relieved from inventory.
8. Not using the same standard cost at the end of the year you used at the beginning of the year. If the standard cost changed from the beginning of the year, you should calculate the standard cost twice at the end of the year. Once at the beginning of the year standard and once at the revised end of year standard.
9. If you use outside processor(s) to do part of the work on your finished goods, have you accounted for the inventory that is in their possession when you take your physical count?
10. If you are in a multi-warehouse environment, have you accounted for all of your inter-warehouse transfer correctly, including transfers shipped from one warehouse, but are still in transit?

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