



FEDERAL PRISON INDUSTRIES, INC. ANNUAL FINANCIAL STATEMENTS FISCAL YEAR 2011

U.S. Department of Justice
Office of the Inspector General
Audit Division

Audit Report 12-06
December 2011

FEDERAL PRISON INDUSTRIES, INC. ANNUAL FINANCIAL STATEMENTS FISCAL YEAR 2011

OFFICE OF THE INSPECTOR GENERAL COMMENTARY AND SUMMARY

This audit report contains the Annual Financial Statements of the Federal Prison Industries, Inc. (FPI) for the fiscal years (FY) ended September 30, 2011, and September 30, 2010. In accordance with the Government Corporation Control Act, as amended (31 U.S.C. §9105), and under the direction of the Office of the Inspector General (OIG), Cotton & Company LLP performed the audit in accordance with U.S. generally accepted government auditing standards. The audit resulted in an unqualified opinion on the FY 2011 financial statements. An unqualified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in conformity with U.S. generally accepted accounting principles. For FY 2010, the FPI also received an unqualified opinion on its financial statements (OIG Report No. 11-06).

Cotton & Company LLP also issued reports on internal control over financial reporting and on compliance and other matters. The auditors did not identify any significant deficiencies in the FY 2011 *Independent Auditors' Report on Internal Control over Financial Reporting*. In the FY 2011 *Independent Auditors' Report on Compliance and Other Matters*, the auditors identified no instances of non-compliance with applicable laws and regulations and the *Federal Financial Management Improvement Act of 1996*.

The OIG reviewed Cotton & Company LLP's reports and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the FPI's financial statements, conclusions about the effectiveness of internal control, conclusions on whether the FPI's financial management systems substantially complied with the *Federal Financial Management Improvement Act of 1996*, or conclusions on compliance with laws and regulations. Cotton & Company LLP is responsible for the attached auditors' reports dated November 1, 2011, and the conclusions expressed in the reports. However, our review disclosed no instances where Cotton & Company LLP did not comply, in all material respects, with U.S. generally accepted government auditing standards.

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**FEDERAL PRISON INDUSTRIES, INC.
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 2011**

TABLE OF CONTENTS

	<u>PAGE</u>
MESSAGE FROM THE ACTING CHIEF EXECUTIVE OFFICER AND THE CHIEF OPERATING OFFICER.....	1
MANAGEMENT'S DISCUSSION AND ANALYSIS.....	5
INDEPENDENT AUDITORS' REPORTS	
REPORT ON FINANCIAL STATEMENTS.....	15
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING.....	17
REPORT ON COMPLIANCE AND OTHER MATTERS	19
PRINCIPAL FINANCIAL STATEMENTS AND RELATED NOTES	
BALANCE SHEETS	23
STATEMENTS OF OPERATIONS AND CUMULATIVE RESULTS OF OPERATIONS	24
STATEMENTS OF CASH FLOWS	25
NOTES TO FINANCIAL STATEMENTS.....	26

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November 9, 2011

We are pleased to present the Fiscal Year 2011 Annual Management Report to the Congress of the United States. This report includes FPI's commercial financial statements, Management's Discussion and Analysis, Office of the Inspector General Commentary and Summary, and the independent auditor's report on the Corporation's financial statement, internal controls, compliance and other matters. FPI received an unqualified audit opinion on its financial statements and it was free of significant deficiencies or material weaknesses.

The FPI program is one of the Bureau of Prisons' (BOP) most important correctional management and reentry programs. It was established by statute and Executive Order in 1934, to provide opportunities for education and work-related experiences to federal offenders. FPI's mission is to employ and train as many Federal inmates as possible, while maintaining its self-sufficiency without appropriated funds, and minimizing its impact on private sector business. The program reduces recidivism, increases the likelihood that participants will be gainfully employed upon release, and is a significant contributor to the safe and effective management of BOP facilities.

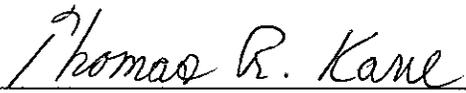
As a federal government corporation, FPI must function as a program and a business and faces a dynamic set of external as well as internal constraints. In recent years, the nation's economic trend has had a trickle down effect on FPI. Increased competition for government business, reduced discretionary spending of its government customers and adverse legislation affecting FPI's mandatory source have impacted FPI's ability to operate at the same level it has in prior years. During fiscal year 2009, FPI recognized this downward trend and began taking the necessary steps to ensure that it remains viable during these challenging economic times.

FPI is committed to maintaining a lean organization to ensure it continues to function as an effective program and meet its core mission. Toward this end, in an effort to conserve resources, FPI has taken steps over the last three years to ensure that its factory capacity is commensurate with its customers' current demand. Additionally, FPI has made progress toward reducing factory overhead and general administrative expenses. While FPI incurred an operating loss for fiscal year 2011, the loss represented only two tenths of one percent of its sales for the year.

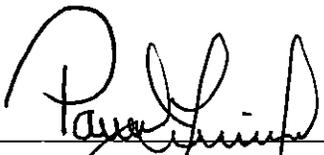
Maintaining cash is also an important component of FPI's plan to respond to the future demands of its customers. FPI continues to focus on reducing its inventories, delaying purchases,

minimizing capital expenditures and ensuring that accounts receivable are collected promptly. During fiscal year 2011 FPI was successful in increasing its cash balance by \$28.7 million.

FPI remains grateful for the outstanding contributions and dedication of its staff as well as the exceptional leadership provided by FPI's Board of Directors during these difficult financial times.



Thomas R. Kane, Acting Chief Executive Officer



Paul M. Laird, Chief Operating Officer

U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

MANAGEMENT'S
DISCUSSION & ANALYSIS
(UNAUDITED)



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**U.S. Department of Justice
Federal Prison Industries, Inc.
Management's Discussion and Analysis
(Unaudited)**

Mission

It is the mission of Federal Prison Industries, Inc. (FPI) to employ and provide job skills training to the greatest practicable number of inmates confined within the Federal Bureau of Prisons; contribute to the safety and security of our Nation's federal correctional facilities by keeping inmates constructively occupied; provide market-quality products and services; operate in a self-sustaining manner; and minimize FPI's impact on private business and labor.

Organizational Structure of Federal Prison Industries, Inc.

FPI is a wholly-owned government corporation created by Congress in 1934. FPI is authorized to operate industries in federal penal and correctional institutions and disciplinary barracks (18 U.S.C. § 4121 to § 4129). The Director of the Federal Bureau of Prisons (BOP), who has jurisdiction over all federal correctional institutions, is the Chief Executive Officer. General management of FPI is provided by the Chief Operating Officer who also serves as an Assistant Director for the BOP.

In fiscal year 2011, FPI operated in seven business segments: Clothing and Textiles, Electronics, Fleet Management and Vehicular Components, Industrial Products, Office Furniture, Recycling, and Services. FPI has industrial and service operations at 88 factories located at 66 prison facilities representing approximately 8% of the work eligible inmate population as of September 30, 2011. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

FPI processes primarily all customer orders and invoicing through a centralized customer service and accounts receivable center at Lexington, Kentucky. Vendor payments are processed at a centralized accounts payable center at the Butner, North Carolina facility. In addition, FPI performs product development, testing and costing at its facility in Englewood, Colorado.

Financial Structure

FPI operates as a revolving fund and does not receive an annual appropriation. The majority of revenues are derived from the sale of products and services to other federal departments, agencies, and bureaus. Operating expenses such as the cost of raw materials and supplies, inmate wages, staff salaries, and capital expenditures are applied against these revenues resulting in operating income or loss, which is reapplied toward operating costs for future production. In this regard, FPI makes

capital investments in buildings and improvements, machinery, and equipment as necessary in the conduct of its industrial operation.

FPI sells products and services to the majority of federal departments, agencies and bureaus. FPI's largest federal government customers include the Department of Defense (DOD), the Department of Homeland Security (DHS), the Department of Justice (DOJ), the General Services Administration (GSA), and the Social Security Administration (SSA).

Critical Accounting Policies

The following discussion and analysis of FPI's financial condition, results of operations, liquidity and capital resources are based upon FPI's financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. These generally accepted accounting principles require FPI management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. In this regard, FPI management evaluates the estimates on an on-going basis, including those related to product returns, bad debt, inventories, long-lived assets, and contingencies and litigation. FPI bases its estimates upon historical experience and various other assumptions that FPI believes are reasonable under the circumstances. The actual results may differ from these estimates when assumptions or conditions change.

FPI believes that some of its accounting policies involve complex or higher degrees of judgment than its other accounting policies. The following accounting policies have been identified by FPI management as being critical and therefore require more significant estimates or reliance on a higher degree of judgment on the part of FPI management.

Revenue recognition: Revenue is generally recognized when 1) delivery has occurred or services have been rendered, 2) persuasive evidence of an arrangement exists, 3) there is a fixed or determinable price, and 4) collectability is reasonably assured. Revenue from contracts that specify a customer acceptance criteria is not recognized until either customer acceptance is obtained or upon completion of the contract. Sales returns are primarily replaced with like items and are recorded as they occur.

Revenue is recognized on multiple element (numerous stages of product delivery, set up, and installation) agreements as a single unit of accounting for manufactured items when the product has been accepted by the customer. Revenue for services provided on behalf of FPI is recognized when the service provider presents a valid invoice including a customer acceptance or completion notice.

Allowance for doubtful accounts receivable: The allowance for doubtful accounts is based upon an analysis of several factors including payment trends, historical write off experience, credit quality for non-governmental accounts, and specific analysis of collectability of an account. During the course of time, these factors may change which will cause the allowance level to adjust accordingly. As part of their analysis, customer accounts determined to be unlikely to be paid are recorded as a charge to bad debt expense in the income statement and the allowance account is increased. When it

becomes certain that a customer account will not be paid, the receivable is written off by removing the balance from accounts receivable.

As of September 30, 2011 and September 30, 2010, FPI had established an allowance for bad debt in the amount of \$.66 million and \$.83 million on accounts receivable balances of \$47.34 million and \$34.83 million, respectively.

Inventory Valuation: FPI maintains its inventory primarily for the manufacture of goods for sale to its customers. FPI's inventory is composed of three categories: Raw Materials, Work-in-Process, and Finished Goods. These categories are generally defined by FPI as follows: Raw Materials consist of materials that have been acquired and are available for the production cycle, Work-in-Process is composed of materials that have moved into the production process and have some measurable amount of labor and overhead added by FPI, Finished Goods are materials with FPI added labor and overhead that have completed the production cycle and are awaiting sale to customers.

Raw material inventory value is based upon moving average cost. Inventories are valued at the lower of average cost or market value (LCM) and include materials, labor and manufacturing overhead. Market value is calculated on the basis of the contractual or anticipated selling price, less allowance for administrative expenses. FPI values its finished goods and sub-assembly items at a standard cost that is periodically adjusted to approximate actual cost. FPI has established inventory allowances to account for LCM adjustments and obsolete items that may not be utilized in future periods.

Program Values

It is the mission of Federal Prison Industries, Inc. (FPI) to employ and provide job skills training to the greatest practicable number of inmates confined within the Federal Bureau of Prisons; contribute to the safety and security of our Nation's federal correctional facilities by keeping inmates constructively occupied; provide market-quality products and services; operate in a self-sustaining manner; and minimize FPI's impact on private business and labor.

The goal of FPI is to reduce undesirable inmate idleness by providing a full-time work program for inmate populations (goal of approximately 25 percent of "work eligible" inmates). Many of the inmates do not have marketable employment skills. FPI provides a program of constructive industrial work and services wherein job skills can be developed and work habits acquired.

As with most governmental programs, the real value of the entity is not readily measured in dollars and cents and is not always contained in the financial reports. FPI has existed as an effective correctional program for 77 years. Over the course of these years, FPI has positively impacted the lives of countless inmates and staff members that reside and work in the Bureau of Prisons and the surrounding local communities in which we live.

It is impossible to quantify the extent to which FPI's success has prevented inmate unrest that would

have been costly in lives as well as dollars. In the face of an escalating inmate population and an increasing percentage of inmates with histories of violence, FPI's programs have helped ease tension and avert volatile situations, thereby protecting lives and federal property. Prisons without meaningful activities for inmates are dangerous prisons, and dangerous prisons are expensive prisons. The work and education programs of FPI have played an essential role in protecting lives, preserving stability and saving money in America's federal prisons.

At the same time, FPI has met its other goal of offering opportunities for inmates who want to take the personal responsibility for rehabilitating themselves. Most inmates eventually will be returned to society; industrial and educational programs can help them to steer clear of criminal activity after release. FPI plays a vital role in management of inmates, and also improves the likelihood that inmates will remain crime-free upon their release from BOP custody. A comprehensive study conducted by the BOP demonstrated that FPI provides inmates with an opportunity to develop work ethics and skills, contributes substantially to lower recidivism and increases job-related success of inmates upon release. This study indicates that inmates involved in FPI work programs and educational programs are substantially less likely to return to prison. The impact on the lives of people who live in the communities in which these inmates will return is immeasurable. Countless lives are spared the devastating impact of continued criminal activity.

Analysis of Financial Statements

Cash and Investments

Cash and Cash Equivalents decreased \$30.9 million. This is primarily the result of a decrease in cash advances of \$59.6 million. FPI's cash advances are primarily for the purchase of inventory in support of the Fleet Management and Vehicular Components vehicle retrofitting operation. The primary customer for these operations is the Department of Homeland Security; advances fluctuate throughout the year as they receive appropriations. Reductions in inventory along with successful cost containment measures resulted in an increase in FPI (non-advance) cash of \$28.7 million during fiscal year 2011. Other factors which affected the overall change in cash include a \$12.7 million increase in Accounts Receivable and a decrease in inventory of \$69.4 million.

Accounts Receivable

The Accounts Receivable balance increased \$12.7 million during fiscal year 2011. The Accounts Receivable balance of \$46.7 million as of September 30, 2011, represents 78.9 percent of September's total revenues. FPI's average days to collect for fiscal year 2011 was approximately 25 and was 24 in the month of September while the average days to collect for fiscal year 2010 was 24 and was 18 for the month of September 2010. Although sales were approximately the same for September 2011 (\$59.2 million) and September 2010 (\$59.6 million), collections during the month of September 2010 were exceptional and extraordinary which resulted in extremely low accounts receivable balance. The Accounts Receivable balance over sixty days old represented only 5 percent of the total balance as of September 30, 2011.

Inventory

Inventory decreased by \$69.4 million during fiscal year 2011. FPI continued to place an increased emphasis on inventory reduction during fiscal year 2011. While some business segments achieved reductions, the Electronics and Fleet Management and Vehicular Component business segments were the primary contributors to the reduction with decreases of \$32.2 and \$42.6 respectively. The Electronics segment decrease can be attributed to the sale of solar panel raw materials through GSA totaling \$32.7 million. The decrease in Fleet Management business segment can be attributed to a decrease of \$30.8 million in current backlog as of September 30, 2011, compared to September 30, 2010. Modest increases resulted for Office Furniture, Services, and Clothing and Textiles business segments.

Liabilities

Total Liabilities decreased by \$101 million during fiscal year 2011. Advances Payable decreased \$98.6 million during fiscal year 2011. This decrease is attributable to a change in customer advances payable on hand primarily for the retrofitting of vehicles for the Department of Homeland Security (DHS) as a result of a decrease in customer contracts. Accounts Payable remained fairly consistent between the two fiscal years accounting for a \$1.2 million decrease.

Revenue, Cost of Revenue and Net Loss

Total Revenue increased by \$46.1 million while total cost of revenue decreased by \$8.0 million. The increase in revenue resulted from the sale of Solar Cells of \$32.7 million, increase in Interagency Solutions Group services of \$17.3 million, and an increase in installation services performed primarily for Office Furniture business segment of \$10.3 million. These substantial increases were offset by a decrease in sales of \$31.6 million. Two of the largest business segments showing a decrease in sales were Electronics with \$22.7 million and Fleet with \$27.4 million. The Office Furniture and Industrial Products business segments had offsetting increases of \$26.5 million \$11.3 million in sales respectively. The decrease in Cost of Revenues is the result of FPI's efforts to reduce inventories and expenditures through capacity reductions. Net Loss decreased \$54.5 million in fiscal year 2011 compared to fiscal year 2010. Factory Earnings were \$56.4 million higher in fiscal year 2011 than the previous fiscal year with six out of the seven business segments showing improved earnings. The Clothing and Textiles business segment was the only group with slightly lower earnings in fiscal year 2011.

Business Segments

In fiscal year 2011, FPI's businesses were organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products. FPI's net industrial income (earnings) at the business segment level consists of sales offset by cost of goods sold and under /over applied overhead. Fiscal Year 2010 net sales of \$776,984 included \$4,088

recorded to FPI's Corporate Office. FPI's net sales and earnings for the fiscal years ended September 30, 2011 and 2010 for each of its current business segments is presented for comparative purposes:

Business Segment	Fiscal Year	
	2011	2010
Clothing and Textiles		
Sales	\$238,631	\$246,470
Earnings	\$34,035	\$35,885
Electronics		
Sales	\$76,443	\$99,107
Earnings	(\$7,391)	(\$45,360)
Fleet Management and Vehicular Components		
Sales	\$177,863	\$205,221
Earnings	\$14,112	\$7,029
Industrial Products		
Sales	\$55,281	\$44,029
Earnings	\$7,004	\$5,999
Office Furniture		
Sales	\$155,819	\$129,312
Earnings	\$11,141	\$2,880
Recycling		
Sales	\$15,276	\$13,596
Earnings	\$4,555	\$3,586
Services		
Sales	\$26,110	\$35,161
Earnings	(\$1,447)	(\$4,385)
Corporate Total		
Sales	\$745,423	\$772,896
Earnings	\$62,009	\$5,634

Possible Future Effects of Existing Events and Conditions

As reported in fiscal years 2009 and 2010, FPI continues to face the negative impact of economic and legislative forces. In fiscal years 2011 and beyond, FPI faces the additional challenge of the shrinking federal budget, the resulting decline in discretionary spending and the ultimate impact of

decline in FPI sales. FPI continues to address these external challenges through aggressively pursuing new customers and new products, involvement in legislative initiatives, capacity reductions, and strict measures to control cash.

During fiscal year 2011, FPI encountered a decline in sales for the second consecutive year and experienced a net loss for the third consecutive year. However, FPI's net loss for fiscal year 2011 was \$1.8 million, a considerable improvement compared to the original projected loss for fiscal year 2011 of \$12.6 million, and actual losses of \$36.9 and \$56.3 million in fiscal years 2009 and 2010, respectively. Included in the \$56.3 million dollar loss during fiscal year 2010 were write-offs totaling \$35.1 million in military helmet inventory and solar cells. \$4.6 million in fiscal year 2011 losses were due to Property, Plant and Equipment (PP&E) losses related to capacity reductions announced in prior years. If the referenced PP&E losses were to be factored out, FPI would have achieved net income of \$2.8 million for fiscal year 2011. The improved results for fiscal year 2011 were primarily due to prior capacity reductions and ongoing efficiency measures.

FPI's Cash position remains strong. During fiscal year 2011, in addition to capacity and overhead reductions, FPI focused efforts towards maintaining minimal inventory on hand, collections of receivables and reducing capital improvements. As a result of these efforts, FPI achieved a \$28.7 million increase in operating cash during fiscal year 2011. FPI developed a realistic fiscal year 2012 operating plan which includes a sales reduction of \$66 million compared to fiscal year 2011 actual results and projects a \$23.6 million loss (including PP&E loss of \$8 million). However, despite the planned reduction in sales and earnings, operating cash is expected to remain stable. FPI remains confident that through continued efforts toward maintaining capacity commensurate with demand, a stable balance sheet, and a strong cash balance while continuing to develop new sales opportunities, it will minimize the impact of these external challenges and ensure FPI continues to have the resources to meet its goals.

In December 2009, the Department of Justice, Office of Inspector General, initiated an investigation regarding the manufacturing and quality procedures for some of the military helmets produced by FPI. This investigation is still ongoing. FPI's management is committed to ensuring FPI produces a quality product that meets the requirements of our customers.

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U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

INDEPENDENT AUDITORS' REPORTS



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INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

Acting Inspector General
United States Department of Justice

Acting Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the accompanying Balance Sheets of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2011 and 2010, and the related Statements of Operations and Cumulative Results of Operations, and Statements of Cash Flows for the years then ended. These financial statements are the responsibility of FPI's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of FPI's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Department of Justice, Federal Prison Industries, Inc. as of September 30, 2011 and 2010, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America and OMB Circular No. A-136, *Financial Reporting Requirements*, require that the *Management's Discussion and Analysis* be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board and OMB, who consider it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with

management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 1, 2011, on our consideration of FPI's internal control over financial reporting and on our tests of its compliance with certain provisions of applicable laws and regulations. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

COTTON & COMPANY LLP

A handwritten signature in black ink, appearing to read "Alan Rosenthal", with a long, sweeping horizontal stroke extending to the right.

Alan Rosenthal, CPA, CFE
Partner

November 1, 2011
Alexandria, Virginia



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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Acting Inspector General
United States Department of Justice

Acting Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the Balance Sheets of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2011 and 2010, and the related Statements of Operations and Cumulative Results of Operations, and Statements of Cash Flows for the years then ended, and have issued our report thereon dated November 1, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

FPI's management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our fiscal year 2011 audit, we considered FPI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of FPI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FPI's internal control over financial reporting or on management's assertion on internal control included in *Management's Discussion and Analysis*. We limited our internal control testing to only those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*, such as controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the second paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2011 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of FPI's management, DOJ Office of the Inspector General, DOJ Justice Management Division, OMB, U.S. Government Accountability Office, and the U.S. Congress; it is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

A handwritten signature in black ink that reads "Alan Rosenthal". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Alan Rosenthal, CPA, CFE
Partner

November 1, 2011
Alexandria, Virginia



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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND OTHER MATTERS

Acting Inspector General
United States Department of Justice

Acting Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the Balance Sheets of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2011 and 2010, and the related Statements of Operations and Cumulative Results of Operations, and the Statements of Cash Flows for the years then ended, and have issued our report thereon dated November 1, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

FPI's management is responsible for complying with laws, regulations, and contract agreements applicable to the FPI. As part of obtaining reasonable assurance about whether FPI's fiscal year 2011 financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contract agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04.

Under FFMIA, we are required to report whether FPI's financial management systems substantially comply with federal financial management system requirements; applicable federal accounting standards; and application of the United States Standard General Ledger at the transaction level based upon U.S. generally accepted accounting principles issued by the Financial Accounting Standards Board, as applicable to the FPI in accordance with the provisions of the Government Corporation Control Act of 1945 (31 U.S.C. §9101 to 9110) and Statement of Federal Financial Accounting Standards No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The results of our tests of FFMIA disclosed no instances in which FPI's financial management systems did not substantially comply with the requirements described in the preceding paragraph.

This report is intended solely for the information and use of FPI's management, DOJ Office of the Inspector General, DOJ Justice Management Division, OMB, U.S. Government Accountability Office, and the U.S. Congress; it is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

A handwritten signature in black ink, appearing to read "Alan Rosenthal", with a long, sweeping horizontal stroke extending to the right.

Alan Rosenthal, CPA, CFE
Partner

November 1, 2011
Alexandria, Virginia

U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

PRINCIPAL FINANCIAL STATEMENTS AND RELATED NOTES



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Federal Prison Industries, Inc.

Balance Sheets

<i>As of September 30, (DOLLARS IN THOUSANDS)</i>	2011	2010
Assets		
Current:		
Cash and cash equivalents	\$ 291,510	\$ 322,448
Accounts receivable, net	46,680	34,006
Inventories, net	133,934	203,331
Other assets	2,582	3,691
Total current assets	474,706	563,476
Property, plant and equipment, net	102,775	116,896
Total Assets	\$ 577,481	\$ 680,372
Liabilities and United States Government Equity		
Current:		
Accounts payable	\$ 42,192	\$ 43,359
Deferred revenue	99,669	198,217
Accrued salaries and wages	10,620	11,244
Accrued annual leave	8,892	9,911
Other accrued expenses	9,681	9,950
Total current liabilities	171,054	272,681
FECA actuarial liability	16,403	15,857
Total Liabilities	187,457	288,538
United States Government Equity		
Initial capital	4,176	4,176
Cumulative results of operations	385,848	387,658
Total United States Government Equity	390,024	391,834
Total Liabilities and United States Government Equity	\$ 577,481	\$ 680,372

The accompanying notes are an integral part of these financial statements.

Federal Prison Industries, Inc.

Statements of Operations and Cumulative Results of Operations

<i>For the fiscal years ended September 30, (DOLLARS IN THOUSANDS)</i>	2011	2010
Revenue:		
Net sales	\$ 745,423	\$ 776,984
Other revenue	154,654	77,025
Total revenue	900,077	854,009
Cost of revenue:		
Cost of sales	683,928	763,327
Cost of other revenue	146,642	75,267
Total Cost of Revenue	830,570	838,594
Gross profit	69,507	15,415
Operating expenses:		
Sales and marketing	7,237	5,907
General and administrative	105,103	106,535
Total operating expenses	112,340	112,442
Loss from operations	(42,833)	(97,027)
Interest income	191	259
Interest expense	(3)	(4)
Other income, net	40,835	40,444
Net loss	(1,810)	(56,328)
Cumulative results of operations, beginning of fiscal year	387,658	443,986
Cumulative results of operations, end of fiscal year	\$ 385,848	\$ 387,658

The accompanying notes are an integral part of these financial statements.

Federal Prison Industries, Inc.

Statements of Cash Flows

<i>For the fiscal years ended September 30, (DOLLARS IN THOUSANDS)</i>	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (1,810)	\$ (56,328)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,469	11,120
Loss on disposal of property, plant and equipment	4,985	4,079
Changes in:		
Accounts receivable	(12,674)	21,706
Inventories	69,397	60,901
Other assets	1,109	2,271
Accounts payable and accrued expenses	(2,531)	(5,352)
Deferred revenue	(98,549)	6,903
Net cash provided by (used in) operating activities	(29,604)	45,300
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(1,334)	(8,416)
Construction-in-progress of plant facilities	-	5
Net cash used in investing activities	(1,334)	(8,411)
Net increase (decrease) in cash and cash equivalents	(30,938)	36,889
Cash and cash equivalents, beginning of fiscal year	322,448	285,559
Cash and cash equivalents, end of fiscal year	\$ 291,510	\$ 322,448

The accompanying notes are an integral part of these financial statements.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Note 1. Organization and Mission

Federal Prison Industries, Inc. (FPI) was established in 1934 by an act of the United States Congress. FPI operates under the trade name UNICOR, as a wholly-owned federal government corporation within the Department of Justice, and functions under the direction and control of a Board of Directors, (the "Board"). Members of the Board are appointed by the President of the United States of America and represent retailers and consumers, agriculture, industry, labor, the Attorney General, and the Secretary of Defense. FPI's statutory mandate is to provide employment and training for inmates in the Federal Prison System while remaining self-sufficient through the sale of its products and services.

FPI's federal government customers include departments (percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (47%), the Department of Homeland Security (18%), the Department of Justice (9%), the General Services Administration (5%), and the Social Security Administration (5%). These and other federal organizations are generally required to purchase products from FPI, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in FPI's enabling statute and the Federal Acquisition Regulation.

FPI has industrial and service operations at 88 and 94 factories located at 66 and 70 prison facilities that employed 14,200 and 15,907 inmates representing approximately 8% and 9% of the work eligible inmate population as of September 30, 2011 and September 30, 2010, respectively.

Note 2. Summary of Significant Accounting Policies

Basis of Accounting

FPI transactions are recorded on the accrual basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when the cash is exchanged.

Basis of Presentation

FPI has historically prepared its external financial statements in conformity with U.S. generally accepted accounting principles based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. The Federal Accounting Standards Advisory Board (FASAB) has been designated as the standards-setting body for federal financial reporting entities with respect to the establishment of US GAAP. FASAB allows certain government agencies to utilize FASB standards for Financial Statement presentations.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and contingent liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Cash and Cash Equivalents

FPI considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. FPI limits its investment activities and cash equivalents to short-term overnight repurchase agreements with the Bureau of Public Debt of the United States Treasury. The market value of these overnight repurchase agreements is equivalent to cost.

Accounts Receivable / Concentration of Credit Risk

Financial instruments that potentially subject FPI to concentrations of credit risk consist primarily of accounts receivable. FPI sells products and services to various federal government departments, agencies and bureaus, as well as certain private sector companies, without requiring collateral. Accounts receivable consists of amounts due from those entities and is stated net of an allowance for doubtful accounts.

FPI routinely assesses the payment histories of its federal customers and the financial strength of its private sector customers and maintains allowances for anticipated losses as they become evident. In this regard, an insignificant amount of accounts receivable remained past due at September 30, 2011 and September 30, 2010. A majority of these past due items relate to billings to various entities within Department of Defense (DOD) who rely on the Defense Finance and Accounting Service (DFAS) to process vendor payments. Historically, customer payments processed through DFAS have generally taken longer to receive than payments from other federal and private sector customers. FPI believes that ultimately, a majority of its past-due accounts receivable are fully collectable. The amount due FPI, net of allowances, from DOD for the fiscal years ended September 30, 2011 and 2010 was \$27,399 and \$19,067 respectively.

While federal accounts receivable are normally fully collectible in accordance with federal law, FPI has established an allowance for future losses against its federal accounts receivable to account for potential billing errors related to pricing and customer discounts, as well as instances of expired or cancelled funding from its federally appropriated customers. At September 30, 2011 and 2010, FPI's allowance for doubtful accounts is stated at approximately \$660 and \$825, respectively, of which approximately \$131 and \$224, respectively, represents the amounts allocated against federal accounts receivable.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Inventories

FPI maintains its inventory primarily for the manufacture of goods for sale to its customers. FPI's inventory is composed of three categories: Raw Materials, Work-in-Process, and Finished Goods. These categories are generally defined by FPI as follows: Raw Materials consist of materials that have been acquired and are available for the production cycle, Work-in-Process is composed of materials that have moved into the production process and have some measurable amount of labor and overhead added by FPI, Finished Goods are materials with FPI added labor and overhead that have completed the production cycle and are awaiting sale to customers.

Raw material inventory value is based upon moving average cost. Inventories are valued at the lower of average cost or market value (LCM) and include materials, labor and manufacturing overhead. Market value is calculated on the basis of the contractual or anticipated selling price, less allowance for administrative expenses. FPI values its finished goods and sub-assembly items at a standard cost that is periodically adjusted to approximate actual cost. FPI has established inventory allowances to account for LCM adjustments and obsolete items that may not be utilized in future periods.

Advances to Vendors

FPI generally does not offer advances to the public, however, where warranted, FPI will on occasion make an advance to a vendor upon their request. Historically, these advances have been insignificant and made primarily to the Industries for the Blind. During 2008, FPI established a program to produce solar panels in anticipation of an expanding federal market as a result of Executive Order 13423 "Strengthening Federal Environmental, Energy, and Transportation Management," which requires federal agencies to improve energy efficiencies by the year 2015. A majority of advances in fiscal year 2011 were given to the suppliers of the raw materials to produce solar panels. Prior to issuing advances to a vendor, the Centralized Accounts Receivable section performs a review as though they were a public customer, to include performing a due diligence review to assess risk and a review of applicant financial statements. A letter of credit is obtained as needed based on the results of this review. The FPI Controller approves advances prior to their disbursement. Advances are reduced by offset to the vendor invoice as goods are delivered.

Revenue Recognition

FPI sells a wide range of products and services to a diversified base of customers, primarily governmental departments, agencies and bureaus. Revenue is generally recognized when delivery has occurred or services have been rendered, persuasive evidence of an arrangement exists, there is a fixed or determinable price, and collectability is reasonably assured. Revenue from contracts that require customer acceptance are not recognized until either customer acceptance is obtained, or upon completion of the contract. Sales returns are primarily replaced with like items and are recorded as they occur.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Revenue is recognized on multiple element agreements as a single unit of accounting for manufactured items when the product has been accepted by the customer. Revenue for services provided on behalf of FPI through an outside company is recognized when the service provider presents a valid invoice including a customer acceptance or completion notice.

FPI records as other revenue the shipping and handling costs that have been billed to our customers, installation costs for FPI products, and items procured for its customers as part of procurement services provided by the Interagency Solutions and Procurement Branch. The cost of providing this service is recorded as a cost of other revenue.

Deferred revenue is comprised of customer cash advances, which have been paid to FPI prior to the manufacturing of goods, delivery of goods, or performance of services.

Other income includes imputed financing for retirement, health benefits and life insurance (Note 8).

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Machinery & Equipment	5 - 25
Computer Hardware	5 - 10
Computer Software	3 - 5
Building & Improvements	24- 40

Upon retirement or disposition of property and equipment, the related gain or loss is reflected in the statements of operations. Repairs and maintenance costs are expensed as incurred.

Taxes

As a wholly-owned corporation of the federal government, FPI is exempt from federal and state income taxes, gross receipts tax, and property taxes.

Reclassifications

Certain fiscal year 2010 financial statement line items have been reclassified to conform with the current year presentation. The reclassifications had no material effect on total assets, liabilities, equity, cumulative results of operations or cash flows as previously reported.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Note 3. Accounts Receivable, Net

Accounts receivable, net consists of the following:

<u><i>As of September 30,</i></u>	<u>2011</u>	<u>2010</u>
Intragovernmental billed receivables	\$ 34,491	\$ 25,443
Private sector billed receivables	12,849	9,388
	47,340	34,831
Less allowance for doubtful accounts	660	825
Accounts receivable, net	\$ 46,680	\$ 34,006

FPI incurred bad debt expense of \$(66) and \$546, respectively, for the fiscal years ended September 30, 2011 and 2010.

Note 4. Inventories, Net

Inventories, net consist of the following:

<u><i>As of September 30,</i></u>	<u>2011</u>	<u>2010</u>
Raw materials	\$ 46,988	\$ 103,411
Raw materials – vehicles	17,500	50,298
Work-in-process	25,857	31,312
Finished sub-assemblies	6,138	8,576
Finished goods	35,206	36,399
Finished goods – acceptance contracts	29,510	22,074
	161,199	252,070
Less inventory allowance	27,265	48,739
Inventories, net	\$ 133,934	\$ 203,331

\$17,500 of FPI's fiscal year 2011 and \$50,298 of FPI's fiscal year 2010, raw materials balance represents vehicles and component parts for use in the Fleet Management and Vehicular Components business group's retrofit product line. A majority of that inventory balance has been contracted on behalf of the Customs and Border Protection and Bureau of Immigration and Customs Enforcement of the Department of Homeland Security (DHS) for retrofit services that are performed by FPI. As part of an interagency agreement, DHS provides advance funding to FPI to procure these vehicles. Revenue is recognized by FPI at the time of shipment of retrofitted vehicles to DHS.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

\$29,510 of FPI's fiscal year 2011 and \$22,074 of its fiscal year 2010 finished goods balance represents goods shipped to customers or their agents for unrecognized revenue due to acceptance criteria within the customer contract. The balances as of September 30, 2011 and September 30, 2010 are primarily systems furniture installations and destination acceptance contracts shipped after the cutoff date for revenue recognition.

Included in total inventories as of September 30, 2011 and September 30, 2010, is \$16,345 and \$42,393 in raw materials, work-in-process and finished goods in support of the solar panel product line respectively.

Note 5. Property, Plant and Equipment, Net

Property, plant and equipment, net consist of the following:

<i>As of September 30,</i>	2011	2010
Buildings and improvements	\$ 178,347	\$ 179,656
Machinery and equipment	104,052	109,453
Computer hardware	2,149	1,970
Computer software	6,506	6,484
	291,054	297,563
Less accumulated depreciation	188,279	180,667
Property, plant and equipment, net	\$ 102,775	\$ 116,896

Depreciation and amortization expense totaled \$10,469 and \$11,120 for the fiscal years ended September 30, 2011 and 2010, respectively. During fiscal year 2011, FPI invested \$1,334 for the purchase and construction of property, plant and equipment. During fiscal years 2011 and 2010, FPI deactivated factories in an effort to reduce excess factory capacity. As a result of these deactivations, FPI incurred losses on property plant and equipment of \$4,599 in fiscal year 2011, and \$4,039 in fiscal year 2010.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Note 6. Other Accrued Expenses

Other accrued expenses consist of the following:

<i>As of September 30,</i>	2011	2010
Materials in transit	\$ 1,108	\$ 1,607
Relocation travel expense	1,053	1,107
FECA liabilities – current portion	1,942	1,656
Financial audit expense	530	461
Telecommunication expense	1,132	934
Utilities	936	1,204
Warranty expense	444	451
Other expense	2,536	2,530
Other accrued expenses	\$ 9,681	\$ 9,950

Included in other expense as of September 30, 2011 and September 30, 2010 are accruals for Intra-Departmental agreements of \$622 and \$501 and accruals for vendor invoices of \$645 and \$1,292, respectively.

Note 7. Business Segments

FPI's businesses are organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. These segments represent virtually all of FPI's product lines. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products and services. Fiscal year 2010 net sales of \$776,984 included \$4,088 recorded to FPI's Corporate Office. FPI's net sales for the fiscal years ended September 30, 2011 and 2010 for each of its business segments is presented for comparative purposes:

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Net Sales

<u>For the years ended September 30,</u>	<u>2011</u>	<u>2010</u>
<u>Business Segment</u>		
Clothing and Textiles	\$ 238,631	\$ 246,470
Electronics	76,443	99,107
Fleet Management and Vehicular Components	177,863	205,221
Industrial Products	55,281	44,029
Office Furniture	155,819	129,312
Recycling	15,276	13,596
Services	26,110	35,161
Net sales	\$ 745,423	\$ 772,896

Regulatory Compliance

FPI's ability to add or to expand production of a specified product is regulated by the Federal Prison Industries Reform Act ("the Act"). The Act provides specific guidelines to FPI regarding its methodology for evaluating and reporting new or expanded products, including requiring FPI to provide direct notice to trade associations and interested parties of such actions. Finally, publication of annual decisions of the FPI Board of Directors and semi-annual sales disclosures are mandated under the Act.

Note 8. Intra-Department of Justice (DOJ) / Intragovernmental Financial Activities

FPI's financial activities interact with and are dependent upon those of DOJ and the federal government as a whole. The following is a discussion of certain intra-DOJ and intragovernmental activities and their relationship with FPI:

Relationship with the Federal Bureau of Prisons

FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their respective missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP, who has jurisdiction over all federal penal correctional institutions, is the Chief Executive Officer (CEO). General management of FPI is provided by the Chief Operating Officer who also serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI. In accordance with Managerial Cost Accounting Concepts a reasonable estimate of these costs as provided by the BOP is included in

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

general expense and other income of FPI for the fiscal years ended September 30, 2011 and 2010, respectively.

Self Insurance

In accordance with federal government policy, FPI is uninsured with respect to property damage, product liability, and other customary business loss exposures. Losses incurred are absorbed as a current operating expense of FPI or, if they are induced by factors related to FPI's relationship with the Federal Prison System, may be reimbursed by BOP. Certain other costs, principally relating to personal injury claims, are paid directly by the federal government.

Federal Employees Compensation Act

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to cover federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job related injury or occupational disease. The United States Department of Labor (DOL), which administers FECA, annually charges each federal agency and department for its applicable portion of claims and benefits paid in the preceding year. As of September 30, 2011 and September 30, 2010, the accrued FECA liabilities as charged to FPI, approximated \$1,942 and \$1,656, respectively.

DOL also calculates the liability of the federal government for future claims and benefits, which includes the estimated liability of death, disability, medical, and other approved costs. Future claims and benefits are determined from an actuarial extrapolation, utilizing historical benefit payment patterns and calculations of projected future benefit payments discounted to current value over a 23.5 year period. FPI's estimated future liability approximated \$16,403 and \$15,857 at September 30, 2011 and 2010, respectively.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under CSRS (those employees hired prior to January 1, 1984), FPI contributed approximately 7 percent (for normal retirement) or 7.5 percent (for hazardous duty retirement) of each employee's salary. CSRS covered employees do not have Federal Insurance Contributions Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered by the FERS, (generally those employees hired on or after January 1, 1984), FPI contributed (for normal retirement) 11.7 and 11.2 percent for fiscal years ended September 30, 2011 and September 30, 2010, respectively. FPI contributed (for hazardous retirement) 25.7 and 24.9 percent for fiscal years ended September 30, 2011 and September 30, 2010, respectively.

Under FERS, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift). Under the thrift plan, an employee may contribute (tax deferred) to an investment fund, up to \$16,500 of salary for the fiscal years ended September 30,

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

2011 and September 30, 2010. FPI then matches this amount up to 4 percent, in addition to an automatic 1 percent that is contributed for all FERS employees. Those employees, which elected to remain under CSRS after January 1, 1984, continue to receive benefits in place, and may also contribute (tax deferred) up to \$16,500 of salary to the thrift plan, but with no matching amount contributed by FPI.

CSRS and FERS are multi-employer plans. Although FPI funds a portion of pension benefits relating to its employees, and provides for the necessary payroll withholdings, it does not maintain or report information with respect to the assets of the plans, nor does it report actuarial data with respect to accumulated plan benefits or the pension liability relative to its employees. The reporting of such amounts is the responsibility of the United States Office of Personnel Management (OPM).

FPI's contribution to both plans approximated \$29,352 and \$31,465 for the fiscal years ended September 30, 2011 and 2010, respectively.

FPI must recognize its share of the cost of providing pension benefits to eligible employees utilizing cost factors determined by the OPM. Included in general and administrative expense is approximately \$3,531 and \$2,209 in the fiscal years ended September 30, 2011 and 2010, respectively, with an offsetting credit to other income on the Statements of Operations and Cumulative Results of Operations.

Health Benefits and Life Insurance

FPI, through the OPM, offers health and life insurance plans under which premium costs for health care are shared between FPI and the employees. A substantial portion of life insurance premiums are paid for by employees. Amounts paid by FPI for health benefits and life insurance approximated \$10,334 and \$10,739 for the fiscal years ended September 30, 2011 and 2010, respectively.

OPM also provides health care and life insurance benefits for FPI's retired employees. FPI must recognize an expense related to its share of the cost of such post-retirement health benefits and life insurance on a current basis (while its employees are still working), with an offsetting credit to other income. Costs in this regard, which approximated \$7,405 and \$7,778 during the fiscal years ended September 30, 2011 and 2010, respectively, were determined by OPM utilizing cost factors used to estimate the cost of providing post-retirement benefits to current employees. However, because of the offsetting credit, which is reflected as other income on the Statements of Operations and Cumulative Results of Operations, the recording of these costs has no impact on reported net income or cash flows.

Future post-retirement health care and life insurance benefit costs are not reflected as a liability on FPI's financial statements, as such costs are expected to be funded in future periods by OPM.

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Note 9. Sales and Marketing, General and Administrative Expenses

Sales and marketing, general and administrative expenses consist of the following:

<i>Sales and marketing, general and administrative expenses</i>	2011	2010
<i>Fiscal years ended September 30,</i>		
Salaries, wages and benefits	\$ 46,491	\$ 47,841
Permanent change of station expense	1,350	700
Purchases of minor equipment	307	389
Contract services	9,787	9,225
Bad debt expense	(66)	539
Credit card service fees	897	1,093
Travel	1,721	1,723
Personal computer expense	2,290	910
Accident compensation	2,409	3,482
Financial audit	1,690	1,681
Marketing	1,793	1,791
Depreciation	2,056	2,005
Net loss on disposition of assets	4,984	4,068
Telecommunication expense	2,976	3,159
Other expense	(2,745)	(3,599)
Imputed pension costs (Note 8)	3,531	2,209
Imputed post-retirement health care and life insurance cost (Note 8)	7,405	7,778
Imputed operating costs	25,464	27,448
 Sales and marketing, general and administrative expenses	 \$ 112,340	 \$ 112,442

Other expense is comprised primarily of inmate wages, maintenance agreements, and distributions to factory operations. FPI distributes certain General and Administrative expenses that benefit all locations to the individual factory levels. These charges include Computer licenses and fees, Civilian and Inmate Accident Compensation, and Check Charges. These charges totaled \$8.1 million for fiscal year 2011 and \$9.3 million for fiscal year 2010. Contract services consist primarily of consulting and sales and marketing fees. Salaries, wages and benefits are shown net of the imputed financing offsetting credit (Note 8).

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Note 10. Commitments and Contingencies

Legal Contingencies

FPI is party to various administrative proceedings, legal actions, and claims. FPI was party to no legal proceedings that are expected to result in a probable loss; accordingly, the balance sheets contain no liabilities for contingencies. Legal actions where management and the Chief Council consider adverse decisions reasonably possible and the amounts are reasonably estimable, should not result in judgments which would have a material adverse effect on the organizations financial statements. Furthermore, there are cases where amounts have not been accrued or disclosed because the amounts of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is considered remote.

Lease Commitments

FPI leases certain facilities, machinery, vehicles and office equipment under noncancelable capital and operating lease agreements that expire over future periods. Many of these lease agreements provide FPI with the option (after initial lease term) to either purchase the leased item at the then fair value or to renew the lease for additional periods of time. As of September 30, 2011, future capital lease payments due and future operating lease commitments total \$149 and \$146, respectively.

Product Warranty

FPI offers its customers a promise of an “Escape Proof Guarantee” on the products it manufactures. FPI has analyzed the historical pattern of warranty returns and the adequacy of the warranty returns and allowances. In this regard, FPI has established an estimate of future warranty returns related to current period product revenue.

Minimum Buy Contracts

FPI has entered into firm purchase commitments for solar panel materials totaling \$13,129 to be delivered in fiscal year 2012 and \$23,672 to be delivered in fiscal year 2015.

Changes in aggregate product warranty liability

<i>Fiscal years ended September 30,</i>	2011	2010
Balance at the beginning of the period	\$ 451	\$ 478
Accruals for warranties issued during the period	353	342
Settlements made (in cash or in kind) during the period	(360)	(369)
Balance at the end of the period	\$444	\$ 451

Fiscal Years 2011 and 2010
Notes to Financial Statements
(Dollars in Thousands)

Congressional Limitation on Administrative Expenses

Congress has imposed an annual spending limit on certain administrative expenses relating to FPI's central office management. These costs include salaries for management personnel, travel expenses and supplies. The following is a comparison of actual expenses to the limitation imposed:

Congressional limitation on administrative expenses

<u><i>Fiscal years ended September 30,</i></u>	<u>2011</u>	<u>2010</u>
Congressional limitation on expenses	\$ 2,695	\$ 2,700
<u>Expenses incurred subject to Congressional limitation</u>	<u>\$ 1,775</u>	<u>\$ 2,025</u>