



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



Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2014

**FEDERAL PRISON INDUSTRIES, INC.
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 2014**

**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, 2014, and September 30, 2013. 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 2014 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 2013, the FPI also received an unmodified opinion on its financial statements (OIG Audit Report No. 14-06).

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 2014 *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 2014 *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 4, 2014, 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.

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**AUDIT OF THE
FEDERAL PRISON INDUSTRIES, INC.
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 2014**

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We are pleased to present Federal Prison Industries, Inc.'s (FPI) Fiscal Year 2014 Annual Management Report to the Congress of the United States. This report includes FPI's financial statements, Management's Discussion and Analysis, Office of the Inspector General's 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.

FPI was established by statute and Executive Order 6917 in 1934, signed by President Roosevelt to provide opportunities for educational and work-related experiences to federal offenders. FPI celebrates its 80th anniversary this year. 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. In addition, FPI has established a new goal to reach as many inmates as possible by focusing on employment of inmates within two years of release. FPI has also established priority placement for United States military veterans.

As one of the Bureau of Prisons' (BOP) most important inmate reentry programs, over 12,000 federal inmates were working in FPI factories at fiscal year-end. The need to address inmate idleness was a contributing factor in the creation of FPI in 1934. The 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.

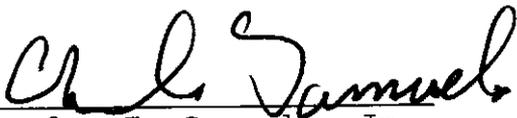
FPI is a program with proven lasting benefits, including reduced recidivism and a positive impact on the U.S. economy through the raw materials purchased from suppliers, including small and women owned businesses, as well as the staff salaries spent in the community, all without an additional tax burden to society.

As a federal government corporation, FPI is a program that also functions as a business to remain self-sustaining and that continues to face a dynamic set of external and internal constraints.

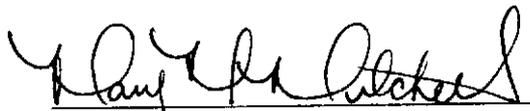
Due to reduced purchasing from FPI by the government sector, emphasis has been placed on exploring more opportunities with commercial customers. New market authorities, contained in the Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) now enable FPI to obtain commercial customers through manufacturing repatriation and bringing sales otherwise sent to foreign countries back into the United States. FPI has built on its fiscal year 2013 progress and capitalized on many new opportunities by implementing a number of pilot programs. At fiscal year-end, FPI employed approximately 1,000 inmates dedicated to repatriated work.

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 is proud to announce that its first PIECP operation was established at FCI Estill, South Carolina, and began operations in July of this year. As with any new initiative, the first hurdle is the biggest one. 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. We are also grateful for the exceptional contributions and dedication of FPI staff, as well as the continued outstanding support and leadership provided by the Board of Directors.



Charles E. Samuels, Jr.
Chief Executive Officer



Mary M. Mitchell
Chief Operating Officer

U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

MANAGEMENT'S
DISCUSSION & ANALYSIS
(UNAUDITED)



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

Mission

It is the mission of Federal Prison Industries, Inc. (FPI) to 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 Chief Executive Officer. General management of FPI is provided by the Chief Operating Officer who also serves as an Assistant Director for the BOP.

In fiscal year 2014, FPI operated in five business segments: Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI has industrial and service operations at 78 factories located at 62 prison facilities as of September 30, 2014. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed 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, staff salaries, and capital expenditures are applied against these revenues resulting in operating income or loss, which is reapplied toward operating costs for future production. In this regard, FPI makes capital investments in buildings and improvements, machinery, and equipment as necessary in the conduct of its industrial operation.

FPI sells products and services to the majority of federal departments, agencies and bureaus. FPI's largest federal government customers include the Department of Defense (DOD), the Department of 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 effecting Federal Prison Industries 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 2014 through research and discussion within the organization and other agencies. FPI activated its first PIECP factory at FCI Estill, SC in July 2014.

Critical Accounting Policies

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

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

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

Revenue is recognized on multiple element (numerous stages of product delivery, set up, and installation) agreements as a single unit of accounting for manufactured items when the product has been accepted by the customer.

Allowance for doubtful accounts receivable: The allowance for doubtful accounts is based upon an analysis of several factors including payment trends, historical write off experience, credit quality for non-governmental accounts, and specific analysis of collectability of an account. During the course of time, these factors may change which will cause the allowance level to adjust accordingly. As part of their analysis, customer accounts determined to be unlikely to be paid are recorded as a charge to bad debt expense in the income statement and the allowance account is increased. When it becomes certain that a customer account will not be paid, the receivable is written off by removing the balance from accounts receivable.

As of September 30, 2014 and 2013, FPI had established an allowance for doubtful accounts in the amount of \$.57 million and \$.41 million on accounts receivable balances of \$28.13 million and \$39.49 million, respectively.

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

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

Program Values

It is 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 80 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 Investments

Cash and Cash Equivalents increased \$49.9 million due to a \$55.7 million increase in Cash Advances of which \$49.2 million remained in deferred revenue as of September 30, 2014. FPI's cash advances are primarily for the purchase of inventory in support of the Fleet Management and Vehicular Components vehicle retrofitting operation. The primary customer for these operations is the Department of Homeland Security; advances fluctuate throughout the year as they receive appropriations. Despite a net loss of \$37.5 million, FPI preserved its cash through continued control of inventory and accounts receivable, reducing them to levels commensurate with its current sales. Additionally, FPI has maintained capital investment at a minimum. In the event sales increase to previous levels, cash will decline as FPI re-invests.

Accounts Receivable

The Accounts Receivable balance decreased \$11.5 million in fiscal year 2014. The Accounts Receivable balance of \$27.6 million as of September 30, 2014, represents 72.5 percent of September's total revenues. FPI's average days to collect for fiscal year 2014 were approximately 31. The Accounts Receivable balance over sixty days old represented 20.0 percent of the total balance as of September 30, 2014.

Inventory

Inventory decreased by \$16.8 million during fiscal year 2014. FPI continued to place emphasis on inventory reduction during fiscal year 2014. The Clothing and Textiles and Electronics business segments were the primary contributors to the reduction with a decrease of \$13.0 and \$4.3 million respectively. The Clothing and Textiles business segment decrease can be attributed to the decrease in protective wear inventories totaling \$12.8 million. The Electronics business segment decrease can be attributed to a \$5.7 million decrease in fleet vehicle inventory.

Liabilities

Total Liabilities increased by \$53.8 million. The primary contributors to the increase were a \$49.2 million increase in Deferred Revenue and a \$3.7 million increase in Accounts Payable. 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 (DHS) as a result of a decrease in customer contracts.

Revenue, Cost of Revenue and Net Loss

Total Revenue decreased by \$138.6 million while total cost of revenue decreased by \$100.9 million. The decrease in revenue resulted primarily from the decrease in sales revenue of \$144.2 million and a reduction in corresponding freight collections of \$2.4 million. The largest business segments showing a decrease in sales were Clothing and Textiles with \$69.4 million, Electronics with \$56.5 million and Office Furniture with \$20.2 million. The net loss increased \$33.3 million in fiscal year 2014 compared to fiscal year 2013. Factory earnings were \$37.2 million lower in fiscal year 2014 than fiscal year 2013. A significant increase in the number of factories operating below the break even point contributed to a 6 percent decrease in gross profit percentage during fiscal year 2014.

Business Segments

In fiscal year 2014, FPI's businesses were organized, managed and internally reported as five operating segments based on products and services. These segments are 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.

Business Segment	Fiscal Year	
	2014	2013
Clothing and Textiles		
Net Sales	\$166,246	\$235,691
Earnings	\$11,242	\$36,663
Electronics		
Net Sales	\$71,593	\$128,120
Earnings	(\$11,090)	(\$3,969)
Office Furniture		
Net Sales	\$98,323	\$118,533
Earnings	(\$1,384)	\$3,904
Recycling		
Net Sales	\$19,642	\$17,900
Earnings	\$7,334	\$6,566
Services		
Net Sales	\$33,327	\$33,093
Earnings	\$2,905	\$3,051
Factory Total		
Net Sales	\$389,131	\$533,337
Earnings	\$9,007	\$46,215

Possible Future Effects of Existing Events and Conditions

During fiscal year 2014, FPI encountered a decline in sales for the fifth consecutive year and experienced a net loss for the sixth consecutive year.

In fiscal years 2015 and beyond, FPI faces the additional challenge of the shrinking federal budget, the resulting decline in discretionary spending and the anticipated continued impact of decline in FPI sales. FPI is striving 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 has invested significant time and effort into pursuing this goal in fiscal year 2014 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 July 2014. Plans have been made to continue to aggressively pursue the implementation of the PIECP program in fiscal year 2015.

Repatriation

Due to the volatile nature of the changes effecting Federal Prison Industries 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.

Job Share Inmates

FPI employed 12,468 inmates as of September 30, 2014. FPI's continued emphasis on the use of job share inmate workers resulted in 911 job share inmates during fiscal year 2014 which contributed to FPI surpassing its planned employment of 12,300 inmates at the end of fiscal year 2014. Continued emphasis in 2015 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 25% 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. This goal has been incorporated into the fiscal year 2015 performance measurement system and FPI strategic plan.

Civilian Salaries

In fiscal year 2013, a realignment of staff was implemented resulting in reductions in total staffing, the realignment was completed in January 2014. FPI continues to evaluate staffing on a daily basis with continued savings through attrition. As positions become vacant corporate management evaluates each vacancy for need prior to filling.

Investment

FPI's investment activities include one-year market bonds with the Bureau of Public Debt of the United States Treasury. FPI's investment in market bonds is redeemable at any time without penalty at the original market interest rate and is therefore not subject to interest rate risk. During fiscal year 2013, FPI began investing in one-year market bonds through the Treasury Department. Past research revealed that it was not advantageous. Due to changed rates and market conditions, the prospect of investing in one-year bonds was re-evaluated and was determined to be beneficial to pursue. The initial investment of \$100 million took place in January 2013 and an additional \$100 million was invested in July 2013. During fiscal year 2014, FPI continued with its longer term investing strategy, maintaining total one-year bond investment of \$200 million. Due to the longer term nature of the bonds, FPI receives a higher rate of return on its investment. As a result, fiscal year 2014 investment earnings are approximately triple what they would have been had the longer term option not been pursued.

Pending Investigations

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

U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

INDEPENDENT AUDITORS' REPORTS



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KPMG LLP
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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, 2014 and 2013, 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; 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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02, require that we plan and perform the audits 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.



Independent Auditors' Report on the Financial Statements
Page 2

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

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, 2014 and 2013, and its net loss, cumulative results of operations, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Other Information

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 4, 2014 on our consideration of the FPI's internal control over financial reporting, and our report dated November 4, 2014 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 results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FPI's internal control over financial reporting and compliance.

KPMG LLP

November 4, 2014



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; 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. 14-02, *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, 2014 and 2013, 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 4, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2014, 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



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

November 4, 2014



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; 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. 14-02, *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, 2014 and 2013, 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 4, 2014.

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, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 14-02.

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 system requirements, (2) applicable federal accounting standards, and (3) application of the United States Government Standard General Ledger at the transaction level.



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

The purpose of this report is solely to describe the scope of our testing of compliance and the results 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

November 4, 2014

U.S. DEPARTMENT OF JUSTICE

FEDERAL PRISON INDUSTRIES, INC.

PRINCIPAL FINANCIAL STATEMENTS AND RELATED NOTES



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Federal Prison Industries, Inc.

Balance Sheets

<i>As of September 30, (DOLLARS IN THOUSANDS)</i>	2014	2013
Assets		
Current:		
Cash and cash equivalents	\$ 332,036	\$ 282,165
Accounts receivable, net	27,556	39,074
Inventories, net	78,628	95,411
Other assets	580	325
Total current assets	438,800	416,975
Property, plant and equipment, net	75,156	80,748
Total Assets	\$ 513,956	\$ 497,723
Liabilities and United States Government Equity		
Current:		
Accounts payable	\$ 42,044	\$ 38,295
Deferred revenue	108,325	59,098
Accrued salaries and wages	4,903	4,563
Accrued annual leave	6,887	7,337
Other accrued expenses	9,302	9,193
Total current liabilities	171,461	118,486
FECA actuarial liability	22,502	21,715
Total Liabilities	193,963	140,201
United States Government Equity		
Initial capital	4,176	4,176
Cumulative results of operations	315,817	353,346
Total United States Government Equity	319,993	357,522
Total Liabilities and United States Government Equity	\$ 513,956	\$ 497,723

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>	2014	2013
Revenue:		
Net sales	\$ 389,131	\$ 533,337
Other revenue	82,001	76,391
Total revenue	471,132	609,728
Cost of revenue:		
Cost of sales	378,071	486,494
Cost of other revenue	82,134	74,561
Total cost of revenue	460,205	561,055
Gross profit	10,927	48,673
Operating expenses:		
Sales and marketing	4,171	4,257
General and administrative	76,584	82,210
Total operating expenses	80,755	86,467
Loss from operations	(69,828)	(37,794)
Interest income	252	238
Interest expense	(8)	(2)
Other income, net	32,055	33,306
Net loss	(37,529)	(4,252)
Cumulative results of operations, beginning of fiscal year	353,346	357,598
Cumulative results of operations, end of fiscal year	\$ 315,817	\$ 353,346

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>	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (37,529)	\$ (4,252)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,059	8,650
Loss on disposal of property, plant and equipment	18	291
Changes in:		
Accounts receivable	11,518	(12,933)
Inventories	16,783	33,843
Other assets	(255)	503
Accounts payable and accrued expenses	4,535	(6,629)
Deferred revenue	49,227	(35,794)
Net cash provided by (used in) operating activities	52,356	(16,321)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(2,485)	(2,058)
Net cash used in investing activities	(2,485)	(2,058)
Net increase (decrease) in cash and cash equivalents	49,871	(18,379)
Cash and cash equivalents, beginning of fiscal year	282,165	300,544
Cash and cash equivalents, end of fiscal year	\$ 332,036	\$ 282,165

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

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Note 1. Organization and Mission

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

FPI’s federal government customers include departments (percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (53%), the Department of Justice (13%), the Department of Homeland Security (9%), the Social Security Administration (5%), and the General Services Administration (5%). These and other federal organizations are generally required to purchase products from FPI, if its products meet the customer’s price, quality, and delivery standards, under a mandatory source preference specified in FPI’s enabling statute and the Federal Acquisition Regulation.

FPI has industrial and service operations at 78 factories located at 62 prison facilities that employed 12,468 and 13,001 inmates as of September 30, 2014 and 2013, 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.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

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 purchased with an original maturity of three months or less to be cash equivalents. FPI's investment activities and cash equivalents include both overnight repurchase agreements and one-year market bonds with the Bureau of Public Debt of the United States Treasury. FPI's investment in market bonds is redeemable at any time without penalty at the original market interest rate and is therefore not subject to interest rate risk. As a result, these market bonds are classified as cash equivalents on the accompanying balance sheets. The market value of overnight purchase agreements is equivalent to cost. The discount on the market bonds is amortized monthly and recorded as investment income.

Accounts Receivable / Concentration of Credit Risk

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

FPI routinely assesses the payment histories of its federal customers and the financial strength of its private sector customers and maintains allowances for anticipated losses as they become evident. In this regard, an insignificant amount of accounts receivable remained past due at September 30, 2014 and September 30, 2013. A significant portion of these past due items relate to billings to various entities within Department of Defense (DOD) who rely on the Defense Finance and Accounting Service (DFAS) to process vendor payments. Historically, customer payments processed through DFAS have generally taken longer to receive than payments from other federal and private sector customers. FPI believes that ultimately, a majority of its past-due accounts receivable are fully collectable. The amount due FPI, net of allowances, from DOD for the fiscal years ended September 30, 2014 and 2013 was \$11,585 and \$23,238, 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, 2014 and 2013, FPI's allowance for doubtful accounts is stated at approximately \$570 and \$412, respectively, of which approximately \$336 and \$206, respectively, represents the amounts allocated against federal accounts receivable.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Inventories

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

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

Advances to Vendors

FPI generally does not offer advances to the public; however, where warranted, FPI will on occasion make an advance to a vendor. 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 Marketing, Activation, Research, and Corporate Support Branch. The cost of providing this service is recorded as a cost of other revenue.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

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

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

Property, Plant and Equipment

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

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

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

Taxes

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

Reclassifications

Certain fiscal year 2013 financial statement line items have been reclassified to conform with the current year presentation. The reclassifications had no material effect on total assets, liabilities, equity, cumulative results of operations, or cash flows as previously reported.

Subsequent Events

Subsequent events are evaluated by management through the date that the financial statements are available to be issued, which is November 4, 2014.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Note 3. Accounts Receivable, Net

Accounts receivable, net consists of the following:

<u><i>As of September 30,</i></u>	<u>2014</u>	<u>2013</u>
Intragovernmental receivables	\$ 22,718	\$ 35,468
Private sector receivables	5,408	4,018
	28,126	39,486
<u>Less allowance for doubtful accounts</u>	<u>570</u>	<u>412</u>
Accounts receivable, net	\$ 27,556	\$ 39,074

FPI incurred bad debt expense of \$205 and \$(37), respectively, for the fiscal years ended September 30, 2014 and 2013.

Note 4. Inventories, Net

Inventories, net consist of the following:

<u><i>As of September 30,</i></u>	<u>2014</u>	<u>2013</u>
Raw materials	\$ 42,535	\$ 52,221
Work-in-process	18,450	19,830
Finished sub-assemblies	5,565	5,681
Finished goods	23,559	27,209
Finished goods – acceptance contracts	16,323	17,084
	106,432	122,025
<u>Less inventory allowance</u>	<u>27,804</u>	<u>26,614</u>
Inventories, net	\$ 78,628	\$ 95,411

\$16,323 of FPI's fiscal year 2014 and \$17,084 of its fiscal year 2013 finished goods balance represents goods shipped to customers or their agents for unrecognized revenue due to acceptance criteria within the customer contract.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Note 5. Property, Plant and Equipment, Net

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

<i>As of September 30,</i>	2014	2013
Buildings and improvements	\$ 172,093	\$ 172,093
Machinery and equipment	99,043	99,297
Computer hardware	3,346	2,732
Computer software	7,601	7,139
	282,083	281,261
Less accumulated depreciation	206,927	200,513
Property, plant and equipment, net	\$ 75,156	\$ 80,748

Depreciation and amortization expense totaled \$8,059 and \$8,650 for the fiscal years ended September 30, 2014 and 2013, respectively. During fiscal years 2014 and 2013, FPI invested \$2,485 and \$2,058, respectively, for the purchase and construction of property, plant and equipment.

Note 6. Other Accrued Expenses

Other accrued expenses consist of the following:

<i>As of September 30,</i>	2014	2013
Materials in transit	\$ 779	\$ 1,753
Relocation travel expense	1,244	966
FECA liabilities – current portion	2,161	2,135
Financial audit expense	496	492
Telecommunication expense	985	1,048
Utilities	948	804
Warranty expense	361	388
Other expense	2,328	1,607
Other accrued expenses	\$ 9,302	\$ 9,193

Included in other expense as of September 30, 2014 and 2013 are accruals for Intra-Departmental agreements of \$291 and \$701 and accruals for vendor invoices of \$1,976 and \$311, respectively.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Note 7. Business Segments

FPI's businesses are organized, managed and internally reported as five operating segments based on products and services. These segments are 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, 2014 and 2013 for each of its business segments is presented for comparative purposes:

<i>Net Sales</i>		
<i>For the fiscal years ended September 30,</i>	2014	2013
<u>Business Segment</u>		
Clothing and Textiles	\$ 166,246	\$ 235,691
Electronics	71,593	128,120
Office Furniture	98,323	118,533
Recycling	19,642	17,900
Services	33,327	33,093
Net sales	\$ 389,131	\$ 533,337

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

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

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Relationship with the Federal Bureau of Prisons

FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their 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 Chief Executive Officer (CEO). General management of FPI is provided by the Chief Operating Officer who also serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI. In accordance with Managerial Cost Accounting Concepts a reasonable estimate of these costs as provided by the BOP is included in general expense and other income of FPI for the fiscal years ended September 30, 2014 and 2013, 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, 2014 and 2013, the accrued FECA liabilities as charged to FPI, approximated \$2,161 and \$2,135, 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 \$22,502 and \$21,715 as of September 30, 2014 and 2013, respectively.

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, 2014 and 2013, FPI contributed approximately 7 percent (for normal

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

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) 11.9 percent for fiscal years ended September 30, 2014 and 2013. FPI contributed (for hazardous retirement) 26.3 percent for fiscal years ended September 30, 2014 and 2013. For employees covered by the FERS-RAE, (generally those employees hired on or after January 1, 2013), FPI contributed (for normal retirement) 9.6 percent for fiscal years ended September 30, 2014 and 2013. FPI contributed (for hazardous duty retirement) 24.0 percent for the fiscal year ended September 30, 2014 and 2013.

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 \$17,500 of salary for the fiscal years ended September 30, 2014 and 2013. 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 \$17,500 of their salary to the thrift plan for the fiscal years ended September 30, 2014 and 2013, 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 \$23,140 and \$25,253 for the fiscal years ended September 30, 2014 and 2013, respectively.

FPI must recognize its share of the cost of providing pension benefits to eligible employees utilizing cost factors determined by the OPM. Included in general and administrative expense is approximately \$3,420 and \$2,362 in the fiscal years ended September 30, 2014 and 2013, 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 \$8,880 and \$9,407 for the fiscal years ended September 30, 2014 and 2013, respectively.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

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 \$4,656 and \$5,127 during the fiscal years ended September 30, 2014 and 2013, 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 9. 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>	2014	2013
Salaries, wages and benefits	\$ 35,199	\$ 39,494
Permanent change of station expense	1,845	743
Purchases of minor equipment	667	495
Contract services	7,713	7,625
Bad debt expense	205	(37)
Credit card service fees	903	716
Travel	1,121	1,063
Personal computer expense	1,602	1,315
Accident compensation	2,694	4,881
Financial audit	1,185	1,131
Marketing	1,481	1,261
Depreciation	1,264	1,496
Loss on disposition of assets	18	291
Gain on disposition of assets	(38)	(29)
Telecommunication expense	1,931	2,451
Other expense	(4,902)	(4,987)
Imputed pension costs	3,420	2,362
Imputed post-retirement health care and life insurance cost	4,656	5,127
<u>Imputed operating costs</u>	<u>19,791</u>	<u>21,069</u>
Sales and marketing, general and administrative expenses	\$ 80,755	\$ 86,467

Fiscal Years 2014 and 2013
Notes to Financial Statements
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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 \$8.0 million for fiscal year 2014 and \$7.4 million for fiscal year 2013. Contract services consist primarily of consulting and sales and marketing fees. Salaries, wages and benefits are shown net of the imputed financing offsetting credit.

Note 10. 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, 2014, future capital lease payments due and future operating lease commitments total \$48 and \$93, 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.

Fiscal Years 2014 and 2013
Notes to Financial Statements
(Dollars in Thousands)

Changes in aggregate product warranty liability

<i>Fiscal years ended September 30,</i>	2014	2013
Balance at the beginning of the period	\$ 388	\$ 418
Accruals for warranties issued during the period	115	253
<u>Settlements made (in cash or in kind) during the period</u>	<u>(142)</u>	<u>(283)</u>
Balance at the end of the period	\$ 361	\$ 388

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:

<i>Fiscal years ended September 30,</i>	2014	2013
Congressional limitation on expenses	\$ 2,700	\$ 2,700
<u>Expenses incurred subject to Congressional limitation</u>	<u>\$ 2,230</u>	<u>\$ 2,170</u>

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