

[Date]

To: [Name of Management/Board of Directors]

From: [Name of Auditor/Firm]

Subject: Management Letter regarding Inventory Valuation Deficiencies

Dear [Name],

In connection with our audit of the financial statements of [Company Name] for the period ended [Date], we identified certain deficiencies in internal controls relating to inventory valuation that we believe merit your attention.

Observation: Lack of Lower of Cost or Net Realizable Value (NRV) Analysis

Condition: During our testing, we noted that the company does not perform a formal periodic review to ensure inventory is recorded at the lower of cost or net realizable value. Several items held in stock appeared to have market values below their recorded cost due to age and decreased demand.

Risk: Inventory may be overstated on the balance sheet, leading to a potential material misstatement of both assets and net income.

Recommendation: We recommend that management implements a quarterly review process to identify slow-moving or obsolete stock. An allowance for inventory write-downs should be established based on current market trends and historical sales data.

Observation: Inaccurate Overhead Allocation

Condition: The current method for allocating manufacturing overhead to inventory is based on outdated estimates that do not reflect actual production volumes or current utility and labor costs.

Risk: Product costs may be distorted, resulting in inaccurate gross profit margins and incorrect valuation of ending inventory.

Recommendation: Management should perform an annual study of overhead costs and production capacity to ensure that the allocation rates used in the valuation model are current and accurate.

Management's Response: [Space for Management Comments]

We would like to thank your staff for their cooperation during this process. We are available to discuss these matters further at your convenience.

Sincerely,

[Signature]

[Name of Auditor]

[Firm Name]