

PS 8331.02 PHYSICAL INVENTORIES - FPI



Program Statement

OPI: FPI
NUMBER: 8331.02
DATE: 1/11/2000
SUBJECT: Physical Inventories -
FPI

1. **PURPOSE AND SCOPE.** To provide guidance for maintaining accurate inventory records and conducting physical inventories within Federal Prison Industries (FPI).

2. **SUMMARY OF CHANGES.** This directive has been revised to modify the Inventory Accuracy program by requiring that all random counts be conducted using the Cycle Count feature of the Inventory Module of the Management Control System (MCS).

Also, the annual inventory schedule is to be submitted to the respective Field Financial Administrator (FFA) in the Financial Management Branch (FMB) by October 31 of each year.

3. **PROGRAM OBJECTIVES.** The expected results of this program are:

a. Accurate and reliable inventory records will be maintained at each FPI factory location.

b. Physical inventory test counts will be conducted to ensure that inventory problems are identified and corrected on a continuing basis.

c. Inventory schedules and plans will be developed for each physical inventory performed.

d. All required reports and records will be completed accurately and timely and maintained at the factory location.

4. **DIRECTIVES AFFECTED**

a. **Directive Rescinded**

PS 8331.01 Physical Inventories, UNICOR (2/25/97)

b. **Directives Referenced**

PS 8000.01 UNICOR Corporate Policy and Procedures
(5/13/81)
PS 8510.01 Factory Costing Procedures (11/21/97)
PS 8563.06 Machinery & Equipment (Fixed Assets)
(6/11/99)

5. STANDARDS REFERENCED

a. American Correctional Association 3rd Edition Standards for Adult Correctional Institutions: 3-4037

b. American Correctional Association 3rd Edition Standards for Adult Local Detention Facilities: 3-ALDF-1B-10

c. American Correctional Association 2nd Edition Standards for Administration of Correctional Agencies: 2-CO-1B-08

d. American Correctional Association Standards for Adult Correctional Boot Camp Programs: 1-ABC-1B-12

6. INVENTORY ACCURACY. Accurate inventory records are an integral part of a good material requirements planning system and ensure the integrity of the valuation of physical inventories and their presentation on the Corporation's financial statements.

It is FPI's goal to have a 95 percent accuracy rate or greater in its raw materials, work in process, and finished goods inventories.

In order to achieve and maintain at least 95 percent accuracy in raw materials, subassemblies and finished goods inventories, the Associate Warden (Industries and Education)/Superintendent of Industries (AW(I&E)/SOI) at each location first must develop and approve an Inventory Accuracy Plan to include:

classification of inventory,
assignment of accountability,
determination of inventory accuracy rate, and
procedures for obtaining and maintaining 95 percent accuracy.

The AW(I&E)/SOI is to forward a copy of the plan to the respective Field Financial Administrator by December 31 of each year.

a. **Classification of Raw Material, Finished Goods, and Sub-Assembly Inventories.** The AW(I&E)/SOI is to ensure that all inventory items are classified according to the importance and feasibility of controlling the item's quantity and movement. Each identified class of inventory items is to be assigned a deviation tolerance level. Physical inventory count differences of items that fall within these specified tolerance levels are to be considered as 100 percent accurate.

However, the inventory records are to be adjusted for any of these differences even though they are considered 100 percent accurate for accuracy plan purposes.

The following classes and tolerance levels are to be used when classifying inventory. These categories may not be modified.

! Class I - Large Part, Easily Controlled 0%

(These items are large in individual size, issued infrequently, and easily controlled. A 55-gallon drum of glue, where the unit of issue is 'drum', is an example.)

! Class II - Hand Count 0-1%

(Quantities of these items are maintained by hand count. Plywood or metal sheets are examples.)

! Class III - Small Part, Scale Counted 0-2%

(High volumes are regularly received and issued based upon package weights and/or scale count. Rivets, crimps, or buttons are examples. **Note:** Some small parts may be of such high dollar value that a 0% tolerance level is required.)

b. **Accountability.** The AW(I&E)/SOI is to delegate responsibility and authority for inventory accuracy to the Business Manager/Plant Controller and Factory Manager. The Business Manager/Plant Controller is accountable for inventory accuracy of raw material and finished goods inventories. The Factory Manager is responsible for inventory accuracy of work in process and subassembly inventories that are on the factory floor.

Note: At certain locations, the warehouse function is the Factory Manager's responsibility. In that case, the Factory Manager is to have ultimate responsibility for the accuracy of raw material and finished goods inventories.

c. **Accuracy Rate.** The inventory accuracy rate must be established through a comparison of test counts of actual inventory with inventory records. The Business Manager is to randomly select 10 percent of those items with quantities on hand for a test count. Upon completing the test count, the Business Manager will compare the actual data with the recorded amounts. The accuracy level is to be determined by dividing the number of correct counts by the total number of items counted.

d. **Cycle Count Feature.** Unless waived by the Controller, all random counts are to be conducted using the Cycle Count feature of MCS' Inventory Module.

e. **Procedures for Factories with Less than 95 Percent Accuracy.** If the inventory accuracy level for a factory is less than 95 percent, the Business Manager is to establish a control group sample of inventory items to be counted weekly. The control group are to be governed by the following criteria:

- ! The Business Manager, with input from the Factory Manager and Warehouse Supervisor, is to select the items to be included in the control group.
- ! The size of the sample is to be two percent of the total inventory, but no less than five items and no more than 20 items.
- ! The sample items are to be representative of the inventory as a whole. For example, an inventory consisting of different types of panels, lumber, packaging materials, and hardware must include items from each of these categories in the sample group.
- ! The Business Manager may include items from known "problem areas" in the sample. This may include items with differences recorded in past physical inventories and/or items for which accurate counts are difficult to maintain.
- ! The control group sample is to be counted weekly. The Business Manager is to ensure that the weekly counts' integrity is maintained. The Business Manager must review and authorize any adjustment resulting from the

control group or any other adjustment to inventory and forward the results of the count to the AW(I&E)/SOI and Factory Manager.

! The Business Manager is to keep a record of all test counts and submit a report to the AW(I&E)/SOI identifying the causes of the differences and the plan for corrective action.

! The control group sample counts are to continue until 100 percent accuracy has been achieved for four consecutive weeks. A second control group is then to be selected and counted until 100 percent accuracy has been achieved for an additional four consecutive weeks.

At the end of the eight week period, a complete physical inventory is to be conducted. Upon that physical inventory's completion, all corresponding inventory adjustments are to be made in the MCS. Then, random counts are to be performed (in lieu of control group counts) in accordance with the procedures listed below.

f. Procedures for Factories with at Least 95 Percent Accuracy.

Factories that have a 95 percent or greater inventory accuracy level are exempt from the control group procedures listed above. However, the Business Manager must perform random counts of raw materials and finished goods inventories using the following criteria:

! Random counts are to be performed weekly unless otherwise waived by the Controller.

! The count size are to be five percent of the total items on hand, but no less than five items. In addition, at the Business Manager's discretion the count size may be limited to 25 items.

! Random count items are to be selected randomly. However, they may be selected in such a way as to ensure a count of the complete inventory before items are selected again.

! The AW(I&E)/SOI is to review all inventory discrepancies and adjustments to the inventory records.

! If the accuracy rate drops below 95 percent accuracy for two consecutive random counts, control groups are to be established. Then the procedures outlined in subsection 6.e. are to be followed.

7. **PHYSICAL INVENTORIES.** The AW(I&E)/SOI at each field location is responsible for ensuring that annual physical inventories are conducted for all:

- # raw materials,
- # work in process,
- # shop stock, and
- # finished goods.

The AW(I&E)/SOI is responsible for performing annual inventories of sensitive equipment and fixed assets as defined in the Program Statement on Machinery & Equipment (Fixed Assets). Additional procedures are contained in the Program Statement on Factory Costing Procedures for work in process inventories.

Factories that have documented evidence of 95 percent accuracy for inventories may submit a request and receive approval from the FPI Controller for an exemption from the requirement to perform annual physical raw material and/or finished goods inventories. Documented evidence may include physical inventories or cycle counts.

An exemption may be granted for no more than two consecutive fiscal years, but must be approved for each year.

a. **Inventory Schedule and Plan.** The AW(I&E)/SOI must prepare and submit to the respective FFA an inventory schedule no later than October 31 of each fiscal year. The schedule is to list the type of inventory and the month/year in which the physical inventory is scheduled. A copy of the inventory schedule is to be retained on file. The types of inventories to include are:

- ! Raw materials and supplies,
- ! Work in process,
- ! Finished goods,
- ! Shop stock,
- ! Fixed assets, and
- ! Sensitive equipment.

Work in process inventories must be accomplished during September (August or September for those factories that do not use the MCS Shop Floor Control Module) of each fiscal year.

The AW(I&E)/SOI is to develop a written inventory plan to use when conducting physical inventories. The plan is to be submitted to the respective FFA at least 30 days before the scheduled inventory is to take place. A copy of the plan is to be maintained on file with the inventory documentation.

The plan is to include separate sections for:

- ! preparation,
- ! logistics,
- ! count sheet information,
- ! summarization, and
- ! reconciliation.

b. **Inventory Taking Techniques.** The primary goal in selecting the proper physical inventory technique is validation of inventory counts. The MCS cycle counting process or the physical inventory process in the MCS Inventory Module is to be used to conduct physical inventories of all items in the Item Master. The following procedures are required for all physical inventories:

- ! Stock in warehouse and factory areas is to be arranged in an orderly manner and clearly marked before actual counting takes place. The contents of boxed items are to be indicated. If possible, all like items are to be placed in the same location. The Warehouse Supervisor is to determine the cut-off date for stock issues and receipts and communicate that date to the inventory teams.
- ! The AW(I&E)/SOI must ensure that physical inventories are conducted at times that least interfere with the production process. Periods when stock levels are low are most appropriate.
- ! The AW(I&E)/SOI is to appoint a crew supervisor for conducting the physical inventory. The crew supervisor provides verbal and written instructions for:
 - ! making counts,
 - ! issuing and controlling inventory count slips,
 - ! recording count data, and
 - ! assuring that all items are counted.

The crew supervisor must also make spot counts to ensure that proper counting and item identification is occurring.

- ! The AW(I&E)/SOI is to ensure that only qualified personnel who are not otherwise involved in inventory control or record-keeping perform the physical inventory. Two-member teams are to be used to perform the physical inventory. Each member must count each item independently to ensure count integrity.

Inventory recounts are to be performed for all significant deviations between physical counts and stock record balances.

- ! Inventory teams may use MCS printouts containing warehouse stock location, unit of issue, and nomenclature for recording counts, and identifying stock items that have been counted. However, these printouts are **not** to contain the actual item counts. The field location is to maintain physical count records and reconciliation work papers for three years.
- ! The crew supervisor is to record actual counts of physical inventories of raw materials, sub assemblies, shop stock, and finished goods into the MCS through the cycle counting process or the physical inventory process in the MCS Inventory Module.
- ! The crew supervisor must determine promptly which items require recounting. Receipt or issue of materials is not to resume until the recount is completed. The crew supervisor is to assign new counters to recount the required items to avoid prejudicial counts.

c. **Reconciliation, Review, and Analysis.** All physical inventory items must be reconciled with the appropriate subsidiary ledgers or MCS modules. The AW(I&E)/SOI must review adjustments after reconciliation. As a part of the reconciliation, review, and analysis process, the AW(I&E)/SOI is to address corrective actions for significant or recurring differences.

The crew supervisor is responsible for the following:

- ! Ensuring that a Variance Report or Pre-adjustment Report is generated for items inventoried using the cycle count or physical inventory process in the MCS. The crew supervisor is to review the report carefully to ensure that the actual physical inventory counts were entered accurately. Items with significant

differences are to be recounted. The AW(I&E)/SOI must review the adjustments to inventory resulting from the actual physical inventory.

- ! With the assistance of Business Office staff, reconciling the physical inventory of work in process with the MCS WIP Valuation Report.
- ! Reviewing and analyzing the variances in the physical inventory to identify the root cause of differences. The crew supervisor may make recommendations for procedural compliance or change to avoid similar problems in the future.
- ! Preparing a separate memorandum to address specific problems noted by physical inventory teams that need to be corrected for general improvement of the inventory control system.
- ! After the review and analysis of inventory differences are completed, the Business Manager is to prepare a memorandum detailing the causes for the differences and corrective actions taken to prevent future differences. The memorandum is to be distributed through the AW(I&E)/SOI to all appropriate staff and included in the inventory documentation.

8. **REPORTING.** The Business Manager is to complete a Report of Inventory (FPI Form 63), and submit a copy to the respective FFA in the FMB upon completion of the physical inventory process. It is not necessary to include the supplementary report of actual differences. The Business Manager and the AW(I&E)/SOI are to approve the FPI Form 63.

9. **ASSISTANCE.** For further assistance, contact the respective FFA in the FMB.

/s/
Kathleen Hawk Sawyer
Director