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UNITED STATES GENERAL ACCOUNTING OFFICE  
REGIONAL OFFICE  
2006 WASHINGTON BOULEVARD BUILDING  
234 STATE STREET  
DETROIT, MICHIGAN 48226

JAN 2 1969

Mr. B. J. Clendening  
Superintendent of Industries  
Federal Prison Industries, Inc. (2)  
Milan, Michigan 48160

Dear Mr. Clendening:

We have examined the balance sheet of the Federal Prison Industries, Inc. (FPI), Milan, Michigan, as of June 30, 1968, and the related statements of operations and manufacturing expenses. The examination was made pursuant to the Government Corporation Control Act (31 U.S.C. 841).

*Investigation  
pending*

Our examination, completed in October 1968, was made in accordance with generally accepted auditing standards and included such tests of the accounting records and financial transactions as we considered necessary under the circumstances. Although we did not observe the taking of cyclical physical inventories, we made physical tests and reviewed accounting evidence to assure the reasonableness of the inventory balances. We considered the audit work completed in February 1968 by the FPI examiners, which also included test verifications of inventory balances.

Our examination disclosed no matters of sufficient significance to materially affect the reliability of the financial statements. However, certain matters requiring your attention were discussed with you and your staff during our examination. These matters are set forth below for your further consideration and comment.

Transactions Affecting  
Capital Asset Accounts

1. By September 30, 1967, FPI had expended \$267,400 of the \$267,500 total cost authorized as of that time for the vocational training building, and on October 1, 1967, the building was placed in use. The agreement between the Federal Correctional Institution and FPI provided for the Institution to absorb 42 percent of the utility charges for the building beginning October 1, 1967. However, as of June 30, 1968, the total cost of construction of \$288,045, consisting of the \$267,400 that had been incurred at the time the building

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was placed in use plus \$20,645 incurred for additional items approved thereafter, was still recorded in construction account 35.2 and depreciation schedules had not been established.

In accordance with the FPI manual which requires that construction costs be capitalized and that depreciation be charged beginning with the month following the month in which the building was placed in use, we recommend that FPI:

(a) transfer construction costs of the vocational training building from construction account 35.2 to building account 30, retroactive to November 1, 1967, and

(b) establish the required depreciation schedules and charge the related expense account for depreciation on the vocational training building retroactive to November 1, 1967.

Because 42 percent of the floor space in the building is occupied by the Institution's maintenance shops, we believe that the Institution should bear its share of the building use cost as it does for utilities. Therefore, we recommend that FPI attempt to revise its agreement with the Institution to enable it to bill the Institution for its proportionate share of the monthly depreciation charge retroactive to November 1, 1967. It was agreed that an attempt would be made to obtain the required approval for this action.

2. In accounting for a \$10,600 payment made on May 10, 1968, for its share of the cost of constructing a new incinerator, FPI charged the amount to other expense account 63.3. However, because the incinerator was to be jointly owned by FPI and the Institution and since its construction was not started until after July 1, 1968, the \$10,600 represented an advance payment that should have been accounted for as an asset. FPI's accounting treatment of the payment, therefore, resulted in a \$10,600 overstatement of expenses and a \$10,600 understatement of assets in fiscal year 1968. We recommend that FPI capitalize its share of the incinerator cost, credit the applicable expense account, and charge related depreciation when appropriate. It was agreed the recommended action would be taken and that depreciation charges would be made beginning with the month following the month in which the incinerator is placed in use.

3. The cost of constructing the inflammable storage building in 1964 was \$30,496. Of this amount, FPI has capitalized only \$24,849. The difference of \$5,647 represents construction costs expended by the Institution for civilian supervisory personnel and the use of its equipment.

Because \$5,647 incurred by the Institution represents construction costs of the FPI building, we recommend that FPI reimburse the Institution for its costs, and adjust its capital asset accounts and depreciation schedules and charges. In reimbursing the Institution, consideration should be given by FPI to the cost for space used by the Institution while occupying a portion of the inflammable storage building.

Transactions and Procedures  
Affecting Inventories

Our examination of inventory records indicated a need for closer supervision, in some instances, over the recording of transactions and for greater emphasis on compliance with FPI manual requirements. For example:

1. Special tooling costs of \$4,157 related to the unfinished or unstarted portion of an order for beds were charged to finished goods inventory as of June 30, 1968, rather than to work-in-process, as required by the FPI manual.
2. About 6,500 springs donated by a vendor were not recorded on the inventory records, as required by the FPI manual, because FPI officials believed the donated springs had no value.
3. Steel tubing valued at \$966 was not posted to stock record cards.
4. The procedure used for reporting obsolete, excess, and slow-moving items identifies only slow-moving items. We found that most of the transfer case material purchased in 1960 and identified as excess in our fiscal year 1964 audit is still on hand and was not reported on Form 63B (Report of Obsolete, Excess, and Slow-Moving Items) during 1968. Also, recommendations for retention of items reported on Form 63B were not justified in writing as required by the FPI manual.

We recommend that greater emphasis be given to supervision and control over these types of transactions and reports. We also recommend that FPI officials review the quantity of an item on hand even though there have been some issues of the item during the year to assure that excess quantities are not being retained.

Other Matters

Our review also disclosed other instances indicating that closer supervision over the recording of transactions may be required and that certain controls deserve greater emphasis. For example:

1. Welding supplies and utilities expenses of about \$1,421 incurred in fiscal year 1968 were recorded as fiscal year 1969 expenses.

2. Welding wire received on receiving report number 488 was erroneously recorded as 1,645 pounds, the quantity of wire ordered, instead of 1,065 pounds, the amount actually received.

3. Several "Requests for Purchase" (FPI Form 89) had been altered to show item description changes and additional items ordered without the indicated acknowledgement of the approving official.

4. Review of accounts receivable schedules disclosed instances of accounts past-due over 60 days without a written request for payment being made as required by the FPI manual.

5. Overtime is paid to inmates for hours worked in excess of a normal weekly work period. However, normal work periods are sometimes changed for various reasons, such as recalls resulting from staff meetings, and no written notices of the changes are prepared. As a result, the propriety of overtime hours reported by foremen on inmates' weekly time forms cannot be subsequently verified.

It was agreed that corrective action would be taken for these matters including the issuance of instructions in writing establishing the inmates' work-week.

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We wish to acknowledge the courtesy and cooperation extended to our staff during the examination, and would appreciate your comments as to the final actions taken on the matters discussed herein.

Copies of this letter are being sent to the Commissioner of Industries, Federal Prison Industries, Inc.; the Assistant Attorney General for Administration, Department of Justice, and the Warden, Federal Correctional Institution, Milan, Michigan.

Sincerely yours,

*C. H. Moore*  
C. H. Moore  
Regional Manager