

UNFINISHED BUSINESS: MANAGING WIP INVENTORY EFFECTIVELY



Work-in-process (WIP) inventory hold significant weight on a manufacturer's balance sheet, playing a pivotal role in financial accuracy and performance evaluation. By closely monitoring WIP, manufacturers not only maintain the integrity of their financial statements but also gain valuable insights into their operational efficiency and overall business performance.

What is WIP?

WIP refers to all inventory in the stage between raw materials and finished-product inventory. When direct labor is applied to raw materials not yet ready for sale, their production costs (like raw materials, direct labor and factory overhead) are recorded in WIP. The formula for estimating ending WIP is:

Beginning WIP + production costs – cost of goods manufactured (COGM) = ending WIP

For example:

A manufacturer starts the quarter with \$100,000 worth of WIP inventory. Throughout the quarter, they spend \$250,000 on production costs. Now, the Cost of Goods Manufactured (COGM), which represents the total production costs for

goods available for sale, amounts to \$200,000. So, to find out the ending WIP, we add the initial WIP (\$100,000) to the production costs (\$250,000) and subtract the COGM (\$200,000). This calculation shows the ending WIP to be \$150,000.

Benefits of Tracking WIP

Estimating and monitoring WIP provides several important benefits, including:

1. **Accurate Inventory Values:** WIP tracking ensures your balance sheet reflects accurate inventory values, preventing overstatement of COGM and distorting financial performance.
2. **Reduced Reliance on Physical Counts:** Proper tracking and estimating of production costs lessen the need for costly physical counts of WIP and your reliance on them, though they remain important for identifying issues like damaged or stolen goods.
3. **Identifying Trends and Red Flags:** Monitoring WIP uncovers trends and red flags, such as supply chain bottlenecks (excessive WIP), higher storage costs due to high WIP levels or risk of loss, damage, expiration or obsolescence while awaiting completion.

Optimal WIP Levels

Generally speaking, lower WIP is better for cost and efficiency. However, some WIP can minimize downtime during supply chain delays.

Finding the optimal level of WIP depends on factors like product variety, supply chain dynamics and inventory management strategies.

Getting help

To manage WIP effectively, you must measure it accurately. That means you'll need to have the ability to track the costs of raw materials, direct labor and factory overhead at various stages of the manufacturing process. Advisors can assist in establishing systems for collecting the data needed to optimize your WIP.

Conclusion

Mastering WIP inventory is crucial for manufacturers. It ensures financial accuracy, reduces reliance on physical counts and helps identify operational inefficiencies. Finding the right balance of WIP is key to optimizing your manufacturing processes and staying competitive in the market.