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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FIFTH FLOOR  
803 WEST BROAD STREET  
FALLS CHURCH, VIRGINIA 22046

AUG 14 1975

Mr. David C. Jelinek, Associate Commissioner  
Federal Prison Industries, Inc.  
HOLC Building  
320 First Street, NW.  
Washington, D.C. 20534

Dear Mr. Jelinek:

We have had several discussions with you and other corporation officials regarding our views on improvements needed in the management of the corporation's inventory. Although several improvement actions have already been initiated, we thought it would be useful to summarize our observations so that you may consider whether further improvement could be achieved.

Inventory management  
could be strengthened

Inventory management generally encompasses the functions of determining future supply requirements and ordering and holding inventory to meet those requirements. Simply stated, good inventory management is knowing how much of an item to order at one time and when to order it. Inventory excesses or shortages can have an adverse affect on the corporation. For example, overstocking ties up cash that could otherwise be put to other productive use, increases warehousing costs, and increases the risk of obsolescence. Understocking can result in the disruption of production, possibly idling inmates, and hence a potential loss of sales and profits to the corporation.

During our prior year's examination of the corporation we pointed out to management that the inventory level was increasing at the expense of cash and at a rate inconsistent with overall corporate asset growth. At June 30, 1974, the corporation's total inventory was valued at \$27.3 million, an increase of almost \$5.5 million or 25 percent above the prior year's level and was 39 percent of all corporate assets. An analysis of inventory turnover ratios for the past 3 years reveals a steady decline in the inventory turnover rate from 2.32 to 2.03. This means the average inventory levels over this period have increased at a rate faster than the cost of goods sold.

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Inventory controls outlined in the corporation's policy and procedures manual provide the foundation for a sound inventory control system. For example, it contains procedures for controlling the storage and issuance of raw materials and supplies and a system for reporting obsolete, excess, and slow moving items. The manual could be improved by expansion to cover procedures for determining how much of an item to order at one time and when to order it. This is an important additional element that would further strengthen inventory management.

The manual does provide that each industry establish maximum and minimum inventory levels to avoid shortages and overstocking. However, it lacks the necessary guidance on how the maximum and minimum levels are to be determined, such as through the use of the Economic Order Quantity Principle or other techniques. Audits have disclosed that not all locations are adhering to the established maximum and minimum inventory levels and in some cases no levels have been established at all. This may be due to the lack of procedures for periodic reviews of inventory levels in order to update and adjust them when necessary and also because of the lack of central office review procedures to ensure that each industrial operation is properly adhering to these levels.

The corporation recently implemented a reorganization of management responsibilities. Product divisions were created in order to, among other reasons, place prime responsibility for inventory management directly with the product division managers. Also, the corporation is in the process of implementing an automated data system designed to facilitate the accountability of inventory items. We believe these actions are steps in the right direction and should contribute to better management control of inventories.

We suggested that current inventory management controls be supplemented to include:

1. Instructions for establishing maximum and minimum inventory levels. These instructions should include detailed criteria on how to determine the most optimum inventory levels.
2. Procedures for periodic reviews of each industry's maximum and minimum inventory levels in order for them to be updated and adjusted if necessary.
3. A central office review procedure to ensure that each industrial location is adhering to these inventory controls.

The Board of Directors and other corporation officials indicated awareness of the increasing proportion inventory has become of corporate assets. They expressed confidence that the recent reorganization along product lines and the implementation of an automated data system to facilitate the accountability of inventory items will enhance overall inventory management.

We agree these actions will help to improve the corporation's management of inventories and we suggest the corporation supplement these actions by expanding upon its current inventory control procedures as outlined above.

In view of our mutual concern to improve the corporation's inventory management, we will be in touch with you early in our current audit to assess actions being taken. In the meantime, if you have any questions or wish to discuss these matters further, please contact us.

Sincerely yours,



H. L. Krieger  
Regional Manager