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UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
ROOM 201, 415 FIRST AVENUE NORTH
SEATTLE, WASHINGTON 98109

NOV 4 1974

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Mr. Paul Ward, Superintendent
Federal Prison Industries, Inc.
Department of Justice
P. O. Box 500
Steilacoom, Washington 98388

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 1974. The primary purpose of our audit this year was to review the work performed by the Department of Justice's Office of Internal Audit in March and April of this year, and to determine the adequacy of the industry's cash and inventory management.

Overall, we concluded that cash and inventory management was satisfactory. As discussed with you on October 11, 1974, we did note the following minor matters which can be corrected locally: (1) understatement of accounts payable; (2) high number of slow and non-moving items in inventory; (3) maximum inventory levels for common use items not established; (4) lack of internal inventory control; and (5) possible underpayment to inmates working in Industries.

At the time of our discussion, you had not decided what specific actions would be taken on these matters. A brief discussion of each of the areas follows.

Understatement of accounts payable

At the end of fiscal year 1974, accounts payable were understated by $20,000, or 7 percent, due to the accounting treatment of materials paid for but physically returned to the vendor for repair or replacement. The returned materials were recorded as a reduction of both assets and liabilities by crediting one of the asset accounts for inventory and by debiting the accounts payable subaccount, Vouchers in Transit.

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Since the material had been received and paid for, we believe that the subsequent return should have been recorded in a special subaccount as reclassified assets rather than as a reduction of liabilities. If title to the specific goods reverted to the vendor, the materials should have been recorded in an accounts receivable subaccount for returned merchandise. If title remained with the Government, the materials should have been recorded in an "items returned for repair" inventory subaccount.

High number of slow moving items in inventory

FPI's fiscal year 1974 physical inventory disclosed that obsolete, excess, and slow moving items (hereafter called slow moving items) accounted for 31 percent of the items in the furniture factory inventory and 45 percent of the items in the electronics factory inventory. These items represented 11 percent and 16 percent of the total dollar value of the respective factories' inventories.

We noted this same condition during our fiscal year 1970 audit and recommended that slow moving items be disposed of. In response to our report, FPI stated in February 1971 that any item appearing on two successive yearly reports of slow moving items would require extensive justification to be retained.

Our analysis of the 1974 report of slow moving items to be retained disclosed that 41 percent of the electronics factory items and 39 percent of the furniture factory items have had no issue for the past 2 years. These items, instead of being extensively justified, were marked only with the general comment "needed for future use" (except for three items that were identified as needed for specific orders).

A further analysis of slow moving items reported in 1974 disclosed that out of the 924 slow moving items to be retained, 18 percent had no usage since 1970. Those items represent 16 percent of the slow moving inventory dollar value.

In our opinion, maintaining such quantities of slow moving items unnecessarily increases inventory handling costs. Also, to the extent that the items having no recent usage cannot be converted to cash or other usable assets, we believe their retention overstates the value of current assets on the balance sheet. We recommend that slow moving items again be reviewed and all items having no usage in the last 3 years be disposed of, unless they are required for a specific firm order.

Maximum inventory levels not established

Minimum reorder levels for common use items and factory supplies maintained in inventory have been established on the stock record cards at FPI McNeil. However, no maximum inventory levels have been established for these same items as required by the FPI Policy and Procedures Manual.

A discussion of this matter with the storekeeper disclosed that he was unaware of the FPI requirement that maximum levels be noted on the stock record card. He stated that he would establish a maximum inventory level for those items currently having minimum levels.

Lack of internal inventory control

The fiscal year 1974 physical FPI inventory at McNeil was taken by the storekeeper who was also accountable for the items in the inventory that he was verifying. FPI accounting personnel made independent test counts of 4 percent of the items shown as correct by the physical inventory and noted no discrepancies.

We believe that allowing the storekeeper to take the physical inventory was a weakness in internal controls and that test counts should be a supplement to, rather than an alternative for, the basic internal control of having inventories counted by individuals independent of both custodianship and recordkeeping. Accordingly, we recommend that future inventories be taken by personnel not accountable for the items in the inventory.

Possible underpayments to inmates working in Industries

Inmates at McNeil who normally receive longevity pay while working in the furniture or electronic factories are not paid longevity when they are receiving vacation pay, administrative leave pay, or field accident compensation. The FPI Policy and Procedures Manual indicates, however, that in these cases, the pay shall include longevity where applicable.

A discussion of this matter with the Business Manager disclosed that longevity was not paid in these cases, even though the inmates were eligible, because the same regulations also state in another section that longevity is to be paid for "each actual hour worked." The Business Manager concluded that longevity was not applicable because of his view that the inmate was not actually working when on vacation, administrative leave, or field accident compensation.

We believe that McNeil should request headquarters clarification of the situations in which an inmate is entitled to receive longevity pay. If the inmates were entitled to longevity pay while on vacation, administrative leave, or field accident compensation, we believe that FPI should make reasonable effort to identify and pay the inmates who have been underpaid in the past fiscal years.

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A copy of this report is being sent to the Commissioner, 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,

JOSEPH W. KEGEL

for Philip A. Bernstein
Regional Manager

cc: Commissioner, FPI
Assistant Attorney General for Administration, DOJ
Warden, McNeil Island

bc: Director, Office of Policy
Regional Manager, Washington Regional Office
Chief, Distribution Section, OAPS - 3 copies