



Program Statement

OPI: FPI
NUMBER: 8561.03
DATE: 7/23/2002
SUBJECT: Excess and Obsolete
Inventory - FPI

1. **PURPOSE AND SCOPE.** To establish procedures for identifying, reporting, writing off, and disposing of excess and obsolete inventory and evaluating alternative uses for this inventory.

Inventory values may become inflated when excess and obsolete items are allowed to accumulate to such an extent that the utility of that inventory is no longer as great as its cost.

When this situation exists, this Program Statement provides a method for establishing an allowance to adjust for that inflated value. In addition, various levels of approval authority are established for writing off excess and obsolete inventory.

2. **SUMMARY OF CHANGES.** This Program Statement incorporates changes required due to the implementation of the integrated management information system, **Millennium**.

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

a. Management will be more effective in identifying and disposing of excess and obsolete inventory.

b. Warehouse space will be better utilized as a result of reduced amounts of excess and obsolete inventory.

c. The value of inventories will be fairly stated on the financial statements of Federal Prison Industries (FPI).

4. DIRECTIVES AFFECTED**a. Directives Rescinded**

PS 8561.01 Excess and Obsolete Inventory - FPI (7/9/99)

OM 005-02 (8561) Excess and Obsolete Inventory - FPI
(3/5/02)

b. Directive Referenced

PS 8000.01 UNICOR Corporate Policies and Procedures
(5/13/81)

5. STANDARDS REFERENCED. None

6. EXCESS AND OBSOLETE INVENTORY ITEMS. Excess and obsolete items may be found in Raw Materials and Supplies (RM&S), Work In Process (WIP) or Finished Goods (FG) inventories.

a. Excess Inventory. Excess inventory items are those items on hand in far greater volume than needed to meet known production schedules or anticipated needs for the next 12 months.

- Excess inventory items may include items that have had either very little or no production usage at all in the past 12 months.

b. Obsolete Inventory. Obsolete items are those items that relate to:

- products no longer produced,
- those that have become unusable because of changes in customer specifications, or
- those for which a more desirable substitute has been found.

7. IDENTIFYING AND DISPOSING OF EXCESS AND OBSOLETE INVENTORY.

The Associate Warden (I&E)/Superintendent of Industries (AW(I&E)/SOI) is responsible for ensuring that all inventory, including raw materials, finished goods and work in process, is reviewed periodically throughout the year.

- Whenever excess and obsolete inventory is identified, that inventory is to be reclassified as Operating Materials and Supplies - Excess, Unserviceable, Defective and Obsolete (account 151300) for Raw Materials inventory or,

- Finished Goods Inventory - Excess, Obsolete and Unserviceable (account 152400) for Finished Goods inventory.

Write off and disposal procedures are to begin immediately.

a. **Board of Survey.** Whenever there is sufficient evidence that any raw material, work in process or finished goods item is excess or obsolete, the AW(I&E)/SOI must appoint a Board of Survey to:

- physically inspect the items,
- determine actual value (if any), and
- recommend disposal action.

b. **Work In Process Inventory.** Generally, excess and obsolete items are not found in work in process inventory because of the constant flow of inventory in and out of the production process.

- However, any job that remains in work in process for **more than 120** days must be inventoried and any excess and obsolete items identified must be written off and disposed of immediately.

c. **Transfer of Excess and Obsolete Inventory.** Before writing off excess and obsolete inventory, the AW(I&E)/SOI must first determine if the inventory can be used at another FPI operation.

Upon request, the factory's General Manager must provide assistance in identifying locations that may need the inventory.

Inventory transferred to other locations will be shipped at book value. If the actual value of such inventory is less than book value, the sending and receiving locations must negotiate an acceptable valuation.

The sending location is to bear shipping charges incurred resulting from the transfer.

d. **Write-Off of Excess and Obsolete Inventory.** When writing off excess and obsolete inventory, a Report of Survey must be completed and submitted for approval to the following:

- AW(I&E), \$5,000 and less;
- Senior Program Manager, \$5,001 thru \$10,000;
- Deputy Assistant Director, \$10,000 and higher.

Procedures for obtaining approval to write off excess and obsolete inventory resulting from the annual review are contained in Section 8.

e. **Disposal of Excess and Obsolete Inventory.** Once excess and obsolete inventory has been identified and approval has been obtained to write it off, disposal procedures must begin immediately.

If it is determined that there is no commercial value to the items, Business Managers must take the necessary steps either to sell the items as scrap or abandon or destroy the items in accordance with the Federal Property Management Regulations.

- Once the items are disposed, the appropriate expense is charged and the inventory reduced on the general ledger.

8. **ESTABLISHING ALLOWANCES.** Apart from any authorized Central Office allowance resulting from an annual review of inventory, the AW(I&E)/SOI must establish an allowance for excess and obsolete inventory for each factory at his or her location and adjust it quarterly as necessary.

- The allowance must be established for raw materials, subassemblies, and finished goods as necessary.
- Although subassemblies may be carried in work in process inventory, it is not perceived that the amount of excess or obsolete subassemblies found will be significant enough to warrant a separate allowance account for them.

Any allowances established for these items are to be carried in the Allowance for Obsolete Inventory - Raw Materials account.

a. **Estimating Excess and Obsolete Inventory Allowances.** The Business Manager must estimate the excess and obsolete inventory allowance in the following manner:

Potential excess and obsolete inventory is to be identified as the value of un-**utilized** inventory taken from the **Dead Stock** Report (MC50) at the end of the quarter.

- This report is can be generated via **Millennium**. The report must be compiled for the period beginning with the start of the fiscal year and through the end of the quarter.

- The report must be produced separately for each material type.

The estimate is to be determined by multiplying the Dead Stock inventory value at the end of the quarter by the applicable Program's percentage rate as established by an annual operations memorandum published by the Financial Management Branch (FMB). The excess and obsolete inventory value must include:

- Actual inventory that has been previously identified as excess and obsolete awaiting disposal and for which an allowance was previously established must be deducted from the excess and obsolete inventory value before multiplying that value by the allowance percentage rate.

b. Adjusting the Allowance Account. The appropriate allowance for excess and obsolete inventory account must be adjusted to agree with the estimated excess and obsolete inventory amount calculated by following the procedures in Section 7.a.

- The allowance must include any previously identified excess and obsolete inventory isolated and awaiting disposal.

The accountant must record the allowance by crediting (or debiting) the appropriate allowance account (151900 for raw materials and 153000 for finished goods). The offsetting account must be the applicable Damaged/Obsolete expense (613600 for raw materials and 613700 for finished goods).

Example: A cable factory has an existing balance of \$25,000 in its allowance for excess and obsolete inventory account. Of this amount, \$10,000 worth of inventory had been previously isolated and is awaiting disposal. Given the additional information provided below, the allowance will be computed as follows:

Beginning allowance account balance	\$25,000.00
Un-allocated Inventory value	100,000.00
Less inventory isolated and awaiting disposal	<u>10,000.00</u>
Adjusted Un-allocated Inventory value	90,000.00
Electronics Program Percentage rate	<u>20%</u>
Estimated excess and obsolete inventory	18,000.00
Inventory isolated and awaiting disposal	<u>10,000.00</u>
Ending Allowance account Balance	<u>28,000.00</u>
Adjustment to allowance account (28,000 - 25,000)	\$ 3,000.00

Journal Entry

613600	Damaged/Obsolete Property Raw Materials	\$3,000.00
151900	Allowance for Obsolete Inventory Raw Material	\$3,000.00

To adjust allowance for excess and obsolete inventory to reflect quarterly estimate.

c. **Disposal Of Excess/Obsolete Inventory.** As excess and obsolete inventory is disposed, it is to be written off against the appropriate inventory allowance account. The excess and obsolete inventory is to be estimated again at the end of the quarter using the procedures above and the allowance account must be adjusted accordingly.

Example: Using the information in the previous example, \$15,000 of excess/obsolete inventory has been disposed, including the \$10,000 worth of inventory that had been previously isolated and awaiting disposal.

Journal Entry

151900	Allowance for Obsolete Inventory Raw Materials	\$15,000.00
151100	Raw Materials	\$ 5,000.00
151300	Operating Materials and Supplies- Excess and Obsolete	10,000.00

To record disposal of excess/obsolete inventory.

Note: Factories are not required to establish allowances for amounts less than \$1,000.

9. **ANNUAL REVIEW OF EXCESS/OBSOLETE INVENTORY.** In July of each year, the AW(I&E)/SOI at each field location must conduct a thorough review of all Raw Materials, Work in Process subassemblies, and Finished Goods inventories to determine items that are excess and/or obsolete.

- This review must be conducted using the Dead Stock and Slow Moving (MC46) Report generated in **Millennium**.

a. **Identifying Excess and Obsolete Inventory.** Reports used to determine excess and obsolete inventory as a result of the annual review must be compiled as of June 30.

All unused and/or slow moving inventory materials identified on the required reports must be considered excess and/or obsolete.

b. **Reporting Requirements.** The AW(I&E)/SOI must review the Dead Stock and Slow Moving Reports and recommend disposition of each item by annotating the report with one of the following codes:

- **Code 1 - Retain for future use.** (Use of this recommendation must include a written justification attached and referenced to the item in question. The quantity to be retained is limited to no more than five years of expected usage.)
- **Code 2 - Transfer to another FPI location.** (Use of this recommendation must include the location to which the items are to be transferred and that location's job or customer order number. The transferring location must contact the receiving location to obtain that information.)
- **Code 3 - Trade-in, re-stock, sell to another government agency, or sell to the public.**
- **Code 4 - Sell for scrap.** (Use of this recommendation must include a written justification, i.e., shelf life of item expired, certificate of conformance no longer available, etc.)
- **Code 5 - Write off the value only and retain items.**

After approving and signing the report, the AW(I&E)/SOI must submit the report along with any justifications to the applicable Program's Field Financial Administrator in FMB between July 1 and July 20.

- Submission of negative reports are required.

c. **Program Management Review.** After ensuring that all locations have reported, the Field Financial Administrators in FMB must submit the inventory reviews to the applicable General Manager no later than July 31.

The General Manager must complete the review by signing and routing the inventory reports back to FMB, with any additional disposition instructions, no later than August 10.

d. **Financial Management Branch Review.** Upon receiving the inventory reports from the General Manager, the respective FMB, Field Financial Administrator will instruct each field location concerning dollar amounts and procedures for setting up allowances and writing off excess and obsolete inventory. Any allowances authorized by FMB as a result of the annual review are in addition to the quarterly allowances previously set up.

/s/

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Director