

UNITED STATES GENERAL ACCOUNTING OFFICE REGIONAL OFFICE

CA000370

3086 FEDERAL OFFICE BUILDING, 909 FIRST AVENUE SEATTLE, WASHINGTON 98104

IN REPLY REFER TO:

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DEC 28 1970

Mr. Paul Ward Superintendent Federal Prison Industries, Inc. Department of Justice McNeil Island, Washington

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Dear Mr. Ward:

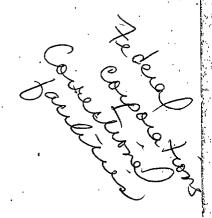
We have completed our examination of the financial statements of the Federal Prison Industries, Inc. (FPI), McNeil Island, Washington, for fiscal year 1970. The results of our review were discussed with you and your staff. Those items for which your central office has control will be considered for inclusion in a report to that office.

There are certain areas, however, in which you may wish to make improvements at the local level. These matters, which we have discussed with members of your staff, are (1) overstatement of accounts receivable, (2) control over requisitioning of materials and supplies, (3) control over raw materials inventory, (4) obsolete and slow-moving items in the raw materials and supplies inventory, (5) fixed assets understated, (6) overstatement of unliquidated obligations, (7) cost of sales understated, and (8) premature purchase of equipment. A brief discussion of each of these areas follows.

Overstatement of accounts receivable

The accounts receivable listed as due from Triangle Electronics Manufacturing Company, \$11,940.50, is contingent on the outcome of the

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Department of Justice's legal case. The amount was not derived from sales but from defaulted contracts. Deleting the amount from your accounts receivable and footnoting it on your financial statements would more clearly disclose the amounts receivable.

Control over requisitioning of materials and supplies

We noted that memorandum requisitions, rather than formal, signed requisitions, were used to record issue and return of materials and supplies in the Electronics Shop. As a result, there was a lack of accountability, and stock records did not show the correct quantities on hand. In one instance, electrical cable valued at \$4,787 was informally returned to stock but not picked up on office stock cards. In order to improve internal control and reflect correct inventory values on financial statements, you may wish to discontinue the use of memorandum requisitions and provide for receipt and return of materials issued to work-in-process to be acknowledged at the time of delivery.

Control over raw materials inventory

The audit sample and inventory of raw materials and supplies revealed many overages and shortages. The Electronics Shop had 349 line items in error out of 1,398, a 25 percent error rate, and the Furniture Shop had 73 line items in error out of 353, a 21 percent error rate. Journal entries to correct the accounts were made putting \$6,582.24 of raw material costs into the Defective Materials account and \$2,739.89 into Cost of Goods Sold. Since the work-in-process materials are stored in the same area as the raw materials, you may wish to improve the accuracy of financial statements and control of raw materials by segregating the raw material stores and work-in-process inventories. In addition, annual raw material inventories taken in the last 6 months of the fiscal year should improve the accuracy of the inventory account.

Obsolete and slow-moving items in the raw materials and supplies inventory

Our review of the obsolete and slow-moving items showed an increase from January 1970 to August 1970 of approximately \$19,000. The

inventory taken by FPI on August 29-30, 1970, reflected slow-moving, obsolete items valued at \$59,821.71. During the last year only \$2,433.82 of raw materials had been surveyed out. The FPI 1969 Internal Audit recommended that slow-moving items be reviewed and as many items as possible be surveyed and removed. Disposing of obsolete and slow-moving raw materials could gain needed warehouse space.

Fixed assets understated

We noted that the Electronics Shop had two uncapitalized music systems. The cost estimate for the two systems was \$1,834.82 of which \$154.73 was capitalized. Capitalizing the remaining \$1,680.09 would more accurately reflect the value of fixed assets.

Overstatement of unliquidated obligations

Our examination of Accounts Payable showed about \$3,000 of General Services Administration material had been received but not deleted from the total unliquidated obligations amount. The amount of unliquidated obligations is provided for compliance with Public Law 663 and does not affect the operating or balance sheet accounts. You may wish to consider maintaining adequate supporting detail to correctly report unliquidated obligations.

Cost of sales understated

Cost of sales was understated \$5,437.13 and profit was overstated a like amount at June 30, 1970, because not all the material credits or charges to expense for three shipments made on June 18, 1970, had been posted to the fiscal year 1970 accounts. Special procedures at year end may be needed to assure that all significant transactions affecting cost of sales have been posted to the correct fiscal year.

Premature purchase of equipment

The Sign Shop received a process camera costing \$5,407.62 on June 16, 1970. We noted in September that the camera was still in a packing crate awaiting expansion of the sign shop. We also noted that the 90-day portion of the camera's warranty had expired on September 16, 1970, and that the remaining portion would expire on June 16, 1971. A checklist

requiring an evaluation whether the equipment proposed for purchase can be promptly placed in reasonably continuous use upon receipt could help assure that equipment is not purchased prematurely in the future, and prevent unproductive investment of capital and loss of warranties.

We would like to acknowledge the courtesy and cooperation given our representatives during this review. We are available for further discussions and assistance if you so desire.

A copy of this report is being sent to the Commissioner of Industries, Federal Prison Industries, Inc., Department of Justice, Washington, D.C.; the Assistant Attorney General for Administration, Department of Justice, Washington, D.C.; and the Warden, U.S. Penitentiary, McNeil Island, Washington.

Sincerely yours,

William N. Conrardy Regional Manager