

**VIRGINIA CORRECTIONAL ENTERPRISES
DEPARTMENT OF CORRECTIONS
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE PERIOD
JANUARY 1, 2002 THROUGH JUNE 30, 2003**



AUDIT SUMMARY

Our audit of Virginia Correctional Enterprises, a division of the Department of Corrections, for the period of January 1, 2002, through June 30, 2003, found:

- Internal control matters that we consider reportable conditions; however, we do not consider these to be a material weakness;
- One instance of noncompliance with applicable laws and regulations tested that is required to be reported;
- Proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and VCE's accounting records; and
- Inadequate implementation of corrective action plans with respect to prior year audit findings "Enforce and Perform Job Sampling to Validate Standard Costs" and "Establish Controls for Disposing of Slow-moving, Obsolete and Excessive Inventory."

Our audit findings include the following:

- Implement a Strategic Plan to Guide Operations
- Enforce and Perform Job Sampling to Validate Standard Cost
- Establish Controls for Disposing of Slow-moving, Obsolete and Excessive Inventory

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AUDIT SUMMARY

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AGENCY OVERVIEW AND FINANCIAL INFORMATION

The Virginia Department of Corrections has operated Virginia Correctional Enterprises (VCE) since 1934 as one of its many work programs for inmates. VCE is the only work program that is entirely self-sufficient, using sales revenue to pay for operations. The Code of Virginia requires VCE to provide job skill training and wage earning opportunities for Corrections' inmates. At June 30, 2003, VCE employed 1,606 (5 percent) of the 31,645 inmates housed in state correctional facilities. These inmates work in 16 different industries located in 15 state prisons and 2 off-site locations throughout the state. VCE also employs 164 civilian staff who work in the central office and warehouse in Richmond or in the various correctional facilities throughout the state

Section 53.1-47 of the Code of Virginia requires all Commonwealth departments, institutions, and agencies, supported in whole or in part with funds from the state treasury, to purchase goods manufactured by VCE. Agencies must obtain a waiver in order to purchase the same goods VCE manufactures from another vendor. Currently, state agencies, as defined in Section 53.1-47, account for approximately 62 percent of sales. The Code also allows counties, districts, cities, towns, nonprofit organizations, volunteer lifesavings first aide crews, rescue squads, fire departments, sheltered workshops, and community service organizations to purchase from VCE. During fiscal year 2003, these types of customers accounted for approximately 38 percent of sales.

VCE is a self-sufficient operation, paying for all expenses from monies collected for sales of its good and services. VCE receives no general fund appropriations, relying totally on monies collected from sales. The following table summarizes the VCE's financial results over the last three years.

Financial Summary

| | <u>Year Ended</u> <u>June 30, 2003</u> | <u>Year Ended</u> <u>June 30, 2002</u> | <u>Year Ended</u> <u>June 30, 2001</u> |
|---|---|---|---|
| Charges for sales and services | \$ 35,246,708 | \$ 35,403,787 | \$ 38,422,923 |
| Cost of good sold: | | | |
| Raw materials | 14,159,243 | 15,084,930 | 16,425,906 |
| Inmate labor | 1,690,518 | 1,313,281 | 1,134,325 |
| Total cost of goods sold | 15,849,761 | 16,398,211 | 17,560,231 |
| Manufacturing overhead | 9,597,313 | 10,851,869 | 12,106,487 |
| Administrative and warehouse expenses | 8,622,821 | 6,486,100 | 5,908,863 |
| Total cost of goods, overhead, and operating expenses | 34,069,895 | 33,736,180 | 35,575,581 |
| Operating income | <u>1,176,813</u> | <u>1,667,607</u> | <u>2,847,342</u> |
| Non-operating revenues (expenses) | 86,855 | (134,855) | (589,191) |
| Transfers out | <u>2,600,880</u> | <u>1,203,418</u> | <u>847,284</u> |
| Net Income (loss) | <u>\$ (1,337,212)</u> | <u>\$ 329,334</u> | <u>\$ 1,410,867</u> |

Source : VCE financial statements

Overall, VCE sales have remained fairly consistent over the last three years. VCE received a one time order from the Department of Transportation in 2001 to furnish their Chantilly office. This resulted in increased sales in that year as reflected above. VCE has generated operating income of \$1-2 million for each of the past three years. The net loss in 2003 is due to a \$1.5 million transfer to the federal government in 2003 required by the Department of Planning and Budget. The federal government performed a review of internal service funds in the Commonwealth for fiscal years 1999-2001. Based on this review, they determined the internal service funds had earned an excessive profit and required the internal service funds to return a portion of the profit to the federal government. The Department of Planning and Budget allocated the amount between agencies, and determined that VCE's portion would be \$1.5 million. VCE also made transfers to the General Fund of the Commonwealth totaling a little more than \$1 million in 2002 and 2003. The next section has further details on sales and profit for each industry.

Sales and Profit Information by Industry

VCE manages 16 different manufacturing and service industries in various correctional facilities throughout the state. They are listed below:

Clothing Plants - Halifax, Haynesville, Augusta, Fluvanna

Copy Shop - Atmore, State Corporation Commission

Dental Plant - Southhampton

Laundry Plants - Virginia Correctional Center for Women (VCCW), Greenville

License Tag Plant - Powhatan

Metal Plants - Dillwyn, Buckingham

Microfilm Plant - VCCW

Office Systems - Brunswick

Optical Plant - Fluvanna

Plastic Bag - Indian Creek

Printing - Powhatan

Shoe Plant - Augusta

Vinyl binders/silkscreen - Powhatan

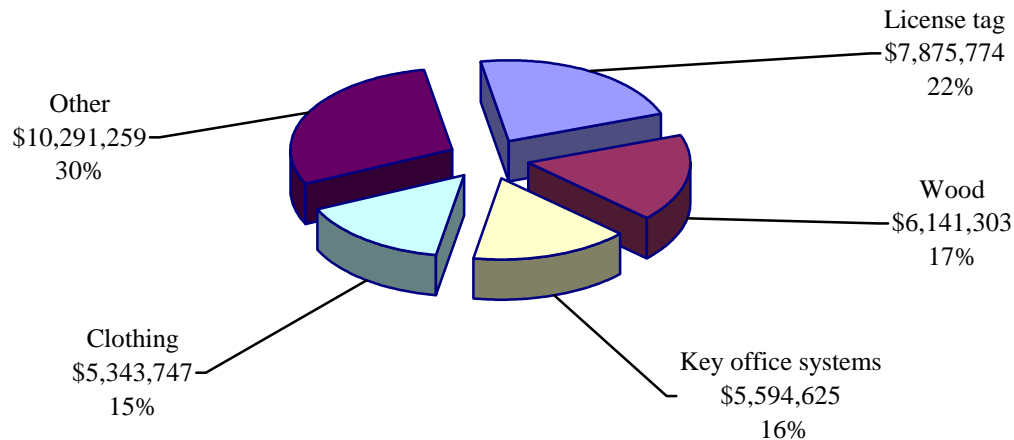
Wood Plants - Greenville, Lunenburg, Nottoway

Joint Venture (Automotive services) - Coffeewood

Prison Industry Enhancement (Wood pallets) – Haynesville, Caroline Field Unit 2

Of these industries, the license tag industry is the largest in sales volume, accounting for over 22 percent of all sales. The license tag plant, located at the Powhatan Correctional Center, manufactures license plates for the Department of Motor Vehicles. Overall, there are four industries (license tag, wood, key office systems, and clothing) which account for over 71 percent of all sales revenue as shown below.

Sales Revenue by Industry for 2003



Source: VCE Financial Statements

Overall, VCE industries have earned a gross profit of between \$8-9 million for each of the past three years. Of the various industries, some have consistently earned a profit while others have had mixed results. Customer demand is the primary factor in determining which industries VCE will support. The following table shows sales as well as gross profits by industry for the last two years.

Sales and Gross Profit by Industry for 2002 and 2003

| | 2003 | | | 2002 | | |
|---------------------|---------------|--------------|------------------------------------|---------------|--------------|------------------------------------|
| | Sales Revenue | Gross Profit | Gross Profit as a percent of Sales | Sales Revenue | Gross Profit | Gross Profit as a percent of Sales |
| License tag | \$ 7,875,774 | \$ 3,496,545 | 44% | \$ 7,472,966 | \$ 2,406,221 | 32% |
| Wood | 6,141,303 | (24,903) | 0% | 6,433,002 | (272,621) | (4%) |
| Key Office Systems | 5,594,625 | 1,871,165 | 33% | 6,516,627 | 1,878,326 | 29% |
| Clothing | 5,343,747 | 2,003,765 | 37% | 5,809,532 | 1,916,421 | 33% |
| Laundry | 3,404,962 | 1,277,288 | 38% | 2,546,358 | 850,364 | 33% |
| Print Shops | 2,188,541 | 397,795 | 18% | 1,933,037 | 476,498 | 25% |
| Metal | 2,144,733 | 330,862 | 15% | 2,902,046 | 809,805 | 28% |
| Shoe | 720,987 | 226,875 | 31% | 679,711 | 156,682 | 23% |
| Automotive Services | 1,229,795 | 209,405 | 17% | 634,407 | 71,137 | 11% |
| Dental | 151,872 | 93,074 | 61% | 107,160 | 14,127 | 13% |
| Microfilm | 109,111 | (15,334) | (14%) | 123,674 | (5,343) | (4%) |
| Optical | 66,633 | (18,783) | (28%) | 0 | (72,750) | 0% |
| Vinyl/Silkscreen | 274,627 | (48,120) | (18%) | 245,266 | (75,390) | (31%) |
| Total | \$35,246,710 | \$ 9,799,634 | | \$ 35,403,786 | \$ 8,153,477 | |

Source: VCE Financial Statements

The license tag industry has consistently been the largest revenue producer with the highest gross profits for VCE over the last several years. Other industries generating significant profits are office systems and clothing. Although the wood industry had the second highest sales revenue for VCE in 2003, it did not generate a profit. The wood industry has experienced a loss for the past several years due to the high cost of raw materials. Other VCE industries that experienced losses for the last several years include the vinyl/silkscreen, microfilm, and optical. The optical industry did not begin operations until 2003, but did have set up costs in 2002.

Inventory Information by Industry

VCE has 25 decentralized plant sites that produce finished goods for the 16 industries. In addition, VCE has a central warehouse that maintains some finished goods for shipment to its customers. The print shop, license tag, dental, and optical plants ship their finished goods directly from the manufacturing plant to the customer. VCE's inventory at the end of fiscal year 2003 was valued at almost \$10 million. The following table shows the inventory balance by industry.

Inventory by Industry
(June 30, 2003)

| <u>Industry</u> | <u>Inventory Amount</u> | <u>Percentage</u> |
|--------------------|-----------------------------|-------------------|
| Wood | \$ 3,305,602 | 33.16% |
| License tag | 2,042,463 | 20.49% |
| Clothing | 1,668,499 | 16.74% |
| Key office systems | 1,228,446 | 12.32% |
| Metal | 1,049,143 | 10.52% |
| Other | <u>675,457</u> | 6.78% |
| Total | <u>\$ 9,969,880</u> | |

Source: Syteline System

The inventory balance consists of raw material, work-in-progress, and finished goods for all industries. Of the total inventory on hand at year end, four industries own 83 percent of the inventory. The wood industry has the highest amount of inventory on hand at year end due to the number of furniture order they receive from agencies and universities towards year end.

VCE maintains a perpetual inventory system. The plant staff perform a complete inventory count each February, instead of fiscal year end, due to increased orders and high production towards the end of the fiscal year. During the last quarter of the fiscal year, VCE increases the number of test counts at each plant to ensure that the plants are correctly reporting inventory balance at fiscal year end.

VCE values inventory at standard cost for financial reporting purposes on a monthly basis and uses the standard cost to help determine product pricing. For year-end financial reporting purposes, VCE sets inventory value to the lower of cost or market. VCE develops standard cost for material, labor, and manufacturing overhead. To ensure the accuracy of these standard costs, VCE requires each plant to sample a set amount of jobs and document actual cost. Based on these samples, VCE adjusts the system for variances between the sample and what the system estimates.

Prison Industries Enhancement Certification Program

VCE received federal certification under the Prison Industries Enhancement (PIE) program on March 2, 1995. PIE is a federal Bureau of Justice Assistance certification program where prison industries goods are exempt from federal interstate commerce regulations. All state and local government correctional agencies authorized to administer prison industry programs are eligible to apply for project certification and project partnerships. Certified programs must provide certain safeguards to private sector labor and industry and to prisoner-workers. These requirements include:

- Inmate workers must receive a prevailing wage consistent with similar conditions in the private sector that can never be less than federal minimum wage.
- Deduction for taxes, reasonable charges for room and board, allocation for family, and contributions to victim compensation funds will not exceed 80 percent of the gross wages.
- The program must consult with organized labor and local businesses before initiating any certified project. The program must also identify the scope of the intended project and its initiation date.
- Programs must show that the project will not result in a significant displacement of employed workers. Workers should not work in skills, crafts, or trades when there is a surplus of available laborers in the community.

Since October 2001, VCE has entered into a PIE contracts with Potomac Supply Corporation to repair broken wooden pallets at Haynesville Correctional Center and Caroline Field Unit #2. In fiscal year 2003, VCE received \$245,840 in revenue and had a gross profit of \$88,642. In March 2003, VCE also entered into a short tem PIE contract with Richmond Commercial Services to manufacture and assemble 100 wooden storage cabinets. The contract expired after the manufacture of 100 cabinets.

Joint Ventures

In November 2000, VCE entered into a joint venture agreement with World Wide Automotive to disassemble, clean, repair, test, and reassemble used automotive parts at Coffeewood Correctional Center. Joint ventures differ from PIE programs because they are an agreement for services performed, for a private industry, instead of the actual production of a good or product. Also, VCE is not required to meet federal regulations established for PIE programs, including the requirement that they pay inmates the prevailing wage rate. In fiscal year 2003, VCE received \$1,229,795 in revenue, earning a gross profit of \$209,405 from this contract.

INTERNAL CONTROL, COMPLIANCE FINDINGS, AND RECOMMENDATIONS

Implement a Strategic Plan to Guide Operations

Virginia Correctional Enterprises (VCE) has not implemented a strategic plan to guide its current and future operations or set a performance base for management to direct operations. Although VCE developed a business and expansion plan in 2000, management did not implement the plan or use it to guide its daily business operations.

Since VCE relies solely on public and private sector contracts and sales to fund its operations, it is imperative that they develop a strategic plan that outlines their mission, goals, performance measures, and a methodology for determining when to establish, expand, or discontinue product lines. VCE's financial stability is very dependent on the license tag industry generating 44 percent of VCE's total gross profit and the loss of this industry through outsource or other means could significantly affect operations.

We recommend VCE develop and implement business plans outlining strategies for addressing future business and operational goals as well as potential issues. Not only is this a good business practice, it is also required in section 2.2-5510 of the Code of Virginia. The first step in this process is for VCE to examine its purpose. They must clearly define what they do, who they do it for, and what they strive to accomplish. Then VCE should use what they find to help develop their strategic approach to business. It should outline strategies for addressing future business and operational goals and potential negative issues. An approach of this nature will play a vital role in helping VCE to avoid mistakes as well as recognize hidden opportunities.

Enforce and Perform Job Sampling to Validate Standard Costs

VCE is not performing the job sampling cost validations according to their internal procedures. VCE values materials, work-in-progress, and finished goods at standard cost. VCE uses these standard costs for financial reporting purposes on a monthly basis, to value inventory at the lower of cost or market for year-end financial reporting, and for product pricing. To ensure the accuracy of these standard costs, VCE requires each plant to perform a specified number of job sample validations in a given time frame and document the actual production cost. Based on these samples, VCE then adjusts production costs for variances between the sample results and the original estimated costs.

We have reported this issue in previous reports, and while VCE has strengthened their policies and procedures over job sampling validation, the production plants are still not performing the required validations. Out of the five months reviewed, VCE did not perform 22 of the required job samples, which indicates an average noncompliance rate of 31 percent.

Since a large percentage of job sampling validations result in changes and adjustments to the set standard cost for a production item, it is critical that VCE performs the required sampling validations to ensure that it is properly recording standard costs. If managers are not properly performing the sampling costs validations, management should hold the plant managers at the facilities accountable for a lack of adherence to policies and procedures.

Establish Controls for Disposing of Slow-moving, Obsolete and Excessive Inventory

As we have reported previously, VCE does not have documented policies and procedures for reviewing inactive, slow moving, and excessive inventory. As of March 22, 2004, VCE's Central Warehouse

had over 19,179 items in its finished good items in inventory that had been on hand for over a year. These items have an estimated sales value of over \$1 million.

In addition, during the annual physical inventory count performed in February 2004, we found \$93,247 of fabric that VCE had not used in over a year. We also found several items in the Central Warehouse that were considered outdated, going back as early as 1995.

To ensure VCE's inventory is not overstated, they should develop and document policies and procedures to review all outdated inventory and determine whether or not to write the inventory off as obsolete or record the inventory down to its net realizable value. VCE should also develop and communicate procedures for the disposition of obsolete and slow moving inventory, to ensure that this situation does not occur again in the future.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

March 23, 2004

The Honorable Mark Warner
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Virginia Correctional Enterprises**, a division of the **Department of Corrections**, for the period January 1, 2002 through June 30, 2003. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of VCE's internal control, and test compliance with applicable laws and regulations. We also reviewed VCE's corrective actions of the audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of VCE's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues and Cash Receipts
Expenditures
Private Industry Contracts
Fixed Assets

Accounts Receivable
Procurement
Inventory
Leases

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether VCE's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

VCE's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that VCE properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. VCE records its financial transactions in its accounting records on the accrual basis of accounting. The financial information presented in this report came directly from VCE's accounting records and financial reports.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. Reportable conditions are discussed in the section entitled "Internal Control and Compliance Findings and Recommendations." We believe that none of the reportable conditions is a material weakness.

The results of our tests of compliance with applicable laws and regulations disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards, which are discussed in the section entitled "Internal Control and Compliance Findings and Recommendations."

VCE has not taken adequate corrective action with respect to the previously reported findings entitled "Enforce and Perform Job Sampling to Validate Standard Costs" and "Establish Controls for Disposing of Slow-moving, Obsolete, and Excessive Inventory". These findings are included in the section entitled "Internal Control and Compliance Findings and Recommendations." The Department has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on May 14, 2004.

AUDITOR OF PUBLIC ACCOUNTS

LCR:whb
whb:31



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Department of Corrections

Virginia Correctional Enterprises

May 20, 2004

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Auditor of Public Accounts
Mr. Walter J. Kucharski
PO Box 1295
Richmond, VA 23218-1295

RE: Response to APA Audit Report on Virginia Correctional Enterprises for the Period
January 1, 2002 through June 30, 2003

Dear Mr. Kucharski,

In accordance with Section No. 10205 of the Commonwealth's Accounting Policies and Procedures Manual, enclosed is our response to APA's report on the audit of VCE for the eighteen months ended June 30, 2003.

Please let me know if you have any questions regarding this report.

Sincerely,

D. R. Guillory
CEO, VCE

Enclosure

CC: Mr. David A. Von Moll, Comptroller
Department of Accounts



APA COMMENT:

Implement a Strategic Plan to Guide Operations

Virginia Correctional Enterprises (VCE) has not implemented a strategic plan to guide its current and future operations or set a performance base for management to direct operations. Although VCE developed a business and expansion plan in 2000, management did not implement the plan or use it to guide its daily business operations.

Since VCE relies solely on public and private sector contracts and sales to fund its operations, it is imperative that they develop a strategic plan that outlines their mission, goals, performance measures, and a methodology for determining when to establish, expand, or discontinue product lines. VCE's financial stability is very dependent on the license tag industry generating 44 percent of VCE's total gross profit and the loss of this industry through outsource or other means could significantly affect operations.

APA RECOMMENDATION:

We recommend VCE develop and implement business plans outlining strategies for addressing future business and operational goals as well as potential issues. Not only is this a good business practice, it is also required in section 2.2-5510 of the Code of Virginia. The first step in this process is for VCE to examine its purpose. They must clearly define what they do, who they do it for, and what they strive to accomplish. Then VCE should use what they find to help develop their strategic approach to business. It should outline strategies for addressing future business and operational goals and potential negative issues. An approach of this nature will play a vital role in helping VCE to avoid mistakes as well as recognize hidden opportunities.

VCE RESPONSE: Management agrees that the agency's Business Plan must be updated and distributed to staff. VCE did in fact implement several key components of the prior plan, to include recapitalizing factory assets, upgrade of information technology systems and expansion of product offerings. VCE's management has already begun the process of updating the plan and anticipates completion by the end of the first quarter of FY 2005.

ACTION: Update and expand VCE's Business Plan

RESPONSIBILITY: Chief Executive Officer

DUE DATE: 1st Quarter, FY2005

APA COMMENT:

Enforce and Perform Job Sampling to Validate Standard Costs

VCE is not performing the job sampling cost validations according to their internal procedures. VCE values materials, work-in-progress, and finished goods at standard cost. VCE uses these standard costs for financial reporting purposes on a monthly basis, to value inventory at the

lower of cost or market for year-end financial reporting, and for product pricing. To ensure the accuracy of these standard costs, VCE requires each plant to perform a specified number of job sample validations in a given time frame and document the actual production cost. Based on these samples, VCE then adjusts production costs for variances between the sample results and the original estimated costs.

We have reported this issue in previous reports, and while VCE has strengthened their policies and procedures over job sampling validation, the production plants are still not performing the required validations. Out of the five months reviewed, VCE did not perform 22 of the required job samples, which indicates an average noncompliance rate of 31 percent.

APA RECOMMENDATION:

Since a large percentage of job sampling validations result in changes and adjustments to the set standard cost for a production item, it is critical that VCE performs the required sampling validations to ensure that it is properly recording standard costs. If managers are not properly performing the sampling costs validations, management should hold the plant managers at the facilities accountable for a lack of adherence to policies and procedures.

VCE RESPONSE: Management is committed to ensuring that standard costs are accurate and agree that the sampling process provides assurance that standards are validated and accurately reflect current conditions. While management believes the current policy and procedures are adequate we acknowledge that the compliance rate is unacceptable. Management must ensure that sample jobs are identified early enough in the related period to ensure compliance.

ACTION: Review the current reporting requirements and hold plant personnel accountable for non-compliance.

RESPONSIBILITY: Operations Manager and General Manager

DUE DATE: 1st Quarter, FY2005

APA COMMENT:

Establish Controls for Disposing of Slow-moving, Obsolete and Excessive Inventory

As we have reported previously, VCE does not have documented policies and procedures for reviewing inactive, slow moving, and excessive inventory. As of March 22, 2004, VCE's Central Warehouse had over 19,179 items in its finished good items in inventory that had been on hand for over a year. These items have an estimated sales value of over \$1 million.

In addition, during the annual physical inventory count performed in February 2004, we found \$93,247 of fabric that VCE had not used in over a year. We also found several items in the Central Warehouse that were considered outdated, going back as early as 1995.

APA RECOMMENDATION:

To ensure VCE's inventory is not overstated, they should develop and document policies and procedures to review all outdated inventory and determine whether or not to write the inventory off as obsolete or record the inventory down to its net realizable value. VCE should also develop and communicate procedures for the disposition of obsolete and slow moving inventory, to ensure that this situation does not occur again in the future.

VCE RESPONSE: Management concurs that obsolete inventory should be identified, written down to its net realizable value and disposed of in a timely manner. VCE's plants routinely salvage parts from scrapped goods, which ultimately improve cash flow and profitability. While it is prudent to carry such items in its facilities (at no value), once an item is determined to be unusable it must be disposed of in a timely manner. Plant and warehouse supervisors were given guidance on how to report the inventory to management however; management agrees that formal procedures must be issued to document the process of identifying such items and appropriate methods of disposal. VCE's sales staff must review slow moving items periodically and be empowered to sell identified items at discounted prices.

ACTION: Issue formal procedures for identifying obsolete inventory.

RESPONSIBILITY: Operations Manager

DUE DATE: 1st Quarter, FY2005

ACTION: Issue formal procedures for identifying and discounting slow moving finished goods inventory.

RESPONSIBILITY: General Manager

DUE DATE: 1st Quarter, FY2005

DEPARTMENT OF CORRECTIONS
VIRGINIA CORRECTIONAL ENTERPRISES
Richmond, VA
As of June 30, 2003

Gene M. Johnson, DOC Director

N. H. "Cookie" Scott, Deputy Director of Administration

Don Guillory, VCE Chief Executive Officer

Jim Sacher, VCE Business Manager