



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

090216

MAR 20 1975

Mr. David C. Jelinek, Associate Commissioner
Federal Prison Industries, Inc.
HOLC Building
101 Indiana Avenue, NW.
Washington, D.C. 20537

Dear Mr. Jelinek:

Our audit of the Federal Prison Industries' (FPI) financial statements for fiscal year 1974 is completed and our report to the Congress is in preparation.

We were again assisted in this year's examination by the Internal Audit Staff, Department of Justice, who will shortly be reporting to you on the accounting discrepancies disclosed during the audit at the Central Office. We have reviewed their work and are in general agreement with their findings. We would like to bring to your attention, however, other matters developed during this year's audit.

Need to complete yearend financial statements in a more timely manner

Each year we plan our audit at the Central Office based on FPI's estimated date for completing the financial statements. For the past 2 years our audit has been hampered by delays in the preparation of the yearend statements although we were assured of their completion by a particular date.

A contributing factor to this condition was the assumption of responsibility by primarily one individual for preparation of the financial statements. When this individual was not present, very little was accomplished. This individual transferred from the Central Office in December 1974 which adds to our concern whether staff has been adequately trained to assume this responsibility in the future. Another factor appears to be the lack of priority given to gathering information necessary for completing the financial statements in an expeditious and timely manner.

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FPI is obligated to report on the conduct of its affairs and the condition of its funds to the Congress. For these financial reports to be of maximum use to the corporation and the Congress, they should be prepared in a timely manner. In order for us and FPI to meet our reporting obligations to the Congress, it is essential that financial statements be completed as close as practicable to fiscal yearend.

It would be helpful if you would appraise this situation and take such steps as are necessary so financial statements will be completed in a more timely fashion. In accomplishing this you might consider the advantages of training more than one individual in the techniques of preparing the financial statements.

Improvements needed to ensure that
audit recommendations are followed

During our audits of field locations this year, deficiencies in accounting controls and procedures identical to those which were identified during prior GAO and internal audits were found. Recommendations were made during prior audits to correct the deficiencies and at that time assurances were given that recommendations for improvements would be followed. It appears that, in these cases, recommendations for improving operations were observed for brief periods after the audit; however, the corrective actions were apparently shortlived and the old methods and procedures were reinstated. This loses for management many benefits obtained through the audit process. Further, it weakens accounting controls and procedures and makes more difficult your achieving effective control over your dispersed operations.

We believe this problem may be quite widespread and recommend that you give it your immediate attention. You might consider communicating with each superintendent and business manager emphasizing the importance of continued adherence to past and future recommendations. It would also be useful if specific inquiry was made into this matter during your regularly scheduled field visits.

Effect of FPI's reorganization
on administrative expense

We were asked by Mr. Paul Plein at the onset of the recent reorganization what our opinion was regarding the effect the reorganization would have on the definitions of administrative and production expenses. We made our views known to Mr. Plein, but at the completion of our work no final disposition was made with respect to how administrative expense would be defined.

In previous years your administrative expense consisted solely of Central Office administrative expenses. Since your administrative expense is subject to congressional limitation, you have informed the Congress that this expense consists of only those administrative expenses incurred at the Central Office. Under the reorganization it has been proposed that the corporation retain this same definition of administrative expense. It is clear, however, that under the decentralized structure of the reorganization, that not all prior Central Office administrative expenses will remain administrative expenses and some administrative expenses will now be incurred outside the Central Office.

In order to provide the Congress with the most meaningful information, we believe that administrative expenses should encompass all expenses incurred in the operation of the corporation that are not directly related to production including those administrative expenses incurred outside the Central Office. Administrative expenses should not be limited to only the Central Office if, in fact, administrative expenses are incurred at industrial locations. If some Central Office expenses are, in fact, directly related to production, they should be treated as such. As the resolution of this issue could have a material affect upon our ability to render an opinion, we would like to discuss your proposed definition of administrative and production expenses.

Nontaxation of inmate wages
needs to be reviewed

During our examination, we noted some inmates were earning incomes of more than \$500 a month in prison industries and were not subject to taxation.

Our research revealed that the subject of taxing inmate earnings was ruled on in 1945 by the Internal Revenue Service (IRS). IRS ruled that wages were not subject to taxation, holding that inmates were paid only nominal sums and referred to the wages as "gratuitous allowances provided by Federal law for the labor required."

We believe you would want to consider whether this matter needs to be re-explored with IRS in view of the current trends in inmate wages.

We are providing a copy of this letter to the Internal Audit Staff of the Department of Justice. We wish to acknowledge the cooperation and courtesy extended to our representatives during this examination and would appreciate any comments you may have on the matters discussed herein.

Sincerely yours,

H. L. Krieger

H. L. Krieger
Regional Manager



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MAR 20 1975

Mr. Harry Shepherd, Director
Internal Audit Staff
Department of Justice
425 Eye Street, NW.
Washington, D.C. 20537

Dear Mr. Shepherd:

Enclosed for your information is a copy of our management letter to the Associate Commissioner, Federal Prison Industries, Inc. The letter contains several matters for consideration by the corporation which were developed during this year's audit.

We have enjoyed working with your staff again this year.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "H. L. Krieger".

H. L. Krieger
Regional Manager

Enclosure