



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

090342

090342

APR 15 1976

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 1975 is completed and our report to the Congress is being processed. We thought it would be useful to summarize certain matters noted during our review which will not be discussed in our report to the Congress but which we feel warrant your attention.

Need for improving
inventory management

During our examinations of the corporation for fiscal years 1974 and 1973 we noted that the inventory levels were increasing at the expense of cash and at a rate inconsistent with overall corporate asset growth. At June 30, 1975, the corporation's total inventory was valued at \$33.3 million, an increase of \$6 million or approximately 22 percent above the prior year's level. Inventories represented almost 46 percent of all corporate assets. An analysis of inventory turnover ratios for the past several years reveals a continuing decline in the inventory turnover rate from 2.32 to 1.90.

While management has expressed concern over this continuing situation and has stressed the need to improve the inventory turnover ratios, they have met with little success. In this regard, we again suggest you establish minimum/maximum inventory levels, preferably on a corporate wide basis, but at least by division.

Prior period adjustments

As part of our examination we analyzed the prior period adjustments made to the financial statements. In doing so, we found that while the adjustments followed FPI policy the

090342 / 910512 TACCNO
AC 706

policy is in conflict with the accounting and financial reporting standards prescribed by the Comptroller General of the United States as stated in the "Principles and Standards for Federal Agencies" (Subsection 14.6) and the AICPA Professional Standards regarding financial statement presentation (Section 2010.22). FPI's current adjustments lack materiality, a prerequisite for being classified as a prior period adjustment. We discussed this matter with FPI officials, who agree with our analysis.

We recommend you change FPI policy so that it will agree with the above standards of accounting for prior period adjustments.

Financial statement presentation

As part of our examination we evaluated FPI's financial statements in light of present practices in financial reporting. An objective of financial reporting is to present clear, concise statements while at the same time provide full disclosure of all aspects of the financial position of an entity and the results of its operations.

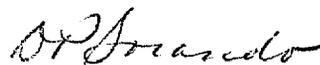
We have restructured FPI's financial statements according to current trends in financial reporting. A copy of the revised statements is enclosed for your review. Mr. Plein and members of his staff have reviewed and agreed to the suggested format.

We believe the revised format is an improvement over FPI's current financial presentation and will satisfy your external reporting requirements of providing clear, concise statements with adequate disclosure. We suggest that the restructured format be used by FPI for fiscal year 1976 and subsequent years.

- - - -

Your comments on the above matters would be appreciated. If we can be of any help, please feel free to call on us.

Sincerely,



D. P. Sorando
Regional Manager

Enclosure

FEDERAL PRISON INDUSTRIES, INC.
BALANCE SHEET
At June 30, 1975 and 1974 (Note 1)

<u>Assets</u>	<u>1975</u>	<u>1974</u>
Current Assets:		
Funds with U.S. Treasury	\$ 4,800,761	\$ 5,852,513
Accounts receivable (Note 2)	5,648,918	7,421,784
Inventories:		
Finished goods	5,798,925	5,148,475
Work-in-process	6,242,502	5,052,098
Materials and supplies	<u>21,285,098</u>	<u>17,113,310</u>
Total Current Assets	<u>43,776,204</u>	<u>40,588,180</u>
Plant and Equipment:		
Operating:		
Machinery and equipment	19,065,481	18,225,983
Buildings and improvements	<u>20,062,959</u>	<u>19,649,795</u>
	39,128,440	37,875,778
Less accumulated depreciation	<u>16,412,599</u>	<u>14,879,785</u>
	22,715,841	22,995,993
Construction-in-process	640,202	507,951
	<u>23,356,043</u>	<u>23,503,944</u>
Vocational Training:		
Machinery and equipment	2,423,645	2,314,738
Buildings and improvements	<u>5,525,400</u>	<u>5,708,556</u>
	7,949,045	8,023,294
Less accumulated depreciation	<u>2,940,372</u>	<u>2,546,241</u>
	5,008,673	5,477,053
Construction-in-process	4,690	-0-
	<u>5,013,363</u>	<u>5,477,053</u>
Other Assets	<u>334,369</u>	<u>299,719</u>
Total Assets	<u>\$72,479,979</u>	<u>\$69,868,896</u>

The notes on pages 5 to 9 are an integral part of the financial statements.

<u>Liabilities and Capital</u>	<u>1975</u>	<u>1974</u>
Current Liabilities:		
Accounts payable	\$ 2,038,288	\$ 3,125,118
Accrued payroll	2,540,556	2,269,218
Other accrued liabilities	883,041	417,442
Contingent liability for price adjustments (Note 3)	<u>421,888</u>	<u>560,752</u>
Total Current Liabilities	<u>5,883,779</u>	<u>6,372,530</u>
Capital:		
Initial investment of U.S. Government	4,176,040	4,176,040
Capital contributions received from other Government agencies, net	3,831,818	3,380,899
Retained earnings	<u>58,588,342</u>	<u>55,939,427</u>
Total Capital	<u>66,596,200</u>	<u>63,496,366</u>
Total Liabilities and Capital	<u>\$72,479,979</u>	<u>\$69,868,896</u>

APPENDIX I

FEDERAL PRISON INDUSTRIES, INC.
 STATEMENT OF INCOME AND RETAINED EARNINGS
 For Fiscal Years Ended June 30, 1975 and 1974 (Note 1)

	<u>1975</u>	<u>1974</u>
Sales to Government agencies	\$68,683,574	\$62,922,722
Cost of goods and services sold (Note 4)	<u>57,300,194</u>	<u>49,653,086</u>
Gross Profit	<u>11,383,380</u>	<u>13,269,636</u>
Selling Expenses:		
Freight	489,848	516,827
Samples	<u>36,482</u>	<u>16,616</u>
	<u>526,330</u>	<u>533,443</u>
Administrative Expenses (Note 5)		
Salaries	1,080,153	909,114
Workmen's compensation (Note 6)	310,399	150,477
Travel	96,077	60,582
Rent for Washington office	54,416	33,801
Telephone	32,993	75,808
Printing and reproduction	46,337	30,516
Auditing (Note 7)	175,000	150,000
Miscellaneous	<u>280,522</u>	<u>169,203</u>
	<u>2,075,897</u>	<u>1,579,501</u>
Depreciation	<u>3,969</u>	<u>3,541</u>
Total Operating Expenses	<u>2,606,196</u>	<u>2,116,485</u>
Income from Operations	8,777,184	11,153,151

Other income	50,299	52,008
Loss on disposition of assets	<u>(114,850)</u>	<u>(189,145)</u>
Income before non- operating expenses (Note 8)	<u>8,712,633</u>	<u>11,016,014</u>
Christmas packages to inmates	42,444	-0-
Meritorious compensation to inmates	1,085,995	987,272
Accident compensation	101,751	100,939
Vocational expenses (Note 9)	<u>4,833,528</u>	<u>4,734,318</u>
Total Non-operating Expenses	<u>6,063,718</u>	<u>5,822,529</u>
Net Income	2,648,915	5,193,485
Retained earnings at beginning of year	<u>55,939,427</u>	<u>50,745,942</u>
Retained earnings at end of year	<u>\$58,588,342</u>	<u>\$55,939,427</u>

The notes on pages 5 to 9 are an integral part of the financial statements.

FEDERAL PRISON INDUSTRIES, INC.
STATEMENT OF CHANGES IN FINANCIAL POSITION
For Fiscal Years Ending June 30, 1975 and 1974 (Note 1)

	<u>1975</u>	<u>1974</u>
Funds Provided By:		
Sales of products and services	\$68,683,574	\$62,922,722
Other income	50,299	208,126
Capital contribution	418,200	217,122
	<u>69,152,073</u>	<u>63,347,970</u>
Funds Used For:		
Cost of goods and services sold, net of depreciation	55,516,807	47,925,513
Selling expenses	526,330	533,443
Administrative expenses	2,075,897	1,579,501
Prior period operating expenses	-0-	57,768
Loss on sale of fixed assets	114,850	189,145
Acquisition of fixed assets	1,561,588	1,200,199
Vocational training expenses Net of depreciation (Note 9)	4,414,986	4,196,895
Christmas packages to inmates	42,444	-0-
Meritorious compensation to inmates	1,085,995	987,272
Accident compensation	101,751	100,939
	<u>65,440,648</u>	<u>56,770,675</u>
Increase in Working Capital	\$ <u>3,711,425</u>	\$ <u>6,577,295</u>
Analysis of Changes in Working Capital:		
Increase (Decrease) in Current Assets:		
Funds with U.S. Treasury	\$(1,051,752)	\$1,196,503
Accounts receivable	(1,772,866)	416,907
Inventories		
Finished goods	650,450	464,233
Work-in-process	1,190,404	901,932
Materials and supplies	4,171,788	4,101,670
Other	34,650	133,905
(Increase) Decrease in Current Liabilities:		
Accounts payable	1,086,830	(418,335)
Accrued payroll	(271,338)	(30,695)
Other liabilities	(465,605)	371,927
Estimated liability for price adjustments	138,864	(560,752)
	<u>138,864</u>	<u>(560,752)</u>
Increase in Working Capital	\$ <u>3,711,425</u>	\$ <u>6,577,295</u>

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

- . The financial statements of Federal Prison Industries, Inc., include the accounts of the central office and the industrial facilities at 23 prisons. Appropriate eliminations are made for interindustry transactions and profits therefrom.

- . The straight line method of depreciation is used 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.

- . Raw materials inventory is recorded at actual cost or appraised value for donated material.

- . Work-in-process inventory is recorded at actual cost determined by one of the following methods: process costing, job costing, or standard costing, depending upon the type of industry.

- . Finish goods inventory is stated at the lower of cost or 95 percent of selling price.

- . All fixed assets costing \$200 or more are capitalized, otherwise they are expensed in the current period.

2. ACCOUNTS RECEIVABLE

Accounts receivable consists primarily of amounts due from Government agencies (e.g., Post Office, General Services Administration and Department of Defense). Accounts receivable are aged as either over or under 60 days old. Approximately \$674,000 of accounts receivable were past due 60 days or more at June 30, 1975.

3. LIABILITY FOR PRICE ADJUSTMENTS

Sales figures are net of anticipated adjustments to customers. A liability has been established in the amount of \$421,888 to provide for anticipated refunds for price reductions on items sold during the year.

4. COST OF GOODS AND SERVICES SOLD

Cost of goods and services sold for fiscal years 1975 and 1974 were as follows:

	<u>1975</u>	<u>1974</u>
Material	\$37,691,317	\$31,777,029
Labor	3,385,885	3,227,894
Overhead	<u>18,063,846</u>	<u>16,014,328</u>
	59,141,048	51,019,251
Add Work in process, beginning	5,052,098	4,150,166
Less Work-in process, ending	<u>(6,242,502)</u>	<u>(5,052,098)</u>
Cost of goods and services manufactured	57,950,644	50,117,319
Add Finished goods, beginning	5,148,475	4,684,242
Less Finished goods, ending	<u>(5,798,925)</u>	<u>(5,148,475)</u>
Cost of goods and services sold	<u>\$57,300,194</u>	<u>\$49,653,086</u>

5. ADMINISTRATIVE EXPENSES

Certain administrative expenses are subject to congressional limitation.

	<u>Fiscal year</u>	
	<u>1975</u>	<u>1974</u>
Amounts subject to congressional limitation:		
Salaries	\$1,080,153	\$909,114
Travel	96,077	60,582
Rent for Washington office	54,416	33,801
Telephone	32,993	75,808
Printing and reproduction	46,337	30,516
Auditing	175,000	150,000
Miscellaneous	73,885	52,519
Expenses subject to limitation	<u>\$1,558,861</u>	<u>\$1,312,340</u>
Congressional limitation:		
1975 -	\$1,804,000	
1974 -	\$1,631,000	

Beginning with fiscal year 1976 all costs related to each product line division, regardless of geographic location, will be charged to that division and, accordingly, will not be subject to congressional limitation. The administrative expense accounts subject to congressional limitation will receive all charges related to the general management of the corporation as a whole.

6. WORKMENS COMPENSATION

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 the fiscal year. Beginning with fiscal year 1975, the Corporation established an accrual to cover the anticipated expense for workmen's compensation for the current year. However, the expense shown for fiscal year 1975 represents the actual cost billed by Labor to the Corporation for fiscal year 1974 of \$154,399, plus an accrual for fiscal year 1975 of \$156,000. An adjustment of \$48,101 to reflect the actual expense billed to the Corporation for fiscal year 1975 will be reflected in the fiscal year 1976 accrual. The amount shown for fiscal year 1974 represents actual expenses of \$79,534 and \$70,943 incurred during fiscal years 1973 and 1972, respectively.

7. AUDITING

The amounts reported represent the charges for the internal audit function performed by the Office of Internal Audit, Department of Justice and the audit of the Corporation's financial statements by the General Accounting Office. Both audit functions are performed annually.

Costs incurred were as follows:

	<u>Fiscal year</u>	
	<u>1975</u>	<u>1974</u>
Department of Justice audit	\$150,000	\$125,000
General Accounting Office audit	<u>25,000</u>	<u>25,000</u>
	<u>\$175,000</u>	<u>\$150,000</u>

8. NON-OPERATING EXPENSES

These expenses are not directly related to the operations of FPI but apply to all inmates of Federal prisons. The amounts are determined by the Board of Directors, except for accident compensation which is based on actual experience.

9. VOCATIONAL EXPENSES

	<u>1975</u>	<u>1974</u>
Personnel compensation	\$3,087,056	\$3,036,413
Personnel benefits	281,322	310,834
Travel and transportation of persons	26,519	102,828
Transportation of things	6,687	21,137
Rent, communications, utilities	229,091	228,418
Printing and reproduction	15,323	31,448
Other services	429,910	243,185
Supplies and materials	339,078	222,632
Subject to congressional limitation	<u>a/ 4,414,986</u>	<u>a/ 4,196,895</u>
Add depreciation:		
Machinery and equipment	227,057	335,947
Building and improvements	<u>191,485</u>	<u>201,476</u>
Total	<u>\$4,833,528</u>	<u>\$4,734,318</u>

a/ Subject to congressional limitation of \$5,051,000 for FY 1975 and \$5,850,000 for FY 1974.