Federal Prison Industries, Inc
Annual Report 2009

Commemorating 75 Years of "Changing Lives"

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

Embracing the ideas of early prison reformers, President Franklin D. Roosevelt saw the need for a program that would instill the value of a good work ethic and its positive impact on success after incarceration. FPI continues to carry on the legacy envisioned by these leaders.

The Federal Prison Industries' Board of Directors proudly presents the Fiscal Year 2009 Annual Report, celebrating 75 years of changing lives.

As a result of the vision and perseverance of its founders three quarters of a century ago, and the tireless support of proponents such as Chief Justice Warren E. Burger, an advocate of educational and industrial programs, the Federal Prison Industries (FPI) program has transformed the lives of thousands. Each year approximately 40,000 federal offenders are released back into our communities by the Federal Bureau of Prisons. Our mission is to prepare each FPI program participant for a successful reentry into society.

The FPI program is instrumental in breaking the cycle of crime. Without sufficient marketable job training, work experience and life skills preparation, the ex-offender's ability to adapt to the world-at-large may be so overwhelming that the path of least resistance — a return to crime — may be taken.

FPI facilitates the offender's transformation to law-abiding citizen by teaching highly valued workforce skills. And by promoting personal responsibility and accountability, we believe that FPI has consistently achieved measurable success. For instance, released FPI inmates show a significant reduction in recidivism when compared to similar inmates who did not participate in the program. Moreover, the impact of reduced recidivism has been shown to have an even greater positive impact on the minority population.

The ability to find a stable, adequate source of income upon release from prison is a critical factor for a successful transition back to the community. Attorney General Eric Holder, in his recent address to the Vera Institute of Justice, advised that 40 percent of former federal prisoners are rearrested within three years of release. Given this statistic, even a modest reduction in the recidivism rate would prevent thousands of crimes and save taxpayer dollars. The Board accepts this opportunity as a challenge to build skills and to better prepare inmates for future reentry success.

As Board members, like our predecessors before us, our core belief is that the decisions and oversight responsibilities entrusted to us make a positive impact on people's lives, and contribute towards the overall well-being of our society. Looking back to 1934, it is interesting to note that many of the challenges faced by FPI's framers — the elimination of inmate idleness, program self-sufficiency, the safety and security of our prisons, and the creation of meaningful job skills training for federal inmates — continue to exist today.

We applaud FPI's staff for pursuing new initiatives and innovative inmate work opportunities during the 2009 Fiscal Year. This year, the Lean Six Sigma methodology was implemented as the organization's corporate-wide approach to continuous improvement. As a result, improvements in service, product quality and efficiency have enabled FPI to significantly reduce waste.

The expansion into the renewable energy sector is exciting, and we are very pleased with FPI's newest "green" product offering on its Schedule of Products: Photovoltaic (solar) Panels. We recognize that new opportunities such as those in the renewable energy sector, as well as the exposure and training of inmates in Lean Six Sigma processes, will strengthen and broaden FPI's continued reentry goals.

Given our Nation's economic climate and employment trends of recent years, FPI has faced the realities of lagging earnings, as well as the loss of valuable inmate jobs. The Board and FPI leadership have made a concerted effort to ensure that FPI's revenue stream remains sufficient to cover its operating expenses. This year, FPI undertook the decisive corrective actions that we felt were necessary to prevent further erosion of operating cash. This included the downsizing and consolidation of several operations, and the closure of several FPI factories. The closures included discontinuing FPI's wood dorm and quarters furniture operations which, at the height of activity during the mid-1990s, employed more than 800 inmates. Despite the financial challenges presented in Fiscal Year 2009, we are committed to our mission to employ and provide job skills training to the greatest practical number of inmates.

Since 1934, FPI has been a program that truly works in every sense of the word, predicated on the dignity and value of the human spirit. If the voices of Boards past could be heard among us today to recognize FPI's 75 years of changing lives, they would surely join us in a resounding, "Well done!"

THE BOARD OF DIRECTORS FOR FEDERAL PRISON INDUSTRIES, INC.

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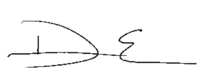

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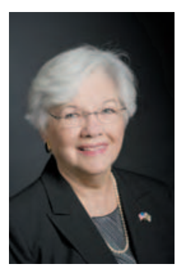

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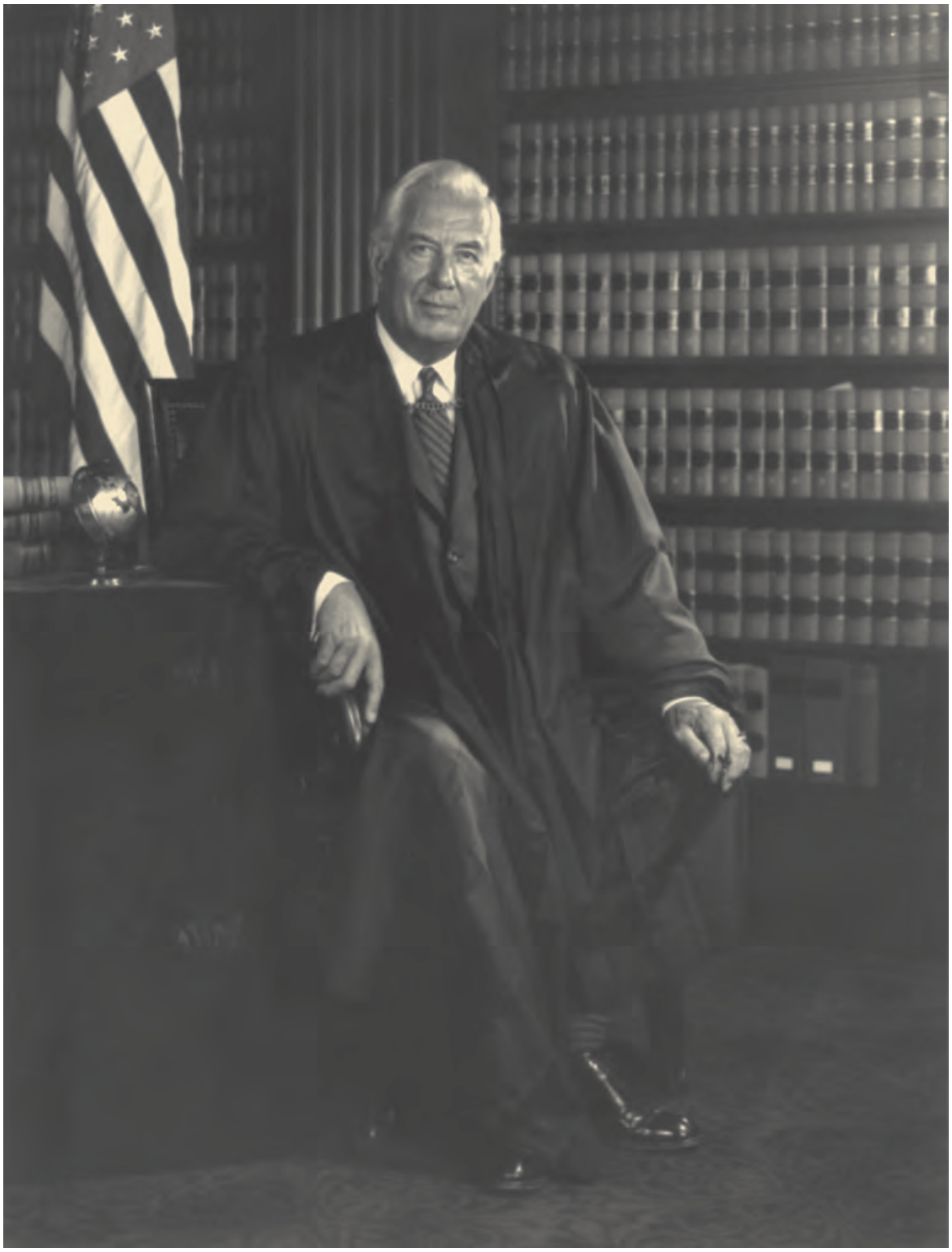


A tireless advocate for prison reform, Chief Justice Warren E. Burger believed that Federal Prison Industries provides offenders meaningful work skills to set a positive course for a productive future.

I have changed so much that my outlook on life is clear. I want to be part of the solution instead of part of the problem. I realized that it's because of my years in UNICOR that I owe this change. I just pray that in the future I get a chance to show my skills and changes to the outside world.

—inmate E. Alvarez
FCI Loretto, Pennsylvania

75 YEARS OF CHANGING LIVES

I am honored, as Director of the Federal Bureau of Prisons, and as Chief Executive Officer of Federal Prison Industries, Inc. (FPI), to join with FPI's Board of Directors in presenting the Annual Report for Fiscal Year 2009, which marks the 75th year since President Franklin Roosevelt signed legislation creating this wholly-owned government corporation. Warren E. Burger, our Nation's 15th Chief Justice and tireless advocate of prison reform once said, "It makes no sense to put people in prison and not train them to do something constructive."

In 1934, Bureau of Prisons Director, Sanford Bates and Assistant Director, James Bennett crafted a comprehensive plan for the operation of Federal Prison Industries, Inc. FPI's statute struck a balance between private sector interests and correctional goals, involved virtually no taxpayer support, helped ensure prison safety, and provided federal inmates positive work experiences and training opportunities fundamental to success upon release.

Initially, FPI operations consisted of only a textile mill, shoe factory and broom and brush operation. By its second year, FPI branched out into other sectors including mattress, clothing and furniture production; a woolen mill, foundry and brick plant followed in subsequent years. Public opposition to prison industries expanded as well. FPI has endured over the decades and continues to embrace and build upon the ideals of its founders.

Professional research validates that inmates who participate in prison industries and vocational training programs are substantially less likely to return to prison, and are more likely to obtain employment, upon release from prison.

FPI provides inmates with opportunities to engage in productive, meaningful work which benefits the inmates and their families, the taxpaying public, businesses, labor organizations, and the criminal justice system. In addition, FPI assists the Bureau to manage federal prisons in a cost-effective, productive and humane manner by reducing idleness and its associated problems.

Unlike many government programs, FPI does not rely upon taxpayer funding to support its operations. FPI covers all operating costs and expenses (including wages for staff and inmates) with revenue generated from the sale of its products and services. FPI customers are primarily agencies of the Federal Government.

Today, FPI provides meaningful work for approximately 19,000 federal inmates in numerous industrial and services operations in more than 71 locations around the country.

I cannot emphasize enough the crucial role FPI has played throughout the last 75 years in responding to the needs of the Bureau of Prisons, the Federal Government, FPI's customers, inmates and the communities to which they return. I extend my sincere appreciation and deep gratitude for the unwavering support and dedication of staff — past, present and future — in upholding the tenets of FPI's program.

Harley G. Lappin

Harley G. Lappin
Director,
Federal Bureau of Prisons
Chief Executive Officer,
Federal Prison Industries

A Message from the Chief Operating Officer

This year, Federal Prison Industries, Inc. (FPI), widely known by our trade name, UNICOR, commemorates 75 years of "changing lives." While this essential Bureau of Prisons program has evolved exponentially over the decades, its core purpose has not changed. The pro-social values that comprise FPI's core ideology influence our everyday business decisions, relationships and strategies.

We are in the business of "changing lives," and this precept shapes the way we view business. FPI's performance is not gauged by a balance sheet alone. Its success depends first and foremost on the social benefits provided to inmates and our society. FPI operates at no cost to taxpayers, creates private sector jobs indirectly, reduces our Nation's criminal justice costs, improves public safety and, through life and job skills training, provides federal inmates a "second chance" to become productive members of our communities upon release from prison.

Over the last fiscal year, UNICOR has faced mounting challenges resulting from prior legislative changes and procurement directives, increased competitive pressures, and a soft economic climate. This year's Annual Report clearly reflects a significant reduction in earnings from the past few years.

In light of the negative earnings in FY 2009 and the continued unstable economic trends, FPI implemented numerous cost containment initiatives to minimize losses. While beneficial, these measures fell short of our objective to reverse negative earnings. Consequently, we made some extremely difficult decisions to reduce excess production capacity and associated levels of staff and inmates working in UNICOR, in order to realign operations with our short and longer term business goals.

Ultimately, we closed or downsized factories impacting 19 of our locations. These initiatives were tremendously sensitive, given the many dedicated FPI staff whose jobs were directly affected by our decisions. Nevertheless, such measures were necessary to eliminate costs in those areas where sales were insufficient to support operations. We anticipate that the actions taken will reduce operating costs by nearly $16 million annually, although the full impact of these savings will not be realized until late 2010.

Tomorrow's successes are built upon today's understanding and strategies. For 75 years, FPI has helped inmates acquire a basic work ethic and job skills. Today, however, the market is shifting, and many jobs requiring minimal technical skills are migrating overseas. Therefore, to prepare inmates for future employer demands, we recognize the need to develop more opportunities in emerging industries such as the environmental and alternative energy sectors. To this end, we are exploring and pursuing these sectors to support future inmate reentry, to enable the organization to remain solid, financially, and to support the Federal Government's greening initiatives.

As the Federal Government curtails expenses through energy conservation and eco-sensitive practices, and the world moves toward renewable energy sources, waste and pollution prevention, the up-and-coming industries guiding America to reach its goals will require thousands of skilled workers. The environmental era holds significant potential for federal inmates to become technically proficient in areas such as zero waste to landfill manufacturing, closed loop recycling, environmental testing, and reclamation and rebuilding programs. We have already begun this journey.

We will continue to carefully monitor the corporation's financial position and, like our predecessors who weathered tough economic times and challenges over the decades, we too will continue to successfully fulfill FPI's mission and emerge even stronger in the years to follow.

We are in the business of "changing lives," and this precept shapes the way we view business.

Paul M. Laird
Chief Operating Officer
Federal Prison Industries

Industrial Programs, Locations, Inmate Employment and Net Sales as of September 30, 2009

	Recycling Activities	Industrial Products	Fleet Management/ Vehicular Components
	Atwater, CA Elkton, OH Fort Dix, NJ Leavenworth, KS Lewisburg, PA Marianna, FL Texarkana, TX Tucson, AZ	Butner, NC Cumberland, MD El Reno, OK Lompoc, CA Pekin, IL Terminal Island, CA Texarkana, TX	Bastrop, TX Bennettsville, SC Gilmer, WV Herlong, CA La Tuna, TX Terre Haute, IN Three Rivers, TX Victorville, CA
Inmates Employed*	860	1,049	1,809
Net Sales**	$9.2	$31.5	$261.2

Some locations have multiple plants.

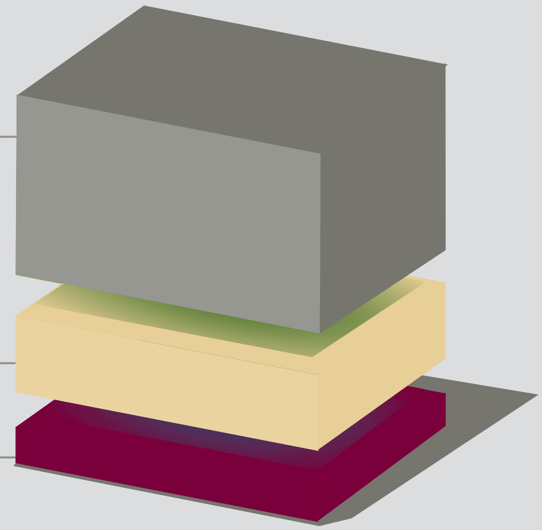
*There are an additional 256 inmates working in Customer Service, Accounts Payable, and Product Support. The total number of inmates who worked for Federal Prison Industries as of September 30, 2009, was 18,972 (this includes 3,894 inmates employed in support positions).

**Dollars in millions

Office Furniture	Services	Electronics	Clothing & Textiles
Allenwood, PA Ashland, KY Beckley, WV Coleman, FL Florence, CO Forrest City, AR Milan, MI Schuylkill, PA Talladega, AL	Alderson, WV Bryan, TX Butner, NC Canaan, PA Carswell, TX Dublin, CA Eglin, FL Elkton, OH Fort Dix, NJ Leavenworth, KS Marianna, FL McCreary, KY Montgomery, AL Morgantown, WV Petersburg, VA Sandstone, MN Sheridan, OR Tallahassee, FL	Beaumont, TX Big Spring, TX Danbury, CT Englewood, CO Fairton, NJ Lexington, KY Lompoc, CA Loretto, PA Marion, IL McKean, PA Memphis, TN Otisville, NY Oxford, WI Phoenix, AZ	Atlanta, GA Beaumont, TX Big Sandy, KY Butner, NC Edgefield, SC Fort Dix, NJ Greenville, IL Hazelton, WV 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 Waseca, MN Yazoo City, MS
3,158	**2,761**	**2,574**	**6,505 Inmates Employed***
$130.1	**$33.1**	**$161.5**	**$262.7 Net Sales****

- **Inmate Workers: 18,972**
- **Percent of Eligible (medically able/sentenced) Population Employed: 16%**
- **Employment Goal: 25%**
- **Inmate Pay Rates: 23 cents to $1.15 per hour**
- **Factories: 98 factories at 71 locations**

Distribution of FPI's Revenues



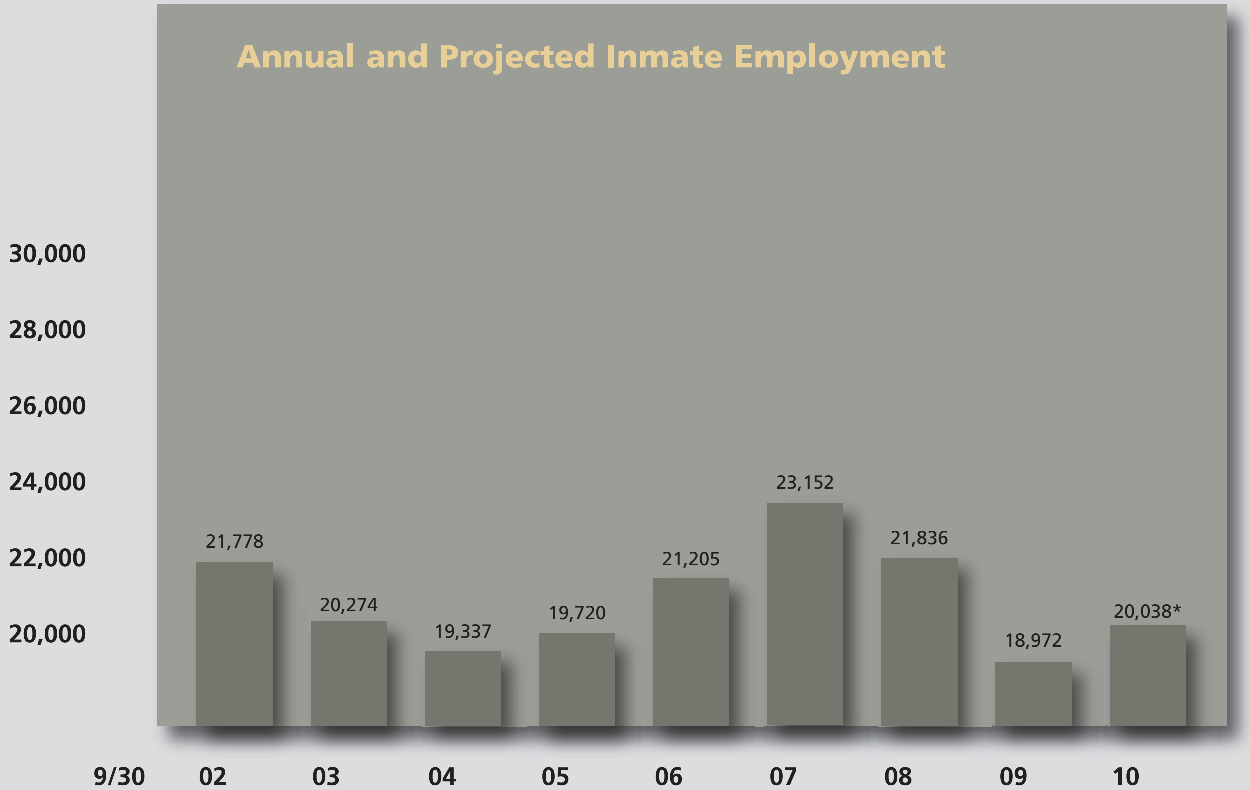
79.7 %
purchase of materials and supplies from private sector vendors

16.7 %
staff salaries

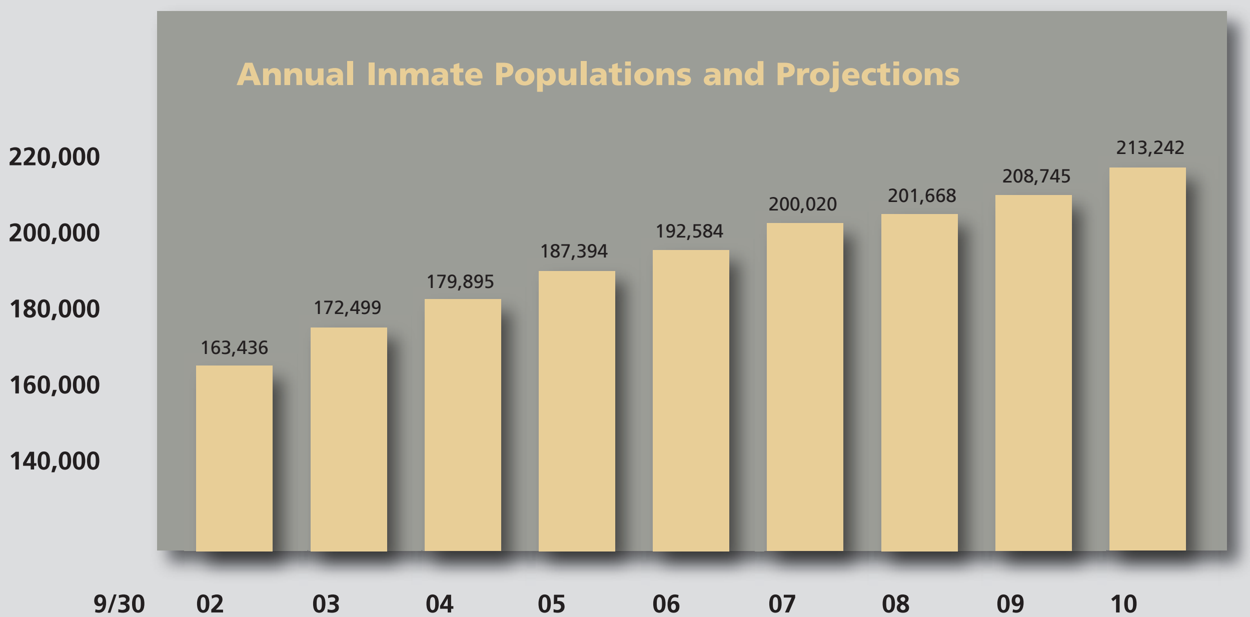
3.6 %
inmate pay (some of which is used to meet financial obligations and for commissary purchases of products that are supplied by local vendors)

Fiscal Year 2009 vs. 2008 Comparison

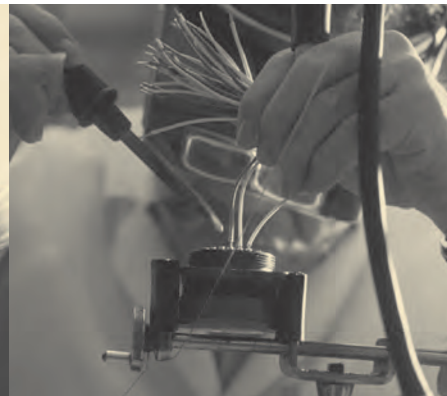
MILLIONS OF DOLLARS	2009	2008
Net sales	$885.3	$854.3
Net income	($35.9)	$3.1
Sales dollars spent on purchases from private sector	$576.7	$578.9
Inmates employed	18,972	21,836



Total institutions activated FY 2003 through FY 2009: 17
* Projected



* Projected

UNICOR taught me that a mature adult works and pays his own way in life...and anything worth having is worth working for.

— inmate J. Green,
USP Pollock



STARTING OVER

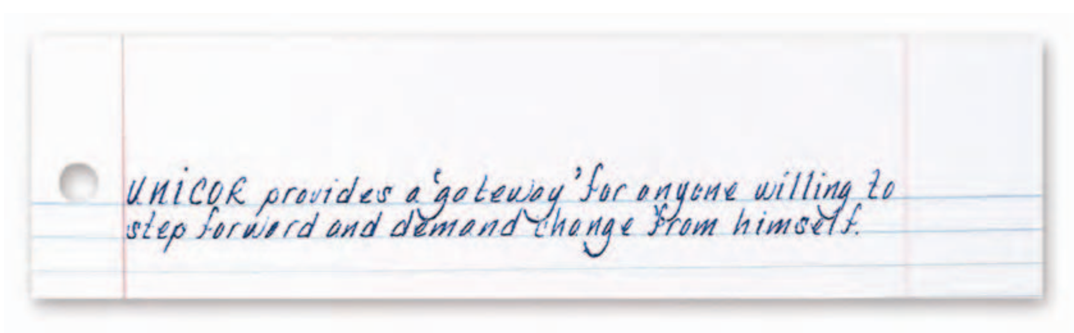
More than 40,000 inmates are released each year from federal prisons. Eventually, 98 percent of the entire federal inmate population will be released. As they return to our communities, too many will be minimally prepared, at best, to re-establish their lives in a modern society, having spent five, ten, perhaps twenty years away from the world we know. Many factors influence whether these men and women successfully reenter their communities, the most prolific one being the ability to obtain sustainable employment. That's where Federal Prison Industries, Inc. (FPI) plays a key role.

For the last 75 years, FPI, widely known by its trade name, UNICOR, has facilitated the offender's transition from federal inmate to law-abiding citizen. More succinctly, FPI has helped those lacking positive initiative become productive citizens. We accomplish this by providing a platform of job skills training and productive work experience to enhance the offender's prospects of securing meaningful post-release employment.

Our Annual Report theme, "*75 Years of Changing Lives*," could not be more fitting in describing FPI's true merits. It inherently teaches the value of earning a paycheck and represents a "second chance" for a brighter future to those who participate in the program. In recognition of FPI's 75th milestone, a number of federal inmates in correctional institutions across the country, volunteered to take part in an essay contest to share their thoughts about the program. The essay's theme was "What UNICOR Means to Me."

Excerpts from several essays appear throughout this Report and provide an "insider glimpse" of the many ways FPI continues to impact so many lives, both within and beyond prison walls.

The *"Yesterday and Today"* insights which follow, speak volumes about FPI's unique story. We believe they will leave an indelible impression of the role this critical correctional program continues to play as an investment in *all* our futures.



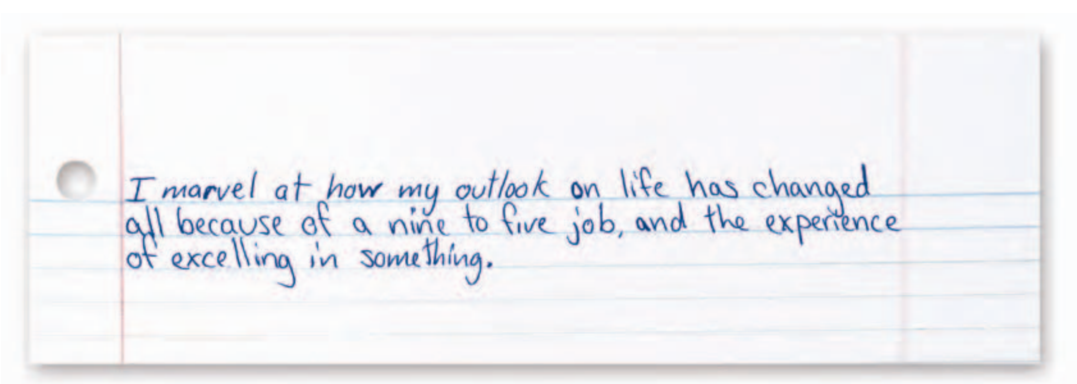
The typical inmate entering federal prison has an 8th grade education, will serve a ten-year sentence for a drug-related offense, and has never held a steady job. Inmates who volunteer to work in UNICOR learn and practice the most valuable skill of all: *How* to work.
Low self-esteem is replaced with confidence, inspiring inmates to succeed after years of struggle.

Yesterday:
When I got off the bus at FCI Oakdale, on that cold January wintry evening back in 1998, I was a tewenty-two year old who had no previous work history, no purpose, no goals, and no aspirations, and I was a newly convicted felon who had no high school diploma. My life was hollow inside like a piece of rotten wood.

Today:
UNICOR changed my life in many ways...When I first came into the federal system, I tested on a third grade level, but with the constant encouragement from various UNICOR supervisors, I was able to work extremely hard to earn my G.E.D. and have taken several self-study courses. For the past decade, I have made responsibility my first priority... When I encounter other inmates who appear to be in a stagnant place of uncertainty, I try to share with them the benefits of working in the UNICOR factories and the gratifying impact it had on my personal life.

— inmate F. Smith, FCC Forrest City , Arkansas

For those inmates who take personal responsibility to rebuild their lives during incarceration, the odds for success upon release from prison are significantly increased. The work and life skills federal inmates acquire unleash a potential most never knew they had.



Yesterday:
By the time my first day in UNICOR was over, I was tired, but also felt a strange sense of relaxation. For the first time in my recent memory, I felt as if I had done something constructive with my time.

Today:
During this journey of self-improvement, I have gone from a Junior Draftsman, to a Team Leader, and ultimately, to where I am now — the Department Trainer.

Today, I am still learning, improving, and I am even more motivated about getting out, knowing that I have prepared myself for the real world. I have spent long hours studying computer software, which was not easy. But something worth learning never is...
I believe that the fundamental difference between success and recidivism is education and job skills training, and thanks to the drafting department in UNICOR, I have gained both. Prison time does not have to mean "dead time."

— inmate A. Sims, FCI Englewood, Colorado

No matter what the job, the fundamental cornerstone of a successful employee — a positive work ethic — is a critical trait employers seek when hiring individuals: being a dependable team player, accepting supervisory direction, and taking pride in a job well-done. UNICOR helps develop and solidify this foundation.

Yesterday:
Like thousands of inmates I had a prison job. However, sweeping and mopping, buffing floors and picking up trash was far from rewarding work. Every day was a repeat of the day before. Time moved at a snail's pace. Each morning those floors looked as if I had not done a thing, and I would gather together a broom, a mop and a bucket and do it all over again, and again, and again...

Today:
Being a part of UNICOR has raised my self-esteem to levels unfelt in years... I have learned to work alongside people of various races and intellects. Now I see and understand the benefits diversity brings to an organization. People coming from different backgrounds offer several possible solutions to a problem, and our working together to achieve a common goal helps bring us together outside of work, which eases tensions on the yard...

My days (as a metal fabricator) are fulfilling now, and I look forward to going to work as part of a team, where I help produce a valuable piece of machinery that will be a functioning part of my nation's armed forces long after I am released...I look forward to being a productive citizen, working in a trade I learned in UNICOR.

— inmate T. Kinerk, FCI Herlong, California

For every inmate who commits an offense, other people's lives are disrupted and, at times, impaired. UNICOR's societal benefits reach far and wide, extending well beyond the confines of prison. Inmates who work in UNICOR operations are required to pay up to one half of their earnings toward crime victim restitution to fulfill outstanding legal obligations and/or to help support their families. Historically, up to $3 million has been deducted from inmate wages each year to help satisfy these obligations.

Yesterday:

There I was, sitting in USP Terre Haute, listening to my new cell mate ramble on and on about my new environment. I listened for awhile and then tuned him out, lost in my own anxious thoughts. How did I end up here? What about my children, my family, my friends; especially my mother? How am I going to survive under these conditions? Too many questions, not enough answers.

Today:

...The unique enabling financial benefits of working in UNICOR have proven to be priceless. I have been able to send my children birthday and Christmas gifts, buy needed shoes, coats and school materials, remain in frequent contact with them, assist with monthly bills, and be a positive influence in their lives. To my children, my name is still "Daddy" after all these years... UNICOR has not only sustained me during my incarceration, but will help me to balance my future. To this end, UNICOR has enabled me to fully pay off my $10,000 court assessment and fine; a truly incredible accomplishment. UNICOR has truly lived up to its mission statement in my life.

— inmate J. Shorter, FCI Butner-Medium, North Carolina

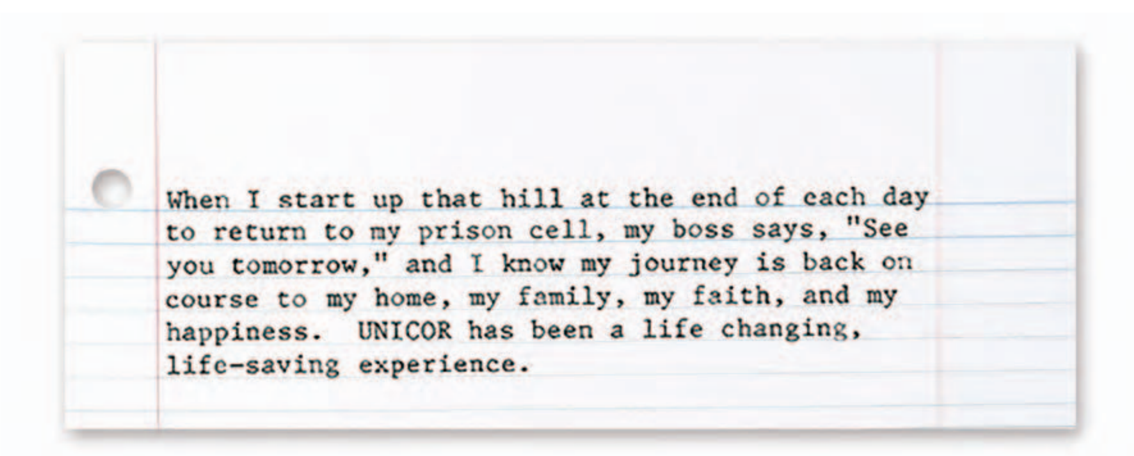
The collateral consequences of reentry touch *everyone* — not just the former offender who faces numerous challenges and critical choices along the road toward a productive life after prison. As a society, we are *all* impacted by the sheer volume of releasing offenders and the associated high rates of recidivism, leading to destabilized communities, rising unemployment, public health concerns, disenfranchisement, and a revolving environment of escalating crime. Yet, it need not be this way. As one inmate said...

UNICOR has changed my life in a positive fashion by giving me an avenue to follow which, with hard work and a drive to succeed, will lead me to that very second chance we all wish for. On my own, I could never be sure what the future would hold in store for me, but with UNICOR as a partner, lending a hand in my rehabilitation process, I know I can pay my debt to society and still come out with the confidence and values necessary to return to a clean and proper life. It's that knowledge, made possible by UNICOR, that has had a truly prolific and positive change on my life, and eventually will be the key to my success.

We do not profess to hold all the answers. To this end, FPI works with other Bureau of Prisons components, such as the Inmate Transition Branch, which helps improve federal inmates' employment prospects by strengthening their job interview and resume development skills through a nationwide mock job fairs program. FPI also collaborates with organizations such as the National Correctional Industries Association (NCIA), to share and validate ideas and management concepts in line with Today's realities, with emphasis on improved offender reentry and public safety in the years to come.

Since 1934, Federal Prison Industries has been a government program that *works* in every sense of the word, providing residual benefits: a reduction in government spending, a strengthened U.S. economy, as well as improved safety and security throughout our Nation's correctional facilities and neighborhoods. As inmate S. Ford (FCI Greenville, Illinois) so aptly summarized...

My cup is raised in toast to your 75th anniversary, UNICOR. Your success has been mine, and may there be many years of it to come.


When I start up that hill at the end of each day to return to my prison cell, my boss says, "See you tomorrow," and I know my journey is back on course to my home, my family, my faith, and my happiness. UNICOR has been a life changing, life-saving experience.

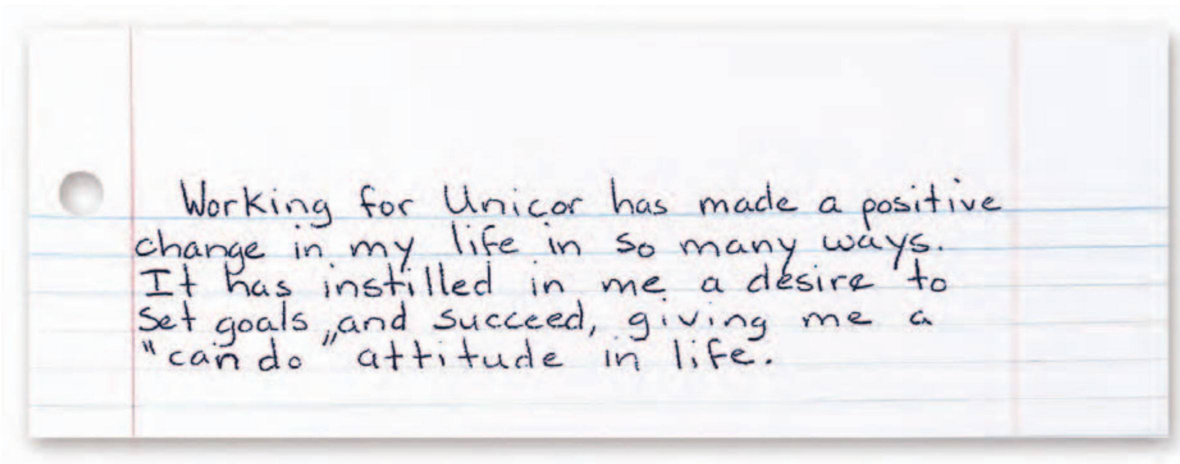
Because our business is changing lives it's never business-as-usual.

UNICOR understands change.

For 75 years UNICOR has provided customers quality goods and services, but its true output has been the thousands of federal offenders who were able to secure a brighter future, because of the jobs skills training and work experience gained from meeting our customers' needs. A productive life after prison can, and does happen. And with your continued support, you'll be helping us transform lives along the way.

unicor

We're life changing.


Working for Unicor has made a positive change in my life in so many ways. It has instilled in me a desire to set goals, and succeed, giving me a "can do" attitude in life.

GENERAL

Mission

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

Organizational Structure of Federal Prison Industries, Inc.

FPI is a wholly-owned government corporation created by Congress in 1934. FPI is authorized to operate industries in federal 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 2009, FPI operated in seven business segments: Clothing and Textiles, Electronics, Fleet Management and Vehicular Components, Industrial Products, Office Furniture, Recycling, and Services. FPI has industrial operations at 98 factories located at 71 prison locations representing approximately 16% of the work eligible inmate population as of September 30, 2009. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

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

Financial Structure

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

While FPI does business with the majority of federal departments, agencies and bureaus, FPI's largest federal government customers include the Department of Defense (DOD), the Department of Homeland Security (DHS), the Department of Justice (DOJ), the General Services Administration (GSA), and the Department of the Army (DOA).

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. Provisions for anticipated contract losses are recognized at the time they become evident. Sales returns are primarily replaced with like items and are recorded as they occur.

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

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

As of September 30, 2009 and September 30, 2008, FPI had established an allowance for bad debt in the amount of $.35 million and $.99 million on accounts receivable balances of $56.06 million and $45.86 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 excess and/or obsolete items that may not be utilized in future periods. This valuation method approximates historical cost.

PROGRAM VALUES

FPI's mission is to employ and provide job skills training to the greatest practicable number of inmates in BOP facilities necessary to ensure the safe and secure operation of such institutions, and in doing so, to produce market priced, quality goods and services in a self-sustaining manner that minimizes the potential impact on private business and labor.

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

As with most governmental programs, the real value of the entity is not readily measured in dollars and cents and is not always contained in the financial reports. FPI has existed as an effective correctional program for 75 years. In the course of the years, FPI has positively impacted the lives of countless inmates and staff members that reside and work in the Bureau of Prisons and the surrounding local communities in which we live.

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

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

Since coming into existence in the 1930s, FPI has been a reliable defense supplier, especially in times of surge demands. FPI has received a number of awards for its outstanding performance as a supplier to the DOD.

ANALYSIS OF FINANCIAL STATEMENTS

Cash and Investments

Total Cash decreased $87.1 million, $25.4 million of which was the result of a decrease in cash advances. FPI's cash advances are primarily for the purchase of inventory in support of the Fleet Management and Vehicular Components vehicle retrofitting operation. The change in cash advances represents less than one half of an average month's sales and is not deemed to be a significant change. Other major factors in the overall change in cash include a $35.9 million loss, an increase in Accounts Receivable of $10.8, an increase in Inventories of $14.1 million and an overall decrease in liabilities of $36.9 million.

Accounts Receivable

The Accounts Receivable balance increased $10.8 million during fiscal year 2009, primarily as a result of a strong month in sales revenue ($76.7 million) in September, a significant portion of which occurred in the latter part of the month. The Accounts Receivable balance of $55.7 million as of September 30, 2009 represents only 72.7 percent of the month's sales revenue. FPI collection efforts continued to improve during FY 2009. FPI was successful in maintaining its days to collect through enhanced results in the areas of electronic funds transfer and IPAC collections from the DOD. FPI's average days to collect for the year was approximately 25. The Accounts Receivable balance (over sixty day old category) decreased $2.9 million (51%) as of September 30, 2009 compared to September 30, 2008.

Inventory

Inventory increased by $14.1 million during fiscal year 2009. FPI placed an increased emphasis on inventory reduction during the second half of fiscal year 2009. Significant reductions were achieved as a whole in the majority of the business segments. The increase was primarily due to production of finished goods for the solar panel operation. These levels should subside once shipments begin in the first quarter of fiscal year 2010. The Textiles business segment had a total of $26.6 million in inventory as of September 30, 2009 compared to $24.3 million as of September 30, 2008. This increase is attributable to the continued growth in the Textiles segment's sales and in support of the $125.8 million in backlog as of September 30, 2009.

Other Assets

In fiscal year 2009, other assets decreased by $2.6 million. During fiscal year 2008, FPI established a program to produce solar panels. Suppliers of solar panel raw materials require customers to advance funds to purchase materials. As of September 30, 2009, FPI has $4.7 million of outstanding advances for solar panel raw materials compared to $7.9 million as of September 30, 2008. Also included in other assets is $0.9 million of accumulated costs paid by FPI for partial completion of customer and vendor contracts.

Liabilities

Total Liabilities decreased by $36.9 million during fiscal year 2009. Decreases were primarily in Accounts Payable and Deferred Revenue. Accounts Payable decreased $20.0 million during fiscal year 2009. The decrease is reflective of FPI's efforts to reduce costs and inventory during the second half of the year and the discontinuation of the customer incentive program. Also a factor in the decrease is the timing of the final vendor payment run which was completed three days later in fiscal year 2009 than was in fiscal year 2008. Deferred Revenue decreased $17.6 million during fiscal year 2009. This 8.4 percent decrease represents a change in customer advances payable on hand primarily for the retrofitting of vehicles for the DHS. The decrease is insignificant considering the volume of the business segment which recorded $261.2 million in sales during fiscal year 2009.

Revenue, Cost of Revenue and Net Loss

Total Revenue increased by $17.3 million while total cost of revenue increased by $32.8 million. The higher cost to revenue ratio is due primarily to an ongoing shift in the source of revenues from the Electronics business segment to other less profitable business segments. In comparison to fiscal year 2008, fiscal year 2009 sales revenue for the Electronics business segment decreased by $57.3 million. A significant portion of this decrease is relative to a decline in military orders for Single Channel Ground-Air Radio System kits and helmets. Contributing to the increased cost to revenue ratio is excess capacity in the Electronics factories. FPI has initiated deactivation of one Electronics factory which is scheduled to cease operations in the first quarter of fiscal year 2010. In addition, a new product line (Solar Panels) began production in one factory during 2009 and is expected to record sales revenue in the first quarter 2010. The Clothing and Textiles and Fleet Management and Vehicular Components business segments had a strong year for revenues. In comparison to fiscal year 2008, 2009 sales revenue for the Clothing and Textiles business segment increased by $59.0 million. While the Clothing and Textiles business segment was FPI's most significant source of earnings during fiscal year 2009, its earnings rate of 13.8 percent was typically lower than the earnings rate for the Electronics business segment during peak war time production (fiscal years 2004 through 2007). The Fleet Management and Vehicular Components business segment increased sales revenue in fiscal year 2009 by $32.1 million in comparison to fiscal year 2008 and was $104.9 million more than fiscal year 2007. Growth in this segment is attributable to the retrofitted vehicles products sold to the DHS. While this segment continues to grow, the earnings rate is low (4.4 percent in 2009) due to the high cost of the raw materials – primarily vehicles. Due to declining interest rates, FPI earned $10.7 million less on cash investments in fiscal 2009 compared to fiscal year 2008. Additionally, during fiscal year 2009 FPI incurred approximately $7.7 million in losses on the disposition of assets as a result of factory closures.

Business Segments

In fiscal year 2009, FPI's businesses were organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products. FPI's net industrial income (earnings) at the Business Segment level consist of sales offset by cost of goods sold and under /over applied overhead. FPI's net sales and earnings for the fiscal years ended September 30, 2009 and 2008 for each of its current business segments is presented for comparative purposes:

Business Segment	Fiscal Year	
Clothing and Textiles	**2009**	**2008**
Sales	$262,686	$203,644
Earnings	$36,165	$21,500
Electronics		
Sales	$161,525	$218,848
Earnings	$6,224	$29,683
Fleet Management and Vehicular Components		
Sales	$261,242	$229,168
Earnings	$11,566	$12,761
Industrial Products		
Sales	$31,533	$26,921
Earnings	($4,969)	($5,277)
Office Furniture		
Sales	$130,088	$129,572
Earnings	($2,994)	$2,434
Recycling		
Sales	$9,212	$10,505
Earnings	($308)	$829
Services		
Sales	$33,069	$35,621
Earnings	($8,070)	($1,583)
Corporate Total		
Sales	$889,355	$854,279
Earnings	$37,614	$60,347

Liquidity and Capital Resources

During fiscal year 2009, FPI's net loss of $35.9 million contributed to a substantial reduction in its cash position, compared with $3.1 million in earnings in fiscal year 2008. However, FPI's cash still remains strong as a result of the last several years of DHS demand combined with fiscal years 2004-2007 DOD demand. Factory earnings are expected to increase to $70.0 million in fiscal year 2010 in comparison to $37.6 million in fiscal year 2009. In fiscal year 2010, FPI's cash (excludes advances) is expected to decrease $10.1 million compared to a decrease of $61.7 million in fiscal year 2009. Reductions in costs and investments in property, plant, and equipment were instituted in FPI's fiscal year 2010 operating plan.

Possible Future Effects of Existing Events and Conditions

FPI's Recycling business segment is involved in the disassembly of components that may contain heavy metals. FPI management is committed to operating its recycling program in a manner that is safe and fully compliant with all applicable laws and regulations. Toward this end, FPI has established Standard Operating Procedures, sought input from regulatory agencies such as Occupational Safety and Health Administration (OSHA) and Environmental Protection Agency (EPA), and contracted for testing, inspection and technical advice with private companies with appropriate expertise.

The Office of the Inspector General (OIG) continues its on-going health and safety investigation of FPI's recycling of electronics equipment and expects it to be completed in FY 2010. As part of this investigation, the OIG has been collaborating with a team of occupational health and safety experts from various Federal agencies, including the Federal Occupational Health Service (FOH), the Occupational Safety and Health Administration (OSHA), and the National Institute of Occupational Safety and Health (NIOSH). This team has visited the FPI recycling plants and collected data to review its compliance with health and safety regulations applicable to electronics recycling and to ensure that FPI has adequately protected staff and inmates from hazards in their work environments. The FOH team has made several recommendations concerning FPI's recycling facilities and has been seeking to implement appropriate measures based on recommendations received thus far. In addition, the Recycling business segment is planning to review its Standard Operating Procedures based on these recommendations and update if appropriate. FPI expects to receive a final report in FY2010.

During fiscal year 2010, FPI will continue to accelerate its efforts to become an environmentally-friendly corporation in both the products it makes, and the raw materials it procures. FPI's ultimate goal in the 'greening effort' is to set the standard of environmental stewardship.

In its fiscal year 2008, Management Discussion and Analysis, FPI reported a possible return to a tentative fiscal position once demand for products in support of the war subsides. Demand for these products gradually, but significantly declined over the course of fiscal year 2009. During fiscal year 2009, FPI faced many financial and operational challenges. While overall demand for FPI's products and services remained strong, profit margins were significantly lower than planned as the result of a product mix that included fewer high profit margin items typically produced for the war effort. As many of our competitors experienced a downturn in their business, competition for government business increased, pushing prices and profit margins lower. Adverse legislation in recent years has made it significantly easier for private sector companies to increase its market share at FPI's expense. Increases in material prices and the cost of carrying excess production capacity and inventory also impacted FPI's profitability. The state of the economy yielded another unexpected turn in that interest rates severely declined, becoming nearly non-existent. Historically, FPI has earned significant income from interest earned by investing its cash reserves. Investment income earned in fiscal year 2009 was $423 thousand dollars compared to $11.1 million in fiscal year 2008.

FPI identified these trends early in the year and instituted aggressive cost containment measures to minimize the overall impact on its financial position. These measures included a reduction in budgeted general and administrative and actual overhead expenses and a reduction in plans for investment in property, plant and equipment. In order to achieve these goals, it was necessary to close or downsize 19 factories and reduce staff and inmate employment. Additionally, during fiscal year 2009, FPI placed an increased emphasis on marketing strategies. Additional reductions in costs and investment were instituted in FPI's fiscal year 2010 operating plan. FPI is working diligently to secure additional legislative authorities to support its mission and offset legislation that is having an impact on the program. These cost containment, capacity reduction, marketing and legislative initiatives have FPI well positioned to capitalize on the opportunities we anticipate in the new year.

FPI has historically focused on cost containment measures, which has allowed it to build sufficient cash reserves during prosperous periods. While FPI incurred a significant reduction in cash during fiscal year 2009, it still maintains a considerable reserve. FPI is confident that by maintaining these initiatives, it will continue to meet its mission challenges of maintaining a 'self-sufficient' fiscal position and providing adequate inmate employment levels. FPI anticipates that it will continue to sustain itself.

Office of the Inspector General Commentary and Summary

This audit report contains the Annual Management Report of the Federal Prison Industries, Inc. (FPI) for the fiscal years (FY) ended September 30, 2009, and September 30, 2008. 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 audit in accordance with U.S. generally accepted government auditing standards. The audit resulted in an unqualified opinion on the FY 2009 financial statements. An unqualified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in conformity with U.S. generally accepted accounting principles. For FY 2008, the FPI also received an unqualified opinion on its financial statements.

KPMG LLP also issued reports on internal control and on compliance and other matters. For FY 2009, the *Independent Auditors' Report on Internal Control over Financial Reporting* identified one significant deficiency. The significant deficiency relates to vulnerabilities identified in the FPI's financial management. Specifically, improvements are needed in the FPI's inventory count controls. In the FY 2009 *Report on Compliance and Other Matters,* the auditors identified no instances of significant non-compliance with applicable laws and regulations.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquires of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the FPI's financial statements, conclusions about the effectiveness of internal control, conclusions on whether the FPI's financial management systems substantially complied with the Federal Financial Management Integrity Act of 1996, or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditors' reports dated November 6, 2009, and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with U.S. generally accepted government auditing standards.

KPMG

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Financial Statements

Inspector General
U.S. Department of Justice

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

We have audited the accompanying balance sheets of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI) as of September 30, 2009 and 2008, and the related statements of operations and cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended. These financial statements are the responsibility of FPI's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Justice Federal Prison Industries, Inc. as of September 30, 2009 and 2008, and the results of its operations and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The information in the *Management's Discussion and Analysis* is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 6, 2009, on our consideration of the FPI's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, 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* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 6, 2009

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control over Financial Reporting

Inspector General
U.S. Department of Justice

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

We have audited the balance sheets of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI) as of September 30, 2009 and 2008, and the related statements of operations and cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated November 6, 2009.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the auditing standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of FPI is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2009 audit, we considered the FPI's internal control over financial reporting by obtaining an understanding of the FPI's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. To achieve this purpose, we did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of the FPI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FPI's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses.

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 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. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

In our fiscal year 2009 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified deficiencies in internal control over financial reporting that we consider to be a significant deficiency and that are described in Exhibit I. Exhibit II presents the status of prior years' findings and recommendations.

The FPI's responses to the findings identified in our audit are presented in the Exhibit I. We did not audit the FPI's responses and, accordingly, we express no opinion on them.

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

KPMG LLP

November 6, 2009

SIGNIFICANT DEFICIENCY

IMPROVEMENTS ARE NEEDED IN INVENTORY CONTROLS

During the 2009 audit we observed and tested the inventory cycle count process and the annual Work In Process (WIP) inventory counts. We noted that the inventory cycle count process lacked proper segregation of duties, was incorrectly performed, and lacked adequate documentation to support the weekly cycle count. In addition, the WIP inventory count process lacked proper segregation of duties and was incorrectly performed.

During our review of the inventory cycle count process, we observed one individual generate the inventory stock listing from the SAP Millennium system inventory count, supervise the inventory count, and record the results in SAP. In another instance we noted that the individuals did not perform a physical inventory count of the materials and goods in stock. Instead, they incorrectly compared the inventory stock listing generated from SAP to inventory stock listings. In addition, in reviewing cycle count documentation we identified cycle counts performed lacking proper segregation of duties, inventory count adjustments recorded to the general ledger that were not properly reviewed and authorized, and periods of time when cycle counts were not performed weekly or the cycle count documentation was not maintained.

During our review of the WIP inventory counts we identified a count performed lacking proper segregation of duties. This count team consisted of one individual, which did not provide for the verification of the accuracy of the counts. In another instance, proper procedures were not followed. The count team performed the work in process inventory while referring to SAP reports that identified inventory rather than performing the count only through observation to ensure the count was "blind" to the amounts maintained in SAP.

As a result of these weaknesses, differences in the quantities of stock in raw materials, sub-assembly, work in process, and finished goods from the quantities and amounts recorded in the ledger may not be identified through the performance of the inventory counts and the general ledger may not be adjusted accurately for the inventory count results.

FPI Program Statement Number 8331.02, "*Physical Inventories – FPI*" dated November 1, 2000, states "Random (inventory) counts are to be performed weekly unless otherwise waived by the Controller. The AW(I&E)/SOI is to ensure that only qualified personnel who are not otherwise involved in inventory control or record-keeping perform the physical inventory. Two-member teams are to be used to perform the physical inventory. Each member must count each item independently to ensure count integrity. Inventory teams may use printouts containing warehouse stock location, unit of issue, nomenclature for recording counts, and identifying stock items that have been counted. However, these printouts are not to contain the actual item counts. The AW/(I&E)/SOI is to review all inventory discrepancies and adjustments to the inventory records."

The FPI factory and warehouse personnel, in performing inventory counts, may not always maintain an awareness of the proper segregation of duties necessary in the supervision and performance of inventory counts and the necessity of properly identifying stock. The FPI management and staff responsible for documenting, recording, and maintaining the inventory count results may not always maintain an awareness of the proper controls necessary for the review and authorization of inventory adjustment entries resulting from the inventory process or the need to maintain complete files documenting the performance of inventory counts.

We recommend that FPI:

1. Emphasize the importance of adhering to the proper segregation of duties regarding inventory count duties for both the cycle counts and the work in process inventory counts, the necessity to perform these inventory counts properly, the requirement for proper review and authorization of adjusting entries resulting from the inventory counts, and the need to maintain complete files documenting the performance and results of inventory counts.

Management Response:

FPI's management concurs with the recommendation and is developing an Inventory Management Corrective Action plan that will be implemented during the month of December.

2. Consider reviewing and testing the adequacy of the performance of inventory counts. FPI management may consider utilizing the Program Review Division or utilizing headquarters management and staff to observe and document the performance of inventory counts in order to identify performance matters for improving the inventory count processes.

Management Response:

FPI's management concurs with the recommendation and is developing an Inventory Management Corrective Action plan that will be implemented during the month of December.

EXHIBIT II

STATUS OF PRIOR YEARS' FINDINGS AND RECOMMENDATIONS

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress FPI has made in correcting the previously identified significant deficiency. We also provide the Office of the Inspector General report number where the deficiency was reported, our recommendation for improvement, and the status of the condition as of the end of fiscal year 2009:

Report	Reportable Condition	Recommendation	Status
Annual Financial Statement Fiscal Year 2007 Report No. 08-10	Improvements are needed in FPI's Financial Management Systems' General Controls.	**Recommendation No. 6:** Use a Secure Sockets Layer (SSL) wrapper to encrypt unsecured protocol (FTP, etc.) transmissions.	Completed *
Annual Financial Statement Fiscal Year 2008 Report No. 09-10	Improvements are needed in FPI's Financial Management Systems' General Controls.	**Recommendation No. 1:** Develop policies and procedures to govern the control of network configuration files, copying of network configuration files using secure copy application FTP, and management of port security.	Completed
		Recommendation No. 2: Perform and document monthly audits to ensure the implementation of the newly developed policies and procedures.	Completed
		Recommendation No. 3: Reassess the roles and responsibilities of the Authorization, Audit, Licensing, and Compliance (AALC) group; adjust and communicate as appropriate. In addition, the communication should also emphasize the importance of following the approved procedures that have been instituted by the FPI Chief Information Officer.	Completed

Report	Reportable Condition	Recommendation	Status
		Recommendation No. 4: Revise the documented procedures for the account management process and establish clear roles and responsibilities related to account management. The revised procedures should include requesting, establishing, and re-certification and disablement of user access.	Completed
		Recommendation No. 5: Distribute the revised procedures authorized and approved by stakeholders to the appropriate responsible parties.	Completed
		Recommendation No. 6: Revise and maintain documentation addressing segregation of duties and the associated mitigating controls.	Completed
		Recommendation No. 7: Implement an automated account management solution to enforce segregation of duties rules and alert management of any conflicts that arise.	Completed
		Recommendation No. 8: Ensure that default configuration settings and default passwords are removed prior to new services being introduced into the IS environment.	Completed *
		Recommendation No. 9: Continue to scan the IS environment for default configuration settings and default passwords, make the appropriate changes, and update the applicable baseline configurations and documentation.	Completed *

* Sufficient progress has been made in addressing this finding and the related recommendation such that the remaining risk of misstatement no longer merits the attention by those charged with governance. Therefore, the condition has been downgraded to a deficiency in internal control.

KPMG LLP
2001 M Street, NW
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Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of Justice

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

We have audited the balance sheets of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI) as of September 30, 2009 and 2008, and the related statements of operations and cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated November 6, 2009.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the auditing standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the FPI is responsible for complying with laws, regulations, and contracts applicable to the FPI. As part of obtaining reasonable assurance about whether the FPI's fiscal year 2009 financial statements are free of material misstatement, we performed tests of the FPI's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the FPI. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed no instances in which the FPI's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) United States Government Standard General Ledger at the transaction level.

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

KPMG LLP

November 6, 2009

Federal Prison Industries, Inc.
Balance Sheets

As of September 30, (DOLLARS IN THOUSANDS)	**2009**	**2008**
Assets		
Current:		
Cash and cash equivalents	$ 285,559	$ 372,691
Accounts receivable, net	55,712	44,869
Inventories, net	264,232	250,116
Other assets	5,962	8,587
Total current assets	611,465	676,263
Property, plant and equipment, net	123,684	131,651
Total Assets	$ 735,149	$ 807,914
Liabilities and United States Government Equity		
Current:		
Accounts payable	$ 48,103	$ 68,068
Deferred revenue	191,314	208,911
Accrued salaries and wages	11,484	11,506
Accrued annual leave	10,363	10,291
Other accrued expenses	11,780	13,097
Total current liabilities	273,044	311,873
FECA actuarial liability	13,943	12,010
Total Liabilities	286,987	323,883
United States Government Equity		
Initial capital	4,176	4,176
Cumulative results of operations	443,986	479,855
Total United States Government Equity	448,162	484,031
Total Liabilities and United States Government Equity	$ 735,149	$ 807,914

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

Federal Prison Industries, Inc.
Statements of Operations and
Cumulative Results of Operations

Fiscal years ended September 30, (DOLLARS IN THOUSANDS)	**2009**	**2008**
Revenue:		
Net sales	$ 885,265	$ 854,279
Other revenue	97,962	111,670
Total revenue	983,227	965,949
Cost of revenue:		
Cost of sales	833,083	786,131
Cost of other revenue	101,829	115,934
Total Cost of Revenue	934,912	902,065
Gross profit	48,315	63,884
Operating expenses:		
Sales and marketing	6,364	6,692
General and administrative	120,241	106,246
Total operating expenses	126,605	112,938
Loss from operations	(78,290)	(49,054)
Interest income	423	11,144
Interest expense	(17)	(15)
Other income, net	42,015	41,044
Net income (loss)	(35,869)	3,119
Cumulative results of operations, beginning of fiscal year	479,855	476,736
Cumulative results of operations, end of fiscal year	$ 443,986	$ 479,855

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

Federal Prison Industries, Inc.
Statements of Cash Flows

Fiscal years ended September 30, *(DOLLARS IN THOUSANDS)*	**2009**	**2008**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (35,869)	$ 3,119
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,739	9,775
Loss on disposal of property, plant and equipment	7,970	134
Changes in:		
Accounts receivable	(10,843)	23,392
Inventories	(14,116)	(68,893)
Other assets	2,625	(6,571)
Accounts payable and accrued expenses	(19,299)	4,345
Deferred revenue	(17,597)	22,130
Net cash provided by operating activities	(76,390)	(12,569)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(8,972)	(9,685)
Construction-in-progress of plant facilities	(1,770)	(2,145)
Net cash used in investing activities	(10,742)	(11,830)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal Payment of Note Payable	(20,000)	
Net cash used in financing activities	-	(20,000)
Net decrease in cash and cash equivalents	(87,132)	(44,399)
Cash and cash equivalents, beginning of fiscal year	372,691	417,090
Cash and cash equivalents, end of fiscal year	$ 285,559	$ 372,691

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

Fiscal Years 2009 and 2008
Notes to Financial Statements
(DOLLARS IN THOUSANDS)

Note 1. Organization and Mission

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

FPI's federal government customers include departments (percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (47%), the Department of Homeland Security (25%), the Department of Justice (6%), the Department of the Army (4%), and the General Services Administration (3%). 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.

FPI has industrial operations at 98 and 109 factories located at 71 and 76 prison facilities that employed 18,972 and 21,836 inmates representing approximately 16% and 17% of the work eligible inmate population as of September 30, 2009 and September 30, 2008, respectively.

Note 2. Summary of Significant Accounting Policies

Basis of Accounting

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

Basis of Presentation

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

Use of Estimates

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

Cash and Cash Equivalents

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

Accounts Receivable / Concentration of Credit Risk

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

FPI routinely assesses the payment histories of its federal customers and the financial strength of its private sector customers and maintains allowances for anticipated losses as they become evident. In this regard, an insignificant amount of accounts receivable remained past due at September 30, 2009 and September 30, 2008. A majority of these past due items relate to billings to various entities within Department of Defense (DOD) who rely on the Defense Finance and Accounting Service (DFAS) to process vendor payments. Historically, customer payments processed through DFAS have generally taken longer to receive than payments from other federal and private sector customers. FPI believes that ultimately, a majority of its past-due accounts receivable are fully collectable. The amount due FPI, net of allowances, from DOD for the fiscal years ended September 30, 2009 and 2008 was $38,037 and $31,148 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, 2009 and 2008, FPI's allowance for doubtful accounts is stated at approximately $345 and $990, respectively, of which approximately $285 and $891, respectively, represents the amounts allocated against federal accounts receivable.

Inventories

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

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

Advances to Vendors

FPI generally does not offer advances to the public, however, where warranted, FPI will on occasion make an advance to a vendor upon their request. Historically, these advances have been insignificant and made primarily to the Industries for the Blind. During 2008, FPI established a pilot program to produce solar panels in anticipation of an expanding federal market as a result of Executive Order 13423 "Strengthening Federal Environmental, Energy, and Transportation Management," which requires federal agencies to improve energy efficiencies by the year 2015. Customarily, suppliers of the raw materials to produce solar panels require advances to procure their own materials. Prior to issuing any 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. Provisions for anticipated contract losses are recognized at the time they become evident. 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. Revenue for services provided on behalf of FPI is recognized when the service provider presents a valid invoice including a customer acceptance or completion notice.

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

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

Other income is comprised primarily of 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:

	Years
Machinery & Equipment	5 – 25
Computer Hardware	5 – 10
Computer Software	3 – 5
Building & Improvements	24 – 40

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

(DOLLARS IN THOUSANDS)

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 2008 financial statement line items have been reclassified to conform with the current year presentation.

Note 3. Accounts Receivable, Net

Accounts receivable, net consists of the following:

As of September 30,	2009	2008
Intragovernmental billed receivables	$ 47,083	$ 37,388
Private sector billed receivables	8,974	8,471
	56,057	45,859
Less allowance for doubtful accounts	345	990
Accounts receivable, net	$ 55,712	$ 44,869

FPI incurred bad debt expense of $(530) and $1,097, respectively, for the fiscal years ended September 30, 2009 and 2008.

FPI incurred minimal direct accounts receivable write-offs during fiscal year 2009. The net downward adjustment of $645 to allowance for doubtful accounts during fiscal year 2009 resulted in negative bad debt expense. FPI's accounting policy regarding the recording of allowance for doubtful accounts is discussed in note 2 — Accounts Receivable / Concentration of Credit Risk.

Note 4. Inventories, Net

Inventories, net consist of the following:

As of September 30,	2009	2008
Raw materials	$ 75,114	$ 51,631
Raw materials – vehicles	91,890	96,656
Work-in-process	41,916	44,318
Finished sub-assemblies	8,577	12,351
Finished goods	38,050	37,883
Finished goods – acceptance contracts	20,899	21,777
	276,446	264,616
Less inventory allowance	12,214	14,500
Inventories, net	$ 264,232	$ 250,116

(DOLLARS IN THOUSANDS)

$91,890 of FPI's fiscal year 2009 and $96,656 of FPI's fiscal year 2008, raw materials balance represents vehicles and component parts for use in the Fleet Management and Vehicular Components business group's retrofit product line. A majority of that inventory balance has been contracted on behalf of the Customs and Border Protection and Bureau of Immigration and Customs Enforcement of the Department of Homeland Security (DHS) for retrofit services that are performed by FPI. As part of an interagency agreement, DHS provides advance funding to FPI to procure these vehicles. Revenue is recognized by FPI at the time of shipment of retrofitted vehicles to DHS.

$20,899 of FPI's fiscal year 2009 and $21,777 of FPI's fiscal year 2008 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. The balances as of September 30, 2009 and September 30, 2008 are primarily systems furniture installations and destination acceptance contracts shipped after the cutoff date for revenue recognition.

Included in total inventories as of September 30, 2009, is $22,752 in raw materials, work-in-process and finished goods in support of the newly activated solar panels product line. Additionally, FPI has entered into firm purchase commitments for solar panel materials totaling $173,159; $80,364 for fiscal year 2010, $53,845 for fiscal year 2011, $11,550 for fiscal year 2012, and an additional $27,400 for fiscal years 2010 through 2014. Solar panel sales revenue is anticipated to begin in the first quarter of fiscal year 2010.

Note 5. Property, Plant and Equipment, Net

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

As of September 30,	2009	2008
Buildings and improvements	$ 181,290	$ 187,431
Machinery and equipment	105,401	112,374
Computer hardware	1,872	1,660
Computer software	6,304	5,778
	294,867	307,243
Less accumulated depreciation	173,001	181,328
	121,866	125,915
Factory construction-in-progress	1,818	5,736
Property, plant and equipment, net	$ 123,684	$ 131,651

Depreciation and amortization expense approximated $10,739 and $9,775 for the fiscal years ended September 30, 2009 and 2008, respectively. During fiscal year 2009, FPI invested $10,742 for the purchase and construction of property, plant and equipment. Additionally, during fiscal year 2009, FPI deactivated factories in an effort to reduce excess factory capacity. As a result of these deactivations, FPI incurred losses on property plant and equipment of $7,746.

(DOLLARS IN THOUSANDS)

Note 6. Other Accrued Expenses

Other accrued expenses consist of the following:

As of September 30,	2009	2008
Materials in transit	$ 1,580	$ 642
Relocation Travel Expense	2,191	2,713
FECA liabilities – current portion	1,643	1,489
Financial audit expense	549	307
Telecommnication Expense	1,174	473
Utilities	1,401	1,026
Warranty expense	478	471
Other expense	2,764	5,976
Other accrued expenses	$ 11,780	$ 13,097

Included in other expense as of September 30, 2009 and September 30, 2008 are accruals for Intra-Departmental agreements of $73 and $2,399 and accruals for vendor invoices of $1,486 and $1,201, respectively.

Note 7. Business Segments

FPI's businesses are organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. These segments represent virtually all of FPI's product lines. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products and services. Fiscal Year 2009 net sales of $885,265 included $(4,090) recorded to FPI's Corporate Office. FPI's net sales for the fiscal years ended September 30, 2009 and 2008 for each of its business segments is presented for comparative purposes:

Net Sales

For the years ended September 30,	2009	2008
Business Segment		
Clothing and Textiles	$ 262,686	$ 203,644
Electronics	161,525	218,848
Fleet Management and Vehicular Components	261,242	229,168
Industrial Products	31,533	26,921
Office Furniture	130,088	129,572
Recycling	9,212	10,505
Services	33,069	35,621
Net sales	$ 889,355	$ 854,279

Regulatory Compliance

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

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

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

Relationship with the Federal Bureau of Prisons

FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their respective missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP 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. 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, 2009 and 2008, 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, 2009 and September 30, 2008, the accrued FECA liabilities as charged to FPI, approximated $1,643 and $1,489, 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 $13,943 and $12,010 at September 30, 2009 and 2008, respectively.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under CSRS (those employees hired prior to January 1, 1984), FPI contributed approximately 7.0 percent (for normal retirement) or 7.5 percent (for hazardous duty retirement) of each employee's salary. CSRS covered employees do not have Federal Insurance Contributions Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered by the FERS, (generally those employees hired on or after January 1, 1984), FPI contributed (for normal retirement) 11.2 percent for fiscal years ended September 30, 2009 and September 30, 2008. FPI contributed (for hazardous retirement) 24.9 percent for fiscal years ended September 30, 2009 and September 30, 2008.

Under FERS, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift). Under the thrift plan, an employee may contribute (tax deferred) to an investment fund, up to $16,500 of salary for the fiscal year ended September 30, 2009 and $15,500 for the fiscal year ended September 30, 2008. FPI then matches this amount up to 4 percent, in addition to an automatic 1 percent that is contributed for all FERS employees. Those employees, which elected to remain under CSRS after January 1, 1984, continue to receive benefits in place, and may also contribute (tax deferred) up to 10 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 United States Office of Personnel Management (OPM).

FPI's contribution to both plans approximated $32,325 and $31,585 for the fiscal years ended September 30, 2009 and 2008, respectively.

FPI must recognize its share of the cost of providing pension benefits to eligible employees utilizing cost factors determined by the OPM. Included in general and administrative expense is approximately $1,043 and $1,274 in the fiscal years ended September 30, 2009 and 2008, respectively, with an offsetting credit to other income on the Statements of Operations and Cumulative Results of Operations.

Health Benefits and Life Insurance

FPI, through the OPM, offers health and life insurance plans under which premium costs for health care are shared between FPI and the employees. A substantial portion of life insurance premiums are paid for by employees. Amounts paid by FPI for health benefits and life insurance approximated $10,667 and $10,253 for the fiscal years ended September 30, 2009 and 2008, respectively.

OPM also provides health care and life insurance benefits for FPI's retired employees. FPI must recognize an expense related to its share of the cost of such post-retirement health benefits and life insurance on a current basis (while its employees are still working), with an offsetting credit to other income. Costs in this regard, which approximated $8,365 and $7,628 during the fiscal years ended September 30, 2009 and 2008, respectively, were determined by OPM utilizing cost factors used to estimate the cost of providing post-retirement benefits to current employees. However, because of the offsetting credit, which is reflected as other income on the Statements of Operations and Cumulative Results of Operations, the recording of these costs has no impact on reported net income or cash flows.

(DOLLARS IN THOUSANDS)

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:

Sales and marketing, general and administrative expenses *Fiscal years ended September 30,*	2009	2008
Salaries, wages and benefits	$ 47,893	$ 43,278
Permanent change of station expense	2,604	3,745
Purchases of minor equipment	1,076	1,224
Contract services	10,282	11,045
Bad debt expense	(516)	1,097
Credit card services	1,051	-
Travel	2,646	2,893
Customer Incentives Expense	-	3,516
Personal Computer Expense	3,508	736
Depreciation	2,033	1,651
Gain on disposition of assets	(52)	(8)
Loss on Disposition of Assets	7,970	134
Telecommunication Expense	3,097	2,550
Other Expense	7,251	4,612
Imputed pension costs (Note 8)	1,043	1,274
Imputed post-retirement health care and life insurance cost (Note 8)	8,365	7,628
Imputed Operating Costs	28,354	27,563
Sales and marketing, general and administrative expenses	$ 126,605	$ 112,938

Other expense is comprised primarily of inmate wages, maintenance agreements, civilian accident compensation (FECA), financial audit expenses, distributions to factory operations, 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 8).

(DOLLARS IN THOUSANDS)

Note 10. Commitments and Contingencies

Legal Contingencies

FPI is involved in various legal actions, including administrative proceedings, lawsuits, and claims. In the opinion of the organization's legal counsel and management, these suits are without substantial merit and should not result in judgments, which in the aggregate would have a material adverse effect on the organization's financial statements.

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, 2009, future capital lease payments due and future operating lease commitments total $189 and $172, respectively.

Product Warranty

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

Changes in aggregate product warranty liability ***Fiscal years ended September 30,***	**2009**	**2008**
Balance at the beginning of the period	$ 471	$ 453
Accruals for warranties issued during the period	377	375
Settlements made (in cash or in kind) during the period	(370)	(357)
Balance at the end of the period	$ 478	$ 471

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 ***Fiscal years ended September 30,***	**2009**	**2008**
Congressional limitation on expenses	$ 2,328	$ 2,328
Expenses incurred subject to Congressional limitation	$ 2,323	$ 2,089

UNICOR has given me a solid foundation for a positive future, and it gives me immense joy to hear work call each morning... In retrospect, I'm thankful for the lessons I've learned, all I've accomplished, and look forward to going home, fully capable to succeed, thanks to UNICOR.

—inmate L. Rogers
USP Atwater, California

U.S. Department of Justice

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