Why an accurate Physical Inventory is so critical to establishing world class financials… Having world class financial in turn improves the retailers' capability to tactically isolate and quantify performance opportunities while optimizing resources to mitigate risk…

Most retailers don't realize the full impact of an inaccurate Physical Inventory. If one inaccurate count is booked as a final result, it requires two 100% accurate counts to correct the initial inaccurate count. Count variants/errors create what is called the "bounce-effect".

Example: Store A historically and consistently posts around a 2.25% shrink rate over the last 4 years

- **2011** - 2.26%, **2012** - 2.28%, **2013** - 2.25%, **2014** - 2.24%

-**2015** Store A – post a 0.48% shrink rate

- The results are clearly an error, as they are well below the norm… nevertheless the results are booked, primarily because the results are viewed as an <u>improvement</u> and not as an error or inaccurate.

However, what that error really means is… for the purpose of this example we are assuming the big "IF"… "IF" the next two counts are 100% accurate the results will look directionally like the chats to the right:

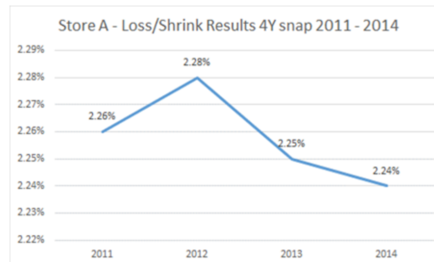
-**2016** the shrink rate explodes to 4.13% *(2x its historical trend creating unnecessary panic which will generate stress in resource deployment to "fix" a problem that is the result of a count error, not theft, or operational in nature)*
-**2017** the shrink rate settles back into the historical performance defined by 2011-2014 results, again assuming the 2016-17 counts are accurate.

When we map that time between accurately accounting for this critical measureable of the P&L statement and the corresponding balance sheet declaration tied to the Asset called Inventory… assuming stores are counted once every fiscal year… <u>the results are astonishingly unacceptable and not a characteristic of world class financials.</u>

-**2014** <u>accurate</u> count – clock starts 12 months pass until we reconcile the next PI - book on hand counts/value with the physical count of on hands…
-**2015** an <u>inaccurate</u> count results in an under indexed rate of 0.48% resulting in a dramatic improvement – *clock continues months 13 thru 24 pass*
-**2016** <u>accurate</u> count with inflated results of 4.13% – the inverse of the Y5 inaccurate count & result – *clock continues months 25 thru 36 pass*
-**2017** <u>accurate</u> count – *<u>48 months have passed</u> before the results are finally aligned and the P&L can accurately report loss/margin, and more importantly, the balance sheet accurately reflects the true value of the business's most significant asset… Inventory.*

Physical Inventory accuracy – data integrity

Example: Store A 2011 - 2014



Example: Store A 2011 - 2017

The 3 most critical elements of accurately reporting shrink – markdowns & margin to the P&L are:

1) Data integrity specific to accurate on hand counts linked to book inventory/stock ledger
2) OPS - Consistent & disciplined management of the Physical inventory count – to ensure section counts are accurate
3) FINANCE - Consistent, disciplined & timely reconciliation of the physical inventory results to ensure accurate reporting of results

Accurate & timely reporting of risk/loss provides the retailer with the best environment to optimize their resources (financial and human capital). Thus the focus is on true performance opportunities instead of chasing ghosts by targeting those locations that created a variant as a result of an inaccurate count.