

Slow moving stock problem: empirical evidence from Malaysia

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Abstract

Purpose – The purpose of this study is to identify weaknesses in the internal control of the stock management processes and provide recommendations to improve those weaknesses. The study also analyses whether the current stock management processes are adequately documented and updated regularly.

Design/methodology/approach – One company involved in the automotive industry was selected as a case study and its stock management examined, focusing on the processes involved and the reliability of the current inventory system. Data were collected via interviews with the selected staff and document analysis on various financial and non-financial company records.

Findings – The results show that there are loopholes and weaknesses in the current stock management system. This is because of poor technology and a lack of exposure and knowledge of staff involved in the stock management system.

Research limitations/implications – As this research is based on one company as a study case, generalization must be done with precaution. Access to certain important documents was denied because of the confidentiality.

Practical/implications – This study will help companies in the automotive sector to improve their stock management process, allowing for more efficient cost control and better services to customers. Specifically, this study identifies weaknesses in the current inventory management and provides recommendations to overcome those weaknesses. This will indirectly prevent fraud and theft and safeguard the cash flow of the company by improving the operation of the procurement and spare parts stock control department.

Originality/value – This study is original, as it focuses on a company that operates in the automotive sector, which is rare in the internal control literature, particularly in developing markets such as Malaysia. It contains examinations of various internal documents that are generally difficult to be accessed by researchers for the publication in an academic journal.

Keywords Case study, Malaysia, Internal control, Inventory management, Automotive, COSO framework

Paper type Case study



Introduction

Inventories are goods that a business keeps for resale purposes. More specifically, they include assets held for sale in the ordinary course of business, in the process of production for such sale or in the form of materials or supplies to be consumed in the production process or in the rendering of services (Malaysian Financial Reporting Standard [MFRS] 102). Inventory is important because it represents a company's financial investment. Without proper and careful management, poor stock handling resulted to company's cash flow in trouble. Because of this, many companies spend extra money on manpower and resources to carefully monitor their stock movement. The process of monitoring stock is known as stock management.

A successful stock management system can be achieved from several approaches, such as the manual method and computerized systems. Even though most companies use inventory software to manage their inventory efficiently and effectively, there are still some companies using old-fashioned methods such as manual calculation. With this method, the stock of the company will be inspected and counted by hand. Owing to the time-consuming process, this activity is usually conducted once a year.

In the automotive industry, inventory or spare parts management is difficult and complicated and sometimes considered uneconomical because spare parts that are purchased might be used one year later or in worst case scenario may never be used in future because of the introduction of the new version or model of the motor vehicles in the market. Furthermore, maintaining inventory of spare parts has associated costs. If the stock is not properly maintained, spare parts may not be available when needed by customers. If the spare parts are not in stock, the customer satisfaction levels might drop, as they have to wait longer time for their vehicle to be repaired.

To maintain spare parts inventory for every contingency is also not an easy task. To overcome the problem, it is crucial to establish an efficient spare parts ordering process and understand the costs associated. This allows the personnel in charge to make good decisions on what part to order for cost-saving purposes. Excellent and effective stock management ensures that a company's businesses run smoothly and efficiently, leading to health financial position and superior profitability of the company. However, there are many problems in the stock management. Most of the problems are typically because of inefficient inventory practices and out-of-date inventory systems.

To further understand this phenomenon, one company was selected as a case study to examine this problem. This company, ABC Enterprise (not a real name), is a subsidiary of one of the leading conglomerates in Malaysia. The company is an authorized importer, assembler and distributor of leading brands of range of special utilities vehicles, multipurpose vehicles and many others commercial vehicles. In addition, the company also has entered into a distributorship agreement with an overseas company for the exclusive distribution of a popular international brand of bike in Malaysia. As the company holds various distributorship rights for motor vehicles and bikes, it is necessary for these to be backed up by comprehensive stock management to ensure constant demand and excellent support on the vehicles.

This company was selected as a case study for two important reasons. Firstly, informal interviews with a few staff of the company revealed that the company currently experiences stock management problems. This justifies its selection, which meets the purpose of the study. [Sekaran and Bougie \(2013\)](#) emphasize that selecting the right subject is crucial for a successful case study research. Secondly, the permission to conduct interviews and access to verify confidential non-publicly available documents were granted by the company's authority. Thus, this research benefits from the actual information and phenomenal currently occurring in the company.

The purpose of this paper is to examine the internal control weaknesses of the current inventory management and the reliability of the inventory management system in the ABC Enterprise. This research examines whether the current stock management processes are adequately documented and updated regularly and identifies whether there is any excessive amount of obsolete inventory of spare parts in the company.

This study contributes in several ways. Firstly, this study helps the management of the company to identify the weaknesses in the current stock management processes and provide recommendations to improve the existing weaknesses. This will indirectly

safeguard the cash flow of the company when focus is given to effectively manage the spare parts with higher demand.

Secondly, this study also hopes to improve the process between the procurement department and spare parts stock control department. For example, the procurement department will be able to conduct proper planning to get better pricing and has sufficient time to make purchase. Currently, purchasing time is too long because of restrictions on approval from the relevant authority, and some of the spare parts are ordered directly from overseas.

Thirdly, the finding of this study will help other companies in the automotive sector in improving their stock management process which allows more efficient cost control and provides better service to customers. The success of a company is based on many factors, and efficient inventory management system is one of those critical factors.

Finally, this study will add to the theoretical understanding and body of the literature on the effective inventory control in the automotive industry, which is based on the actual company practices that are scarce in the literature, particularly on the research that focuses on the emerging market environment such as Malaysia. Prior studies concentrated more on developed areas such as the UK, the USA and Europe.

The next section is a review of literature, followed by the research methodology. The following section presents the findings and discussion. The last section contains conclusions, practical implications and limitations of the study.

Literature review

Internal control and inventory management system

In large firms, inventory such as spare parts is highly varied. It has many types of costs, different service requirements and demand patterns analysis for easy management. There are usually three costs involved in managing spare part stock (Syntetos *et al.*, 2009). First is ordering cost. This is the cost incurred in procuring the stocks, which arises from the work involved in communicating with a supplier. Second is holding cost, which arises because of the existence of stock and varies directly with stock size. Examples of the cost of holding stock are storage, deterioration, obsolescence and also insurance. Finally is out of stock cost. This cost is related to loss of revenue or profit as a result of loss of customers because of cancellation of a job order or the customers who switch to other companies. If the customer is a large customer and never comes back for next order, it may risk the company into a huge financial shortfall situation.

Owing to high cost involved if stock is not managed properly, a company needs to focus on the design of the management information system to establish accurate and sound decision support system to effectively and efficiently manage the stock management system. A sound decision support system, among others, should be able to assist in determining the stock at the most optimum level and create most favourable ordering policies for each material, so that profit can be maximized and loss can be minimized. Advances in information, communication and technology coupled with difficulties in managing large range of inventories materials because of human limitations provide opportunities for computer usage in stock management.

The other focus in managing inventory is to establish a strong internal control system. It is beneficial to support organizations in managing and controlling both systematic and non-systematic risks that will prevent them from meeting their established objectives and key performance indicators (Zakaria *et al.*, 2016). As described by COSO (2013), internal controls are an established policies and procedures to provide reasonable assurance that the entity

objectives will be achieved. It is a process affected by all the members in the organization, including the board of directors, management and other personnel.

Empirical research shows various benefits of strong internal control systems. Robust internal control able to prevent fraudulent activities from occur in the organization (Omar *et al.*, 2016; Szymanski, 2007; Tong *et al.*, 2014; Oh *et al.*, 2014; Lokanan, 2014; Skaife *et al.*, 2013). For example, dealing with the limited number of vendors and suppliers may indicate weaknesses in internal control, and it can be a red flag for fraud (Simser, 2014). Apart from that, strong internal control ensures that employee can manage organization's resources with accountability (Asare, 2009) and discourages them in taking risky effort that will waste organizational resources (Lansiluoto *et al.*, 2016; Jin *et al.*, 2013). This will improve earnings and positive cash flow quality and consistency (Altamuro and Beatty, 2010; Brown *et al.*, 2014) leading to more efficient operations (Feng *et al.*, 2015) and extra precautions to shock from unexpected events (Hajiha and Bazaz, 2016).

On the contrary, weak internal control may lead to low data integrity (Rahim *et al.*, 2017), imprecise decision-making (Allen and Tommasi, 2001) and increase human errors (Allen *et al.*, 2013) which lead to reduction in turnover (Su *et al.*, 2014), and hence company's overall performance (Weiss, 2014). At the top level, poor internal control provides opportunities for higher private control benefits (Gong *et al.*, 2013) that decrease market value of the firm and its value relevance of accounting information (Hu *et al.*, 2013) and result in low financial reporting quality (Ghosh and Lee, 2013) and negative reactions from the stock market (Nishizaki *et al.*, 2014).

Common problems in spare parts stock management

One of the most critical elements in an efficient inventory management system is inventory forecasting (Fildes and Beard, 1992). A good inventory system will easily assist companies to determine the right amount materials needed at the right time and at the right place to meet customer demand. This can be realized via history and good records, as both procurement and stock department will be able to make accurate forecasting and create sufficient and optimal lead time in purchasing parts to ensure supplies are always available to build customers' confidence. In contrast, purchasing too early may damage the product because of obsolescence or damage during the handling or storing period.

There are some examples of problems that can cause awful stock management.

Unqualified employees in charge of stock. The employees in charge of the stock distribution have insufficient experience, knowledge or qualifications. They are neglectful and prone to mistake in conducting their job, possibly because of lack of proper and systematic training. Closer attention is needed in overseeing the human resources involved in stock management. A pre-determined training schedule must be established to make sure employees are competent and have adequate skills to perform their job.

Unrealistic and overestimate business plan for future. The personnel of the company such as top management may wrongly forecast the business activities for the future. Too optimistic prediction such as projected high sales and turnover will lead the company to purchase too large materials, and hence overstocking. In contrast, pessimistic predictions will make the company lose some of potential customers and unable to create sufficient profit and positive cash flow. This possibly leads to the underutilization of assets, and in future, the company may go into liquidation because of an inability to finance its capital expenditure.

Excessive stock in store and late to clear these stocks. This is probably the most frequent and regular inventory trouble for most businesses. Too much stock leads to unnecessary cost incurred in term of storage costs, handling costs and loss of revenue because of much

money or capital tied up with the stock that unable to generate income. If a company buys material in bulk to take advantage of discounts and cheaper price but is unable to use it quickly, the company will end up incurring more cost and lose the purchasing advantage.

Theoretical framework – COSO framework

The findings of this study were analysed by using the latest COSO Internal Control – Integrated Framework (2013). This framework is chosen because as far as study on internal control is concerned, this is the most comprehensive framework available and widely used. It has been adopted by various organizations globally. This framework comprised five components, namely, Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring Activities. From the five fundamental components, it is further described based on 17 underlying principles which broaden into details of 77 points of focus (POF). As such, this framework clearly facilitates employees at every level of an organization in designing and implementing strong internal control as well as assessing its effectiveness. This study, however, explains only the relevant POF related to the weaknesses of the inventory management linked to the findings of this research.

Research methodology

Case study approach

This research adopted a case study approach to benefit from rich and diverse information and analysis by focusing the research effort only to a small samples or subjects. In this study, one company has been selected as a case. Based on [Smith \(2015\)](#), a case study approach is the most appropriate method to use when there is an opportunity to examine actual practices. Thus, using the case study approach provides an in-depth understanding of events in real-world contexts ([Bromley, 1986](#)), and hence produces the best outcomes.

One company, ABC Enterprise (not its real name), was selected as a study case. The company involved in the importation of various range of spare parts, automotive components and tyres of the vehicles from overseas. In this study, all the actual names of individuals were involved, and brands and specific information about the company were not disclosed or amended because of the confidentiality issue. Financial data were obtained from the company's database from 2009 to 2012.

Data collection method

This study used a mixed method of data collection, namely, interviews and the examination on the company's record. In other words, data are collected from both primary and secondary data. Primary data are original data or information given by individuals themselves via interviews, whereas secondary data are collected from the monthly management reports and the standard operating procedures of the company.

This mixed method of study has been selected because this study intends to apply various perspectives to the problems of interest to enhance the validity of the findings ([Flynn et al., 1990](#)). In addition, combining evidence from different sources is able to address the initial propositions of a study firmly and with confidence ([Yin, 1994](#)).

Interviews with selected staff. An interview is a technique used to understand the experiences of others. Face-to-face interviews were conducted with the Senior Manager of the Parts Department, Senior Manager of Service Department, two key staff who are involved in data entry of the Part Management System (PMS) and one staff who responsible of incoming and outgoing of the spare parts. The interview session, ranging from 1 to 2 h, aimed to get a general view on the PMS process in controlling and processing the movement of the spare parts inventory. Their views are important in determining whether the current

PMS is reliable. The interviews were structured interviews because the findings from the interviews could be compared and analysed easily.

The findings were analysed using qualitative analysis software in three stages, namely, data reduction, data display and data conclusion (Malhotra, 2010). Data reduction is a stage in which only information relevant to the research is selected. After that, the selected information was analysed in the data display stage by using diagrams, so that the connection and related information in term of research theme can be classified together. Finally, the information which was grouped together was again re-analysed and verified.

Examination of the company's records. In this study, various documents such as purchase requisition, purchase orders, goods received notes, delivery orders, proforma invoice and sales invoice were examined to assess employee performance using current stock management practice. Samples of data from the PMS are checked and compared with various forms, invoices and documents to examine the completeness of recording. The quantity level of stock was also analysed. Verification of the monthly accounting records with stock-related records was conducted.

Findings and discussions

Findings from qualitative analysis

Results from the interviews. Interviews were conducted with Madam A, the Senior Manager of Parts Department, Mr B, the Senior Manager of Service Department, Madam S, the Executive of Parts Department, Miss R, Clerk in Parts Department and Mr P., who is in charge of the incoming and outgoing of spare parts. In total, five respondents were interviewed. These interviews were sufficient for case study research based on Creswell (2012). Owing to confidentiality, the interviewees were reluctant to disclose more information on their background and demographic profiles.

Based on the interviews, it was found that they have been using the stock management system called PMS for more than 15 years. This is a customized stock system designed based on ABC Enterprise requirements. The system is supported by its local information technology solution suppliers.

PMS was introduced by the previous top management of ABC Enterprise, and no revision of the system was made after the change of new management in 2006. The stock items currently held are spare parts for motor vehicles and motorcycles. These spare parts are inclusive of vehicles components, batteries, spare tyres, oil lubricants and brake fluid. The spare tyres are solely for the motorcycles, as the company is the authorized distributor of the motorcycles, and currently, its spare tyres are not available in other places. The local suppliers usually supply battery, tyres, oil lubricant and brake fluid and also other automotive spare parts for various models. ABC Enterprise does not arrange its spare parts based on category of the region, for example, spare parts from overseas countries or local supplier, but uses its model prefix instead. All small parts are stored in bins.

Based on the interviews, it was found that the company uses out of date software for its computerized inventory management system. The interview results also revealed that all the respondents used PMS, except for Mr B. He stated:

The stock system that they use is running on DOS (Disk Operating System) version that allows using only the computer keyboard and not the computer mouse.

However, Madam A did not totally agree with the opinion by Mr B. Although the software uses outdated language, it is safe from any virus. Madam A highlighted:

There is an advantage of using the system where the system does not easily infected by virus.

Nevertheless, Madam A admits that the software provider does not give adequate support to the users. She clarified:

Support from the system vendor is very weak. When problems with PMS arise, the vendor usually takes a few days to come and fix the problems.

Inadequate support from the system's vendor is non-compliance with *POF 47* of COSO Framework – *establishes relevant technology acquisition, development and maintenance process control activities*. Poor vendor support will interrupt operations and inventory management, and hence create bottleneck activities and decrease productivity. In addition, it time-consuming until the vendor is able to rectify the problems because salary still needs to be paid for the employees, although they are doing nothing because of system breakdown. Thus, management expenses will increase disproportionately with the productivity of the company.

It is also difficult to manage inventory using outdated software that is not user-friendly. This inventory system does not help much in assisting employees to monitor inventory movement and levels. Madam S explained:

The system is unable to keep track of stock and is not user friendly. The company always runs out of fast moving stock because the system is unable to set low level stock warnings to enable the Parts Department to order new stock.

The inability of the software to provide early warning signal of low stock will risk the company to have a shortage of the stock when an order from a customer is received. Because of this, the customer may feel dissatisfied and switch to another company because they want to have the spare parts quickly and are not willing to wait. To avoid this situation, ABC Enterprise does not have the choice but blindly purchase the inventory in bulk. Unfortunately, a wrong decision in purchasing the unpopular spare parts will result in excessive stock, and it may become obsolete. Madam S further reiterated the weaknesses of the system:

The user is unable to see the product history of when the same stock items were received and sold and does not have the ability to work with multiple currencies when doing transactions with people in other countries such as India and Canada.

These problems are incongruent with the recommended *POF 45 – establishes relevant technology infrastructure control activities*. It seems that the company is unable to fully use available technology because of the dysfunction of certain important system applications. One of the threats when the system is unable to provide data history on the stock movement is a risk of stock-out. This occurs because the employee is unable to match the material that enters and exits inventory because of production or sales. Stock-out may frustrate customers and force them to switch to other company and stop future transactions with ABC Enterprise. This is a direct loss of sales and revenue for the company.

Besides, importing stock from overseas is a lot more complex than purchasing from local suppliers. The exchange rate fluctuation is a big problem for ABC Enterprise as an importer because uncertainty of the exchange rate can affect the final materials purchase price. In certain situation, the rate could be unfavourable, and hence exceeded the budgeted amount. Regrettably, the computerized system in place is unable to capture transactions on the multiple currencies as explained by Madam S previously. The inability of the system to work with multiple currencies has slow down the purchasing process of the inventory. These weaknesses are related to *POF 69 – considers rate of change*.

As a result, employees need to manually calculate the purchase price in each foreign currency. It risks the company to wrongly calculate the actual purchase price of the material because of wrong currency rate used or applied outdated rate. For each new order made by

the customers for overseas spare parts, employees need to verify with the overseas supplier portal first, whether there are any spare parts in transit. If the spare parts are not in transit or not available in stock, only then they would make new order of the spare parts. This is time-consuming and may further increase losses because of a non-favourable currency exchange rate. An incorrect quotation price given to the customer may end up reducing the profit margin charged for the purchased material.

Another problem found from the interviews was inconsistency in instruction practices. For example, the inventory examination or stock count was conducted on different interval basis. One respondent suggests that a stock count is performed on a quarterly basis. However, the other three respondents claimed that it was conducted on yearly basis. One respondent mentioned that he was not sure.

The inconsistencies in inventory count practices indicate that there is no uniformity in giving instructions to perform a particular job from different supervisors to their employees, which is related to *POF 62 – selects relevant method of communication*. The unavailability of clear standard operation procedures may have some bearing on the management practices which is based on verbal instructions rather than following the standard operating procedures. This is not a good practice because no proper instruction record will lead to the inaccuracy of messages when they reach the responsible employees. Furthermore, it may confuse the recipients because many versions of instruction are given which creates misunderstanding. In addition, the legal validity of those verbal instructions is questionable and may end up with the employee just ignore the instruction.

The situation is worse when the company do not use advanced technology in managing the stock. For example, during the interviews, all respondents confirmed that the company does not used a barcode label in managing their inventory. Because of this, the employees need to manually count the stock which is not effective, time-consuming and prone to human error. Additionally, stock theft also can easily be committed because no correct number and accurate information of each material in inventory recorded to control its movement in real time. Without barcodes, the incorrect products may be shipped to the customer.

This weakness also leads to a bigger problem, namely, discrepancies between actual stock count and recorded stock. Not surprisingly, all respondents again confirmed and agreed that discrepancies of the figures always occurred. Madam A explained:

The amount of obsolete stock is huge, where the company is still keeping the stock for the old spare parts. Written down value of RM 15 million was provided for certain brand spare parts in 2010.

These weaknesses contribute much to bottlenecks, as the employees need to repeat the same work and tasks many times. Unavailability of the efficient and effective inventory system exposes the company to the risk of error and probably to the fraud and theft of inventory. Weak control provides opportunity to the fraudster to misappropriate assets such as spare parts and embezzle money out from the company. This is incompliance with *POF 31 – considers various types of fraud* and *POF 33 – assess opportunities (of fraud)*.

The final problem found from the interviews is poor customer service. This study found that the company does not maintain a customer complaint form which is disagreement with *POF 64 – enables inbound communications*. This is not a recommended practice because the company is unable to measure customer satisfaction with their service. Thus, the company is unable to improve their products and services to meet customer expectation. In addition, good customer experience cannot be established, which risks the company being unable to retain their loyal customers.

Findings from quantitative analysis

Frequency and accuracy of data entry in ABC enterprise. Samples of documents were taken from the Parts Department and Accounts Department for comparison and verification. It was found that not all documents were recorded on a daily basis. This is based on the date of the data were keyed in into PMS and the customers' delivery order and suppliers' good received note. When ABC Enterprise delivers stock to other service centres throughout Malaysia or to its own centre, an invoice is to be issued immediately using the PMS. Even though the staff involved claimed that they recorded all incoming and outgoing spare parts and components on a daily basis, it was found that the parts received and delivered are sometimes recorded a few days later. This is against *POF 50 – performs in timely manner of COSO Framework*.

There is also evidence showing that every month, there is a disagreement of balance in stock levels recorded in the Parts Department and Accounts Department. Improper recording of purchase or sale of stock items can cause many problems. ABC Enterprise uses ACCPAC system to record its accounting transactions and reporting purposes. Both the PMS and ACCPAC is a stand-alone system, and therefore, the systems are not integrated. Currently, the company's invoices for the sales of spare part are processed and printed by the PMS and forwarded to the Accounts Department for accounting record purposes.

Table I shows the total stock balance of ABC Enterprise that includes spare parts and gas oil at one particular month as reported in the monthly management accounts. The aging summary reports of these stocks were generated from the ACCPAC and PMS aging report.

From the report, it was found that there was a difference in the stock balance totalling RM8,387,551. The Accounts Department recorded higher stock of spare parts in ACCPAC as compared to PMS because of outgoing parts that were recorded in PMS, but the Parts Department did not issue any invoice or forward the documents in the same month, resulting in timing differences. This is in contradiction with *POF 22c – considers the required level of precision*.

There are many consequences if a company does not precisely record their financial transactions. The differences of figure risk companies result in inaccuracy in determining the cost of the materials, and hence profit calculations. In extreme circumstances, a company may record profit but in actual incur losses. Errors in financial reporting will result in negative repercussions for the company when it is discovered later such as damage in reputation and severe penalty from the regulatory authorities because of incorrect figures reported in the financial statements. The weaknesses in the recording system also lead to loopholes in inventory control that eventually provide opportunities for employees to commit fraud, embezzle money and misappropriate inventory and assets of the company. This is worsened if a company has poor ethics among employees, as prior history shows that moral misconducts among the employees may contribute to the financial disaster of the company (Manan *et al.*, 2015). Thefts of assets in a large amount and over a lengthy period of time are detrimental to the profit and performance of the company in the long term.

Table I.
Stock balance report
generated from
ACCPAC and
PMS system

Source	<120 days RM	121-180 days RM	181-270 days RM	271-364 days RM	1-3 years RM	>3 years RM	Total RM
ACCPAC	703,662.51	2,614,799.03	104,993.86	3,200,633.22	2,335,707.89	581,690.98	9,541,487.49
PMS	133,824.99	91,455.47	74,411.03	3,485.88	269,067.25	581,690.98	1,153,935.60
Different	569,837.52	2,523,343.56	30,582.83	3,197,147.34	2,066,640.64	0	8,387,551.89
(%)	80.9	96.5	29.1	99.8	88.5	0	87.9

Analysis on the obsolete stock in ABC enterprise. Based on [Table I](#), the total amount of spare parts stock considered as obsolete is RM850,758 (RM581,691 plus RM269,067) for stock held more than a year. This represents almost 70 per cent of total inventories, which is considered significant. Based on the MFRS 102, ABC Enterprise has to provide the written down value of the spare parts in the financial year end and record the amount based on the current market value of the stock. On average, the company incurred an approximately RM510,455 write down cost which largely reduce company profit in the statement of comprehensive income (assuming the write down value at 60 per cent), as the company has not provide any provision on the stock. This is clearly in opposition to *POF 21b – complies with applicable accounting standard*. Incompliance with required financial reporting standards will lead to improper presentation of financial statement and wrong decisions being taken, not only by the management of the company but also by the external stakeholders. Additionally, a company may be fined by regulators for negligence in preparing a truthful financial report.

Further analysis of the spare parts by yearly basis based on [Table II](#) also supports the previous findings. Spare Parts B represent 68 per cent of the total spare parts holding in ABC Enterprise, followed by Spare Parts A at 21 per cent, Spare Parts C at 7 per cent and Others at 4 per cent. Out of the 68 per cent of Spare Parts B, the total value of stock more than five years is RM420,263.13.

This issue signifies the inability of the company to act in accordance with *POF 35 – assess changes in the external environment*. Obsolete inventory is a sign that ABC Enterprise may have fallen behind the times, because demand for its one or more of its products has clearly decreased. In addition, obsolete inventory indicates poor management practices. The company may have ordered too much of spare parts because of poor sales forecasting methods or too much optimistic thinking.

An important implication of obsolete inventory is that it will lower the profit margin, as the obsolete inventory needs to be recorded as expenses. This will have a material adverse impact on the company reported result of the operations and financial position. In addition, the current working capital is also negatively affected, which may influence the inability of the company to get favourable credit terms from a lender in future. From the management accounting perspective, the company will face difficulty in analysing the projected life cycles of the specific products because the company is unable to accurately predict the product demands. Hence, the company will keep on building excessive inventories and piling up unsaleable inventories. In the long term, investors may be reluctant to invest in the company because large amount of obsolete inventory is a red flag of incompetency of the management in forecasting demand, poor products, negative cash flows and poor inventory management.

Conclusions

The purpose of this study is to examine the internal control weaknesses of the current stock management system in ABC Enterprise. It investigates whether current stock management processes are adequately documented and identifies whether there is an excessive amount of obsolete spare parts in the company.

It was found that the company has been using the stock system for more than 15 years. This system uses outdated software and has below average performance in assisting the employees to manage the company's stock. The system is not effective in monitoring stock levels, keeping track of the stock movement, recording stock history and integrating purchase functions with multiple currencies. System support from the local vendor is also weak.

Table II.
Stock balance report
2005 to 2012

Spare parts	2012 RM	2011 RM	2010 RM	2009 RM	2008 RM	2007 RM	2006 RM	2005 RM
A	249,900.75	43,116.75	9,888.64	4,513.43	48,866.35	104,107.58	98,475.83	283,745.01
B	824,361.46	102,590.92	64,224.20	40,694.36	5,245.03	28,042.29	—	—
C	91,163.17	—	—	—	—	—	—	—
Others	53,5007.05	2,440.60	1,412.61	185.74	—	2,675.77	533.12	—
Total	368,174.20	148,148.27	75,525.45	45,393.53	54,111.38	134,825.64	99,008.95	293,745.01

This study also found that not all documents were recorded on a daily basis. Spare parts received and delivered were recorded a few days later. There was also a disagreement of balance between stock recorded in the Parts Department and Accounts Department. Both the Parts Department and Accounts Department have stand-alone systems which do not integrate well. In addition, no clear standard operating procedures documented related to the specific inventory management procedures.

Finally, this study also discovered that there was an excessive amount of obsolete spare parts, threatening the profit and loss figures of the company. Corrective action was taken in providing written down value in the financial statement, but the accounting treatment was not done in a timely manner. This jeopardizes the integrity of the financial statements prepared by the company.

There are several implications and recommendations of this study. Firstly, it is suggested that the company acquires more advanced software system to enhance the current process of stock movement. One important feature of this new software is the ability of the system to create and print customized reports and its ability to import and export stock files and reports for management reporting purposes. The stock programme also should be easy for anyone to use. An enterprise resource planning (ERP) system is highly commendable for this company because this system has the ability to automate and integrate business processes, share common data across the entire enterprise and produce information in real time (Nah *et al.*, 2001; Soh *et al.*, 2000). A powerful centralized ERP system is capable to incorporate different applications and various data sources, and hence able to maintain consistent and accurate information across personnel, units and departments. Thus, a complete and comprehensive flow of information can be viewed via a single system that provides better visibility, thereby aiding in improving organizational performance (Suhaimi *et al.*, 2016).

Secondly, the employees who are involved in the stock management process should be sent for both internal and external training. It is important to train employees in the stock management which is crucial for growth and survival of the organization. Lack of efficient and effective inventory management will result in losing customers, declining sales, delays in service and other long-term negative effects such as monetary loss and damage of goodwill and reputation. Employee training might be better done in a hands-on environment. Under controlled supervision, employees can observe the correct way to handle stock and make the individuals responsible for maintaining the company's stock. An organization that spends more money in training will collect their human capital investment via greater productivity, fewer errors and minimal wastage (Ahmad *et al.*, 2016).

Thirdly, this study has confirmed the usefulness of the COSO Framework that can be used successfully to assess the internal control of various types of organizations, including the stock management of the automotive company. Thus, a total overhaul of internal control system based on this framework can be taken to strengthen the company's internal control. For example, standard operating procedures on stock count can be established, so that this practice can be defined without any errors and produced consistent results.

Fourthly, it is suggested that the company to break the stock of the company into three categories. The first category is the fastest moving stock, the second is the average moving stock and the third is the slowest moving of stock. Parts Department needs to count items in the first category on fortnightly basis, the second category in every month and the third category on quarterly basis. All variances between physical stock check and the system must be resolved quickly to reflect accurate stock level. Employees also need to track and evaluate all variance for patterns or trends. More frequent counts may be necessary if suspected theft occurred.

Finally, the company is recommended to create more detailed record on obsolete stock. The stock system in place is not able to keep track of stock and is not user-friendly. The company always experiences a lack of fast-moving stock because the system is unable to set low level stock warnings. This impacts the ability of the Parts Department to order new stock. The users are also unable to see the product history of when stock items have been received or sold. This will indirectly increase the possibility of obsolete stocks.

Limitations of the study and suggestion for future research

There are a few limitations of the study. Firstly, it focuses on only one company, ABC Enterprise. The samples of the study were from the company itself, and no comparisons were made with other companies in the same industry in terms of stock management. Secondly, access to data is difficult, as some of the data are treated as confidential, and hence, the data available for analysis and interpretation remain limited. Finally, the respondents that participated in the interviews were not willing to share and discuss certain issues, as it involves the company's business sensitive information, fearing that it is against the company's rules and regulations.

Future research can be conducted by expanding the sample size and including more companies as a case study. Hence, more issues can be identified and better analysis can be conducted. A comparative study with a company with efficient stock management also can be conducted, so that the actual best practices can be shared and applied by the company that having trouble in managing their stock. Other data collection methods such as market survey and questionnaires can be used to increase the sample size and examine many issues concerning stock management. Furthermore, inferential statistics can be used to derive more robust and reliable findings which will lead to more meaningful and generalized conclusions.

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Further reading

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