

[Date]

[To: Name of Management/Board of Directors]

[Company Name]

[Company Address]

**Subject: Management Letter Regarding Physical Inventory and Valuation Controls**

Dear [Recipient Name],

In connection with our audit of the financial statements of [Company Name] for the period ended [Date], we have reviewed the internal controls relating to physical inventory counts and valuation procedures. Our objective was to evaluate the adequacy and effectiveness of these controls to ensure the accurate reporting of inventory assets.

During our assessment, we noted certain areas where internal controls could be strengthened. Our findings and recommendations are as follows:

**1. Physical Inventory Observation and Cut-off**

**Observation:** [Describe specific finding, e.g., lack of pre-numbered tags or inconsistent "freeze" of movement during count.]

**Risk:** This could lead to the double-counting or omission of inventory items, resulting in a material misstatement of ending inventory balances.

**Recommendation:** We recommend implementing a formal cut-off procedure that ensures all shipping and receiving documentation is reconciled immediately before and after the physical count.

**2. Inventory Valuation and Costing**

**Observation:** [Describe specific finding, e.g., outdated standard costs or lack of overhead allocation review.]

**Risk:** Inventory may be recorded at values that do not reflect the lower of cost or net realizable value (NRV).

**Recommendation:** Management should perform a quarterly review of standard costs and ensure that the valuation method is applied consistently across all product lines.

**3. Identification of Obsolete or Slow-Moving Stock**

**Observation:** [Describe specific finding, e.g., no formal policy for identifying damaged or aged items.]

**Risk:** Failure to identify obsolete inventory leads to overvaluation of assets on the balance sheet.

**Recommendation:** Establish a periodic "slow-moving inventory" report and a formal approval process for writing down or disposing of obsolete stock.

#### **4. Segregation of Duties**

**Observation:** [Describe specific finding, e.g., same individual manages the warehouse and performs the system adjustments.]

**Risk:** Increases the risk of undetected errors or unauthorized adjustments to inventory records.

**Recommendation:** Ensure that individuals responsible for physical custody of inventory do not have the sole authority to adjust inventory levels within the accounting system.

We have discussed these comments with management and would be pleased to provide further assistance in implementing these recommendations.

This communication is intended solely for the information and use of management and the Board of Directors and is not intended to be used by anyone other than these specified parties.

Sincerely,

[Your Name/Signature]

[Your Title/Firm Name]