



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



**Audit of the  
Federal Prison Industries, Inc.  
Annual Financial Statements  
Fiscal Year 2016**



**FEDERAL PRISON INDUSTRIES, INC.  
ANNUAL FINANCIAL STATEMENTS  
FISCAL YEAR 2016**

**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, 2016, and September 30, 2015. 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), KPMG LLP performed the FPI's audit in accordance with auditing standards generally accepted in the United States of America. The FY 2016 audit resulted in an unmodified opinion on the financial statements. An unmodified opinion means that the financial statements are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles. For FY 2015, the FPI also received an unmodified opinion on its financial statements (OIG Audit Report No. 16-05).

KPMG LLP also issued reports on internal control over financial reporting and on compliance and other matters. The auditors did not identify any material weaknesses, nor did they report any significant deficiencies in the FY 2016 *Independent Auditors' Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*. No instances of non-compliance or other matters were identified during the audit that are required to be reported under *Government Auditing Standards*, in the FY 2016 *Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*. Additionally, KPMG LLP's tests disclosed no instances in which the FPI's financial management systems did not substantially comply with the *Federal Financial Management Improvement Act of 1996*.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with *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 and other matters. KPMG LLP is responsible for the attached auditors' reports dated November 7, 2016, and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with auditing standards generally accepted in the United States of America.

This page intentionally left blank.

**AUDIT OF THE  
FEDERAL PRISON INDUSTRIES, INC.  
ANNUAL FINANCIAL STATEMENTS  
FISCAL YEAR 2016**

**TABLE OF CONTENTS**

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER AND THE CHIEF OPERATING OFFICER.....	3
MANAGEMENT'S DISCUSSION AND ANALYSIS .....	7
INDEPENDENT AUDITORS' REPORTS	
Report on the Financial Statements .....	17
Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	19
Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	21
PRINCIPAL FINANCIAL STATEMENTS AND RELATED NOTES	
Balance Sheets .....	25
Statements of Operations and Cumulative Results of Operations.....	26
Statements of Cash Flows .....	27
Notes to the Principal Financial Statements .....	28

This page intentionally left blank.

**Message from the Chief Executive Officer and the  
Chief Operating Officer**

This page intentionally left blank.



**U.S. Department of Justice**

**UNICOR**

Federal Prison Industries, Inc.

Washington, DC 20534

November 7, 2016

We are pleased to present the Federal Prison Industries, Inc.'s (FPI) Fiscal Year 2016 Annual Management Report to the Congress of the United States. This report includes the FPI's financial statements, Management's Discussion and Analysis, Office of the Inspector General Commentary and Summary, and the Independent Auditors' reports on the Corporation's financial statements, internal controls over financial reporting and compliance, and other matters. FPI's financial statements received an unmodified audit opinion, and no significant deficiencies or material weaknesses were reported by the Independent Auditors.

FPI was established by statute and Executive Order 6917 in 1934, signed by President Roosevelt to provide opportunities educational and work-related experiences to federal offenders. Although a great deal of time has passed and technology is changing rapidly, FPI's mission throughout these years remains the same - to protect society and reduce crime by preparing inmates for successful reentry through job training. FPI continues to place emphasis on reaching as many inmates as possible by focusing on employment of inmates within two years of release. As one of the Bureau of Prisons' (BOP's) most important inmate anti-recidivism programs, FPI employed over 10,896 federal inmates in FPI factories at fiscal year-end.

The need to address inmate idleness was a contributing factor in the creation of FPI in 1934. This program continues to directly support the BOP's mission by keeping inmates productively occupied which lowers the likelihood that they will engage in disruptive behavior and contributes significantly to the safe and secure management of prisons. Additionally, inmates participating in the FPI program have an increased likelihood of successful reentry into society and are significantly less likely to return to a life of crime, which reduces future costs of enforcement and incarceration.

FPI is a program with proven lasting benefits, including reduced recidivism; a positive impact on the U.S. economy through the

raw materials purchased from suppliers including veteran, small and women owned businesses; and the staff salaries spent in the community, all without an additional tax burden to society.

As a federal government corporation, FPI is a program that also functions as a business to remain self-sustaining, and continues to face a dynamic set of external and internal constraints. Due to the nature of the changes affecting purchases from FPI by the government sector, emphasis has been placed on exploring more opportunities with commercial customers. New market authorities, contained in the Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) are now available for FPI to obtain commercial customers through repatriation and bringing work opportunities otherwise being performed outside of the United States. FPI has built on its progress in fiscal years 2013, 2014 and 2015 capitalizing on many new opportunities and a number of pilot programs already implemented. Additionally, P.L. 112-55 authorized FPI to participate in the Prison Industries Enhancement Certification Program (PIECP). FPI began the lengthy process of implementing this new authority in fiscal year 2013 and has two established PIECP programs at FCI Estill, South Carolina and FCC Butner, North Carolina. FPI is optimistic that we will continue to grow PIECP operations.

FPI is thankful for the support from all of the Department of Justice agencies in assisting with the development of work opportunities to support our mission. Thanks to the outstanding contributions and dedication of FPI staff as well as the continued outstanding support and leadership provided by the Board of Directors.

Thomas R. Kane  
Thomas R. Kane

Acting Director  
Federal Bureau of Prisons  
Commissioner of FPI

Gary M. Simpson  
Gary Simpson

Chief Executive Officer  
Federal Prison Industries, Inc.

**Management's Discussion and Analysis**  
**(Unaudited)**

This page intentionally left blank.

**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 protect society and reduce crime by preparing inmates for successful reentry through job training.

## **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 Commissioner of FPI. General management of FPI is provided by the Chief Executive Officer who also serves as an Assistant Director for the BOP.

In fiscal year 2016, FPI operated in six business segments: Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI has agricultural, industrial and service operations at 63 factories and 3 farms located at 52 prison facilities as of September 30, 2016. 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 primarily from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed primarily by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

FPI processes primarily all customer orders and billings along with vendor payments through a centralized service center in Lexington, Kentucky.

## **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 and staff salaries 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 Social Security

Administration (SSA), and the General Services Administration (GSA).

Due to the volatile nature of the changes affecting FPI with the government sector, emphasis has been placed on exploring more opportunities with commercial customers. Opportunities in this arena have become available as part of the approval for FPI to obtain commercial customers through repatriation and bringing sales otherwise sent to foreign countries back into the United States of America. Many new opportunities are already being pursued through a collaboration of FPI's business groups and the New Business Development Group. Additionally, the Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) authorized FPI to participate in the Prison Industries Enhancement Certification Program (PIECP). FPI has invested and continues to invest significant time and effort into pursuing this goal in fiscal year 2016 through research and discussion within the organization and other agencies.

## 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 (GAAP) based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. GAAP requires 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.

**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 this 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, 2016 and 2015, FPI had established an allowance for doubtful accounts in the amount of \$.8 million and \$1.1 million on accounts receivable balances of \$47.1 million and \$43.0 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, and 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 FPI's vision to protect society, reduce crime, aid in the security of the nation's prisons and decrease taxpayer burden by assisting inmates with developing vital skills necessary for successful reentry into society. Through the production of market-priced quality goods and services, FPI provides job training and work opportunities to inmates, while minimizing impact on private industry and labor.

The goal of FPI is to reduce undesirable inmate idleness by providing a full-time work program for inmate populations. 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.

FPI has existed as an effective correctional program for 82 years. Over the course of these years, FPI has positively impacted countless staff and inmate lives. 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 dangerous situations, thereby protecting lives and federal property. FPI work programs provide meaningful activities for inmates, thereby playing an essential role in the operation of safe, secure and less costly prisons.

At the same time, FPI provides opportunities for inmates who want to take an active role in their rehabilitation. More than 95 percent of inmates eventually will be returned to society; industrial programs can help them to steer clear of criminal activity after release. Participation in FPI programs 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 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 Cash Equivalents**

Cash and Cash Equivalents decreased \$65.4 million due to FPI's additional investment in long term notes during fiscal year 2016. FPI invested an additional \$134.2 million in fiscal year 2016. An increase in Cash Advances of \$34.2 million as of September 30, 2016, offset a portion of the loss of cash due to the increase in long term investing. FPI's cash advances are primarily for the purchase of inventory in support of the Fleet Management and Vehicular Components vehicle retrofitting operation. A decrease in Inventory of \$24.7 million and Net Income of \$4.1 million also offset the loss of cash used in investing activities for 2016.

### **Investments**

During fiscal year 2016, FPI invested an additional \$134.2 million in Treasury fixed-principal notes with Bureau of the Fiscal Service of the United States Treasury. As a general investment strategy, FPI plans to hold all short-term and long-term investments to maturity.

### **Accounts Receivable**

The Accounts Receivable balance increased \$4.4 million during fiscal year 2016. The accounts receivable balance of \$46.3 million represents 87.5% of the total revenue for the month of September 2016. FPI's average days to collect for 2016 were approximately 27.3 days. The accounts receivable balance over sixty days old represented 20% of the total balance as of September 2016.

### **Inventory**

Inventory decreased by \$24.7 million for fiscal year 2016. The Clothing and Textiles business segment was the primary contributor to the decrease, with a decrease of \$11.2 million in fiscal year 2016. The Clothing and Textiles business segment decrease can be attributed to Raw Material and Work in Process decreases, due to factory closures in the Army Combat Uniform and the Protective Wear product lines. The Finished Good inventory balance for Office Furniture decreased \$10.3 million in 2016, due to the completion and installation of large contracts in

fiscal year 2016. The Electronics business segment also had a large decrease in inventory of \$7.6 million in the Fleet Management and Vehicular Components, primarily due to a decrease in finished goods and work in process for fiscal year 2016.

## **Liabilities**

Total Liabilities increased by \$27.7 million during fiscal year 2016. The primary contributor was a \$26.0 million increase in Deferred Revenue. The increase in deferred revenue is primarily attributable to a change in customer advances payable on hand primarily for the retrofitting of vehicles for the Department of Homeland Security.

## **Revenue, Cost of Revenue and Net Income**

Total Revenue increased by \$46.7 million while total cost of revenue increased \$23.4 million. The increase in revenue resulted from the increase in Sales revenue of \$26.5 million. The largest business segments showing an increase in sales were Office Furniture with a \$21.2 million increase and Clothing and Textiles business group with an \$18.6 million increase. Other revenue also increased by \$20.2 million in fiscal year 2016, primarily as a result of increased revenue for contracting services performed by the Interagency Customer Solutions Group. The fiscal year 2016 net income increased \$22.0 million from 2015.

## **Business Segments**

In fiscal year 2016, FPI's businesses were organized, managed, and internally reported as six operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI is not dependent on any single product as a primary revenue source; however, it is currently primarily 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.

<b>Business Segment</b>	<b>Fiscal Year</b>	
	<b>2016</b>	<b>2015</b>
<b>Agribusiness</b>		
Net Sales	\$5,795	\$7,290
Earnings	\$(2,892)	\$947
<b>Clothing and Textiles</b>		
Net Sales	\$196,097	\$177,474
Earnings	\$32,633	\$16,366
<b>Electronics</b>		
Net Sales	\$126,999	\$134,627
Earnings	(\$8,661)	(\$2,620)
<b>Office Furniture</b>		
Net Sales	\$120,488	\$99,338
Earnings	\$14,063	\$2,224
<b>Recycling</b>		
Net Sales	\$13,904	\$17,227
Earnings	\$1,982	\$5,021
<b>Services</b>		
Net Sales	\$35,122	\$35,944
Earnings	\$7,055	\$5,888
<b>Factory Total</b>		
Net Sales	\$498,405	\$471,900
Earnings	\$44,180	\$27,826

## **Possible Future Effects of Existing Events and Conditions**

During fiscal year 2016, FPI realized an increase in sales for the second straight year; FPI experienced a net income for the first time in seven years.

In fiscal years 2017 and beyond, FPI will continue to face challenges of the shrinking federal budget and the resulting decline in discretionary spending. FPI continues to strive to preserve available resources and minimize the impact on its mission through aggressively pursuing new customers and new products, involvement in legislative initiatives, maintaining inmate participation in the program, cost reductions, and stringent measures to control cash.

### Prison Industries Enhancement Certification Program

The Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) authorized FPI to participate in the Prison Industries Enhancement Certification Program (PIECP) and to manufacture products that would otherwise be produced outside of the United States, as approved by FPI's Board of Directors. FPI continued to invest time and effort into pursuing this goal in fiscal year 2016 through research and discussion within our organization and other agencies. FPI obtained approval of its PIECP application from the Bureau of Justice Assistance in May 2013. Production of PIECP products began at our Estill, SC factory in fiscal year 2014, and an additional operation began in our factory in Butner, NC in fiscal year 2015. FPI is currently evaluating PIECP plans for two other locations and will continue to aggressively pursue the implementation of the PIECP program in fiscal year 2017 and beyond.

### Repatriation

Due to the volatile nature of the changes within the government sector affecting FPI, emphasis has been placed on exploring more opportunities with commercial customers. Opportunities in this arena have become available as part of the approval for FPI to obtain commercial customers through repatriation and bringing sales otherwise sent to foreign countries back into the United States of America. Many new opportunities are already being pursued through a collaboration of FPI's business groups and the New Business Development Group. Additionally, in fiscal 2016 FPI began to work with the Department of Commerce's Select USA Program. Working with Select USA provides FPI with another way of pursuing repatriation products.

### Job Share Inmates

FPI employed 10,896 inmates as of September 30, 2016. FPI's continued emphasis on the use of job share inmate workers resulted in 676 job share inmates as of September 30, 2016, which contributed to FPI surpassing its planned employment of 10,595 inmates at the end of fiscal year 2016. Continued emphasis on job share employment opportunities and inmate training positions in 2017 and beyond will allow for an increase in the number of inmates participating in the FPI program while reducing the per inmate cost of employment. Concentration on this goal will increase the impact of our program to the inmate population.

### Inmate Employment Goal

During fiscal year 2014, with the approval of its Board of Directors, FPI revised its inmate employment goal to focus on those inmates that are within 2 years of release. FPI's current goal is that 20% of inmates released by the BOP, who have spent 2 years or more in FPI appropriate facilities, will have at least 180 days of FPI experience. While FPI is not currently able to employ a large percentage of the BOP population at any given point, achievement of this goal will ensure that a significant portion of the population will receive the benefit of the program prior to release. For fiscal year 2016, 24.2% of FPI inmates were within 2 years of their release, exceeding the target of 20%.

This page intentionally left blank.

**Independent Auditors' Reports**

This page intentionally left blank.



**KPMG LLP**  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

## **Independent Auditors' Report on the Financial Statements**

Inspector General  
U.S. Department of Justice

Chief Executive Officer  
Board of Directors  
Federal Prison Industries, Inc.  
U.S. Department of Justice

We have audited the accompanying financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

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, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Independent Auditors' Report on the Financial Statements  
Page 2

***Opinion on the Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Justice Federal Prison Industries, Inc. as of September 30, 2016 and 2015, and its net profit, cumulative results of operations, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

***Other Matter***

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Management's Discussion and Analysis section is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2016 on our consideration of the FPI's internal control over financial reporting and our report dated November 7, 2016 on our tests of its compliance with certain provisions of laws, regulations, and contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the result 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* in considering the FPI's internal control over financial reporting and compliance.

*KPMG LLP*

Washington, D.C.  
November 7, 2016



**KPMG LLP**  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

**Independent Auditors' Report on Internal Control over Financial Reporting Based on an Audit of  
Financial Statements Performed in Accordance with *Government Auditing Standards***

Inspector General  
U.S. Department of Justice

Chief Executive Officer  
Board of Directors  
Federal Prison Industries, Inc.  
U.S. Department of Justice

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 7, 2016.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2016, we considered the FPI's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FPI's internal control. Accordingly, we do not express an opinion on the effectiveness of the FPI's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

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 a 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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the FPI's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FPI's internal control. Accordingly, this communication is not suitable for any other purpose.

*KPMG LLP*

Washington, D.C.  
November 7, 2016



**KPMG LLP**  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

**Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

Inspector General  
U.S. Department of Justice

Chief Executive Officer  
Board of Directors  
Federal Prison Industries, Inc.  
U.S. Department of Justice

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 7, 2016.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the FPI's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 15-02.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of FFMIA disclosed no instances in which the FPI's financial management systems did not substantially comply with the (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) application of the United States Government Standard General Ledger at the transaction level.



### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the FPI's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FPI's compliance. Accordingly, this communication is not suitable for any other purpose.

*KPMG LLP*

Washington, D.C.  
November 7, 2016

**Principal Financial Statements and Related Notes**

**See Independent Auditors' Reports on the Financial  
Statements**

This page intentionally left blank.

# Federal Prison Industries, Inc.

## Balance Sheets

<b>As of September 30, (DOLLARS IN THOUSANDS)</b>	<b>2016</b>	<b>2015</b>
<b>Assets</b>		
Current:		
Cash and cash equivalents	\$ 70,328	\$ 135,683
Accounts receivable, net	46,302	41,885
Short term investments	69,035	-
Inventories, net	106,137	130,838
Other assets	1,599	1,980
<b>Total current assets</b>	<b>293,401</b>	<b>310,386</b>
Investments	145,091	79,925
Property, plant and equipment, net	58,929	75,383
<b>Total long term assets</b>	<b>204,020</b>	<b>155,308</b>
<b>Total Assets</b>	<b>\$ 497,421</b>	<b>\$ 465,694</b>
<b>Liabilities and United States Government Equity</b>		
Current:		
Accounts payable	\$ 35,995	\$ 34,376
Deferred revenue	103,795	77,830
Accrued salaries and wages	4,866	4,874
Accrued annual leave	5,380	6,270
Other accrued expenses	10,100	9,762
<b>Total current liabilities</b>	<b>160,136</b>	<b>133,112</b>
FECA actuarial liability	24,303	23,657
<b>Total Liabilities</b>	<b>184,439</b>	<b>156,769</b>
United States Government Equity		
Initial capital	4,176	4,176
Contributed capital	6,905	6,905
Cumulative results of operations	301,901	297,844
<b>Total United States Government Equity</b>	<b>312,982</b>	<b>308,925</b>
<b>Total Liabilities and United States Government Equity</b>	<b>\$ 497,421</b>	<b>\$ 465,694</b>

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>	<b>2016</b>	<b>2015</b>
Revenue:		
Net sales	\$ 498,405	\$ 471,900
Other revenue	106,847	86,627
Total revenue	605,252	558,527
Cost of revenue:		
Cost of sales	446,926	439,492
Cost of other revenue	105,175	89,236
Total cost of revenue	552,101	528,728
Gross profit	53,151	29,799
Operating expenses:		
Sales and marketing	4,378	3,733
General and administrative	75,796	74,727
Total operating expenses	80,174	78,460
Loss from operations	(27,023)	(48,661)
Interest income	1,896	430
Interest expense	(12)	(8)
Other income, net	29,196	30,266
Net Income (loss)	4,057	(17,973)
Cumulative results of operations, beginning of fiscal year	297,844	315,817
Cumulative results of operations, end of fiscal year	\$ 301,901	\$ 297,844

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>	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income/(loss)	\$ 4,057	\$ (17,973)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,294	8,738
Loss on disposal of property, plant and equipment	10,509	253
Changes in:		
Accounts receivable	(4,417)	(14,329)
Inventories	24,701	(52,210)
Other assets	381	(1,400)
Accounts payable and accrued expenses	1,705	(6,699)
Deferred revenue	25,965	(30,495)
Net cash provided by (used in) operating activities	71,195	(114,115)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(2,349)	(2,256)
Construction-in-progress of plant facilities	-	(57)
Purchase of investments	(134,201)	(79,925)
Net cash used in investing activities	(136,550)	(82,238)
Net increase (decrease) in cash and cash equivalents	(65,355)	(196,353)
Cash and cash equivalents, beginning of fiscal year	135,683	332,036
Cash and cash equivalents, end of fiscal year	\$ 70,328	\$ 135,683

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

## **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 (52%), the Department of Homeland Security (14%), the Department of Justice (14%), the Social Security Administration (3%), and the General Services Administration (3%). 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 agricultural, industrial, and service operations at 63 factories and 3 farms located at 52 prison facilities that employed 10,896 and 12,278 inmates as of September 30, 2016 and 2015, 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 (GAAP) 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 U.S. GAAP. FASAB allows certain government agencies to utilize FASB standards for Financial Statement presentations.

### Use of Estimates

The preparation of financial statements in conformity with U.S. 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 with an original maturity of three months or less to be cash equivalents. In fiscal year 2015, FPI's investment activities and cash equivalents included overnight repurchase agreements, one-year market bonds with the Bureau of the Fiscal Service of the United States Treasury. The market value of overnight purchase agreements is equivalent to cost.

### Fair Value Measurements

FASB Accounting Standard Codification (ASC) 820-10, Fair Value Measurements and Disclosures, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The FPI's financial instruments are comprised of cash, accounts receivable, accounts payable, and accrued liabilities as of September 30, 2016 and 2015, respectively. The carrying amounts of these financial instruments approximate fair value because of the short-term nature of these instruments. The FPI intends to hold their investments until maturity, and therefore, has recorded the investments at amortized costs. See Note 3 regarding the fair value of investments.

### Investments

FPI invests in Treasury fixed-principal notes with Bureau of the Fiscal Service of the United States Treasury. Treasury fixed-principal notes are issued with a stated rate of interest to be applied to their par amount, have interest payable semiannually, and are redeemed at their par amount at maturity. All investments with maturity due dates within the next fiscal year are considered short-term, and classified as current assets. FPI plans to hold these investments to maturity.

### 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. Most of the 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. The amount due to FPI, net of allowances, from DOD for the fiscal years ended September 30, 2016 and 2015 was \$28,773 and \$25,781, 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, 2016 and 2015, FPI's allowance for doubtful accounts is stated at approximately \$770 and \$1,105, respectively, of which approximately \$501 and \$777, respectively, represents the amounts allocated against federal accounts receivable.

#### 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, and 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 excess, obsolete, or unserviceable inventory 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. Historically, these advances have been insignificant. 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.

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.

FPI records as other revenue the shipping and handling costs that have been billed to customers, installation costs for FPI products, and items procured for its customers as part of procurement services provided by the Intragovernmental Solutions Services group. 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, life insurance and BOP operating expenses (Note 9).

### Property, Plant and Equipment

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

	<u>Years</u>
Machinery & Equipment	2 - 25
Computer Hardware	2 - 10
Computer Software	2 - 5
Livestock	4
Building & Improvements	24 - 40

There are several assets that have lives longer than those stated above; however, they were established prior to the current policy.

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.

FPI values livestock, including new cattle born into the herd at lower of cost or market (LCM) value until they are either sold or die. Costs for cattle under development are accumulated

throughout their development cycle. For dairy cattle, the development period is 22 months, which is the average age of maturity for a productive heifer. At this point the cow is considered a capital asset and the LCM analysis can be conducted and the asset properly valued. All beef cattle accumulate costs on a monthly basis until sale or death has occurred. A gain or loss will be recognized on all beef cattle at the time of death or sale.

Agribusiness livestock, property, plant and equipment will be depreciated using straight-line depreciation along with the standard useful life structure noted above.

#### 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.

#### Subsequent Events

Subsequent events are evaluated by management through the date that the financial statements are available to be issued, which is November 7, 2016.

### **Note 3. Investments**

The historical cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities at September 30 were as follows:

<u>As of September 30,</u>	<u>2016</u>	<u>2015</u>
Historical cost	\$ 214,126	\$ 79,925
Gross unrealized holding gains	1,693	418
Gross unrealized holding losses	(284)	(11)
<b>Fair Value of Investments</b>	<b>\$ 215,535</b>	<b>\$ 80,332</b>

The investments above held by FPI at September 30, 2016 and 2015 consist of Market Notes, issued by the U.S. Treasury. All of these notes are either explicitly or implicitly backed by the U.S. Government. Given the backing by the U.S. Government, current market conditions have not had a significant adverse impact on the fair value of these securities.

Maturities of the notes were as follows as of September 30, 2016:

	<u>Historical Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 69,035	\$ 68,807
Due after one year through five years	<u>145,091</u>	<u>146,728</u>
	<b><u>\$ 214,126</u></b>	<b><u>\$ 215,535</u></b>

All of the notes held by FPI at September 30, 2016 are valued using quoted prices (unadjusted) from the U.S. Treasury FedInvest Security Balance Report. The fair value of the notes presented above represents the best estimate of prices that the notes could be sold for in the market as of September 30, 2016.

#### **Note 4. Accounts Receivable, Net**

Accounts receivable, net consists of the following:

<u><i>As of September 30,</i></u>	<b><u>2016</u></b>	<b><u>2015</u></b>
Intragovernmental receivables	\$ 39,580	\$ 38,205
Interest Receivable – Investments	761	216
Private sector receivables	<u>6,731</u>	<u>4,569</u>
	47,072	42,990
Less allowance for doubtful accounts	770	<u>1,105</u>
<b>Accounts receivable, net</b>	<b>\$ 46,302</b>	<b>\$ 41,885</b>

FPI incurred bad debt expense of \$(253) and \$793, respectively, for the fiscal years ended September 30, 2016 and 2015.

#### **Note 5. Inventories, Net**

Inventories, net consists of the following:

<u><i>As of September 30,</i></u>	<b><u>2016</u></b>	<b><u>2015</u></b>
Raw materials	\$ 65,229	\$ 68,689
Work-in-process	14,438	25,398
Finished sub-assemblies	5,750	5,488
Finished goods	26,578	32,425
Finished goods – acceptance contracts	9,214	21,079
	121,209	153,079
Less inventory allowance	15,072	22,241
<b>Inventories, net</b>	<b>\$ 106,137</b>	<b>\$ 130,838</b>

\$9,214 of FPI's fiscal year 2016 and \$21,079 of its fiscal year 2015 finished goods balance represents goods shipped to customers or their agents, and is unrecognized revenue due to acceptance criteria within the customer contract.

#### **Note 6. Property, Plant and Equipment, Net**

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

<i><u>As of September 30,</u></i>	<b>2016</b>	<b>2015</b>
Buildings and improvements	\$ 172,072	\$ 172,043
Machinery and equipment	103,545	103,175
Livestock	2,951	5,378
Computer hardware	3,083	3,064
Computer software	7,600	7,601
	289,251	291,261
<u>Less accumulated depreciation</u>	<u>230,379</u>	<u>215,935</u>
	58,872	75,326
<u>Construction in progress</u>	<u>57</u>	<u>57</u>
<b>Property, plant and equipment, net</b>	<b>\$ 58,929</b>	<b>\$ 75,383</b>

During fiscal year 2015, the BOP transferred control of the farming operations located at El Reno, OK and Lompoc, CA to FPI. The BOP transferred capital assets totaling \$6,905 without reimbursement. Included in the transfer were machinery, equipment and livestock.

Depreciation and amortization expense totaled \$8,294 and \$8,738 for the fiscal years ended September 30, 2016 and 2015, respectively. During fiscal years 2016 and 2015, FPI invested \$2,349 and \$2,313, respectively, for the purchase and construction of property, plant and equipment.

As a result of FPI capacity consolidation in fiscal year 2016, a number of buildings no longer being used for production were impaired. That resulted in an increase in accumulated depreciation, thus reducing overall net value of Property, plant and equipment.

## **Note 7. Other Accrued Expenses**

Other accrued expenses consist of the following:

<u>As of September 30,</u>	<b>2016</b>	<b>2015</b>
Materials in transit	\$ 574	\$ 1,715
Relocation travel expense	510	531
FECA liabilities – current portion	2,019	2,400
Financial audit expense	591	314
Telecommunication expense	1,148	2,267
Utilities	727	1,020
Product Warranties	364	362
Intra-Departmental Agreements	1,453	643
Vendor Invoices	2,591	486
<u>Other expense</u>	<u>123</u>	<u>24</u>
<b>Other accrued expenses</b>	<b>\$ 10,100</b>	<b>\$ 9,762</b>

## **Note 8. Business Segments**

FPI's businesses are organized, managed and internally reported as six operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI is not dependent on any single product as a primary revenue source; however, it is currently predominately dependent on the federal government market for the sale of its products and services. FPI's net sales for the fiscal years ended September 30, 2016 and 2015 for each of its business segments is presented for comparative purposes:

<i>Net Sales For the fiscal years ended September 30,</i>	<b>2016</b>	<b>2015</b>
<b><u>Business Segment</u></b>		
Agribusiness	\$ 5,795	\$ 7,290
Clothing and Textiles	196,097	177,474
Electronics	126,999	134,627
Office Furniture	120,488	99,338
Recycling	13,904	17,227
Services	35,122	35,944
 <b>Net sales</b>	 \$ 498,405	 \$ 471,900

---

*Regulatory Compliance*

FPI's ability to add or to expand production of a specified mandatory 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. FPI also has procedures for competitive and non-mandatory items it produces. Finally, publication of annual decisions of the FPI Board of Directors and semi-annual sales disclosures are mandated under the Act.

**Note 9. 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 financial activities and their relationship with FPI:

*Relationship with the Federal Bureau of Prisons*

FPI and the BOP have a unique relationship in that the nature of their combined 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 Commissioner of Federal Prison Industries. General management of FPI is provided by the Chief Executive 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 general expense and other income of FPI for the fiscal years ended September 30, 2016 and 2015, 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, 2016 and 2015, the accrued FECA liabilities as charged to FPI, approximated \$2,019 and \$2,400, 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 \$24,303 and \$23,657 as of September 30, 2016 and 2015, respectively.

FPI as a Government corporation records FECA liability balance provided by the Department of Labor calculated using a methodology different from application of the current spot rate. The FECA liability would be approximately \$2,268 and \$1,716 larger for the fiscal years ended 2016 and 2015, respectively, using the current spot rate.

### *Retirement*

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS), the Federal Employee Retirement System (FERS) or the Federal Employee Retirement System-Revised Annuity Employees (FERS-RAE) System. For employees covered by the CSRS, (those employees hired prior to January 1, 1984), for fiscal years ended September 30, 2016 and 2015, FPI contributed approximately 7 percent (for normal retirement) or 7.5 percent (for hazardous duty retirement) of each employee's salary, respectively. CSRS covered employees do not have Federal Insurance Contribution Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered by the FERS, (generally those employees hired between January 1, 1984 and December 31, 2012), FPI contributed (for normal retirement) 13.7 percent and 13.2 percent for fiscal years ended September 30, 2016 and 2015. FPI contributed (for hazardous retirement) 30.1 percent and 28.8 percent for fiscal years ended September 30, 2016 and 2015. For employees covered by the FERS-RAE, (generally those employees hired on or after January 1, 2013), FPI contributed (for

normal retirement) 11.9 percent and 11.1 percent for fiscal years ended September 30, 2016 and 2015. FPI contributed (for hazardous duty retirement) 28.4 percent and 26.5 percent for the fiscal years ended September 30, 2016 and 2015.

Under FERS and FERS-RAE, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift savings plan). Under the thrift plan, an employee may contribute (tax deferred) to an investment fund, up to \$18,000 of salary for the fiscal years ended September 30, 2016 and 2015. FPI then matches this amount up to 4 percent in addition to an automatic 1 percent that is contributed for all FERS and FERS-RAE employees. Those employees that elected to remain under CSRS after January 1, 1984 continue to receive benefits in place, and may also contribute (tax deferred) up to \$18,000 of their salary to the thrift plan for the fiscal years ended September 30, 2016 and 2015, but with no automatic or matching amount contributed by FPI.

CSRS, FERS, and FERS-RAE 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 was approximately \$20,417 and \$22,444 for the fiscal years ended September 30, 2016 and 2015, 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 \$1,049 and \$2,104 in the fiscal years ended September 30, 2016 and 2015, 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 \$7,746 and \$8,211 for the fiscal years ended September 30, 2016 and 2015, 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 \$4,474 and \$4,464 during the fiscal years ended September 30, 2016 and 2015, respectively, were determined by OPM utilizing cost factors 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.

#### **Note 10. Sales and Marketing, General and Administrative Expenses**

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

<i>Fiscal years ended September 30,</i>	<b>2016</b>	<b>2015</b>
Salaries, wages and benefits	\$ 30,924	\$ 33,538
Permanent change of station expense	405	630
Purchases of minor equipment	407	477
Contract services	11,109	8,088
Bad debt expense	(263)	793
Credit card service fees	664	843
Travel	746	1,278
Personal computer expense	331	1,486
Accident compensation	2,453	3,265
Financial audit	1,173	1,151
Marketing	966	1,238
Depreciation	1,436	1,458
Loss on disposition of assets	7,447	207
Telecommunication expense	2,537	2,196
Other expense	(3,793)	(4,236)
Imputed pension costs	1,049	2,104
Imputed post-retirement health care and life insurance cost	4,474	4,464
<b>Imputed operating costs</b>	<b>18,109</b>	<b>19,480</b>
 <b>Sales and marketing, general and administrative expenses</b>	 <b>\$ 80,174</b>	 <b>\$ 78,460</b>

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 \$8.7 million for fiscal year 2016 and \$11.0 million for fiscal year 2015. Contract services consist primarily of consulting and sales and marketing fees.

## **Note 11. Commitments and Contingencies**

### Legal Contingencies

FPI is party to various administrative proceedings, legal actions, and claims. The balance sheet includes an estimated liability for those legal actions where management and the FPI General Counsel consider adverse decisions “probable” and amounts are reasonably estimable. Legal actions where management and the FPI General Counsel 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 organization’s 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, 2016 and 2015, future capital lease payments due total \$125 and \$179, and future operating lease commitments total \$81 and \$108, 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.

#### *Changes in aggregate product warranty liability*

<u>Fiscal years ended September 30,</u>	<u>2016</u>	<u>2015</u>
Balance at the beginning of the period	\$ 362	\$ 361
Accruals for warranties issued during the period	361	42
<u>Settlements made (in cash or in kind) during the period</u>	<u>(359)</u>	<u>(41)</u>
Balance at the end of the period	\$ 364	\$ 362

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:

<u>Fiscal years ended September 30,</u>	<u>2016</u>	<u>2015</u>
Congressional limitation on expenses	\$ 2,700	\$ 2,700
Expenses incurred subject to Congressional limitation	\$ 2,353	\$ 2,449

**Note 12. Financial Statement Disclosure**

Acquisition of Agribusiness

During fiscal year 2015, the BOP transferred control of the farming operations located at El Reno, OK and Lompoc, CA to FPI. This noncash transfer of capital assets was contributed capital totaling \$6,905. Included in the transfer were machinery, equipment and livestock. Transferred machinery and equipment were recorded utilizing the existing book values established by the BOP. Livestock values transferred were established by the BOP using the Lower of Cost or Market.

As a noncash transaction, the Agribusiness transfer is not reflected on the Statement of Cash Flows.

*The Department of Justice Office of the Inspector General (DOJ OIG) is a statutorily created independent entity whose mission is to detect and deter waste, fraud, abuse, and misconduct in the Department of Justice, and to promote economy and efficiency in the Department's operations. Information may be reported to the DOJ OIG's hotline at [www.justice.gov/oig/hotline](http://www.justice.gov/oig/hotline) or (800) 869-4499.*



Office of the Inspector General  
U.S. Department of Justice  
[www.justice.gov/oig](http://www.justice.gov/oig)