



Audit of the Federal Prison Industries,
Inc. Annual Financial Statements
Fiscal Year 2022



AUDIT DIVISION

23-039

MARCH 2023



COMMENTARY AND SUMMARY

Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2022

Objectives

Pursuant to the Government Corporation Control Act, as amended (31 U.S.C. § 9105), the Department of Justice Office of the Inspector General (OIG) contracted with an independent auditor to perform an audit of the Federal Prison Industries, Inc.'s (FPI) annual financial statements.

The objectives of the audit were to opine on the financial statements; report on internal control over financial reporting; and report on compliance and other matters, including compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA).

Results in Brief

KPMG LLP (KPMG) found that the FPI's financial statements are fairly presented as of and for the year ended September 30, 2022, and issued an unmodified opinion. KPMG identified one material weakness in the Independent Auditors' Report and did not report any instances of non-compliance.

The OIG reviewed KPMG's report 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 FFMIA, or conclusions on compliance and other matters. KPMG is responsible for the attached Independent Auditors' Report dated November 15, 2022, and the conclusions expressed in the report. Our review disclosed no instances where KPMG did not comply, in all material respects, with Government Auditing Standards.

Recommendations

KPMG provided FPI one recommendation to develop and implement internal controls over the recognition of revenue.

Audit Results

Under the direction of the OIG, KPMG performed the FPI's audit in accordance with auditing standards generally accepted in the United States of America. The fiscal year (FY) 2022 audit resulted in an unmodified opinion on the financial statements. An unmodified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in accordance with U.S. generally accepted accounting principles. For FY 2021, the FPI also received an unmodified opinion on its financial statements (OIG Audit Division Report Number 22-022).

KPMG identified one material weakness in the FY 2022 Independent Auditors' Report, noting untimely revisions were made to the internal control system after the adoption of Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, in fiscal year 2021. No instances of non-compliance or other matters were identified during the audit that are required to be reported under Government Auditing Standards. Additionally, KPMG's tests disclosed no instances in which the FPI's financial management systems did not substantially comply with FFMIA.

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

**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 2022, FPI operated in seven business segments: Agribusiness, Clothing and Textiles, Electronics, Fleet, Office Furniture, Recycling, and Services. FPI has agricultural, industrial and service operations at 69 factories and 2 farms located at 51 prison facilities as of September 30, 2022. 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 for fiscal year 2022 include the Department of Defense (DOD), the Department of Justice (DOJ), the Department of Homeland Security (DHS), 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 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 2022 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: In May 2014, the FASB issued Accounting Standard Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new guidance requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. FPI adopted Topic 606 on October 1, 2020 utilizing the modified retrospective method for all open contracts. FPI also adopted the related guidance in ASC 340-40, *Contracts with Customers* (ASC 340-40) on October 1, 2020 with respect to costs to obtain and costs to fulfill a contract.

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.

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 net realizable value (LCNRV) and include materials, labor and manufacturing overhead. Net realizable 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 LCNRV 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 88 years. Over the course of these years, FPI has positively impacted countless staff and inmate lives. 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 increased \$12.7 million during fiscal year 2022. The primary factor in the increase in cash was related to investments redeemed of \$19.9 million,

Investments

During fiscal year 2022, FPI redeemed \$19.9 million in investments. 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 \$7.9 million during fiscal year 2022. FPI's average days to collect in fiscal year 2022 were approximately 20.4 days.

Liabilities

Total Liabilities increased by \$9.6 million during fiscal year 2022. The primary contributor was a \$7.6 million increase in deferred revenue. The deferred revenue is attributable to customer advances payable on hand primarily for the retrofitting of vehicles for the Department of Homeland Security.

Revenue, Cost of Revenue, COVID-19, and Net Loss

Total revenue increased by \$14.5 million while total cost of revenue increased \$25.5 million. The COVID-19 pandemic continued during the beginning of fiscal year 2022 as well as a national lockdown. Net sales for the year decreased \$17.8 million from fiscal year 2021. Clothing and Textiles business group led the way with an increase of \$15.0 million. Total cost of revenue increased \$25.5 million from previous year, resulting in a decrease in gross profit of \$11.0 million. With a slight increase of \$1.3 million in operating expenses, FPI recognized a \$10.8 million decrease in net income/(loss) over fiscal year 2021.

Business Segments

In fiscal year 2022, FPI's businesses were organized, managed, and internally reported as seven operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Fleet, 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 certain other general and administrative costs.

The amounts listed in the table below are presented as dollars in thousands.

Business Segment	Fiscal Year	
Agribusiness	2022	2021
Net Sales	\$7,314	\$6,132
Earnings	\$(1,473)	\$(1,444)
Clothing and Textiles		
Net Sales	\$142,973	\$127,956
Earnings	\$11,418	\$2,569
Electronics		
Net Sales	\$16,571	\$14,582
Earnings	\$(1,551)	\$(1,524)
Fleet		
Net Sales	\$67,411	\$92,514
Earnings	\$5,213	\$12,129
Office Furniture		
Net Sales	\$93,135	\$103,478
Earnings	\$(615)	\$8,056
Recycling		
Net Sales	\$30,642	\$30,593
Earnings	\$14,972	\$16,343
Services		
Net Sales	\$28,262	\$28,810
Earnings	\$5,699	\$7,603
Factory Total		
Net Sales	\$386,308	\$404,065
Earnings	\$33,663	\$43,732

Possible Future Effects of Existing Events and Conditions

During fiscal years 2021 and 2022, COVID-19, inflation and other economic factors related to COVID-19, negatively impacted the anticipated growth from the preceding five years. FPI realized a loss of \$6.2 million at the end of fiscal year 2022. The total cash and investment balance decreased by \$6.9 million during fiscal year 2022, to a total balance of \$299.1 million. Fiscal year 2022 net sales were \$386.3 million, a decrease of 4.4% over the previous year.

Continuing Impact of COVID-19 and related economic factors on FPI Operations

In fiscal year 2023, FPI will continue to work on recovering from the unprecedented disruptions to its operations due to the COVID-19 pandemic. The disruptions began at the end of March 2020, when all FPI factories were closed, except those converted to the production of personal protective equipment and two farm operations. In fiscal year 2022, most FPI factories were operational, but overall factory capacity operated at an average of only 68%, well below breakeven. By the end of September 2022, FPI was operating at only 80% of pre-pandemic levels due to necessary COVID-19 operational restrictions.

These restrictions had a negative impact on FPI's ability to manufacture and ship products to customers in a timely manner. Additionally, many customers were unable to accept deliveries, as they were either working a modified schedule or non-operational, due to the pandemic.

The recovery, defined as reaching pre-pandemic operational levels, is anticipated to take over 1 year, though this estimate is dependent on improving pandemic conditions. Driving this recovery will continue to be the exceptional efforts of FPI staff and inmate workers under extraordinary circumstances.

FPI will focus on controlling cost and sales growth as we satisfy customer demands and continue to seek opportunities to expand existing and new product lines. During fiscal year 2022, FPI secured several new contracts or modifications to current contracts that are expected to generate more sales over the next five years. FPI continues to pursue new business leads to assist with our plan of corporate growth.

Plan for Growth

In order to increase sales in fiscal year 2023 and beyond, FPI will review its strategic plan to consider our new economic environment. FPI will review its strategy of increasingly leveraging its Business Development Group (BDG). The BDG is the branch within FPI that explores and acquires commercial opportunities for FPI that are authorized under various authorities (including the First Step Act, repatriation, and PIECP), in addition to identifying and securing prime and subcontracting roles on federal government contracts. FPI will also review its five-year strategy where FPI plans to leverage the BDG to increase revenues by 8% to 10% annually, which is expected to result in the activation of six FPI factories and hundreds of new inmate jobs every year once FPI has recovered from the impact of the COVID-19 pandemic.

FPI is also utilizing the expertise of several third-party resources across business operations. This includes contracting with an information technology service provider to develop a digital marketing strategy; a lead generator organization to identify businesses that can manufacture products at FPI factories under FPI's repatriation and PIECP authorities; a procurement advisory

firm to assist in securing federal government contracts for FPI, primarily in FPI's Clothing and Textiles Business Group; and a consulting group to assist FPI in increasing its sales in the federal government and commercial optic markets. Additionally, FPI is using GovWin, a procurement intelligence database, to increase sales to government agencies, and Salesforce customer relationship management software to optimize customer relationships.

Inmate Employment

FPI employed 17,699 inmate workers throughout fiscal year 2022, which is well above FPI's goal of 12,975 inmate workers. In order to ensure that FPI work skills are up-to-date among releasing inmates with FPI experience, which is likely to enhance these inmates' post-release job prospects, FPI's goal is that 30% of the FPI inmate workforce will consist of inmates within 3 years of their release date. For fiscal year 2022, 30% of FPI inmates were within 3 years of their release, which is higher than last year.

The First Step Act requires the Attorney General to report on efforts to enable 75% of the eligible minimum- and low-risk offenders to have the opportunity to participate in a prison work program for not less than 20 hours per week. FPI will be expected to grow in order to provide a significant number of these opportunities.

Independent Auditors' Reports



KPMG LLP
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Washington, DC 20006

Independent Auditors' Report

Inspector General
U.S. Department of Justice

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

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2022 and 2021, 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.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the U.S. Department of Justice Federal Prison Industries, Inc. as of September 30, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS), 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. 22-01, *Audit Requirements for Federal Financial Statements*. Our responsibilities under those standards and OMB Bulletin No. 22-01 are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the FPI and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about FPI's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our



opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and OMB Bulletin No. 22-01 will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and OMB Bulletin No. 22-01, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Federal Prison Industries' internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the FPI's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Other Information

Management is responsible for the other information included in the annual financial statements. The other information comprises the Management's Discussion and Analysis but does not include the financial statements and our auditors' report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2022, we considered the FPI's internal control over financial reporting (internal control) as a basis for designing 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*.



Our consideration of internal control was for the limited purpose described in the preceding and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in Exhibit I, we identified a deficiency in internal control that we consider to be a material weakness.

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. We consider the deficiency described in the accompanying Exhibit I to be a material weakness.

Exhibit II presents the status of the prior year's finding and recommendation.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FPI's financial statements as of and for the year ended September 30, 2022, 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 financial statements. 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. 22-01.

Purpose of the Reporting Required by Government Auditing Standards

The purpose of the communication described in the Report on Internal Control Over Financial Reporting and the Report on Compliance and Other Matters sections is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the FPI's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 15, 2022

Material Weakness

This section contains our discussion of the material weakness that we identified in internal control over financial reporting.

Untimely Revisions to the Internal Control System

Federal Prison Industries, Inc. (FPI) provides employment and training for inmates in the Federal Prison System while remaining self-sufficient through the sale of its products and services primarily to other federal departments, agencies, and bureaus. FPI recognizes revenue in conformity with U.S. generally accepted accounting principles (GAAP) based on accounting standards issued by the Financial Accounting Standards Board (FASB). FPI adopted Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), in fiscal year 2021.

FPI's internal controls over recognition of revenue as required by Topic 606 were deficient; management did not review the analysis of their year-end accounts with sufficient precision to identify all amounts that needed to be recorded as required by Topic 606. We found that FPI did not perform a sufficient risk assessment to identify and respond to changes and related risks resulting from the prior year adoption of Topic 606 and as such, did not design and implement adequate control activities to prevent or detect and correct errors in their year-end Topic 606 adjustment. As a result, FPI did not identify all customized inventory for which revenue should have been recorded under Topic 606. Prior to management's correction, the resulting error understated total revenue and accounts receivable by \$4.2 million, understated cost of sales by \$3.1 million, and overstated raw materials by \$3.1 million.

Criteria:

The Government Accountability Office's Standards for Internal Controls in the Federal Government states:

- Principle 9 – Identify, Analyze, and Respond to Change
 - 9.01 Management should identify, analyze, and respond to significant changes that could impact the internal control system.
- Principle 10 – Design Control Activities
 - 10.02 Management designs control activities in response to the entity's objectives and risks to achieve an effective internal control system. Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives to achieve the entity's objectives and address related risks.

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) states:

- Section 606-10-05-2 (Overview and Background): This Topic establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

Recommendation:

We recommend that FPI management design and implement control activities to review the population of inventory items that need to be adjusted for and recorded as revenue under Topic 606 on a timely basis.
(New)

Management Response:

FPI Management concurs with this recommendation and FPI Management will evaluate the processes for the control activities associated with Topic 606. This comprehensive evaluation will ensure that procedures allow for sufficient precision to identify all amounts that need to be recorded as required by Topic 606.

FPI management intends to seek contractor support for the automation of Topic 606. While FPI personnel possess sufficient skill to adopt and administer Topic 606, the manual procedures currently in place lack sufficient controls, due to the volume of review required. Additionally FPI Management will, in conjunction with establishing additional required controls, perform internal control testing as required by OMB A-123.

STATUS OF PRIOR YEAR'S FINDING AND RECOMMENDATIONS

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, we have evaluated whether the Federal Prisons Industries, Inc. has taken the appropriate corrective action to address the finding and recommendations from the prior year's financial statements audit that could have a material effect on the financial statements or other financial data significant to the audit objectives. The following table provides the Office of the Inspector General report number where the material weakness was reported, our recommendations for improvement, and the status of the previously identified material weakness and recommendations as of the end of FY 2022.

Report	Material Weakness	Recommendations	Status
Annual Financial Statement Fiscal Year 2021 Report No. 22-022	Improvements Needed in Accounting Standard Implementation Controls	Recommendation No. 1: Design and implement policies and procedures to assess changes in accounting standards.	Completed
		Recommendation No. 2: Enhance its training programs to enable staff to identify and respond to required accounting principles.	Completed

Principal Financial Statements and Related Notes

See Independent Auditors' Report

Federal Prison Industries, Inc.

Balance Sheets

<i>As of September 30, (DOLLARS IN THOUSANDS)</i>	2022	2021
Assets		
Current:		
Cash and cash equivalents	\$ 252,978	\$ 240,245
Accounts receivable, net	43,100	35,226
Short term investments	25,966	19,936
Contract assets	57,797	48,050
Inventories, net	78,456	80,737
Other assets	1,712	2,728
Total current assets	460,009	426,922
Investments	20,127	45,799
Property, plant and equipment, net	77,078	81,165
Total long term assets	97,205	126,964
Total Assets	\$ 557,214	\$ 553,886
Liabilities and United States Government Equity		
Current:		
Accounts payable	\$ 38,518	\$ 38,000
Deferred revenue	106,047	98,413
Accrued salaries and wages	7,286	6,707
Accrued annual leave	5,987	5,787
Other accrued expenses	16,469	11,486
Total current liabilities	174,307	160,393
FECA actuarial liability	12,936	17,293
Total Liabilities	187,243	177,686
United States Government Equity		
Initial capital	4,176	4,176
Contributed capital	6,905	6,905
Cumulative results of operations	358,890	365,119
Total United States Government Equity	369,971	376,200
Total Liabilities and United States Government Equity	\$ 557,214	\$ 553,886

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>	2022	2021
Revenue:		
Net sales	\$ 386,308	\$ 404,065
Other revenue	156,785	124,552
Total revenue	543,093	528,617
Cost of revenue:		
Cost of sales	352,070	357,296
Cost of other revenue	151,448	120,754
Total cost of revenue	503,518	478,050
Gross profit	39,575	50,567
Operating expenses:		
Sales and marketing	7,545	7,261
General and administrative	70,303	69,287
Total operating expenses	77,848	76,548
Loss from operations	(38,273)	(25,981)
Interest income	2,983	2,016
Interest expense	(25)	(2)
Other income, net	29,086	28,507
Net income/ (loss)	(6,229)	4,540
Cumulative results of operations, beginning of fiscal year	365,119	350,514
Effect of adoption of ASU 2014-09, Revenue	-	10,065
Cumulative results of operations, end of fiscal year	\$ 358,890	\$ 365,119

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,</i>		
<i>(DOLLARS IN THOUSANDS)</i>	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ (6,229)	\$ 4,540
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	7,671	5,674
Amortization of discount or premium on investments	(298)	(885)
Loss on disposal of property, plant and equipment	651	1,049
Changes in:		
Accounts receivable	(7,874)	3,987
Contract assets	(9,747)	(9,997)
Inventories	2,281	(1,664)
Other assets	1,016	5,848
Accounts payable and accrued expenses	1,923	(1,840)
Deferred revenue	7,634	16,061
Net cash provided by (used in) operating activities	(2,972)	22,773
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(4,235)	(16,606)
Investments redeemed	19,940	59,473
Net cash provided by investing activities	15,705	42,867
Net increase (decrease) in cash and cash equivalents	12,733	65,640
Cash and cash equivalents, beginning of fiscal year	240,245	174,605
Cash and cash equivalents, end of fiscal year	\$ 252,978	\$ 240,245

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

Fiscal Years 2022 and 2021
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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 (fiscal year 2022 percent of sales activity including interagency sales shown in parenthesis), agencies and bureaus such as the Department of Defense (55%), the Department of Justice (17%), the Department of Homeland Security (11%), the Social Security Administration (5%), and the General Services Administration (1%). 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 69 factories and 2 farms located at 51 prison facilities that employed 11,421 and 10,032 inmates as of September 30, 2022 and 2021, 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 that have historically used FASB standards to continue to utilize FASB standards for Financial Statement presentations.

Fiscal Years 2022 and 2021
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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 years 2022 and 2021, FPI's investment activities and cash equivalents included overnight repurchase agreements 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, 2022 and 2021. 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 cost.

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.

Fiscal Years 2022 and 2021
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Unbilled receivables reflect the value of services provided that is being recognized as revenue for which FPI has an unconditional right to consideration before it invoices the customer.

Inventories

FPI maintains its inventory primarily for the manufacture of goods for sale to its customers. FPI's inventory is composed of four categories: Raw Materials, Work-in-Process, Finished Sub-Assemblies, 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 Sub-Assemblies consist of materials with FPI added labor and overhead that are available for the production cycle, and Finished Goods are materials with FPI added labor and overhead that have completed the production cycle. The Finished Goods are either awaiting sale to customers or represent goods shipped to customers or their agents where revenue is unrecognized due to acceptance criteria within the customer contract.

Raw material inventory is valued at moving average cost. All other inventory is valued at a standard cost that includes materials, labor, and manufacturing overhead and is periodically adjusted to approximate actual cost. Inventories are valued at the lower of cost or net realizable value (LCNRV). Net realizable value is calculated based on the contractual or anticipated selling price, less allowance for administrative expenses. FPI has established inventory allowances to account for LCNRV 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 office performs a review as though the vendor is 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

In May 2014, FASB issued Accounting Standard Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new guidance requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. FPI adopted Topic 606 on October 1, 2020 utilizing the modified retrospective method for all open contracts.

Fiscal Years 2022 and 2021
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FPI also adopted the related guidance in ASC 340-40, *Contracts with Customers* (ASC 340-40) on October 1, 2020 with respect to costs to obtain and costs to fulfill a contract.

FPI records as other revenue the shipping and handling costs that have been billed to customers, installation costs for FPI furniture products, and items procured for its customers, the cost of the items, and the related service fees as part of procurement services provided by the Intragovernmental Solutions Services group.

Contract assets primarily represent revenue earnings over time that FPI does not yet have an unconditional right to consideration based on the terms of the contracts. FPI does not have impairment losses associated with contracts with customers for the year ended September 30, 2022 and 2021.

Deferred revenue (contract liabilities) is comprised of customer cash advances, which have been paid to FPI prior to the manufacturing of goods, delivery of goods, or performance obligations have been satisfied.

Contract assets and contract liabilities are reported in a net position on an individual contract basis at the end of each reporting period. Contract assets and contract liabilities are classified as current as FPI expects to complete the related performance obligations and invoice the customers within one year of the balance sheet date.

Other income includes building rental income and 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 and amortization. Under FPI's current policy, depreciation and amortization 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, if any, is reflected in the statements of operations. Repairs and maintenance costs are expensed as incurred.

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FPI values livestock, including new cattle born into the herd at lower of cost or net realizable value (LCNRV) 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 LCNRV 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 and amortized 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 15, 2022.

Note 3. Investments

The amortized cost and maturities of investment securities were as follows:

<u>As of September 30,</u>	<u>2022</u>	<u>2021</u>
Due in one year or less	\$ 25,966	\$ 19,936
Due after one year through two years	20,127	45,799
	<u>\$ 46,093</u>	<u>\$ 65,735</u>

The investments above held by FPI at September 30, 2022 and 2021 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 had a significant adverse impact on the fair value of these securities.

As of September 30, 2022, all investments are in an unrealized loss position of \$753 thousand in comparison to having no investments in an unrealized loss position in 2021.

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Note 4. Accounts Receivable, Net

Accounts receivable, net consists of the following:

<i>As of September 30,</i>	2022	2021
Intragovernmental receivables	\$ 33,270	\$ 30,749
Interest receivable – investments	106	168
Unbilled receivables	4,825	1,677
Private sector receivables	5,510	3,242
	43,711	35,836
Less allowance for doubtful accounts	611	610
Accounts receivable, net	\$ 43,100	\$ 35,226

FPI incurred bad debt expense of \$2 and \$77, respectively, for the fiscal years ended September 30, 2022 and 2021.

Note 5. Inventories, Net

Inventories, net consists of the following:

<i>As of September 30,</i>	2022	2021
Raw materials	\$ 53,701	\$ 54,997
Work-in-process	5,925	5,199
Finished sub-assemblies	6,309	6,548
Finished goods	14,179	16,136
Finished goods – acceptance contracts	2,994	2,860
	83,108	85,740
Less inventory allowance	4,652	5,003
Inventories, net	\$ 78,456	\$ 80,737

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Note 6. Property, Plant and Equipment, Net

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

<i><u>As of September 30,</u></i>	2022	2021
Buildings and improvements	\$ 174,092	\$ 174,056
Machinery and equipment	86,530	87,102
Livestock	2,589	2,821
Computer hardware	2,263	2,262
Computer software	41,715	6,298
	307,189	272,539
<u>Less accumulated depreciation</u>	<u>231,471</u>	<u>226,590</u>
	75,718	45,949
Software under development	1,108	35,036
<u>Construction in progress</u>	<u>252</u>	<u>180</u>
Property, plant and equipment, net	\$ 77,078	\$ 81,165

Depreciation and amortization expense totaled \$7,671 and \$5,674 for the fiscal years ended September 30, 2022 and 2021, respectively. During fiscal years 2022 and 2021, FPI invested \$4,235 and \$16,606, respectively, for the purchase and construction of property, plant and equipment.

During fiscal years 2022 and 2021, FPI recorded losses of \$0 and \$206, respectively, for the lower of cost or net realizable value analysis conducted on the Agribusiness Group's livestock assets. Each September, FPI conducts market price analysis in the areas surrounding each of the farms to determine the market value of the herd. Any asset categories that have a carrying value more than market are written down and the loss is recorded.

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Note 7. Other Accrued Expenses

Other accrued expenses consist of the following:

<i>As of September 30,</i>	2022	2021
Materials in transit	\$ 380	\$ 551
Relocation travel expense	1,297	612
FECA liabilities – current portion	1,717	1,547
Financial audit expense	1,205	1,302
Telecommunication expense	1,711	2,839
Utilities	1,089	709
Product warranties	311	311
Intra-Departmental agreements	944	696
Vendor invoices	7,827	2,568
Other expense	(12)	351
Other accrued expenses	\$ 16,469	\$ 11,486

Note 8. Business Segments

FPI's businesses are organized, managed and internally reported as seven operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Fleet, 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, 2022 and 2021 for each of its business segments are presented for comparative purposes:

Fiscal Years 2022 and 2021
Notes to Financial Statements
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Net Sales

<i>For the fiscal years ended September 30,</i>	2022	2021
<hr/>		
<u>Business Segment</u>		
Agribusiness	\$ 7,314	\$6,132
Clothing and Textiles	142,973	127,956
Electronics	16,571	14,582
Fleet	67,411	92,514
Office Furniture	93,135	103,478
Recycling	30,642	30,593
Services	28,262	28,810
<hr/>		
Net sales	\$ 386,308	\$ 404,065
<hr/>		

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 an 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, 2022 and 2021, respectively.

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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, 2022 and 2021, the accrued FECA liabilities as charged to FPI, approximated \$1,717 and \$1,547, respectively.

FPI is required by generally accepted accounting principles (GAAP) to account for future workers' compensation costs not yet paid. These costs include employees' medical expenses, payments for continuation of wages, estimated liability of death, and DOL administrative fees. The liability amount is determined by discounting the projected annual benefit payments using Treasury spot rates. FPI's estimated future liability approximated \$12,936 and \$17,293 as of September 30, 2022 and 2021, respectively.

Retirement

All of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS), the Federal Employee Retirement System (FERS), the Federal Employee Retirement System-Revised Annuity Employees (FERS-RAE), or the Federal Employee Retirement System-Further Revised Annuity Employees (FERS-FRAE) System. For employees covered by the CSRS, (those employees hired prior to January 1, 1984), for fiscal years ended September 30, 2022 and 2021, 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) 18.4 percent and 17.3 percent for fiscal years ended September 30, 2022 and 2021, respectively. FPI contributed (for hazardous retirement) 37.6 percent and 35.8 percent for fiscal years ended September 30, 2022 and 2021, respectively. For employees covered by the FERS-RAE, (generally those employees hired between January 1, 2013 and December 31, 2013), FPI contributed (for normal retirement) 16.6 percent and 15.5 percent for fiscal years ended September 30, 2022 and 2021, respectively. FPI contributed (for hazardous duty retirement) 35.8 percent and 34.0 percent for the fiscal years ended September 30, 2022 and 2021, respectively. For

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employees covered by the FERS-FRAE, (generally those employees hired on or after January 1, 2014), FPI contributed (for normal retirement) 16.6 percent and 15.5 percent for fiscal years ended September 30, 2022 and 2021, respectively. FPI contributed (for hazardous duty retirement) 35.8 percent and 34.0 percent for the fiscal years ended September 30, 2022 and 2021, respectively.

Under FERS, FERS-RAE, and FERS-FRAE 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 \$20,500 and \$19,500 of salary for the fiscal years ended September 30, 2022 and 2021, respectively. FPI then matches this amount up to 4 percent in addition to an automatic 1 percent that is contributed for all FERS, FERS-RAE, and FERS-FRAE 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 \$20,500 and \$19,500 of their salary to the thrift plan for the fiscal years ended September 30, 2022 and 2021 respectively, but with no automatic or matching amount contributed by FPI.

CSRS, FERS, FERS-RAE, and FERS-FRAE 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 \$25,093 and \$23,172 for the fiscal years ended September 30, 2022 and 2021, 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 \$1,145 and \$549 in the fiscal years ended September 30, 2022 and 2021, 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 \$8,145 and \$7,934 for the fiscal years ended September 30, 2022 and 2021, 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 \$5,985 and \$5,726 during the fiscal years ended September 30, 2022 and 2021, respectively, were determined by OPM utilizing cost factors

Fiscal Years 2022 and 2021
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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. Revenue Recognition

<i><u>As of September 30,</u></i>	2022	2021	\$ Change	%Change
Accounts receivable	\$ 43,100	35,226	7,874	22%
Contract assets	57,797	48,050	9,747	20%
Contract liabilities	(106,047)	(98,412)	(7,634)	(8)%

Revenue Recognition

FPI recognizes revenue in accordance with ASC Topic 606, *Revenue from Contracts with Customers*, which provides a five-step model for recognizing revenue from contracts with customers as follows:

- Identify the contract with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognize revenue when or as performance obligations are satisfied

FPI's revenue is primarily derived from a wide range of products and services that are produced through its full-time work program for inmate populations. FPI's products and services are marketed and sold primarily to governmental departments, agencies, and bureaus, as well as end-user commercial customers in the United States. Sales of products and services are subject to economic conditions and may fluctuate based on changes in the industry and financial markets.

FPI assesses the contract term as the period in which the parties to the contract have presently enforceable rights and obligations. The contract term can differ from the stated term in contracts that include certain termination or renewal rights, depending on whether there are penalties associated with those rights. Generally, FPI's orders of products and services can be terminated for convenience, but these products and services allow for termination where FPI would be entitled to consideration, including a reasonable profit margin, for work completed up through the effective date of termination. These contracts with termination for convenience rights impact the

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determination of the contract term and may give rise to material rights with respect to implied renewal options for periods related to customer decision to not terminate.

Nature of products and services

Agribusiness:

Milk Delivery: FPI contracts with customers to deliver milk products. Revenue from agribusiness is recognized upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Clothing and Textiles:

Uniforms and Mattresses: FPI contracts with customers to manufacture uniforms and mattresses, which can be customized or non-customized. Revenue for customized uniforms and mattresses is recognized over time as a series as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes an output method based on the number of uniforms or mattresses completed as a measurement of progress toward satisfaction of the performance obligation. Revenue for non-customized uniforms and mattresses is recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Personal Protective Equipment: FPI contracts with customers to manufacture non-custom personal protective equipment. Revenue is recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

PIE Certification Program: FPI contracts with customers to provide sewing services. Revenue is recognized over time as a series as the customer simultaneously receives and consumes the benefits of services provided. FPI can apply the right to invoice practical expedient because FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date.

Electronics:

Cable Assemblies: FPI contracts with customers to manufacture cable assemblies, which can be customized to customer specifications or non-customized. Revenue for customized cable assemblies is recognized over time as a series as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes an output method based on the number of cable assemblies manufactured as a measurement of progress toward satisfaction of the performance obligation. Revenue for non-customized cable assemblies and other standard finished goods are recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Manufacturing finished goods: FPI contracts with customers to manufacture finished goods, which are non-customized, and have alternate use. Revenue for these finished goods is recognized at a point in time, upon delivery to customer based on shipping terms.

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Eyewear: FPI manufactures eyewear, which can be customized to customer specifications or non-customized. Revenue for customized eyewear is recognized over time as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes the output method as a measurement of progress toward satisfaction of the performance obligation. Revenue for non-customized eyewear is recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Fleet:

Upfit Services: FPI contracts with customers to provide vehicle upfit services. Revenue for vehicle upfit services, including the ordering of vehicles and customized upfit services, is recognized over time as there is no alternative use for the asset and FPI has an enforceable right to payment. These services are recognized using an input method as costs are incurred compared to estimated costs, as that best depicts the measure of progress toward satisfaction of the performance obligation.

Fleet Procurement Services: Revenue, in the form of an administrative fee, for fleet procurement services are recorded gross as FPI is the principal in the transaction. Revenue should be recognized overtime as FPI enhances an asset the customer controls. Design is a fulfillment cost.

Office Furniture:

Office Furniture and Pallet Racking: FPI manufactures and installs furniture and pallet racking. Furniture and pallet racking can be customized to customer specifications or non-customized. Revenue for customized furniture and pallet racking are recognized over time as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes the input method to measure costs incurred to date compared to the total cost for the contract as a measurement of progress toward satisfaction of the manufacturing performance obligation. Revenue for non-customized furniture and pallet racking are recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms. Installation services for customized and non-customized furniture and pallet racking is recognized over time because the service is enhancing an asset that the customer controls under the input method as costs are incurred compared to estimated costs, as that best depicts the measure of progress toward satisfaction of the performance obligation.

Storage: FPI stores furniture for its customers. Storage is recognized over time ratably over the storage period.

Scanning, Printing, and Mailing Services: FPI contracts with customers to provide scanning, printing, and mailing services. Revenue is recognized over time as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI applies the right to invoice practical expedient because the FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date.

Recycling:

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Recycled Products: FPI contracts with customers to sell recycled products. Revenue is recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Services:

Signs: FPI creates signs which include manufacturing and installation services. Signs can be customized to the customer specifications or non-customized. Revenue for customized signs is recognized over time as a series as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes an output method based on the number of signs completed as a measurement of progress toward satisfaction of the manufacturing performance obligation. Revenue for non-customized signs is recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms. Installation services for customized and non-customized signs is recognized over time because the service is enhancing an asset that the customer controls using an input method based on costs incurred compared to total estimated costs, as that best depicts the measure of progress toward satisfaction of the performance obligation.

License Plates, Print Products, and Filtration Products: FPI manufactures license plates, print products or filtration products, which can be customized to customer specifications or non-customized. These services are all separate performance obligations. Revenue for customized license plates, print products, and filtration products are recognized over time as a series as there is no alternative use for the asset and FPI has an enforceable right to payment. FPI utilizes an output method based on the number of items completed as a measurement of progress toward satisfaction of the performance obligation. Revenue for non-customized license plates, print products, and filtration products, are recognized at a point in time upon transfer of control to the customer, which is typically upon delivery to the customer based on shipping terms.

Call Center Services: FPI contracts with customers to provide call center services. Revenue is recognized over time as a series as the customer simultaneously receives and consumes the benefits of services provided. FPI applies the right to invoice practical expedient because the FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date.

Laundry Services: FPI contracts with customers to provide laundry services. Revenue is recognized over time as the customer simultaneously receives and consumes the benefits of services provided. FPI applies the right to invoice practical expedient because the FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date. Alterations are also recognized over time under the variable allocation exception.

Distribution Center Services: FPI contracts with customers to provide distribution center services. Revenue is recognized over time as the customer simultaneously receives and consumes the benefits of services provided. FPI applies the right to invoice practical expedient because FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date.

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Data Entry Services: FPI contracts with customers to provide data entry services. Revenue is recognized over time as there is no alternative use for the documents and FPI has an enforceable right to payment. FPI applies the right to invoice practical expedient because the FPI's right to consideration corresponds directly with the value transferred to the customer for performance completed to date.

Procure Electronic Services: FPI also contracts with customers to procure electronic services, including hiring a third party to order materials and provide labor and installation services. Revenue, in the form of an administrative fee, is recorded net for these services as FPI is the agent in the transaction and is recognized at a point in time upon customer acceptance of the service.

FPI recognized revenue over time by business group for the year ended September 30, 2022 and 2021 as follows:

<u><i>As of September 30,</i></u>	<u><i>2022</i></u>	<u><i>2021</i></u>
Fleet	100%	100%
Clothing and Textiles	75 to 85	70 to 80
Electronics	45 to 55	45 to 55
Services	35 to 45	35 to 45
Office Furniture	25 to 35	25 to 35

The remaining revenue including substantially all of Agribusiness and Recycling was recognized at a point in time.

Contracts with multiple performance obligations

When FPI's contracts with customers contain multiple performance obligations, the contract transaction price is allocated on a relative standalone selling price (SSP) basis to each performance obligation. FPI typically determines SSP based on observable selling prices of its products and services. In instances where SSP is not directly observable, SSP is determined using information that may include market conditions and other observable inputs or by using a cost plus margin approach. On a limited basis, certain of the FPI's contracts may include implied renewal periods for shortened contract terms due to termination for convenience rights. FPI evaluated the options and determined that FPI did not have any significant material rights during the year ended September 30, 2022.

Transaction price

The transaction price is the amount of consideration to which FPI expects to be entitled in exchange for transferring goods and services to the customer. Revenue is recorded based on the transaction price, which includes fixed consideration and estimates of variable consideration such as, time and

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material and cost plus contracts, prompt payment discounts, shortages or damaged products, restocking fees, markdowns on damaged or returned items, and chargebacks.

The amount of variable consideration included in the transaction price is constrained and is included only to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

FPI uses the as-invoiced practical expedient for time and materials and cost plus contracts if the value transferred to the customer is commensurate with the invoice amount throughout the term of the contract. Although the rates are fixed in time and materials contracts, the activity in time and materials contracts will not be fixed at contract inception as the labor and materials used is billed as incurred. The costs and related fees in cost plus contracts is variable consideration because the amount of the costs is not fixed at the inception of the contract so although the fee percentage may be a fixed percentage the amount of compensation is variable.

The nature of FPI's business gives rise to prompt pay discounts, shortages or damaged products, restocking fees, markdowns on damaged or returned items, and chargebacks. FPI applies the expected value method to these forms of variable consideration using the sum of probability-weighted amounts in a range of possible amounts under the contract.

The timing of revenue recognition may not align with the right to invoice the customer. FPI records accounts receivable when it has the unconditional right to issue an invoice and receive payment, regardless of whether revenue has been recognized. If revenue has not yet been recognized, a contract liability (deferred revenue) also is recorded. If revenue is recognized in advance of the right to invoice, a contract asset (unbilled receivable) is recorded.

FPI applies the practical expedient which allows them to not adjust the amount of consideration for the effects of a significant financing component if FPI expects, at contract inception, that the period between when FPI transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. In instances where the timing of revenue recognition differs from the timing of the right to invoice, FPI has determined that a significant financing component generally does not exist under the practical expedient. Although there are contracts that can exceed 12 months, FPI does not wait until the end of the contract term to invoice the customer. Invoicing in amounts that correspond with the transfer of value to the customer is done throughout the length of the contract and, therefore, FPI did not identify any significant financing components during the year ending September 30, 2022.

FPI excludes from revenue sales taxes and other government-assessed and imposed taxes on revenue generating activities that are invoiced to customers.

Shipping and handling

All shipping and handling costs are included in cost of goods sold. When shipping and handling costs are incurred after a customer obtains control of the good, FPI has elected the practical

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expedient to account for such costs as fulfillment activities which are recognized in cost of goods sold when control of the good transfers to the customer. Any amounts billed to a customer in a sales transaction related to shipping and handling are classified as revenue.

Costs to obtain a contract

Sales commissions and other costs that are incremental to the acquisition of customer contracts, are capitalized as deferred contract costs under the provisions of ASC 340-40. FPI has elected to apply the practical expedient to expense sales commissions and associated costs as incurred when the expected amortization period is one year or less. FPI's contract acquisition costs meet the criteria to apply the practical expedient and thus no contract acquisition costs are capitalized.

Note 11. 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>	<i>2022</i>	<i>2021</i>
Salaries, wages and benefits	\$ 34,421	\$ 31,120
Permanent change of station expense	875	771
Purchases of minor equipment	49	1,512
Contract services	12,147	8,527
Bad debt expense	2	77
Credit card service fees	568	695
Travel	642	252
Personal computer expense	201	185
Accident compensation	(2,900)	(2,144)
Financial audit	1,473	1,554
Marketing	7,545	7,261
Depreciation	3,266	1,269
Loss on disposition of assets	6	32
Telecommunication expense	1,564	2,710
Other expense	(4,939)	(102)
Imputed pension costs	1,145	549
Imputed post-retirement health care and life insurance cost	5,985	5,726
<u>Imputed operating costs</u>	<u>15,798</u>	<u>16,554</u>
Sales and marketing, general and administrative expenses	\$ 77,848	\$ 76,548

Other expense is comprised primarily of, sales consulting fees, inmate wages, maintenance agreements, prior year RA adjustments, and distributions to factory operations. FPI distributes certain General and Administrative expenses that benefit all locations to the individual factory

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levels. These charges include computer licenses and fees, civilian and inmate accident compensation, and check charges. These charges totaled \$8.2 and \$8.1 million for fiscal years 2022 and 2021, respectively. Contract services consist primarily of consulting and sales and marketing fees.

Note 12. 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. As of September 30, 2022 and 2021, legal contingencies total \$975 and \$900, respectively.

Lease Commitments

FPI leases certain machinery 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, 2022, future capital lease payments due total \$0 and future operating lease commitments total \$126.

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

<i>Fiscal years ended September 30,</i>	<i>2022</i>	<i>2021</i>
Balance at the beginning of the period	\$ 311	\$ 311
Accruals for warranties issued during the period	60	9
Settlements made (in cash or in kind) during the period	(60)	(9)
Balance at the end of the period	\$ 311	\$ 311

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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><i>Fiscal years ended September 30,</i></u>	<u>2022</u>	<u>2021</u>
Congressional limitation on expenses	\$ 2,700	\$ 2,700
<u>Expenses incurred subject to Congressional limitation</u>	<u>\$ 2,576</u>	<u>\$ 2,387</u>

Appendix

APPENDIX: Office of the Inspector General Analysis and Summary of Actions Necessary to Close the Report

The Office of the Inspector General (OIG) provided a draft of the Independent Auditors' Report to the Federal Prison Industries, Inc. (FPI). The FPI's response is incorporated in the Exhibit of the Independent Auditors' Report of this final report. In response to the Independent Auditors' Report, the FPI concurred with the recommendation and discussed the actions it will implement in response to the finding. As a result, the status of the report is resolved. The following provides the OIG analysis of the response and summary of actions necessary to close the report.

Recommendation for the FPI:

- 1. We recommend that FPI management design and implement control activities to review the population of inventory items that need to be adjusted for and recorded as revenue under Topic 606 on a timely basis. (New)**

Resolved. FPI management concurred with this recommendation. FPI management stated in its response that it will evaluate the processes for the control activities associated with Topic 606. FPI management further stated that a comprehensive evaluation will ensure that procedures allow for sufficient precision to identify all amounts that need to be recorded as required by Topic 606. FPI management intends to seek contractor support for the automation of Topic 606. Additionally, FPI management will, in conjunction with establishing additional required controls, perform internal control testing as required by OMB A-123.

This recommendation can be closed when subsequent annual financial statement audit testing verifies that FPI designed and implemented control activities to review the population of inventory items that need to be adjusted for and recorded as revenue under Topic 606 on a timely basis.