



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

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GENERAL GOVERNMENT  
DIVISION

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Dear Mr. Carlson:

Our examination of the financial statements of Federal Prison Industries, Inc. (FPI), for fiscal year 1971 was completed upon the issuance of our report dated December 14, 1971, to the Congress on the financial condition of FPI. Our opinion of FPI's financial condition was based on examinations at the central office in Washington, D.C., and at seven institutions located at Allenwood, Pennsylvania; El Reno, Oklahoma; Lewisburg, Pennsylvania; Petersburg, Virginia; Sandstone, Minnesota; Terre Haute, Indiana; and Texarkana, Texas.

During our examinations we observed certain practices which required the attention of local officials. These practices were brought to their attention, and copies of our letter reports to these institutions were made available to you. The Assistant Commissioner, Financial Management Division, has informed us that the local officials have taken or have promised to take the necessary actions. In addition, we discussed the need for the revision of certain central office accounting policies and practices with your staff. Our comments on these matters follow.

IMPROVEMENTS NEEDED IN ACCOUNTING FOR  
AND INTERNAL CONTROL OVER INVENTORIES

Our examinations at the above institutions showed deficiencies in the accounting for and internal control over inventories at several of the institutions. Similar deficiencies have been reported in previous years by our Office and by internal auditors of the Department of Justice. Because inventories constitute one of the largest assets of FPI, a continuous knowledge of the kinds and quantities of goods on hand is essential for management to make efficient use of FPI's invested capital.

We believe that the actions proposed by members of your staff to alleviate the major inventory problems identified during our examinations are adequate. We believe, however, that all deficiencies in the present inventory system should be identified and that the monitoring of the institutions'

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inventory procedures by the Washington staff should be increased to ensure continued improvements in this area.

QUESTIONABLE CHARGES TO CENTRAL OFFICE  
BUILDINGS AND IMPROVEMENTS ACCOUNT

The FPI central office maintains a buildings and improvements account which had a balance of about \$15,100 at June 30, 1971. A corresponding reserve account is maintained to depreciate this balance annually. Our analysis of the buildings and improvements account showed that the entire balance consisted of expenditures made for repainting and altering offices and for relocating corporation personnel within the space rented from the General Services Administration and used solely by the central office.

We believe that the capitalization of these expenditures is inappropriate; they should, instead, be charged to the appropriate expense accounts. FPI officials agreed with us and stated that the necessary adjustments would be made.

ACCOUNTING FOR REIMBURSABLE POSITIONS

During fiscal year 1971 and in previous fiscal years, it was the practice of FPI to reimburse the Bureau of Prisons for the salaries of certain employees who had provided various services for FPI at some institutions. These salaries were reimbursed from central office funds and were recorded as an expense of the central office.

In our opinion, the reimbursable positions were of direct benefit to the institutions that received the services and should have been included as part of their normal operating overhead and should have been paid from funds of the institutions.

We discussed this matter with Washington officials of FPI, and they agreed with us. The officials indicated that they would revise the accounting for the reimbursable positions to reflect this expense as an operating expense of the institutions which received the services.

FAILURE TO USE PRESCRIBED DEPRECIATION PERIODS

Guidelines used at all institutions for determining the useful lives of office furniture, fixtures, machinery, and equipment prescribe a depreciable life of 10 years. During

fiscal year 1971 items of this nature at the central office were, in most cases, depreciated over a useful life of 4 years.

An official of the FPI central office informed us that this occurrence had been caused by oversights. He stated that any deviation from the guidelines would have to be documented and approved by the central office. He advised us that care would be taken to prevent a recurrence.

INCONSISTENT ACCOUNTING FOR  
CHANGES MADE TO ASSETS

In previous years we cited examples of what we considered an improper accounting practice for alterations, replacements, or other improvements to existing assets which significantly prolonged their useful lives. We recommended that such costs be capitalized and depreciated over the remaining lives of the assets. At the time of our review, no corrective action had been taken by FPI to revise its manual accordingly.

FPI officials informed us that the manual, including this accounting principle, was being revised and that it was expected to be completed within a year.

EXCLUSION OF DIRECT LABOR AND OVERHEAD COSTS  
FROM WORK-IN-PROCESS INVENTORIES

In previous years our examination of the inventory certificates submitted by each industry showed that direct labor and overhead costs had not been allocated to the work-in-process inventory by all industries.

Our latest examinations showed that only the cable and tire factories at Petersburg and the tire factory at Texarkana had not properly allocated direct labor and overhead costs to their work-in-process inventories at the end of the fiscal year, contrary to regulations. These two institutions also were cited in our fiscal year 1970 report for the same deficiency.

In discussing this matter with FPI officials, we were assured that follow-up action would be taken to ascertain the reasons for the exclusion of these costs.

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We shall appreciate being advised of any further action taken or proposed in connection with the foregoing matters. Also we shall be glad to discuss these matters with you and officials of FPI at your convenience. The courtesy and co-operation given to our representatives during our examination are appreciated.

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Assistant Attorney General for Administration.

Sincerely yours,

*Victor L. Lowe*

Director, General  
Government Division

Mr. Norman A. Carlson  
Commissioner of Industries  
Federal Prison Industries, Inc.  
Department of Justice

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