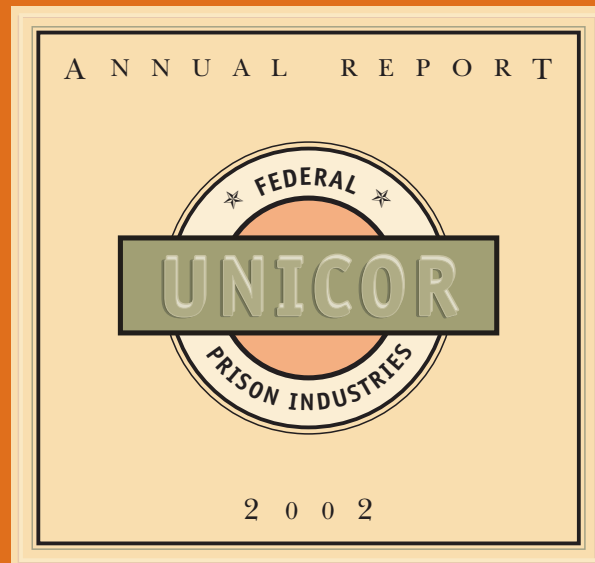




MISSION STATEMENT



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

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That Vital Link...

The prospect of having to search for meaningful work upon release from prison can be a daunting one, particularly for inmates who have been out of the labor market for upwards of ten years.

While acquiring valuable work experience and skills through programs like Federal Prison Industries is certainly important, that, in and of itself is not enough. Inmates nearing release in today's society need to re-learn, or perhaps for the first time learn, how to effectively "search for a job." One program that meets this very need is the Bureau of Prisons' Inmate Placement Program (IPP).

Established in October 1996, the IPP was created out of a realization that many offenders were being released to the streets ill-equipped, lacking even the most basic skills necessary to secure and retain employment. Since its inception, the IPP has provided instruction to thousands of incarcerated men and women on résumé writing, job search techniques, and interview skills.

One of the most practical experiences the IPP offers offenders is the Mock Job Fair. Recruiters from companies large and small come to the institution to interview program participants who are roughly within 18 months of release. Through simulated job interviews, recruiters ask tough questions such as, "How can I be sure you won't repeat the behavior that landed you in prison?" or "Why should I give you the job over someone without a record?" The interviewers also review the inmate's résumé, suggest appropriate modifications, and evaluate the inmate's appearance and demeanor during the interview. Both the interview experience and feedback from the evaluations contribute significantly to the overall "job readiness" of the inmate participants.

For many inmates, programs like FPI and Inmate Placement represent "that vital link" that can facilitate an offender's successful transition from prisoner to law-abiding, contributing member of society.

Introduction by the Attorney General

Without question, one of the greatest challenges facing senior executives today is organizational complacency, being satisfied with "business as usual." While broad-based change in any organization can be unsettling, the greater danger lies in not changing, holding steadfast to the status quo. In fact, failure to move "*beyond business as usual*" can leave any entity—including the Government—stagnant and ineffective at carrying out its mission.

CONGRESS ENACTED H.R. 7412

On May 27, 1930, Congress enacted H.R. 7412, which defined a "duty of the Attorney General" to provide employment for all physically fit inmates in the United States penal and correctional institutions in such forms as will reduce to a minimum competition with private industry or free labor.

1934

On June 23, 1934, President Roosevelt signed the law that authorized the establishment of Federal Prison Industries, and on December 11, 1934, he issued Executive Order 6917, which formally created FPI. FPI officially commenced operations on January 1, 1935.



1934

To encourage innovative thinking and progress, however, is not without its own risks. Change takes time, and can be difficult. Yet businesses and organizations today recognize that forward thinking is essential if they expect to influence the shaping and viability of their futures.

One Government program that intends to do just that is Federal Prison Industries, commonly referred to as FPI or by its trade name, UNICOR. This wholly owned Government corporation, which employs and provides job skills training to inmates incarcerated in the Federal Bureau of Prisons, underwent a succession of changes during Fiscal Year 2002. Some were directly related to its overall strategic plan to become more business-like, while others were mandated by externally driven forces. For FPI, the past 12 months have been anything but



JOHN ASHCROFT
*United States
Attorney General*

“business as usual.” However, FPI’s staff is committed to seizing every opportunity to improve FPI’s operations, recognizing the “value in change.”

There has been one notable constant in FPI’s 68-year-old history, and that is its mission to provide inmates with the technical skills, work ethic, and positive social values needed for successful re-entry into our communities upon release from prison. In the pages that follow, you will read more about FPI and the deliberate steps this proactive Department of Justice

program is taking to move beyond “*business as usual*” to ensure continued success.

John Ashcroft
Attorney General

original logo 1934	UNICOR Federal Prison Industries, Inc.	1977 FPI introduced a new corporate logo and trade name. Coinciding with its new image, FPI established a Corporate Marketing Office to develop nationwide marketing strategies and programs.	
1930s Throughout its history, FPI has adapted and upgraded its product lines in response to changing customer demands; the canvas feed bags for horses and wicker settees it produced in the 1930's, for example, have been supplanted by automated data processing services, modular office furniture, and electronic cables for defense systems.			

*2002 Board of Directors
(from left to right)*

Diane K. Morales
Donald R. Elliott
Audrey J. Roberts
Vice Chairman David D. Spears
Chairman Kenneth R. Rocks



Message from the Board

It is our pleasure, as Federal Prison Industries' (FPI) Board of Directors, to present the corporation's Fiscal Year 2002 Annual Report to the Congress of the United States.

Since our appointment last May, we have been engaged in a steep learning curve. To help us get an understanding of the challenges facing today's FPI organization, we have visited several FPI factories and met with industry representatives and legislators. Our conclusion: FPI's mission is based upon a 1934 business model that many feel should be modified to address today's social and economic realities. The Board is committed to pursuing real change, but not without the proper analysis. Our goal is to find a balance between ensuring employment for law-abiding citizens and finding productive work opportunities for those in Federal custody.

The challenge is to create a rehabilitative program that does not negatively impact the private or public sectors. Is the answer

to expand the sale of traditional FPI products, to explore non-traditional product lines, to sell our products to charitable and relief organizations, or to pursue nonindustrial markets? Until we have evaluated the feedback from all interested parties, the answer will not be apparent, but we are committed to finding an optimal solution.

Finding the best solution will require open communications, analysis, and commitment by all parties. Each Board member comes with unique credentials to face these challenges. However, we do not intend to work alone. We are committed to an "open door" environment. The Board will look to the Administration, Congress, industry, FPI staff and together, foster open dialogue and sound recommendations.

Although FPI's objective is to prepare as many inmates as practical for a successful transition into mainstream society, our mission is to do so without jeopardizing the job security of the American taxpayer.

Admittedly, our challenge is complex, but the Board believes that through persistence, commitment, and joint effort among all concerned, our objective will be ultimately achieved.

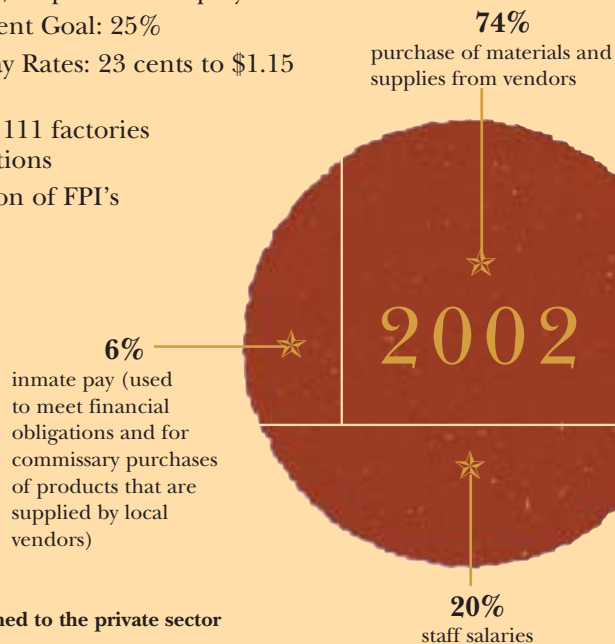
1934 Original industrial operations included a textile mill in Atlanta, a shoe factory and a broom & brush factory in Leavenworth. 	 1939 The officers and directors of FPI Inc., in 1939.	1941 When the United States entered World War II in December 1941, FPI was almost 7 years old, and it was well-enough established to make a major contribution to the war effort. Its most immediate contribution was in the manufacture of war material. Even though the number of inmates employed by FPI remained fairly stable at about 3,500, FPI increased production threefold and, in 4 years, produced more than \$75 million of goods that went directly to the war effort. WWII effort	
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Year in Review

•2002•

Federal Prison Industries Snapshot

- ★ Inmate Workers: 21,778
- ★ Percent of Eligible (medically able/sentenced) Population Employed: 22%
- ★ Employment Goal: 25%
- ★ Inmate Pay Rates: 23 cents to \$1.15 per hour
- ★ Factories: 111 factories at 71 locations
- ★ Distribution of FPI's Revenues:



FPI Receives Unqualified Audit Opinion



The independent auditing firm of PricewaterhouseCoopers, LLP was retained to review and test FPI's internal accounting and administrative control systems for fiscal year (FY) 2002. The Board is pleased to announce that FPI has received an unqualified audit opinion for its FY 2002 financial statements.

SPECIAL RECOGNITION

The Department of Defense recognized FPI for its sustained performance achievements in the Pentagon Renovation/swing space project over the past two consecutive contract review periods.

FPI was one of only a select few providers working on this project to receive an award and earned the highest performance rating of all participants.

The Pentagon Renovation management team evaluated the performance of all participating vendors on the basis of their ability to provide quality products, meet delivery and scheduling milestones, address all inquiries/issues both during and beyond normal business hours, as well as overall dependability.

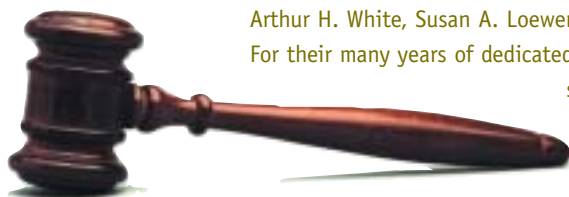
FPI is most appreciative of this prestigious award, which reinforces its ongoing commitment to all Federal customers.



Departure From the Board

May 29, 2002, marked the end of service on FPI's Board of Directors for Chairman Joseph M. Aragon, Vice Chairman Arthur H. White, Susan A. Loewenberg, and Richard G. Womack. For their many years of dedicated service on the Board and ardent

support of the program, we extend our gratitude and best wishes for the future.



Fiscal Year 2002 Comparison

Millions of Dollars	2001	2002
Net Sales	\$583.5	\$678.7
Net Income	\$4.9	\$9
Sales Dollars Spent on Purchases from Private Sector	\$425.9	\$502.2
Inmates Employed	22,560	21,778

Industrial Programs, Locations, Inmate Employment, and Net Sales as of September 30, 2002							UNICOR
CLOTHING & TEXTILES Alderson, WV Atlanta, GA Beaumont, TX Butner, NC Dublin, CA Edgefield, SC Fort Dix, NJ Greenville, IL Jesup, GA Leavenworth, KS Lee, VA Manchester, KY Miami, FL Oakdale, LA Pollock, LA Ray Brook, NY Safford, AZ Sandstone, MN Seagoville, TX Terre Haute, IN Tucson, AZ Waseca, MN Yazoo City, MS	ELECTRONICS Beaumont, TX Big Spring, TX Danbury, CT Fairton, NJ Lexington, KY Lompoc, CA Loretto, PA Marion, IL Memphis, TN Otisville, NY Oxford, WI Petersburg, VA Phoenix, AZ Rochester, MN	FLEET MANAGEMENT/VEHICULAR COMPONENTS Bastrop, TX Beaumont, TX Estill, SC La Tuna, TX Petersburg, VA Three Rivers, TX Victorville, CA	GRAPHICS Cumberland, MD Fort Dix, NJ Fort Worth, TX Leavenworth, KS Lexington, KY Lompoc, CA Petersburg, VA Sandstone, MN Taft, CA	INDUSTRIAL PRODUCTS Butner, NC El Reno, OK La Tuna, TX Leavenworth, KS Lewisburg, PA Marianna, FL Pekin, IL Talladega, AL Terminal Island, CA	OFFICE FURNITURE Allenwood, PA Ashland, KY Beckley, WV Coleman, FL Dublin, CA Florence, CO Forrest City, AR Lompoc, CA Marianna, FL McKean, PA Milan, MI Morgantown, WV Schuylkill, PA Sheridan, OR Taft, CA Tallahassee, FL Texarkana, TX	RECYCLING ACTIVITIES Atwater, CA Elkton, OH Fort Dix, NJ La Tuna, TX Lewisburg, PA Marianna, FL Texarkana, TX	SERVICES Bryan, TX Carswell, TX Dublin, CA Eglin, FL Elkton, OH El Paso, TX Fort Dix, NJ Marianna, FL Montgomery, AL Tallahassee, FL
							
Inmates Employed† 6,665	3,171	1,706	930	1,816	5,304	833	1,020
Net Sales* \$159.7	\$132.7	\$99	\$26	\$27.8	\$217.9	\$3.4	\$12.2

Some locations have multiple plants.

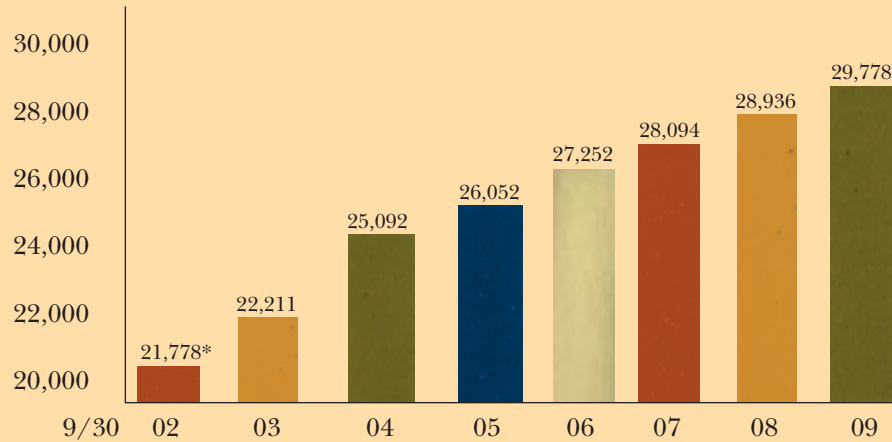
† There are an additional 333 inmates working in Customer Service and Product Support. The total number of inmates who worked for Federal Prison Industries as of **September 30, 2002**, was **21,778** (this includes **2,369** inmates employed in support positions).

* Dollars in millions

•2002•

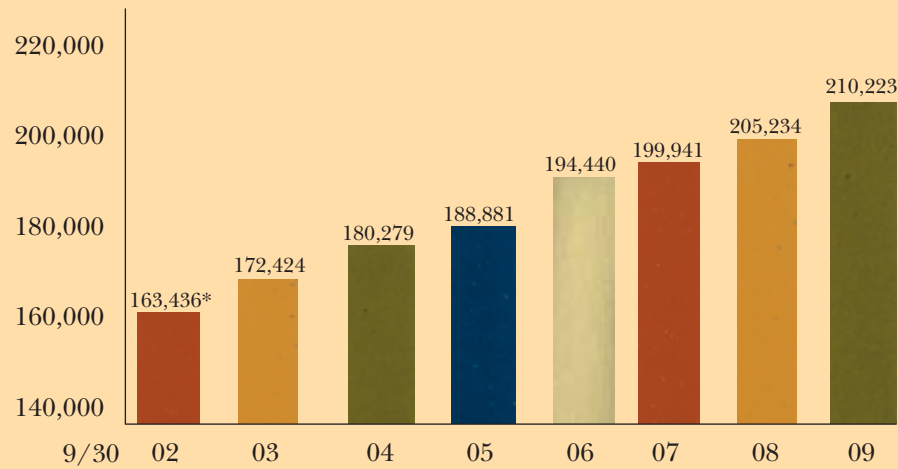
Population Growth and Inmate Jobs

Projected Inmate Job Requirements



Total jobs required for FY 2002 through FY 2009 = 8,000
Total institutions to be activated through FY 2009 = 17

Population Projections



* Actual

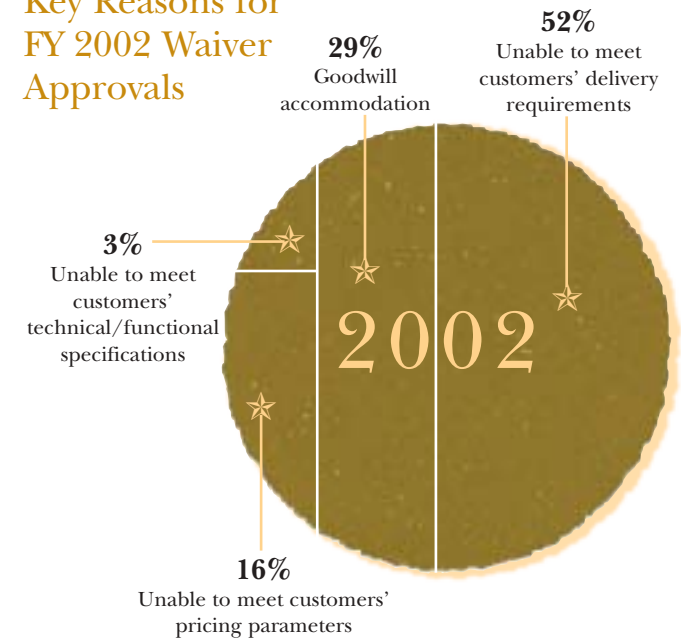
FPI Waiver and Appeal Activities

FY 2001 VERSUS FY 2002

FISCAL YEAR 2001		FISCAL YEAR 2002
23,892	Waiver Requests	20,512
\$328,040,218	Waiver Request Dollars	\$241,608,164
\$237,310,271 72%	Waiver Approval Dollars	69% \$166,312,286
\$90,729,947 28%	Waiver Denial Dollars	31% \$75,295,878
334	Appeal Requests	252
\$34,303,316	Appeal Request Dollars	\$14,583,668
\$23,435,948 68%	Approvals	68% \$9,970,148
\$10,737,068 32%	Denials	32% \$4,613,520

Factoring in Appeal reversals, the adjusted FY 2002 Waiver Approval Rate was 73%.

Key Reasons for FY 2002 Waiver Approvals



Program Benefits

★ **to society**—Rigorous research demonstrates that participation in prison industries/vocational training programs has a positive effect on post-release employment and recidivism for up to 12 years following release. Inmates who worked in prison industries or completed vocational and apprenticeship programs were 24 percent less likely to recidivate than non-program participants and 14 percent more likely to be gainfully employed. These programs had an even greater positive impact on minority offenders, who are at the greatest risk of recidivism. FPI is entirely

self-sustaining and operates at no cost to the taxpayer.

★ **to the courts, crime victims, and inmate families—**

In FY 2002, inmates who worked in FPI factories contributed approximately \$3 million of their earnings toward meeting their financial obligations, e.g., court-ordered fines, child support, and/or restitution. Many inmates also contributed to the support and welfare of their families by sending home a portion of their earnings.

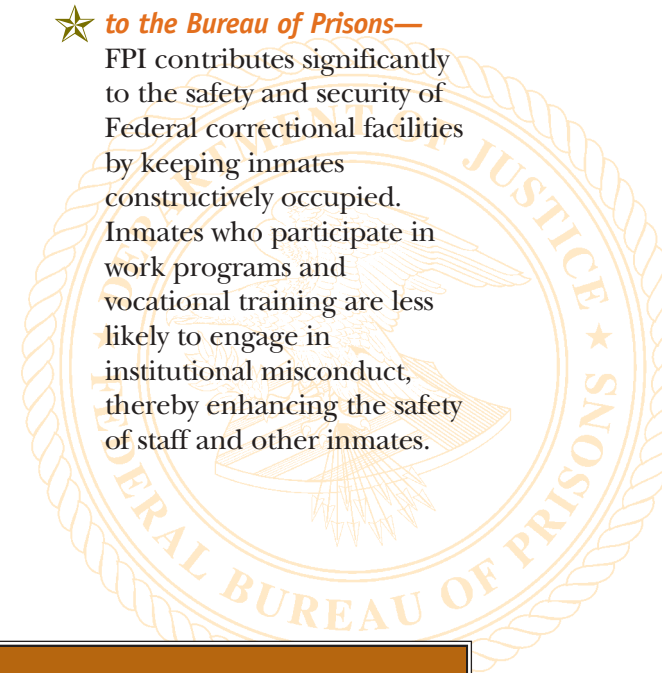
★ **to thousands of incarcerated men and women in Federal prisons—**For many inmates, working in Federal Prison Industries represents an

opportunity to learn a marketable skill and gain valuable work experience that will substantially enhance their ability to successfully reintegrate into society following release from prison. The program teaches inmates pro-social values including the value of work, responsibility, and the need to respect and work with others. Many inmates gain a sense of dignity and self-worth that they had lost or never before experienced.

★ **to private sector businesses—**During FY 2002, FPI purchased approximately \$502 million of raw materials, supplies, equipment, and services from private sector

businesses. Over 62 percent of FPI's purchases were from small businesses, including businesses owned by women, minorities, and those who are disadvantaged.

★ **to the Bureau of Prisons—**FPI contributes significantly to the safety and security of Federal correctional facilities by keeping inmates constructively occupied. Inmates who participate in work programs and vocational training are less likely to engage in institutional misconduct, thereby enhancing the safety of staff and other inmates.



1960's—THE "MEDICAL MODEL"

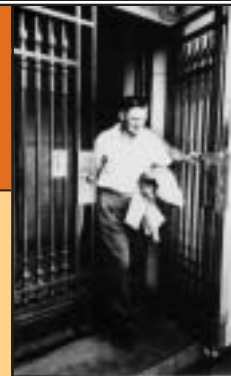
The rehabilitation philosophy reached its zenith in the 1960s. The "Medical Model"—the theory that an inmate's criminal tendencies could be diagnosed and treated, almost like a physical disease—was in vogue throughout the Bureau and corrections in general. If the diagnosis showed poor socialization and inadequate work skills as the factors causing a person to turn to crime, the prescription could involve a combination of social skills counseling and vocational training.

1982-91



In 1982, the Bureau decided that inmates must demonstrate a 6th grade literacy level before they could advance beyond entry level pay status in UNICOR. In 1986, the literacy standard was increased to 8th grade level, and in 1991 a high school diploma or GED certificate became the requirement.

education



INMATE PLACEMENT PROGRAM

Established in October 1996, the IPP was created out of realization that many offenders were being released to the streets lacking even the most basic skills necessary to secure and retain employment. This program provides instruction on résumé writing, job search, and interview skills.

1996

Ombudsman's Message

Implementing the Right Changes for the Right Reasons



Jan Hynson
Ombudsman

Having served as Federal Prison Industries' Ombudsman since 1994, I have seen many improvements and considerable innovation in the breadth of FPI products, as well as increased sophistication in the level of value-added customer services offered to Federal agencies. Yet, little has changed in terms of FPI's relationship with the private sector and other representative organizations.

Seemingly, the subject of prison industries has always been a controversial one. Despite years of attempted dialogue through meetings, work groups, summits, and independent studies to find some "middle ground," today, we face the very challenges that Bureau of Prisons Director Sanford Bates and Assistant Director James Bennett confronted in the 1930s: how to create prison industrial programs to ensure prison safety and to rehabilitate those incarcerated in a manner that minimizes adverse impact on business and labor.

The many arguments and untoward sentiments over the years among the parties have led to a stalemate. As a neutral observer, it is my sense that our collective failure to progress beyond a "them/us" mentality hinges on the fact that the parties have been *speaking out*, rather than *reaching out* to each other in an effort to find meaningful consensus.

If FPI did not exist, naturally some private sector companies would receive more Federal Government business—but at what cost? The issues surrounding FPI's program are far more complex and extensive than sorting out who deserves the bigger slice of government sales. Further, there would be no

guarantee that struggling companies would remain viable through increased government business, given the competitive edge other larger, more prominent companies might hold. Focus cannot be one-sided. While it is well and good for industry to think of FPI's impact on the "bottom line," the societal benefits, safe prison management, and reduced recidivism rates, that are a direct result of FPI's program, must not be ignored.

We cannot address the issues fairly by working in a vacuum or by focusing solely on self-gratification. Finding a broad-based solution requires the collaboration of all concerned, as well as the consideration of potential economic and social implications on the direct and indirect stakeholders.

With the appointment of an entirely new Board of Directors, harboring no preconceived opinion, it is an opportune time to "make things right"...but "for the right reasons."

The Board has made it clear, in dialogue with legislators, the private sector, and other business organizations, that it is committed to bringing about change so that a balance can be achieved between protecting jobs for Americans while teaching inmates meaningful job skills. Moreover, the Board will look to FPI, business leaders and members of the Congress to identify new venues that will benefit all parties, without the need for appropriated funds to maintain FPI's program.

The Board has directed that FPI's Ombudsman work in partnership with all outside parties to narrow the communications gap, identify the credible issues, and put them on the table for healthy debate and consensus resolution. To this end, in the coming year I look forward to hosting independent brainstorming sessions with the private sector and other interested parties, to identify "out of the box" solutions for joint presentation to the Board.

This is an exciting new chapter in FPI's history, and I will do my part to foster collaborative relationships and to explore workable business solutions, while maintaining the tenets of FPI's mission.



Contact FPI's Ombudsman on-line!

For general information, the latest waiver/appeal activity updates, to schedule a consultation, or to request participation in an upcoming brainstorming session, log on to UNICOR's website at www.unicor.gov. Click on "Ombudsman" and follow the prompts.

Your Direct Line to FPI's Board of Directors

FPI's Board of Directors welcomes your comments and any one of its members may be contacted at his or her respective business address. For questions specific to FPI's business practices and/or daily operations, the Board would encourage you to direct your inquiries to Federal Prison Industries, Inc., 320 First Street, NW, Washington, DC 20534, Attention: Steve Schwalb, Chief Operating Officer.

For information on upcoming Board meetings and public access opportunities, please visit FPI's website at www.unicor.gov. FPI's website also includes links to information regarding public notices, board decisions, and small business development. New this year, is a direct link to FPI's Ombudsman.



Kenneth R. Rocks
Chairman
1336 Spring
Garden Street
Philadelphia,
Pennsylvania 19123
**Labor
Representative**

Mr. Rocks is Sergeant-at-Arms for the Grand Lodge Executive Board, Fraternal Order of Police. He has served as a police officer for over 31 years with the Philadelphia, Pennsylvania Police Department.



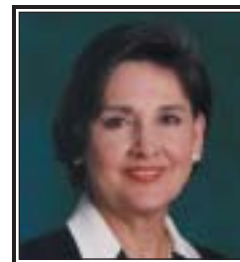
David D. Spears
Vice Chairman
2627 KFB Plaza
Manhattan, Kansas
66503
**Agriculture
Representative**

Mr. Spears is currently Director of Kansas Farm Bureau—Agriculture Solutions. Prior to that, he served as Commissioner of the Commodity Futures Trading Commission in Washington, DC.



Donald R. Elliott
Director
1660 Indian Wood
Circle
Maumee, Ohio
43537
**Industry
Representative**

Mr. Elliott is Director of Global Hose Operations for Eaton Corporation's Fluid Power Group. He has also worked for the U.S. Department of Labor, the State of Maryland, and the banking industry.



Diane K. Morales
Director
3500 Defense
Pentagon
Room 3E808
Washington, DC
20301-3500
**Secretary of Defense
Representative**

Ms. Morales is the Deputy Undersecretary of Defense for Logistics and Materiel Readiness. She has more than 20 years of experience in both business and defense matters.



Audrey J. Roberts
Director
Post Office Box 14
Martin, Tennessee
38237
**Retailers &
Consumers
Representative**

Ms. Roberts is retired as President and Chief Administrative Officer, Martin Manufacturing Company, Martin, Tennessee. She has also served as Chairperson of the Government Contracts Committee, American Apparel and Footwear Association.



Clothing & Textiles Business Group

- Law Enforcement, Medical, Military and Institutional Apparel
- Mattresses, Bedding, Linens and Towels
- Embroidery and Screenprinting on Textiles
- Custom-Made Draperies and Curtains



Electronics Business Group

- Exterior and Interior Task Lighting Systems
- Wire Harness Assemblies and Circuit Boards
- Electrical Components and Connectors
- Electrical Cables (Both Braided and Cord Assemblies)

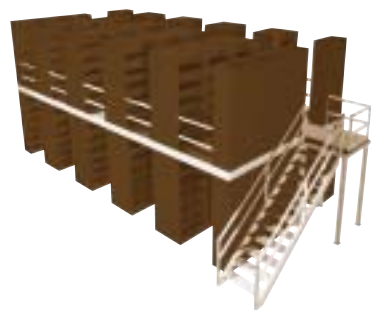
Fleet Management/ Vehicular Components Business Group

- Rebuild and Refurbish Vehicle Components
 - New Vehicle Retrofit Services
- Fleet Management Customized Services and Programs/Turnkey Solutions



Graphics Business Group

- Custom Engraving and Printing on Awards, Promotional Gifts, and License Plates
- Interior and Exterior Architectural, Safety, and Recreational Signs
- Printing and Creative Design Services
- Remanufacturing of Toner Cartridges



Industrial Products Business Group

- Dorm and Quarters Furnishings and Packaged Room Solutions/Turnkey
- Industrial Racking Catwalks, Mezzanines, Warehouse/Office Shelving
- Custom Fabricated Industrial Products, Lockers and Storage Cabinets
- Optical Eyewear (Safety and Prescription)
 - Security Fencing
 - Replacement Filters



Office Furniture Business Group

- Office Furnishings and Accessories
 - Seating Products
- Casegoods and Training Table Products
 - Office System Products
 - Filing and Storage Products
- Packaged Office Solutions/Turnkey Solutions

Recycling Activities Business Group

- Recycling of Electronic Components
 - Reuse and Recovery of Usable Components for Resale
 - Recycling Activities



Services Business Group

- Distribution and Mailing Services
- Assembly and Packing Services
 - Document Conversion
- Call Center and Order Fulfillment Services
 - Laundry Services



Report of Management

Responsibility for the integrity and objectivity of the financial information in this report rests with the management of Federal Prison Industries, Inc. The accompanying financial statements have been prepared to conform with United States generally accepted accounting principles (U.S. GAAP).

To ensure the integrity of financial data, FPI management maintains a system of internal accounting controls. The system provides reasonable assurance that transactions have management authorization and are properly recorded. It also safeguards, verifies, and maintains accountability of assets and permits preparation of financial statements that conform with U.S. GAAP. This system of internal controls is subject to periodic reviews by both management and FPI's independent auditors.

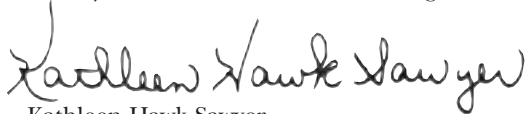
Internal accounting and administrative control systems have been reviewed and tested. Accordingly, FPI management provides the following assurances:

1. There are sufficient controls and security measures to compensate for any identified risks associated with the program/system and/or its environment,
2. The program/system is being operated in an effective manner and complies with applicable laws and regulations,
3. There is proper management of the program/system information, and
4. The program/system complies with management, financial, information resources management, accounting, budget and other appropriate standards.

The independent public accounting firm of PricewaterhouseCoopers LLP is retained to audit FPI's financial statements. The role of independent auditors is to provide an objective review of management's responsibilities to fairly report operating results, cash flows and financial position. The independent auditor's reports are presented on the following pages. The report on the fairness of the presentation of the financial statements is unqualified.

The independent auditor obtains an understanding of FPI's internal control sufficient to plan the audit and to determine the nature, timing, and extent of tests to be performed to form an opinion on the fairness of the presentation of the financial statements.

Although management may periodically adopt certain cost-effective recommendations made by the independent auditors to further strengthen FPI's system of internal control, management believes that FPI's internal and accounting control system is accomplishing its objectives.



Kathleen Hawk Sawyer

Director, Federal Bureau of Prisons

Chief Executive Officer, Federal Prison Industries

2002

Federal Prison Industries, Inc.

UNICOR

Report of Independent Accountants



PricewaterhouseCoopers, LLP
1301 K Street NW, Suite 800W
Washington, DC 20005-3333
Telephone (202) 414-1000

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

Board of Directors
Federal Prison Industries, Inc.

We have audited the accompanying balance sheet of the Federal Prison Industries, Inc., a financial reporting component of the U.S. Department of Justice referred to herein as FPI, as of September 30, 2002, and the related statement of operations and cumulative results of operations, and cash flows, for the year then ended. These financial statements are the responsibility of FPI's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of FPI as of September 30, 2001, and for the year then ended, prior to the restatement described in Note 12, were audited by other independent accountants whose report dated January 2, 2002, expressed an unqualified opinion on those statements.

We conducted our audit 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. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the financial position of FPI at September 30, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Note 12, the fiscal year 2001 financial statements have been restated to properly present certain revenues in the statement of operations and cumulative results of operations.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 6, 2002, on our consideration of FPI's internal control and a report dated December 6, 2002, on its compliance with laws and regulations. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

December 6, 2002
Washington, DC

Report of Independent Accountants on Internal Control



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

Board of Directors
Federal Prison Industries, Inc.

PricewaterhouseCoopers, LLP
1301 K Street NW, Suite 800W
Washington, DC 20005-3333
Telephone (202) 414-1000

We have audited the financial statements of the Federal Prison Industries, Inc., a financial reporting component of the U.S. Department of Justice referred to herein as FPI, as of September 30, 2002, and for the year then ended, and have issued our reports thereon dated December 6, 2002. We conducted our audit 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. 01-02, *Audit Requirements for Federal Financial Statements*. The financial statements of FPI as of September 30, 2001, and for the year then ended, prior to the restatement described in Note 12, were audited by other independent accountants whose report dated January 2, 2002, expressed an unqualified opinion on those statements.

The management of FPI is responsible for establishing and maintaining accounting systems and internal control. In fulfilling this responsibility, estimates and judgments are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that: (1) transactions are properly recorded, processed, and summarized to permit the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America and to safeguard assets against loss from unauthorized acquisition, use or disposition; (2) transactions are executed in compliance with laws and regulations, that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified in Appendix C of OMB Bulletin No. 01-02; and (3) transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by FPI management. Because of inherent limitations in any internal control, errors or fraud may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of FPI's financial statements, we obtained an understanding of the design of significant internal controls and whether they had been placed in operation, tested certain controls, and assessed control risk in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We limited our control testing to those controls necessary to achieve the objectives described above, and we did not test all controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. Our purpose was not to provide an opinion on FPI's internal controls. Accordingly, we do not express such an opinion.

With respect to internal control relevant to data that support reported performance measures, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures. Accordingly, we do not provide an opinion on such controls.

Report of Independent Accountants on Internal Control (Continued)



We noted certain matters in FPI's internal control that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the entity's ability to meet the internal control objectives described in the second paragraph. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control elements does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. The reportable conditions we identified are summarized below, and with respect to the first condition, we considered it to be a material weakness:

1. The FPI information security program management and controls require improvement. (Updated Finding)
2. FPI requires improvement in the development and implementation of accounting policies and procedures designed to enable preparation of complete and accurate financial statements in accordance with generally accepted accounting principles. (New Finding)

The remainder of this report discusses the reportable conditions in more detail. Our recommendations for corrective action are also provided.

A handwritten signature in cursive script that reads "Price Waterhouse Coopers LLP".

December 6, 2002
Washington, DC

Detailed information concerning the reportable conditions noted in Federal Prison Industries, Inc., internal control report can be obtained from the Department of Justice, Office of Inspector General for Audit, Office of Policy and Planning, 1425 New York Avenue, NW, Suite 5000, Washington, DC 20530 and from the Internet site at www.unicor.gov.



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

Board of Directors
Federal Prison Industries, Inc.

PricewaterhouseCoopers, LLP
1301 K Street NW, Suite 800W
Washington, DC 20005-3333
Telephone (202) 414-1000

We have audited the financial statements of the Federal Prison Industries, Inc., a financial reporting component of the U.S. Department of Justice referred to herein as FPI, as of September 30, 2002, and for the year then ended, and have issued our reports thereon dated December 6, 2002. We conducted our audit 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. 01-02, *Audit Requirements for Federal Financial Statements*. The financial statements of FPI as of September 30, 2001, and for the year then ended, prior to the restatement described in Note 12, were audited by other independent accountants whose report dated January 2, 2002, expressed an unqualified opinion on those statements.

Compliance with laws and regulations applicable to FPI is the responsibility of management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of FPI's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions and, accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed the following instance of noncompliance that was reported under *Government Auditing Standards* and OMB Bulletin No. 01-02: FPI did not assess interest and penalties on past-due debt with the public in accordance with FPI's policy and provisions of the Debt Collection Improvement Act of 1996.

Under FFMIA, we are required to report whether FPI's financial management systems substantially comply with (1) the Federal financial management systems requirements, (2) the applicable Federal accounting standards, and (3) the United States Standard General Ledger at the



transaction level. The results of our tests disclosed the following instance where FPI's financial management systems did not substantially comply with the three FFMIA requirements discussed in this paragraph:

Federal Financial Management System Requirements: During fiscal year 2002, FPI did not have adequate controls over information security program management, as noted in our Report of Independent Accountants on Internal Control, dated December 6, 2002, which contains our findings and recommended remedial actions. Specifically, FPI was not in compliance with OMB Circular A-130, *Management of Federal Information Systems*, and other applicable federal information security requirements.

This report is intended solely for the information and use of the U.S. Department of Justice Office of the Inspector General, management of the Department of Justice, FPI's Board of Directors, the OMB, and Congress. This report is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Price Waterhouse Coopers LLP".

December 6, 2002
Washington, DC

2002

Federal Prison Industries, Inc.

UNICOR

Balance Sheets

September 30

(DOLLARS IN THOUSANDS)

2002

2001

Assets

Current:

Cash and cash equivalents:	\$108,247	\$54,397
Accounts receivable, net	92,883	88,364
Inventories, net	141,847	140,767
Other assets	2,025	1,835

Total current assets	345,002	285,363
-----------------------------	----------------	----------------

Property, plant, and equipment, net	127,202	132,094
-------------------------------------	---------	---------

Total Assets	472,204	417,457
---------------------	----------------	----------------

Liabilities and United States Government Equity

Current:

Accounts payable	44,824	40,806
Deferred revenue	83,834	45,177
Accrued salaries and wages	6,988	11,408
Accrued annual leave	8,065	7,537
Other accrued expenses	12,669	5,751

Total current liabilities	156,380	110,679
----------------------------------	----------------	----------------

FECA actuarial liability	7,935	7,979
--------------------------	-------	-------

Note payable to United States Treasury	20,000	20,000
--	--------	--------

Total Liabilities	184,315	138,658
--------------------------	----------------	----------------

United States Government Equity

Initial capital	4,176	4,176
-----------------	-------	-------

Donated property	—	143
------------------	---	-----

Cumulative results of operations	283,713	274,480
----------------------------------	---------	---------

Total United States Government Equity	287,889	278,799
---------------------------------------	---------	---------

Total Liabilities and United States Government Equity	\$472,204	\$417,457
--	------------------	------------------

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

2002

Federal Prison Industries, Inc.

UNICOR

Statements of Operations and Cumulative Results of Operations

Fiscal years ended September 30

(DOLLARS IN THOUSANDS)

2002

2001
(Restated)

Revenue:

Net sales	\$678,655	\$583,500
Other revenue	38,207	18,476
Total revenue	716,862	601,976

Cost of revenue:

Cost of sales	603,303	518,807
Cost of other revenue	41,497	22,518
Total cost of revenue	644,800	541,325

Gross profit

72,062 60,651

Operating expenses:

Sales and marketing	8,788	6,520
General and administrative	66,335	61,086
Total operating expenses	75,123	67,606

Loss from operations

(3,061) (6,955)

Interest income

1,409 1,424

Interest expense

(172) (987)

Other income, net

10,914 11,463

Net income

9,090 4,945

Cumulative results of operations, beginning of fiscal year

274,480 269,535

Donated property reclassified to cumulative results
of operations

143 —

Cumulative results of operations, end of fiscal year

\$283,713 \$274,480

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

2002

Federal Prison Industries, Inc.

UNICOR

Statements of Cash Flows

Fiscal years ended September 30

(DOLLARS IN THOUSANDS)

2002

2001

Cash Flows From Operating Activities

Net income	\$9,090	\$4,945
------------	---------	---------

Adjustments to reconcile net income to net cash

provided by operating activities:

Depreciation and amortization	12,404	11,887
-------------------------------	--------	--------

Loss on disposal of property, plant and equipment	278	260
---	-----	-----

Changes in:

Accounts receivable	(4,520)	14,916
---------------------	---------	--------

Inventories	(1,080)	(23,704)
-------------	---------	----------

Other assets	(190)	1,463
--------------	-------	-------

Accounts payable and accrued expenses	7,001	(13,601)
---------------------------------------	-------	----------

Deferred revenue	38,657	23,335
------------------	--------	--------

Net cash provided by operating activities	61,640	19,501
---	--------	--------

Cash Flows From Investing Activities

Purchases of property, plant, and equipment	(7,771)	(2,811)
---	---------	---------

Construction-in-progress of plant facilities	(19)	(889)
--	------	-------

Construction reimbursement from Bureau of Prisons	—	1,242
---	---	-------

Net cash used in investing activities	(7,790)	(2,458)
---------------------------------------	---------	---------

Net increase in cash	53,850	17,043
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Cash and cash equivalents, beginning of fiscal year	54,397	37,354
---	--------	--------

Cash and cash equivalents, end of fiscal year	\$108,247	\$54,397
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The accompanying notes are an integral part of these financial statements.

Note 1

Organization and Mission

Federal Prison Industries, Inc. (FPI) was established in 1934 by an act of the United States Congress. FPI operates under the trade name UNICOR, as a wholly owned federal government corporation within the Department of Justice, and functions under the direction and control of a Board of Directors (the Board). Members of the Board are appointed by the President 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, agencies, and bureaus such as the Department of Justice, the Department of Defense, the Postal Service, the Veterans Administration, and the General Services Administration. These and other federal organizations are 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.

As of September 30, 2002, FPI had industrial operations at 111 factories located at 71 facilities within the Federal Prison System; these factories employed over 21,000 inmates representing approximately 18% of the total federal inmate population.

Note 2

Summary of Significant Accounting Policies

Basis of Presentation

FPI has historically prepared its external financial statements in conformity with accounting principles generally accepted in the United States of America (US 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 US GAAP. FASAB has indicated, however, that accounting standards published by FASB may also be in accordance with US GAAP for those federal entities, including FPI, that have issued such financial statements in the past.

Use of Estimates

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

Cash and Cash Equivalents

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

Notes to Financial Statements (Dollars in Thousands) continued

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, a significant amount of accounts receivable remained past due at September 30, 2002 and 2001. A majority of these past due items related to billings to various entities within 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 from DOD for fiscal years ended September 30, 2002 and 2001, was \$74,913 and \$71,810 respectively.

While federal accounts receivable are normally fully collectable 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, 2002 and 2001, FPI's allowance for doubtful accounts is stated at approximately \$5,034 and \$5,778, respectively, of which approximately \$4,447 and \$4,781, respectively, represents the amounts allocated against federal accounts receivable.

Inventories

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 allowances, to maintain a target gross margin for each product. FPI values its finished good and subassembly items at a standard cost that is periodically adjusted to approximate actual cost.

FPI has established inventory allowances to account for LCM adjustments and excess and/or obsolete items that may not be utilized in future periods.

Revenue Recognition

FPI sells a wide range of products and services to a diversified base of customers, primarily governmental departments, agencies, and bureaus. Revenue from product sales and services, including delivery fees, are reported net of estimated returns and allowances and are recognized when the related goods are shipped and all significant obligations of FPI have been satisfied. Provisions for anticipated contract losses are recognized at the time that they become evident.

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

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

Notes to Financial Statements (Dollars in Thousands) continued

Other income is comprised primarily of imputed financing for retirement, health benefits, and life insurance (Note 9).

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of an allowance for accumulated depreciation. Donated property and equipment, which is recorded at its appraised value at the date of donation, principally relates to property and equipment transferred from other federal government agencies and bureaus. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which generally range between three and 40 years. Upon retirement or disposition of property and equipment, the related gain or loss is reflected in the statement of operations. Repairs and maintenance costs are expensed as incurred.

FPI adopted the provisions of Standards of Federal Financial Accounting Statements No. 10, Accounting for Internal Use Software, for the fiscal year ended September 30, 2001.

Taxes

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

Reclassifications

Certain fiscal year 2001 financial statement line items have been reclassified to conform to the current year presentation.

Note 3***Accounts Receivable, Net***

Accounts receivable, net consists of the following:

<i>September 30</i>	2002	2001
Intragovernmental billed receivables	\$92,349	84,781
Private sector billed receivables	5,568	9,361
	97,917	94,142
Less allowance for doubtful accounts	5,034	5,778
Accounts receivable, net	\$92,883	\$88,364

Notes to Financial Statements (Dollars in Thousands) continued

Note 4***Inventories, Net***

Inventories, net consist of the following:

<i>September 30</i>	2002	2001
Raw materials	\$ 46,229	\$ 54,462
Raw materials—vehicles	24,886	17,510
Work-in-process	31,546	22,148
Finished subassemblies	7,816	6,686
Finished goods	30,951	30,801
Finished goods—acceptance contracts	12,215	22,421
	153,643	154,028
Less inventory allowance	11,796	13,261
Inventories, net	\$141,847	\$140,767

Approximately \$24,900 of FPI's fiscal year 2002 and \$17,500 of FPI's fiscal year 2001 raw materials balance represents vehicles and component parts that have been purchased on behalf of the Immigration and Naturalization Service (INS) for retrofit services that are performed by FPI. As part of an interagency agreement, INS provides funding to FPI to procure these vehicles. Revenue is recognized by FPI at the time of shipment of retrofitted vehicles to INS.

Approximately \$12,200 of FPI's fiscal year 2002 and \$22,400 of FPI's fiscal year 2001 finished goods balance represents goods that have been shipped to customers or their agents, but for which revenue has not been recognized because of acceptance criteria within the customer contract. A majority of this amount consists of systems furniture installations in progress at September 30, 2002.

Notes to Financial Statements (Dollars in Thousands) continued

Note 5

Property, Plant, and Equipment, Net

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

<i>September 30</i>	2002	2001
Machinery and equipment	\$ 91,296	\$ 93,033
Computer hardware	2,740	2,504
Computer software	6,806	1,259
Buildings and improvements	166,321	166,250
	267,163	263,046
Less accumulated depreciation	140,072	131,044
	127,091	132,002
Factory construction-in-progress	111	92
Property, plant and equipment, net	\$127,202	\$132,094

Depreciation and amortization expense approximated \$12,404 and \$11,887 for the fiscal years ended September 30, 2002 and 2001, respectively.

Note 6

Other Accrued Expenses

Other accrued expenses consist of the following:

<i>September 30</i>	2002	2001
Permanent change of station	\$1,662	\$1,536
Information systems	3,614	1,076
FECA liability—current portion	764	799
Other expenses	6,629	2,340
Other accrued expenses	\$12,669	\$5,751

Information systems included \$2,300 for software licenses that are capitalized and \$1,314 for communication expenses. Other expenses included \$2,067 for materials in transit, \$900 for financial audit expenses, \$1,768 for utilities, and the remainder for other services.

Note 7

Note Payable to United States Treasury

Congress has granted FPI borrowing authority pursuant to Public Law 100-690. Under this authority, FPI has borrowed \$20,000 from the United States Treasury ("the Treasury") with an extended lump-sum maturity date of September 30, 2008. The funds received under this note have been internally restricted for use in the construction of plant facilities and the purchase of equipment. The note accrues interest, payable March 31 and September 30 of each fiscal year at 5.5% (the rate equivalent to the yield of United States Treasury obligations of comparable maturities which existed on the date of a note maturity extension, granted in fiscal year 1998). Accrued interest payable under the note is either fully or partially offset to the extent FPI maintains non-interest bearing cash deposits with the Treasury. In this regard, there is no accrual of interest unless FPI's daily cash balance on deposit with the Treasury is less than the unpaid principal balance of all note advances received, as determined by a monthly calculation performed by the Treasury. When FPI's daily cash balance is less than the unpaid principal balance of all note advances received, interest is calculated by the Treasury on the difference between these two amounts. The note agreement provides for certain restrictive covenants and a prepayment penalty for debt retirements prior to 2008. Additionally, the agreement limits authorized borrowing in an aggregate amount not to exceed 25% of FPI's net equity.

There was no interest expense related to this note for the fiscal years ended September 30, 2002 and 2001.

Note 8

Business Segments

FPI's businesses are organized, managed, and internally reported as eight operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular; Graphics; Industrial Products; Office Furniture; Recycling; and Services and Product Distribution. These segments have responsibility for virtually all of FPI's product lines. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products. FPI's net sales for the fiscal years ended September 30, 2002 and 2001, for each of its business segments is presented for comparative purposes.

Notes to Financial Statements (Dollars in Thousands) continued

Net Sales

<i>Fiscal year ended September 30</i>	2002	2001
Business Segment		
Clothing and Textiles	\$159,730	\$157,391
Electronics	132,662	116,732
Fleet Management and Vehicular Components	99,054	31,334
Graphics	26,006	29,044
Industrial Products	27,782	59,946
Office Furniture	217,852	174,918
Recycling Activities	3,359	5,499
Services	12,210	8,636
Net sales	\$678,655	\$583,500

Regulatory Compliance

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

Relationship with the Federal Bureau of Prisons

FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their respective missions requires the sharing of facilities and responsibilities relative to the custody, training, and employment of federal inmates. The Director of the BOP serves as the Chief Executive Officer of FPI and the Chief Operating Officer of FPI 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.

Self Insurance

In accordance with federal government policy, FPI is uninsured with respect to property damage, product liability, and other customary business loss

Notes to Financial Statements (Dollars in Thousands) continued

exposures. Losses incurred are absorbed as a current operating expense 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 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. During the fiscal years ended September 30, 2002 and 2001, such claims and benefits, as charged to FPI, approximated \$737 and \$799, respectively, for which the related current liability is disbursed in the subsequent period.

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 \$7,935 and \$7,979 at September 30, 2002 and 2001, respectively.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under CSRS (those employees hired prior to January 1, 1984), FPI contributes approximately 8.51 percent (for normal retirement) or 9.01 percent (for hazardous duty retirement) of each employee's salary. CSRS covered employees do not have Federal Insurance Contributions Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered under FERS (generally those employees hired on or after January 1, 1984) FPI contributes 10.7 percent (for normal retirement) or 23.3 percent (for hazardous duty retirement).

Under FERS, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift). Under the thrift plan, an employee may contribute (tax deferred) up to 12 percent of salary to an investment fund. FPI then matches this amount up to 5 percent. Those employees which elected to remain under CSRS after January 1, 1984, continue to receive benefits in place and may also contribute (tax deferred) up to 7 percent of their salary to the thrift plan, but with no matching amount contributed by FPI.

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

FPI's contribution to both plans was approximately \$22,340 and \$20,580 for the years ended September 30, 2002 and 2001, respectively.

Health Benefits and Life Insurance

FPI, through the Office of Personnel Management (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 care and life insurance benefits approximated \$6,727 and \$5,869 for the fiscal years ended September 30, 2002 and 2001, respectively.

Notes to Financial Statements (Dollars in Thousands) continued

OPM also provides health care and life insurance benefits for FPI's retired employees. Based on the requirements of SFFAS No. 5, FPI must recognize an expense related to its share of the cost of such postretirement 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 \$5,143 and \$4,406 during the fiscal years ended September 30, 2002 and 2001, respectively, were determined by OPM utilizing cost factors which estimate the cost of providing postretirement benefits to current employees. However, because of the offsetting credit, the recording of these costs have no impact on reported net income or cash flows.

Future postretirement 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

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses consist of the following:

Selling, general, and administrative expenses

<i>Fiscal year ended September 30</i>	2002	2001
Salaries, wages, and benefits	\$29,714	\$26,913
Permanent change of station expense	1,901	414
Purchases of minor equipment	974	758
Contract services	9,388	3,102
Bad debt expense	4,957	10,417
Credit card services	1,733	2,193
Travel	2,020	1,842
Customer goodwill	1,039	328
Personal computer expense	1,864	1,271
Depreciation	2,883	3,021
Other expense	10,482	9,724
Imputed pension costs	3,025	3,217
Imputed postretirement health care and life insurance cost	5,143	4,406
	\$75,123	\$67,606

Notes to Financial Statements (Dollars in Thousands) continued

Other expense is comprised primarily of imputed financing expenses, inmate wages, and certain sales and marketing expenses. 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 9).

Note 11

Commitments and Contingencies

Legal Contingencies

The legal contingency from fiscal year 2001 was settled subsequent to fiscal year end for \$1,500. At September 30, 2002, FPI was party to no legal proceedings that are expected to result in a probable loss however, management estimates that the range for reasonably possible losses related to other legal matters is estimated to be \$500 as of September 30, 2002.

Lease Commitments

FPI leases certain facilities, machinery, vehicles, and office equipment under noncancelable 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. Future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of September 30, 2002, are as follows: fiscal year 2003-\$625; fiscal year 2004-\$219; fiscal year 2005-\$153; fiscal year 2006-\$115; fiscal year 2007-\$48; and fiscal years after 2007-\$3.

Planned Construction

As of September 30, 2002, various projects were in progress for the construction of new industrial facilities and the renovation of existing facilities. In this regard, BOP, on behalf of FPI, is planning to invest a total of approximately \$14,800, provided from their fiscal year 2001 and 2002 buildings and facilities appropriations, during the next fiscal year for the construction of buildings and improvements. In addition, during the next fiscal year, FPI is planning to invest approximately \$7,400 for the purchase of machinery and equipment.

Congressional Limitation on Administrative Expenses

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

Congressional limitation on administrative expenses

<i>Fiscal years ended September 30</i>	2002	2001
Congressional limitation on expenses	\$3,429	\$3,429
Expenses incurred subject to Congressional limitation	\$1,254	\$1,195

Notes to Financial Statements (Dollars in Thousands) continued

Note 12

Restatement of Prior Year Financial Statements (Unaudited)

Prior to fiscal year 2002, FPI presented certain revenues (primarily shipping costs billed to customers and installation revenues), net of related costs, as a component of "other income, net." Emerging Issues Task Force, Issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs," which was effective for FPI beginning in fiscal year 2001, does not permit the netting of these revenues and costs and requires such amounts to be reflected as "revenues" and "cost of revenues"; accordingly, the fiscal year 2001 Statement of Operations has been restated. This change did not affect net income, assets, liabilities, equity, or cash flows. The effect of the restatement is summarized below:

Restatement of Statement of Operations

Fiscal year ended September 30

	2001	2001
	(As Restated)	(As Originally Presented)
Total revenue	\$601,976	\$583,500
Total cost of revenue	541,325	518,807
Gross profit	60,651	64,693
Loss from operations	(6,955)	(2,913)
Other income, net	11,463	7,421
Net income	4,945	4,945



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