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UNITED STATES
GENERAL ACCOUNTING OFFICE
SEP 8 1975



REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES



Examination Of Financial Statements Of Federal Prison Industries, Inc., Fiscal Year 1974

Department of Justice

SEPT. 8, 1975

FOD-76-2

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114826

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the examination of the financial
statements of the Federal Prison Industries, Inc., Depart-
ment of Justice, for the fiscal year ended June 30, 1974.

We made our examination pursuant to the Government
Corporation Control Act (31 U.S.C. 841).

We are sending copies of this report to the Director,
Office of Management and Budget, and to the Attorney General.

A handwritten signature in black ink, appearing to read "Thomas B. Heath".

Comptroller General
of the United States



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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL
STATEMENTS OF FEDERAL PRISON
INDUSTRIES, INC.
FISCAL YEAR 1974
Department of Justice

D I G E S T

In GAO's opinion the financial statements included in this report present fairly the financial position of Federal Prison Industries, Inc., at June 30, 1973, and June 30, 1974, and the results of its operations for the years then ended, and changes in its financial position for the year ended June 30, 1974, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States applied on a basis consistent with that of the preceding year--except for the change in the method of capitalizing fixed assets, with which GAO concurs.

The Corporation could improve its effectiveness in providing inmates with job skill training by evaluating ongoing industries to determine the extent of job skill training provided and by placing more emphasis on establishing new industries which offer more skill training.
(See p. 2.)

The Corporation recognized the need to improve job skill training available to inmates and agreed to study and evaluate the potential for establishing additional industries of this type.
(See p. 4.)

CHAPTER 1

INTRODUCTION

The Federal Prison Industries, Inc., a wholly owned Government Corporation created pursuant to the act of June 23, 1934 (48 Stat. 1211), functions within the Department of Justice under the general direction and supervision of the Attorney General. The Corporation's primary goal is to offer inmates in Federal institutions training and work experience in skills that provide for employment opportunities upon release.

The operating policies of the Corporation are prescribed by a six-member Board of Directors appointed by the President. The Directors are appointed for indefinite terms and serve without compensation. These members and the principal officials responsible for administering the day-to-day operations of the Corporation are included in appendix II.

Government agencies are required to purchase from the Corporation industry products as meet their requirements and as may be available at prices not exceeding current market prices. The Board of Directors has established the policy that prices shall not be materially below current market prices.

During fiscal year 1974 the Corporation operated 47 industries at 22 Federal institutions. Types of industries ranged from the manufacture of gloves, brushes, and brooms to automatic data processing and printing services. (See app. I.) Total employment for the year averaged 5,328, or about 22 percent of the total inmate population.

CHAPTER 2

INDUSTRIAL OPERATIONS

Fiscal year 1974 sales to Government agencies totaled almost \$63 million, or about \$8.9 million more than in the preceding year. These sales resulted in industrial profits of \$11 million, an increase of more than \$4.4 million over profits of the previous year.

Industrial profits were distributed as follows: \$4.7 million, which includes depreciation, was used to support vocational training programs and \$1.1 million was spent on meritorious compensation to inmates and inmate accident compensation. Profits retained by the Corporation amounted to \$5.2 million, an increase of about \$4.8 million from that of the preceding year.

Of the 47 industrial operations in effect during the year, 36 showed increases in sales volume from the preceding year. The largest increases occurred at the Lompoc, California, and Atlanta, Georgia, institutions. The electronic cable industry at Lompoc showed an increase of over \$1.5 million and the basket and textile industries at Atlanta each showed an increase of about \$1.4 million. During the year a new automotive repair industry was started at Ashland, Kentucky, and the clothing industry at Leavenworth, Kansas, was discontinued.

SKILLS TRAINING AVAILABLE TO INMATES

General statutory authority for diversified employment of Federal prison inmates and for training them in trades and occupations was first approved on May 27, 1930 (46 Stat. 391). That statute requires the Attorney General to provide employment for all physically fit inmates in such diversified forms as will reduce competition with private industry to a minimum and will provide the inmates a maximum opportunity to acquire knowledge and skill in trades and occupations which will provide a means of earning a livelihood upon release. In 1934 Congress authorized the formation of a Corporation to permit more effective diversification of prison industries and left to the Board of Directors full discretion as to how this was to be accomplished.

We have been told that the Corporation has created industries to eliminate widespread idleness and to prevent

the consequent mental and physical deterioration of the inmates. Further, the establishment and operations of industries have been justified in part because they provide inmates with good work habits and funds to assist in supporting their families. Another objective was to build up the inmates' morale by providing them with a means to earn reasonable wages and develop self-discipline.

In November 1973 we issued a report entitled "Rehabilitating Inmates of Federal Prisons: Special Programs Help, But Not Enough" (B-133223). The report evaluated the success of the prison system's programs for preparing Federal offenders to reenter society, including the Corporation's program. It discussed a wide range of issues, including inmate participation and marketable skills learned in rehabilitation programs, prerelease job placement services, funding of vocational training programs, and program needs and progress. The report concluded, among other things, that the Corporation's industries had not been fully effective in training inmates in marketable skills.

We recommended in the 1973 report that the Bureau of Prisons work with the Corporation to develop and implement a plan that would increase the opportunities for inmates to acquire a marketable skill. In response to our November 1973 report evaluating the training available to inmates, we were advised that the Corporation had recognized the need to develop an effective operating plan to increase opportunities for inmates to acquire marketable skills. A long-range plan was developed with its main thrust directed at developing precise industries which would provide more marketable skills to inmates. It was to assess the training value of all existing industries and offer guidelines for replacing those which have become outdated. Although the plan does provide an assessment of each industry currently in operation in terms of training value, it fails to lay out constructive long-range plans for replacing those which have become outdated.

The Corporation has taken actions in recent years to establish industries, such as automobile repair and computer programming, which offer training in vocations that are in need of qualified persons.

Industries such as canvas goods and sewing trades, textile mills, and shoe manufacturing continue to employ

a large part (42 percent) of the working inmate population and may not have a high potential for providing marketable skills. We believe the Corporation could improve its effectiveness by evaluating ongoing industries to determine the extent of job skill training provided and by placing more emphasis on establishing new industries which offer more skill training.

We suggested that the Board of Directors require the Plans and Policies Division to undertake a research study to (1) evaluate the Government market that can be served by prison industries, (2) evaluate the skills in demand in the private sector job market, and (3) identify additional industries that could be established to increase the development of marketable skills, as well as meeting the other purposes of prison industries.

The Board of Directors recognized the need for a continuing effort to increase the proportion of jobs in prison industries that provide training in a marketable skill. They pointed out that previously established industries that are less desirable from a training standpoint have not been expanded in recent years. Instead, such industries as cable fabrication and manufacture of electronic gear are being expanded and provide more useful training opportunities. The Board of Directors agreed to study and evaluate the potential for establishing additional industries of this type.

CHAPTER 3

INTERNAL AUDIT

The internal audit function is one of management's most essential tools, complementing all other elements of management control. The overall objective of internal auditing is to assist management in attaining its goals by furnishing information and recommendations pertinent to management's duties and objectives. The internal audit function uniquely supplements routine management checks through its independent approach and methods of review. Effective internal auditing can benefit management with timely information on problems so that remedial measures can be taken before the functioning of the organization is impaired. These problems, once they have been examined and appraised, often lead to opportunities for achieving lower costs, increased efficiency, and faster ways of getting things done.

The Internal Audit Staff, Department of Justice, conducts detailed audits annually of financial operations at selected industrial locations. A comprehensive audit program is used at each location visited. The basic audit objective is to evaluate the effectiveness of the administrative practices, procedures, and internal controls over financial activities. Each audit includes such tests of financial transactions and related documents considered necessary to accomplish the objective. This year's audits included 13 field locations, encompassing 27 industrial operations. Additionally, they audited the central office in Washington, D.C., and assisted us greatly in reviewing the Corporation's consolidated financial statements. Each audit is followed by a report to the Commissioner of Federal Prison Industries, Inc.

We reviewed the work of the Internal Audit Staff and found it to be both accurate and reliable, and as a result, we were able to reduce the scope of our work. Further, we believe the Internal Audit Staff, through its timely and comprehensive reports, contributed greatly in improving over-all industrial operations.

CHAPTER 4

SCOPE OF EXAMINATION AND OPINION ON

FINANCIAL STATEMENTS

SCOPE OF EXAMINATION

Our examination of the financial statements of the Federal Prison Industries, Inc., for fiscal year 1974 was made in accordance with generally accepted auditing standards and included such tests of the accounting records and financial transactions and such other auditing procedures as we considered necessary in view of the nature of the internal controls, including the internal audit function.

We made our examination at the central office in Washington, D.C., and at the institutions in Lewisburg and Allenwood, Pennsylvania; Sandstone, Minnesota; and McNeil Island, Washington.

OPINION ON FINANCIAL STATEMENTS

In our opinion, the accompanying financial statements (schs. 1 through 3) present fairly the financial position of the Federal Prison Industries, Inc., at June 30, 1973, and June 30, 1974, and the results of its operations for the years then ended and the changes in its financial position for the year ended June 30, 1974, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States applied on a basis consistent with that of the preceding year--except for the change in the method of capitalizing fixed assets as described in note 1 to the financial statements, with which we concur.

SCHEDULES AND APPENDIXES

SCHEDULE 1

F E D E R A L P R I S O N I N D U S T R I E S , I N C .

STATEMENT OF FINANCIAL CONDITION
FISCAL YEARS ENDED JUNE 30, 1974 AND 1973

A S S E T S

	<u>Fiscal year 1974</u>		<u>Fiscal year 1973</u>	
FUNDS WITH U.S. TREASURY:				
Available for operations	\$ 5,833,419		\$ 4,638,255	
Special deposits	<u>19,094</u>	\$ 5,852,513	<u>17,755</u>	\$ 4,656,010
ACCOUNTS RECEIVABLE (principally from Government agencies)		7,421,784		7,004,877
INVENTORIES (at cost):				
Finished goods	5,148,475		4,684,242	
Work in process	5,052,098		4,150,166	
Materials and supplies	<u>17,113,310</u>	27,313,883	<u>13,011,640</u>	21,846,048
PLANT AND EQUIPMENT (at cost or appraised value) (note 1):				
Operating:				
Machinery and equipment	18,225,983		17,744,068	
Less accumulated depreciation	<u>9,081,030</u>	9,144,953	<u>8,318,649</u>	9,425,419
Buildings and improvements	19,649,795		17,856,565	
Less accumulated depreciation	<u>5,798,755</u>	13,851,040	<u>5,290,972</u>	12,565,593
Construction in process		507,951		2,033,657
Vocational training:				
Machinery and equipment	2,314,738		2,711,164	
Less accumulated depreciation	<u>1,339,980</u>	974,758	<u>1,285,062</u>	1,426,102
Buildings and improvements	5,708,556		5,595,697	
Less accumulated depreciation	<u>1,206,261</u>	4,502,295	<u>1,043,274</u>	4,552,423
Construction in process		-		39,251
Total plant and equipment		28,980,997		30,042,445
SUNDRY ASSETS		<u>299,719</u>		<u>165,814</u>
Total assets		<u>\$69,868,896</u>		<u>\$63,715,194</u>

The notes on page 13 are an integral part of this statement.

L I A B I L I T I E S A N D C A P I T A L

	<u>Fiscal year 1974</u>	<u>Fiscal year 1973</u>
LIABILITIES:		
Accounts payable	\$ 3,125,118	\$ 2,706,783
Accrued payroll and other liabilities	1,482,837	1,837,649
Employees' accrued annual leave	1,184,729	1,172,488
Estimated liability for price adjustments (note 2)	560,752	-
Deposit fund liabilities	<u>19,094</u>	<u>17,755</u>
Total liabilities	<u>6,372,530</u>	<u>5,734,675</u>
CAPITAL:		
Initial investment of U.S. Government	4,176,040	4,176,040
Property received from other Government agencies, net	3,380,899	3,156,887
Net income since inception	\$137,939,427	\$132,647,592
Less dividends paid into U.S. Treasury	<u>82,000,000</u>	<u>82,000,000</u>
Retained earnings (notes 1 and 3)	<u>55,939,427</u>	<u>50,647,592</u>
Total capital	<u>63,496,366</u>	<u>57,980,519</u>
Total liabilities and capital	<u>\$69,868,896</u>	<u>\$63,715,194</u>

FEDERAL PRISON INDUSTRIES, INC.
STATEMENT OF INCOME AND EXPENSE
FISCAL YEARS ENDED JUNE 30, 1974 AND 1973

	<u>Fiscal year 1974</u>		<u>Fiscal year 1973</u>
TOTAL SALES OF PRODUCTS AND SERVICES (note 2)	\$67,446,956		\$58,757,095
Less sales between industries	<u>4,524,234</u>		<u>4,765,064</u>
SALES TO GOVERNMENT AGENCIES	62,922,722		53,992,031
Cost of goods and services sold	<u>49,879,733</u>		<u>44,614,249</u>
GROSS PROFIT	<u>\$13,042,989</u>		<u>\$9,377,782</u>
OPERATING EXPENSES:			
Sales expenses:			
Outgoing freight	97,928		87,225
Shipping	418,899		399,349
Samples and sundries	<u>16,616</u>	533,443	<u>18,950</u>
			505,524
Administrative expenses:			
Salaries and related	909,114		919,229
Travel	60,582		80,202
General Accounting Office audit	25,000		25,000
Department of Justice audit	125,000		125,000
Rent for Washington office	33,801		30,553
Telephone	75,808		46,814
Printing and reproduction	30,516		26,448
Freight	12,439		24,735
Other	<u>40,080</u>		<u>70,174</u>
Total administrative expenses subject to limitation set by the Congress (1973--\$1,500,000) (1974--\$1,631,000)		1,312,340	1,348,155
Depreciation:			
Machinery and equipment		<u>3,541</u>	<u>3,904</u>
NET OPERATING EXPENSES		<u>1,849,324</u>	<u>1,857,583</u>
OTHER INCOME:			
Miscellaneous sales income	411,551		152,400
Sundry income	<u>61,823</u>	473,374	<u>52,875</u>
			205,275
OTHER EXPENSES:			
Extraneous losses on inventories	194,719		171,774
Reimbursable salaries	6,384		649,388
Loss on disposition of assets	189,145		87,513
Christmas packages to inmates	-		29,820
Factory closing and organization expense	21,543		29,079
workmen's compensation (note 4)	150,477		48,209
Incentive awards to civilians	8,805		9,725
Miscellaneous	<u>79,952</u>	651,025	<u>89,815</u>
			1,115,323
NET INDUSTRIAL PROFIT (note 2)		11,016,014	6,610,151
Less:			
Accident compensation	100,939		98,504
Vocational expense	4,734,318		5,226,660
Meritorious compensation to inmates	<u>987,272</u>	5,822,529	<u>900,948</u>
			6,226,112
NET PROFIT TO RETAINED EARNINGS		<u>\$5,193,485</u>	<u>\$ 384,039</u>

The notes on page 13 are an integral part of this statement.

FEDERAL PRISON INDUSTRIES, INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

FISCAL YEAR ENDED JUNE 30, 1974

FUNDS PROVIDED:

Sales of products and services		\$62,922,722
Miscellaneous sales		1,905,751
Materials and supplies received without exchange of funds, net		217,122
Sundry income current year		61,823
Sundry income earned in prior years		<u>156,118</u>
Total funds provided		<u>\$65,263,536</u>

FUNDS APPLIED:

Cost of goods and services sold	\$49,879,733	
Less production depreciation	<u>1,727,573</u>	\$48,152,160
Vocational training and place- ment expense	4,734,318	
Less depreciation	<u>537,423</u>	4,196,895
Administrative expense	1,315,881	
Less depreciation	<u>3,541</u>	1,312,340
Acquisition of fixed assets		1,200,199
Cost of miscellaneous sales		1,494,200
Other operating expense		995,323
Inmate compensation for meritorious or outstanding service		987,272
Accident compensation		100,939
Loss on disposal of assets		189,145
Operating expenses incurred in prior years		57,768
Increase in working capital		<u>6,577,295</u>
Total funds applied		<u>\$65,263,536</u>

The notes on page 13 are an integral part of this statement.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Following is a summary of the significant accounting policies of Federal Prison Industries, Inc.

1. The consolidated financial statements include the accounts of the central office of the Federal Prison Industries, Inc., and its industrial facilities. Appropriate eliminations are made for interindustry transactions and profits therefrom.
2. Federal Prison Industries, Inc., uses the straight-line method of depreciation for all depreciable assets. Rates of depreciation are based on useful life guidelines established in Revenue Procedures 62-21, issued by the Treasury Department, Internal Revenue Service.
3. Raw materials inventory is recorded at actual cost.
4. Work in process and finished goods inventories are recorded at actual cost determined by one of the following cost systems: process costing, job costing, or standard costing, depending upon the type of industry.

NOTES TO FINANCIAL STATEMENTS

1. Beginning with fiscal year 1974, the Corporation changed its method of capitalizing fixed assets. All fixed assets acquired during the year costing \$200 or more were capitalized. In prior years the Corporation capitalized fixed assets costing \$100 or more. Accordingly, all capitalized items which originally cost less than \$200 and were capitalized on the "over \$100 basis" were written off as expenses. Had the corporation continued to use this method, its retained earnings and capitalized value of plant and equipment would have been more than that shown in the financial statements.
2. Sales and profits have been reduced by \$560,752 and a liability established to provide for anticipated payments for price adjustments on items sold during the year under tentative prices.
3. Inclusive of \$98,350 representing adjustments affecting prior year's transactions.
4. The Department of Labor pays all workmen's compensation expenses incurred by the Corporation. Labor is then reimbursed by the Corporation. Bills for each fiscal year's workmen's compensation expense are not received by the Corporation until after the close of each fiscal year. Because the Corporation has tried unsuccessfully to obtain supporting data for these expenses from Labor and because the expense varies from year to year, they have made it their policy not to set up an accrual for workmen's compensation. Instead, they record workmen's compensation expenses only after payment is made to Labor. Therefore, fiscal year 1974's expense is exclusive of the actual workmen's compensation expense incurred during the year. The fiscal year 1974 expense of \$150,477 consists of \$70,943 and \$79,534 of expenses actually incurred during fiscal years 1972 and 1973, respectively. The fiscal year 1973 expense of \$48,209 consists of expenses actually incurred during fiscal year 1971.

FEDERAL PRISON INDUSTRIES, INC.
SCHEDULE OF INDUSTRIAL OPERATIONS
FISCAL YEARS ENDED JUNE 30, 1974 AND 1973

Industry	Location	Sales		Net industrial profit (loss)		Average number of inmates in industry 1974
		1974	1973	1974	1973	
MANUFACTURING AND PROCESSING (note a):						
Basket	Atlanta	\$ 2,536,968	\$ 1,184,764	\$ 245,580	\$ 134,668	51
Broom	El Reno	849,731	790,651	127,109	139,606	71
Brush	La Tuna	842,156	692,924	208,252	165,092	53
"	Leavenworth	4,055,142	3,454,077	992,204	930,612	134
Canvas specialty	Atlanta	3,865,931	4,267,274	524,296	436,230	166
Do.	Terre Haute	314,771	708,935	(70,628)	20,943	53
Clothing	Leavenworth	574,958	679,690	(19,308)	(5,342)	54
"	Lewisburg	677,521	541,862	144,757	42,994	101
Dairy	La Tuna	236,316	189,696	24,346	19,577	28
Electronics	Danbury	1,086,123	1,120,989	201,988	181,275	136
"	McNeil Island	4,090,276	3,212,773	1,011,630	694,057	172
"	Petersburg	660,940	244,223	120,093	(6,106)	69
Electronic cable	Lompoc	2,819,230	1,278,457	604,146	173,998	208
Furniture, custom metal	Allenwood	685,577	575,785	120,119	57,953	93
"	Lewisburg	3,356,661	3,399,050	409,578	99,891	297
Do.	Marion	1,694,139	1,616,537	28,659	285,113	95
Furniture, wood	Leavenworth	1,134,569	1,116,613	178,260	150,794	110
Do.	Lompoc	982,514	760,810	206,378	108,036	104
Do.	McNeil Island	808,657	1,282,772	(18,401)	261,331	162
Do.	Tallahassee	468,225	343,838	40,699	14,397	68
Do.	Terminal Island	321,347	354,529	(69,532)	(70,515)	88
Do.	Texarkana	943,093	1,233,853	268,901	472,922	97
Garment	Alderson	1,698,387	1,350,860	409,628	318,300	149
Glove	Danbury	234,977	300,291	4,262	38,616	98
"	Safford	514,965	325,491	135,432	19,220	71
"	Sandstone	466,896	327,053	145,776	43,251	58
Machine, die and tool	El Reno	2,305,655	2,080,559	464,685	503,865	154
Mattress	Atlanta	1,325,278	2,119,056	380,409	474,184	25
Metal equipment	Terminal Island	1,636,698	1,054,529	413,252	61,736	141
" specialty	Milan	1,816,719	1,714,693	310,113	267,200	113
Plastics and furniture	Terre Haute	393,080	322,762	60,602	(3,107)	30
Printing	Lompoc	476,124	482,373	90,777	145,235	45
"	Marion	652,422	510,120	46,355	5,838	47
"	Sandstone	345,121	307,215	57,166	(14,634)	36
Shoe	Leavenworth	6,391,030	5,570,286	844,500	587,989	426
Sign	Atlanta	1,195,743	694,304	270,601	116,237	64
"	Lompoc	573,698	502,759	107,901	37,434	55
Textile, cotton	Atlanta	8,690,719	7,262,246	2,340,244	854,365	719
" , woolen	Terre Haute	3,748,642	2,711,887	947,470	248,074	324
Total manufacturing and processing		65,470,999	56,686,586	12,308,299	8,011,329	4,965
SERVICING (note a):						
Automatic data processing	Alderson	318,357	308,346	92,208	105,474	54
Do.	Fort Worth	73,830	8,396	5,031	(14,728)	33
Do.	Leavenworth	301,936	172,809	36,629	-	46
Automotive repair	Ashland	16,060	-	(24,458)	-	7
Furniture refinishing	La Tuna	527,192	515,348	145,746	156,236	92
Do.	Seagoville	164,881	163,903	5,968	14,247	53
Keypunch	Terminal Island	201,854	176,051	(1,221)	20,119	38
Life raft repair	Oxford	-	-	11	-	4
Tire reconditioning	Petersburg	371,847	274,423	16,480	10,601	36
Total servicing		1,975,957	1,619,276	276,394	291,949	363
Total		\$67,446,956	\$58,305,862	\$12,584,693	\$8,303,278	5,328

a/Exclusive of industries discontinued during fiscal year 1973.

PRINCIPAL MANAGEMENT OFFICIALS
RESPONSIBLE FOR THE ACTIVITIES
DISCUSSED IN THIS REPORT

	<u>Date</u> <u>appointed</u>	<u>Representative of</u>
BOARD OF DIRECTORS:		
James L. Palmer, President	Sept. 1951	Retailers and consumers
John Marshall Briley, Vice President	Jan. 1960	Secretary of Defense
George Meany	Dec. 1947	Labor
Berry N. Beaman	Jan. 1954	Industry
William E. Morgan	May 1966	Agriculture
Peter B. Bensinger	Apr. 1974	Attorney General
COMMISSIONER OF INDUSTRIES: Norman A. Carlson		
ASSOCIATE COMMISSIONER OF INDUSTRIES: David C. Jelinek		
SECRETARY: Paul Plein		

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