



U.S. Department of Justice
Federal Bureau of Prisons

PROGRAM STATEMENT

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Physical Inventories – FPI

/s/

Approved: Charles E. Samuels, Jr.
Director, Federal Bureau Of Prisons

1. PURPOSE AND SCOPE

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

a. Summary of Changes

Policy Rescinded

P8331.02 Physical Inventories – FPI (1/11/00)

The following changes have been incorporated in this Program Statement:

- Individual guidance on performing the various inventory counts.
- Greater emphasis on segregation of duties for the inventory-taking process.
- Defining roles for factory-level inventory administration.

b. Program Objectives. Expected results of this program are:

- Accurate and reliable inventory records will be maintained at each FPI factory location.
- Physical inventory test counts will be conducted to ensure that inventory problems are identified and corrected on a continuing basis.
- Inventory schedules and plans will be developed for each annual physical inventory performed.

- Required reports and records will be completed accurately, in a timely manner, and maintained at the factory location.

c. **Institution Supplement.** None required. Should local facilities make any changes outside the required changes in the national policy or establish any additional local procedures to implement the national policy, the local Union may invoke to negotiate procedures or appropriate arrangements.

2. ACTION REQUIRED

Staff will follow the procedures and meet the standards in this Program Statement.

3. RESPONSIBILITY

The Associate Warden/Superintendent of Industries (AW/SOI) is responsible for the management of physical inventories at their factory operation(s). This is done through the particular supervisory structure employed by the business group operating at the factory. If a location does not utilize an AW/SOI, the Field Financial Administrator (FFA) and the prime business manager will establish procedures for the administration (scheduling, approval of differences, etc.) of physical inventory at affected locations.

4. DEFINITIONS

- a. **Inventory.** The aggregate of items of tangible personal property that (1) are held for sale in the ordinary course of business, (2) are in process of production for future sale, or (3) are basic materials stored for future use in the production of customer orders.
- b. **Inventory Control.** Inventory control is concerned with minimizing the total cost of maintaining and handling material or product. Its function is to keep track of inventory, maintain records to reflect total stock available and provide accountability of material movement, keep track of inventory allocated for future consumption, process deliveries from vendors/production, and facilitate customer shipments and returns.
- c. **Inventory Values.** The value assigned to each item held as inventory. FPI uses the moving average cost method for raw materials (i.e., the value of stock on hand with the latest acquisition value added, divided by units on hand after latest receipt). Standard cost estimates establish standard prices for semi finished and finished products. Standard cost is a planned value for executing an operation, based on an approved bill of materials and work measurements. Standard

values are used in costing, scheduling, and capacity planning to calculate costs, execution times, and capacity requirements.

5. SEGREGATION OF DUTIES

The AW/SOI ensures that only qualified personnel who are not otherwise involved in inventory control or record-keeping perform the physical inventory. A two-staff-member count team ordinarily performs inventories. If the composition of staff is insufficient for a location to maintain an adequate segregation of duties using staff-only count teams, the location may use one staff member and one inmate to make up a count team.

The use of one staff member and one inmate count team(s) is only valid for the following inventory counts: cycle count, shop stock, control groups and WIP production orders over 120 days. Without exception, staff-only count teams are required for annual wall-to-wall inventories of raw materials, sub-assemblies, work-in-process, finished goods, and fixed assets. When conducting inventories, each member of the count team counts each item independently to ensure count integrity.

6. ANNUAL INVENTORY ACCURACY

Accurate inventory records are integral to a good material requirements planning system and ensure the correct 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, sub-assembly, and finished goods inventories.

Due to the nature of shop stock inventory, the requirement for 95 percent accuracy is not applicable; however, every effort must be made to ensure that inventory differences are investigated to maximize the accuracy of shop stock inventory.

To achieve and maintain at least 95 percent accuracy in raw materials, sub-assemblies, and finished goods inventories, the AW/SOI at each location first develops and approves an annual Inventory Accuracy Plan, including:

- Classification of inventory.
- Assignment of accountability.
- Determination of initial inventory accuracy rate.
- Procedures for obtaining and maintaining 95 percent accuracy.
- Annual Inventory Schedule

The AW/SOI forwards a copy of the plan to the Field Financial Administrator (FFA) by October 31 each year.

a. **Classification of Raw Material, Finished Goods, and Sub-Assembly Inventories.** The AW/SOI ensures that inventory items are classified according to the importance and feasibility of controlling each item's quantity and movement. Each identified class of inventory items is assigned a deviation tolerance level. Physical inventory count differences of items that fall within specified tolerance levels are considered 100 percent accurate. However, inventory records are adjusted for any of these differences, even though they are considered 100 percent accurate for accuracy plan purposes.

The classes and tolerance levels used when classifying inventory:

Class I. Large Part, Easily Controlled 0%

These 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 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 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/SOI delegates responsibility and authority for inventory accuracy to one or more of the following staff: prime business manager, operational accountant, and the remote accountant, based on the supervisory structure used by the business group and at the factory location. The prime business manager and the operational accountant are responsible for the inventory accuracy of raw material, sub-assembly, and finished goods inventories maintained in the warehouse. The factory manager is responsible for the inventory accuracy of shop stock (raw material), work in process, and sub-assembly inventories on the factory floor.

c. **Accuracy Rate.** The annual initial baseline inventory accuracy rate is set through an analysis of the last two completed "cycle" counts (see Section 9). The accuracy level is determined by dividing the number of correct counts by the total number of item counts conducted for each class of inventory.

Example: 29 raw material items with correct counts
 30 raw material items, with other than zero stock, counted
 $29/30 = 97\%$ accuracy rate for raw materials.

The purpose of the initial inventory accuracy rate is to determine whether a 95 percent accuracy rate exists. If less than a 95 percent rate exists, locations begin control group counts per Section 13 of this Program Statement. If no historical data to support cycle counts exist, staff randomly select 10 percent of items with quantities on hand for a test count. Upon completing the test count, the location compares test counts of actual inventory with inventory records in the financial information system.

d. **Inventory Schedule.** The AW/SOI submits to the FFA an inventory schedule no later than October 31 each fiscal year. The schedule lists the type of inventory and the month/week/year (e.g. week of March 18, 20XX) in which the physical inventory is scheduled. Changes to the schedule will require notification to the FFA. A copy of the inventory schedule is kept on file. Types of inventories to be scheduled are:

- Raw materials and supplies.
- Work in process.
- Sub assemblies.
- Finished goods.
- Fixed Assets.

Work in process inventories are done during August each fiscal year. Ideally, the inventory should be conducted in the middle of the month to avoid conflict with the monthly close-out.

7. GENERAL INVENTORY-TAKING TECHNIQUES

The primary goal in selecting the proper physical inventory technique is validation of inventory counts. Material or asset counts are conducted using the financial information system processes. The following procedures are required:

- Stock in the warehouse and factory areas should be arranged in an orderly manner and clearly marked before counting takes place. The contents of boxed items are indicated. If possible, like items are placed together. The location determines the cutoff date for stock issues and receipts and communicates that date to staff taking inventory.
- Inventory teams may use financial information system printouts containing warehouse stock location, unit of issue, and nomenclature for recording counts and identifying stock items that

have been counted. However, these printouts may not contain the actual item counts. The field location keeps physical count records and reconciliation work papers for three years.

8. REQUIRED PHYSICAL INVENTORY TYPES

Field locations perform each of the following inventories as part of the administration of physical inventories:

- Cycle Counts. Monthly Shop Stock Counts (if applicable).
- Annual Wall-to-Wall Inventories. Includes raw material, sub-assembly, work-in-process, and finished good inventories.
- Control Group Counts (required if the annual initial accuracy rate, two consecutive cycle counts, or the annual wall-to wall inventory reveals less than 95 percent accuracy).
- Fixed Assets.

9. CYCLE COUNTS

Unless waived by the controller, random counts are conducted using the Cycle Count feature in the financial information system. Cycle counts are completed a minimum of once per month. Locations are encouraged to develop cycle count inventory schedules that best meet the needs of their respective factory location(s); however, there must be at least five workdays between the end of one cycle count and the start of another. Failure to perform system-generated cycle counts must be documented and the prime business manager and FFA notified. Notifications are kept with the cycle count records.

A warehouse staff member creates the inventory document in the financial information system.

Cycle counts are performed using count team(s) consisting of a minimum of two staff members, or one staff member and one inmate. All items are physically counted. Count sheets are signed by each staff member performing the physical count. If an inmate is used to conduct a count, the inmate's register number will be notated on the count document(s). Cycle count sheets cannot be signed by a person entering or posting the counts in the financial information system.

Inventory recounts are performed for significant deviations between physical counts and financial information system record balances.

A warehouse staff member enters the final counts into the financial information system inventory document(s).

Physical inventory items must be reconciled with the financial information system subsidiary records. The AW/SOI reviews adjustments after reconciliation. As part of the reconciliation, review, and analysis process, the AW/SOI addresses corrective actions for significant or recurring differences.

The AW/SOI signs the system-generated inventory report if any inventory adjustments are required.

A financial management staff member posts the inventory count into the inventory document.

The AW/SOI ensures that inventory documentation is created and retained for each cycle count. At a minimum, the file contains:

- The completed “Inventory Count Cover Sheet” (Attachment A).
- The completed physical inventory document(s) from the financial information system.
- Count sheets signed by the staff members conducting the count or by one staff member with the inmate register number of the inmate as the second team member.
- The physical inventory list or list of differences from the financial information system.

10. MONTHLY SHOP STOCK COUNTS

A location only maintains shop stock inventory if it has been approved by the Controller.

If a location maintains shop stock inventory, the AW/SOI conducts a monthly inventory. The factory manager ensures that the monthly count is conducted.

A warehouse staff member creates the inventory document in the financial information system.

Shop stock counts are performed using count team(s) consisting of a minimum of two staff members, or one staff member and one inmate. All selected items are physically counted. Count sheets are signed by each staff member performing the physical count. If an inmate is used to conduct a count, the inmate’s register number will be notated on the count document(s). Shop stock count sheets cannot be signed by a person entering or posting the counts in the financial information system.

Inventory recounts are performed for significant deviations between physical counts and the financial information system record balances.

A warehouse staff member enters the final counts into the financial information system inventory document(s).

The AW/SOI reviews and signs the system-generated inventory report if any inventory adjustments were required.

A financial management staff member posts the inventory count into the inventory document.

Note: Due to the nature of shop stock inventory, the requirement for 95 percent accuracy is not applicable; however, every effort is made to ensure that inventory differences are investigated to maximize accuracy.

The AW/SOI ensures that inventory documentation is created and retained for each shop stock count. At a minimum, the file contains:

- The completed “Inventory Count Cover Sheet” (Attachment A).
- Completed physical inventory document(s) from the financial information system.
- Count sheets signed by the staff members conducting the count or by one staff member with the inmate register number of the inmate as the second team member.
- The physical inventory list or list of differences from the financial information system.

11. ANNUAL PHYSICAL INVENTORIES

In addition to cycle counts, monthly shop stock counts, and the establishment of control groups, if required, the AW/SOI at each location ensures that annual physical inventories are conducted for:

- Raw materials.
- Sub assemblies.
- Finished goods.
- Work in process.
- Fixed Assets.

The following procedures apply to annual wall-to wall inventories:

a. Inventory Plan. The AW/SOI develops a written plan for conducting the individual inventories associated with the annual wall-to wall inventory. The plan is submitted to the FFA at least 30 days before the inventory. A copy is kept on file with the inventory documentation.

The plan includes sections for:

- Preparation.
- Logistics.
- Use of Inventory Count “identifiers.”
- Count sheet information to include the exclusive use of staff only count teams.
- Summarization.
- Reconciliation.

b. Timing of Wall-to-Wall Inventories. The AW/SOI ensures that physical inventories are conducted at times that least interfere with production. Periods when stock levels are low are most appropriate.

Note: Work in process inventories must be done during August each fiscal year.

c. Crew Supervisor. The AW/SOI appoints a crew supervisor for conducting each wall-to-wall physical inventory. The crew supervisor can be the prime business manager, operational accountant, or the warehouse supervisor. The crew supervisor provides verbal and written instructions for:

- Taking counts and ensuring that annual inventories are conducted using staff-only count teams.
- Issuing and controlling count identifiers.
- Issuing and controlling inventory count documentation slips.
- Recording count data.
- Ensuring that all items are counted.

The crew supervisor is responsible for:

- Ensuring that count identifiers are affixed to all materials being counted.
- Performing spot counts to ensure that proper counting and item identification occurs.
- Ensuring that the list of differences, or other pre-adjustment report(s), are generated for items inventoried using the financial information system. The crew supervisor reviews the report(s) carefully to ensure that actual physical inventory counts were entered accurately.
- With the assistance of the operational accountant, or the prime business manager, preparing a written synopsis of the inventory, including the value of the inventory adjustment and the inventory accuracy rate. The synopsis is forwarded to the AW/SOI, who reviews the adjustments to inventory resulting from the actual physical inventory.

- Determining promptly which items require recounting. Receipt or issue of materials does not resume until the recount is completed. The crew supervisor assigns new counters to recount the required items to avoid prejudicial counts.
- With the assistance of the operational accountant, or prime business manager, reconciling the physical inventory of work in process with the financial information system WIP calculation report.
- Reviewing and analyzing variances in the physical inventory to identify the root cause of differences. The crew supervisor may make recommendations for procedural compliance or other changes to avoid similar problems in the future.
- Preparing a separate memorandum to address specific problems noted by inventory teams that need to be corrected for general improvement of the inventory control system.
- After the review of inventory differences is completed, preparing a memorandum detailing the causes for differences and corrective actions taken to prevent future differences. The memorandum is distributed through the AW/SOI to the prime business manager and FFA.

d. **Conducting Annual Inventories.** A warehouse staff member creates the inventory document(s) in the financial information system.

Counts are performed using two-staff-member count teams. To ensure timely completion, a sufficient number of staff should be used. All selected items are physically counted. The count sheets are signed by the two staff performing the physical counts. Count sheets cannot be signed by a person entering or posting the counts in the financial information system.

Note: The requirement for staff-only count teams performing annual inventories cannot be waived.

Inventory recounts are performed for all significant deviations between physical counts and financial information system record balances.

A warehouse staff member enters the final counts into the financial information system inventory document(s).

Physical inventory items must be reconciled with financial information system subsidiary records. The AW/SOI reviews adjustments after reconciliation. As part of the reconciliation, review, and analysis process, the AW/SOI addresses corrective actions for significant or recurring differences.

The AW/SOI signs the system-generated inventory report if any adjustments were required.

A financial management staff member posts the count into the inventory document.

The prime business manager, or operational accountant prints the physical inventory list or list of differences from the financial information system for the inventory, and completes a memorandum detailing the differences, which is submitted to the FFA upon completion of the inventory.

e. **Work in Process Inventory.** The prime business manager, remote operational accountant, or remote accountant issues inventory count sheets to identify the job number, item number, quantity, and operation number, and prepares a manual journal entry for the overage/shortage prior to August 31.

The WIP valuation report is adjusted by this manual journal entry to reconcile to the general ledger at month-end for any production orders that remain open. The prime business manager, remote operational accountant, or remote accountant reverses this manual journal entry in September and re-enters it for production orders that remain open at the end of September. This entry continues each month until all production orders affected by the count are closed.

f. **Annual Inventory Files.** The AW/SOI ensures that an inventory file is created for each annual physical inventory. At a minimum, the file contains:

- The written inventory plan.
- Completed inventory count slips signed by staff members.
- The completed physical inventory document(s) from the financial information system.
- The physical inventory list or list of differences from the financial information system.
- A synopsis of the inventory, including the value of inventory differences and the inventory accuracy rate.
- The memorandum addressing specific problems noted by the physical inventory teams, if applicable.

The list of differences from the financial information system for the inventory and the synopsis of the inventory are submitted to the FFA upon completion of the inventory process.

12. CUSTOMER SUPPLIED PRODUCTS/GOVERNMENT FURNISHED MATERIALS

Per the Program Statement **FPI Quality Program Manual**, the following procedures are followed for the inventory control of Customer Supplied Products (CSP) and Government Furnished Materials (GFM).

A physical inventory of CSP and GFM is performed annually or at the termination of the contract, whichever occurs first.

Procedures for conducting this annual inventory are the same as those in Section 11 of this Program Statement.

Upon completion of the inventory, the Quality Assurance Manager, or designated quality representative, submits the following results to the customer:

- A listing with identified discrepancies, including overages, shortages, and damages, disclosed by the physical inventory.
- A written certificate to the effect that the physical inventory of CSP and GFM was completed on the given date and that the official contract records agree with the physical inventory.

13. PROCEDURES FOR FACTORIES WITH COUNT RESULTS YIELDING LESS THAN 95 PERCENT ACCURACY

If the inventory accuracy level for two consecutive factory cycle counts, or the annual inventory of raw materials, sub-assemblies, finished goods, or work in process is less than 95 percent, the supervising staff member needs to establish a control group sample of inventory items to be counted weekly.

The establishment of a control group is **in addition to** the requirement for cycle counts and is not a substitute for them.

The control group is governed by the following criteria:

- The supervising staff member, with input from the factory manager and warehouse supervisor, selects 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 5 and no more than 20 items.
- Sample items should 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 supervising staff member may include items from known problem areas in the sample. This may include items with differences recorded in past physical inventories or items for which accurate counts are difficult to maintain.
- Control group counts are performed using count team(s) consisting of a minimum of two-staff members, or one staff member and one inmate. All items are physically counted. Count sheets are signed by each staff member performing the count. If an inmate is used to conduct

a count, the inmate's register number will be notated on the count document(s). Control group count sheets cannot be signed by a person entering or posting the counts in the financial information system.

- The supervising staff member ensures that the integrity of weekly counts is maintained.
- The supervising staff member authorizes any adjustment(s) resulting from the control group or any other adjustment(s) to inventory and forwards the results to the AW/SOI and the factory manager.
- The prime business manager, remote operational accountant or remote accountant keeps a record of test counts and submits a report to the AW/SOI identifying the causes of the differences and the plan for corrective action.
- The control group sample counts continue until 100 percent accuracy is achieved for four consecutive weeks. A second control group is then selected and counted until 100 percent accuracy is achieved for an additional four consecutive weeks. At the end of the eight-week period, a complete physical inventory is conducted. Upon its completion, all corresponding inventory adjustments are made in the financial information system.

The AW/SOI ensures that inventory documentation is created and retained for each control group count. At a minimum, the file contains:

- The completed "Inventory Count Cover Sheet" (Attachment A).
- The completed physical inventory document(s) from the financial information system.
- Count sheets signed by the staff members conducting the count or by one staff member with the inmate register number of the inmate as the second team member.
- The physical inventory list or list of differences from the financial information system.

14. PROCEDURES FOR FACTORIES WITH COUNT RESULTS YIELDING 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 supervising staff member must perform at least monthly financial information system-generated cycle counts of raw materials, sub-assembly, and finished goods inventories per Section 9.

The count size for cycle counts should be sufficient to include all inventory items at least once during the year.

The AW(I&E)/SOI reviews discrepancies and adjustments to the inventory records.

If the accuracy rate drops below 95 percent for two consecutive factory cycle counts, or the annual inventory of raw materials, sub-assemblies, finished goods, or work in process is less than 95 percent, control groups are established and the procedures in Section 13 are followed.

REFERENCES

Program Statements

P8340.07 Quality Program Manual (1/14/00)

ACA Standards

None.

Records Retention Requirements

Requirements and retention guidance for records and information applicable to this program are available in the Records and Information Disposition Schedule (RIDS) system on Sallyport.

Attachment A. **INVENTORY COUNT COVER SHEET**

Type of Count: _____

Number of items counted: _____

Date of Count: _____

Number of items correct within tolerance: _____

Accuracy Rate: _____

Inventory Count Packet and Review

_____ Inventory count sheets

_____ Staff (Signatures) and /or inmate (register numbers) are included on count sheet (requires 2). Ensure that staff counting are not entering or posting the counts.

_____ If count differences, include Inventory difference posting document

_____ Inventory difference posting includes the AW/SOI or designee signature.

Name / Reg. No. (Type or Print)	Position	Role
_____	_____	Count Generator
_____	_____	Counter
_____	_____	Counter
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Counter (if applicable)
_____	_____	Count Entry
_____	_____	Count Posting
_____	_____	AW/SOI or designee

_____ Prepared by (printed name)

_____ Date