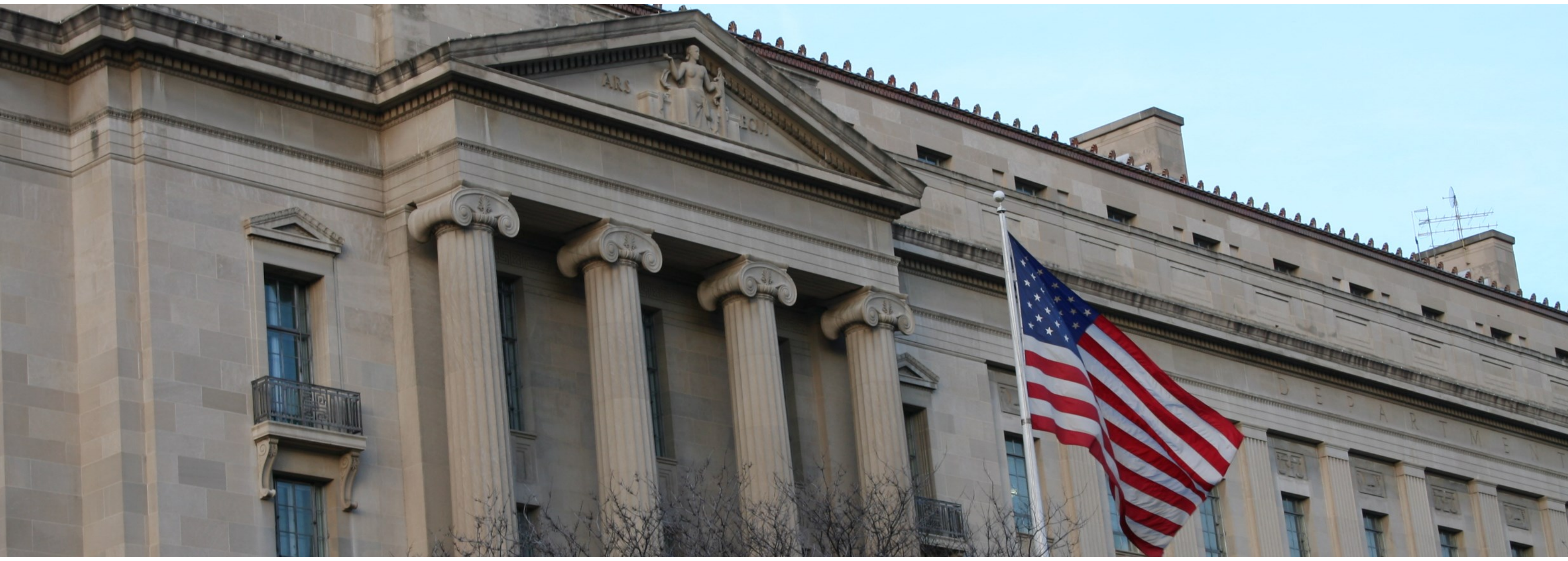
Office of the Inspector General
U.S. Department of Justice

OVERSIGHT ★ INTEGRITY ★ GUIDANCE



Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2017

Audit Division 18-04

December 2017

Commentary and Summary

Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2017

Objective

In accordance with the *Government Corporation Control Act*, as amended (31 U.S.C. § 9105), the Department of Justice Office of the Inspector General (OIG) is required to perform an audit of the Federal Prison Industries, Inc. (FPI) annual financial statements.

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

Results in Brief

The fiscal year (FY) 2017 audit resulted in an unmodified opinion on the FPI's financial statements. The auditors' reports on internal controls over financial reporting and compliance and other matters did not report any material weaknesses or instances of noncompliance.

The OIG reviewed KPMG LLP's reports and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with Government Auditing Standards, was not intended to enable us to express, and we do not express, an opinion on the FPI's financial statements, conclusions about the effectiveness of internal control, conclusions on whether the FPI's financial management systems substantially complied with FFMIA, or conclusions on compliance and other matters. KPMG LLP is responsible for the attached auditors' reports dated November 6, 2017, and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with auditing standards generally accepted in the United States of America.

Recommendations

No recommendations were provided in the report.

Audit Results

Under the direction of the OIG, KPMG LLP performed the FPI's audit in accordance with auditing standards generally accepted in the United States of America. The FY 2017 audit resulted in an unmodified opinion on the financial statements. An unmodified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in accordance with U.S. generally accepted accounting principles. For FY 2016, the FPI also received an unmodified opinion on its financial statements (OIG Audit Division Report No. 17-05).

KPMG LLP also issued reports on internal control over financial reporting and on compliance and other matters. The auditors neither identified any material weaknesses, nor reported any significant deficiencies in the FY 2017 *Independent Auditors' Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*.

No instances of non-compliance or other matters were identified during the audit that are required to be reported under Government Auditing Standards, in the FY 2017 *Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*. Additionally, KPMG LLP's tests disclosed no instances in which the FPI's financial management systems did not substantially comply with FFMIA.

AUDIT OF THE FEDERAL PRISON INDUSTRIES, INC. ANNUAL FINANCIAL STATEMENTS FISCAL YEAR 2017

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Message from the Chief Executive Officer and the Commissioner

U.S. Department of Justice

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Federal Prison Industries, Inc.

Washington, DC 20534

November 6, 2017

We are pleased to present the Federal Prison Industries, Inc.'s (FPI) Fiscal Year 2017 Annual Management Report to the Congress of the United States. This report includes the FPI's financial statements, Management's Discussion and Analysis, Office of the Inspector General Commentary and Summary, and the Independent Auditors' reports on the Corporation's financial statements, internal controls over financial reporting and compliance, and other matters. FPI's financial statements received an unmodified audit opinion, and no significant deficiencies or material weaknesses were reported by the Independent Auditors.

FPI was established by statute and Executive Order 6917 in 1934, signed by President Roosevelt to provide opportunities educational and work-related experiences to federal offenders. Although a great deal of time has passed and technology is changing rapidly, FPI's mission throughout these years remains the same - to protect society and reduce crime by preparing inmates for successful reentry through job training. FPI continues to place emphasis on reaching as many inmates as possible by focusing on employment of inmates within two years of release. As one of the Bureau of Prisons'(BOP's) most important inmate anti-recidivism programs, FPI employed almost 17,000 inmates over the course of FY 2017, employing 10,599 federal inmates in FPI factories at fiscal year-end.

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

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

As a federal government corporation, FPI is a program that also functions as a business to remain self-sustaining, and continues to face a dynamic set of external and internal constraints. Due to the nature of the changes affecting purchases from FPI by the government sector, emphasis has been placed on exploring more opportunities with commercial customers. New market authorities, contained in the Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) are now available for FPI to obtain commercial customers through repatriation and bringing work opportunities otherwise being performed outside of the United States. FPI has built on its progress in fiscal years 2015 and 2016 capitalizing on many new opportunities and a number of pilot programs already implemented. Additionally, P.L. 112-55 authorized FPI to participate in the Prison Industries Enhancement Certification Program (PIECP). FPI began the lengthy process of implementing this new authority in fiscal year 2013 and has two established PIECP programs at FCI Estill, South Carolina and FCC Butner, North Carolina. FPI is optimistic that we will continue to grow PIECP operations.

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

Mark S. Inch

Director
Federal Bureau of Prisons
Commissioner of FPI

Gary M. Simpson

Chief Executive Officer
Federal Prison Industries, Inc.

Management's Discussion and Analysis

(Unaudited)

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

Mission

It is the mission of Federal Prison Industries, Inc. (FPI) to protect society and reduce crime by preparing inmates for successful reentry through job training.

Organizational Structure of Federal Prison Industries, Inc.

FPI is a wholly-owned government corporation created by Congress in 1934. FPI is authorized to operate industries in federal penal and correctional institutions and disciplinary barracks (18 U.S.C. § 4121 to § 4129). The Director of the Federal Bureau of Prisons (BOP), who has jurisdiction over all federal correctional institutions, is the Commissioner of FPI. General management of FPI is provided by the Chief Executive Officer who also serves as an Assistant Director for the BOP.

In fiscal year 2017, FPI operated in six business segments: Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI has agricultural, industrial and service operations at 59 factories and 3 farms located at 51 prison facilities as of September 30, 2017. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased primarily from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed primarily by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

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

Financial Structure

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

FPI sells products and services to the majority of federal departments, agencies, and bureaus. FPI's largest federal government customers include the Department of Defense (DOD), the Department of Homeland Security (DHS), the Department of Justice (DOJ), the Social Security

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

Due to the volatile nature of the changes affecting FPI with the government sector, emphasis has been placed on exploring more opportunities with commercial customers. Opportunities in this arena have become available as part of the approval for FPI to obtain commercial customers through repatriation and bringing sales otherwise sent to foreign countries back into the United States of America. Many new opportunities are already being pursued through a collaboration of FPI's business groups and the New Business Development Group. Additionally, the Consolidated and Further Continuing Appropriations Act of 2012 (P.L. 112-55) authorized FPI to participate in the Prison Industries Enhancement Certification Program (PIECP). FPI has invested and continues to invest significant time and effort into pursuing this goal in fiscal year 2017 through research and discussion within the organization and other agencies.

Critical Accounting Policies

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

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

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

Revenue from contracts with multiple element arrangements is recognized as each element is earned based on the relative fair value of each element provided the delivered elements have value to customers on a standalone basis and amounts can be allocated to each element based on its objectively determined fair value. Otherwise, revenue is recognized on multiple element agreements as a single unit of accounting when the product has been accepted by the customer

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

As of September 30, 2017 and 2016, FPI had established an allowance for doubtful accounts in the amount of $.8 million and $.8 million on accounts receivable balances of $36.7 million and $47.1 million, respectively.

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

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

Program Values

It is FPI's vision to protect society, reduce crime, aid in the security of the nation's prisons and decrease taxpayer burden by assisting inmates with developing vital skills necessary for successful reentry into society. Through the production of market-priced quality goods and services, FPI provides job training and work opportunities to inmates, while minimizing impact on private industry and labor.

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

FPI has existed as an effective correctional program for 83 years. Over the course of these years, FPI has positively impacted countless staff and inmate lives. In the face of an escalating inmate population and an increasing percentage of inmates with histories of violence, FPI's programs have helped ease tension and avert dangerous situations, thereby protecting lives and federal property. FPI work programs provide meaningful activities for inmates, thereby playing an essential role in the operation of safe, secure and less costly prisons.

At the same time, FPI provides opportunities for inmates who want to take an active role in their rehabilitation. More than 95 percent of inmates eventually will be returned to society; industrial programs can help them to steer clear of criminal activity after release. Participation in FPI programs improves the likelihood that inmates will remain crime-free upon their release from BOP custody. A comprehensive study conducted by the BOP demonstrated that FPI provides inmates with an opportunity to develop work ethics and skills, contributes substantially to lower recidivism and increases job-related success of inmates upon release. This study indicates that inmates involved in FPI work programs are substantially less likely to return to prison. The impact on the lives of people who live in the communities in which these inmates will return is immeasurable. Countless lives are spared the devastating impact of continued criminal activity.

Analysis of Financial Statements

Cash and Cash Equivalents

Cash and Cash Equivalents increased $36.4 million primarily due to a $34.6 million increase in deferred revenue. Net income of $16.8 million, $69.0 million in investments redeemed, a decrease in accounts receivable of $10.5 million, and a $12.8 million increase in accounts payable and accrued expenses also contributed to the increase in cash and cash equivalents. Additional investments of $104.1 million partially offset the increases, as FPI continued its long-term investing strategy.

Investments

During fiscal year 2017, FPI redeemed $69.0 million in investments, and invested an additional $104.1 million in Treasury fixed-principal notes with Bureau of the Fiscal Service of the United States Treasury. As a general investment strategy, FPI plans to hold all short-term and long-term investments to maturity.

Accounts Receivable

The Accounts Receivable balance decreased $10.5 million during fiscal year 2017. The net accounts receivable balance of $35.8 million represents 85.8% of total revenue for the month of September 2017. FPI’s average days to collect for 2017 were approximately 23.9 days. The accounts receivable balance over sixty days old represented 20.0% of the total balance as of September 2017.

Liabilities

Total Liabilities increased by $47.4 million during fiscal year 2017. The primary contributor was a $34.6 million increase in deferred revenue. The increase in deferred revenue is primarily attributable to a change in customer advances payable on hand primarily for the retrofitting of vehicles for the Department of Homeland Security.

Revenue, Cost of Revenue and Net Income

Total Revenue decreased by $29.0 million while total cost of revenue decreased $28.6 million. The decrease in revenue resulted from a decrease in Sales of $44.6 million. The largest business segment showing a decrease in sales was the Textiles with a decrease of $69.7 million. The sales decrease was partially offset by increased sales in the Electronics business segments of $33.0 million. The fiscal year 2017 net income increased $12.8 million from 2016.

Business Segments

In fiscal year 2017, FPI’s businesses were organized, managed, and internally reported as six operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI is not dependent on any single product as a primary revenue source; however, it is currently primarily dependent on the federal government market for the sale of its products. FPI's net industrial income (earnings) at the business segment level consists of sales offset by cost of goods sold and certain other general and administrative costs.

Business Segment	Fiscal Year	
Agribusiness	**2017**	**2016**
Net Sales	$6,225	$5,795
Earnings	$(230)	$(2,892)
Clothing and Textiles		
Net Sales	$126,382	$196,097
Earnings	$21,287	$32,633
Electronics		
Net Sales	$159,955	$126,999
Earnings	$5,483	($8,661)
Office Furniture		
Net Sales	$113,791	$120,488
Earnings	$12,607	$14,063
Recycling		
Net Sales	$11,816	$13,904
Earnings	$4,008	$1,982
Services		
Net Sales	$35,594	$35,122
Earnings	$6,986	$7,055
Factory Total		
Net Sales	$453,763	$498,405
Earnings	$50,141	$44,180

Possible Future Effects of Existing Events and Conditions

During fiscal year 2017, FPI realized an increase in earnings for the second straight year after experiencing a net income in 2016 for the first time in seven years. The total cash and investment balance increased $70.8 million during fiscal year 2017, to a total balance of $355.3 million. Net inventory remained low at $106.0 million. 2017 sales were slightly ahead of plan (+2%) but below 2016 levels (-9%) after unusual one-time increases in 2016.

In fiscal years 2018 and beyond, FPI will continue to face the challenge of a shrinking federal budget and the resulting decline in discretionary spending. In spite of these headwinds, FPI five year plan is to grow sales 8% in 2018 and 5% per annum thereafter through 2022 and reach $25 million in earnings by 2019, the long term sustaining goal.

Repatriation

Due to the volatile nature of the changes within the government sector affecting FPI, emphasis has been placed on exploring more opportunities with commercial customers. Opportunities in this arena have become available as part of the approval for FPI to obtain commercial customers through Repatriation by bringing goods currently produced, or that would have been produced, in foreign countries back into the United States of America. For 2017, 20 Repatriation projects have been executed totaling $1.8 million in sales and creating over 300 new UNICOR inmate jobs. Repatriation plans over the next 12 to 24 months project to $7.5 million in sales and an additional 500 UNICOR inmate jobs. Additionally, in fiscal 2017 FPI deepened its partnership with the Department of Commerce's Select USA Program. Working with Select USA provides FPI with another way of pursuing repatriation products. Finally, FPI will be hiring outside sales agents specifically focused on Repatriation opportunities.

Job Share/Training Inmate Jobs

FPI impacted 16,891 inmates in the 12 month period ending September 30, 2017. FPI's continued emphasis on the use of job share inmate workers resulted in 972 job share inmates as of September 30, 2017, which contributed to FPI surpassing its planned annual employment of 16,792 inmates at the end of fiscal year 2017. Continued emphasis on job share employment opportunities and inmate training positions in 2017 and beyond will allow for an increase in the number of inmates participating in the FPI program while reducing the per inmate cost of employment. Concentration on this goal will increase the impact of our program to the inmate population.

Inmate Employment Goal

During fiscal year 2017, with the approval of its Board of Directors, FPI revised its inmate employment goal to focus on those inmates that are within 3 years of release. FPI's current goal is that 30% of inmates working in UNICOR will be within 3 years of release. This balances the number of inmates closer to release, and therefore the utilization of UNICOR's recidivism reduction benefits with a reasonable turnover rate for operational effectiveness. For fiscal year 2017, 33% of FPI inmates were within 3 years of their release, exceeding the target of 30%. The inmate annual employment goal for 2018 is 18,607, an 11% increase versus 2017. By 2022, the 5 year goal is annual inmate employment of 21,105 or a 25% increase over 2017. It will require business growth of $140 million as well as Job Share and Training goals of 10% and 5% respectively to achieve this.

Independent Auditors' Reports

KPMG LLP
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Washington, DC 20006

Independent Auditors' Report on the Financial Statements

Inspector General
U.S. Department of Justice

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

Report on the Financial Statements

We have audited the accompanying financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2017, and 2016, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Justice Federal Prison Industries, Inc. as of September 30, 2017, and 2016, and its net profit, cumulative results of operations, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2017 on our consideration of the FPI's internal control over financial reporting and our report dated November 6, 2017 on our tests of its compliance with certain provisions of laws, regulations, and contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the FPI's internal control over financial reporting and compliance.

KPMG LLP

Washington, D.C.
November 6, 2017

KPMG LLP
Suite 12000
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Washington, DC 20006

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

Inspector General
U.S. Department of Justice

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

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2017 and 2016, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 6, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2017, we considered the FPI's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FPI's internal control. Accordingly, we do not express an opinion on the effectiveness of the FPI's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Purpose of this Report

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

KPMG LLP

Washington, D.C.
November 6, 2017

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

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

Inspector General
U.S. Department of Justice

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

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the U.S. Department of Justice Federal Prison Industries, Inc. (FPI), which comprise the balance sheets as of September 30, 2017 and 2016, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 6, 2017.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FPI's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 17-03.

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

Purpose of this Report

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

KPMG LLP

Washington, D.C.
November 6, 2017

Principal Financial Statements and Related Notes

See Independent Auditors' Reports on the Financial Statements

Federal Prison Industries, Inc.

Balance Sheets

As of September 30, *(DOLLARS IN THOUSANDS)*	2017	2016
Assets		
Current:		
Cash and cash equivalents	$ 106,733	$ 70,328
Accounts receivable, net	35,834	46,302
Short term investments	53,089	69,035
Inventories, net	106,024	106,137
Other assets	11,525	1,599
Total current assets	313,205	293,401
Investments	195,447	145,091
Property, plant and equipment, net	52,942	58,929
Total long term assets	248,389	204,020
Total Assets	$ 561,594	$ 497,421
Liabilities and United States Government Equity		
Current:		
Accounts payable	$ 48,900	$ 35,995
Deferred revenue	138,386	103,795
Accrued salaries and wages	4,354	4,866
Accrued annual leave	4,374	5,380
Other accrued expenses	12,124	10,100
Total current liabilities	208,138	160,136
FECA actuarial liability	23,653	24,303
Total Liabilities	231,791	184,439
United States Government Equity		
Initial capital	4,176	4,176
Contributed capital	6,905	6,905
Cumulative results of operations	318,722	301,901
Total United States Government Equity	329,803	312,982
Total Liabilities and United States Government Equity	$ 561,594	$ 497,421

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

Federal Prison Industries, Inc.

Statements of Operations and Cumulative Results of Operations

For the fiscal years ended September 30, *(DOLLARS IN THOUSANDS)*	2017	2016
Revenue:		
Net sales	$ 453,763	$ 498,405
Other revenue	122,522	106,847
Total revenue	576,285	605,252
Cost of revenue:		
Cost of sales	402,541	446,926
Cost of other revenue	120,983	105,175
Total cost of revenue	523,524	552,101
Gross profit	52,761	53,151
Operating expenses:		
Sales and marketing	3,152	4,378
General and administrative	64,679	75,796
Total operating expenses	67,831	80,174
Loss from operations	(15,070)	(27,023)
Interest income	3,082	1,896
Interest expense	(8)	(12)
Other income, net	28,817	29,196
Net income/ (loss)	16,821	4,057
Cumulative results of operations, beginning of fiscal year	301,901	297,844
Cumulative results of operations, end of fiscal year	$ 318,722	$ 301,901

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

Federal Prison Industries, Inc.

Statements of Cash Flows

For the fiscal years ended September 30, *(DOLLARS IN THOUSANDS)*	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 16,821	$ 4,057
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,247	8,294
Amortization of discount or premium on investments	610	
Loss on disposal of property, plant and equipment	1,883	10,509
Changes in:		
Accounts receivable	10,468	(4,417)
Inventories	113	24,701
Other assets	(9,926)	381
Accounts payable and accrued expenses	12,761	1,705
Deferred revenue	34,591	25,965
Net cash provided by (used in) operating activities	74,568	71,195
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(3,102)	(2,349)
Construction-in-progress of plant facilities	(41)	-
Investments redeemed	69,035	-
Purchase of investments	(104,055)	(134,201)
Net cash used in investing activities	(38,163)	(136,550)
Net increase (decrease) in cash and cash equivalents	36,405	(65,355)
Cash and cash equivalents, beginning of fiscal year	70,328	135,683
Cash and cash equivalents, end of fiscal year	$ 106,733	$ 70,328

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

Note 1. Organization and Mission

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

FPI's federal government customers include departments (percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (50%), the Department of Homeland Security (16%), the Department of Justice (13%), the Social Security Administration (4%), and the General Services Administration (3%). These and other federal organizations are generally required to purchase products from FPI, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in FPI's enabling statute and the Federal Acquisition Regulation.

FPI has agricultural, industrial, and service operations at 59 factories and 3 farms located at 51 prison facilities that employed 10,599 and 10,896 inmates as of September 30, 2017 and 2016, respectively.

Note 2. Summary of Significant Accounting Policies

Basis of Accounting

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

Basis of Presentation

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

Use of Estimates

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

Cash and Cash Equivalents

FPI considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. In fiscal year 2017, FPI's investment activities and cash equivalents included overnight repurchase agreements with the Bureau of the Fiscal Service of the United States Treasury. The market value of overnight purchase agreements is equivalent to cost.

Fair Value Measurements

FASB Accounting Standard Codification (ASC) 820-10, Fair Value Measurements and Disclosures, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The FPI's financial instruments are comprised of cash, accounts receivable, accounts payable, and accrued liabilities as of September 30, 2017 and 2016, respectively. The carrying amounts of these financial instruments approximate fair value because of the short-term nature of these instruments. The FPI intends to hold their investments until maturity, and therefore, has recorded the investments at amortized cost. See Note 3 regarding the fair value of investments.

Investments

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

Accounts Receivable / Concentration of Credit Risk

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

FPI routinely assesses the payment histories of its federal customers and the financial strength of its private sector customers and maintains allowances for anticipated losses as they become evident. Most of the past due items relate to billings to various entities within Department of Defense (DOD) who rely on the Defense Finance and Accounting Service (DFAS) to process vendor payments. Historically, customer payments processed through DFAS have taken longer to receive than payments from other federal and private sector customers. The amount due to FPI from DOD for the fiscal years ended September 30, 2017 and 2016 was $15,820 and $28,773, 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, 2017 and 2016, FPI's allowance for doubtful accounts is stated at approximately $836 and $770, respectively, of which approximately $251 and $501, respectively, represents the amounts allocated against federal accounts receivable.

Inventories

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

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

Advances to Vendors

FPI generally does not offer advances to the public; however, where warranted, FPI will on occasion make an advance to a vendor. Historically, these advances have been insignificant. Prior to issuing advances to a vendor, the Centralized Accounts Receivable section performs a review as though they were a public customer, to include performing a due diligence review to assess risk and a review of applicant financial statements. A letter of credit is obtained as needed based on the results of this review. The FPI Controller approves advances prior to their disbursement. Advances are reduced by offset to the vendor invoice as goods are delivered.

Revenue Recognition

FPI sells a wide range of products and services to a diversified base of customers, primarily governmental departments, agencies and bureaus. Revenue is generally recognized when delivery has occurred or services have been rendered, persuasive evidence of an arrangement exists, there is a fixed or determinable price, and collectability is reasonably assured. Revenue from contracts that require customer acceptance are not recognized until either customer acceptance is obtained, or upon completion of the contract. Sales returns are primarily replaced with like items and are recorded as they occur.

Revenue from contracts with multiple element arrangements is recognized as each element is earned based on the relative fair value of each element provided the delivered elements have value to customers on a standalone basis and amounts can be allocated to each element based on its objectively determined fair value. Otherwise, revenue is recognized on multiple element agreements as a single unit of accounting when the product has been accepted by the customer

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

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

Other income includes imputed financing for retirement, health benefits, life insurance and BOP operating expenses (Note 9).

Property, Plant and Equipment

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

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

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

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

(Dollars in Thousands)

FPI values livestock, including new cattle born into the herd at lower of cost or market (LCM) value until they are either sold or die. Costs for cattle under development are accumulated throughout their development cycle. For dairy cattle, the development period is 22 months, which is the average age of maturity for a productive heifer. At this point the cow is considered a capital asset and the LCM analysis can be conducted and the asset properly valued. All beef cattle accumulate costs on a monthly basis until sale or death has occurred. A gain or loss will be recognized on all beef cattle at the time of death or sale.

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

Taxes

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

Subsequent Events

Subsequent events are evaluated by management through the date that the financial statements are available to be issued, which is November 6, 2017.

Note 3. Investments

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

As of September 30,	**2017**	**2016**
Amortized cost	$ 248,536	$ 214,126
Gross unrealized holding gains	32	1,693
Gross unrealized holding losses	(619)	(284)
Fair Value of Investments	$ 247,949	$ 215,535

The investments above held by FPI at September 30, 2017 and 2016 consist of Market Notes, issued by the U.S. Treasury. All of these notes are either explicitly or implicitly backed by the U.S. Government. Given the backing by the U.S. Government, current market conditions have not had a significant adverse impact on the fair value of these securities.

(Dollars in Thousands)

Maturities of the notes were as follows as of September 30, 2017:

	Amortized Cost	Fair Value
Due in one year or less	$ 53,089	$ 52,968
Due after one year through five years	171,078	170,657
Due after five years or more	24,369	24,324
	$ 248,536	**$ 247,949**

All of the notes held by FPI at September 30, 2017 are valued using quoted prices (unadjusted) from the U.S. Treasury FedInvest Security Balance Report. The fair value of the notes presented above represents the best estimate of prices that the notes could be sold for in the market as of September 30, 2017.

Note 4. Accounts Receivable, Net

Accounts receivable, net consists of the following:

As of September 30,	**2017**	**2016**
Intragovernmental receivables	$ 30,365	$ 39,580
Interest receivable – investments	732	761
Private sector receivables	5,573	6,731
	36,670	47,072
Less allowance for doubtful accounts	836	770
Accounts receivable, net	$ 35,834	$ 46,302

FPI incurred bad debt expense of $138 and $(253), respectively, for the fiscal years ended September 30, 2017 and 2016.

(Dollars in Thousands)

Note 5. Inventories, Net

Inventories, net consists of the following:

As of September 30,	**2017**	**2016**
Raw materials	$ 61,163	$ 65,229
Work-in-process	17,901	14,438
Finished sub-assemblies	5,428	5,750
Finished goods	25,860	26,578
Finished goods – acceptance contracts	7,738	9,214
	118,090	121,209
Less inventory allowance	12,066	15,072
Inventories, net	$ 106,024	$ 106,137

$7,738 of FPI's fiscal year 2017 and $9,214 of its fiscal year 2016 finished goods balance represents goods shipped to customers or their agents, and is unrecognized revenue due to acceptance criteria within the customer contract.

Note 6. Property, Plant and Equipment, Net

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

As of September 30,	**2017**	**2016**
Buildings and improvements	$ 172,147	$ 172,072
Machinery and equipment	101,230	103,545
Livestock	3,014	2,951
Computer hardware	3,116	3,083
Computer software	7,600	7,600
	287,107	289,251
Less accumulated depreciation	234,206	230,379
	52,901	58,872
Construction in progress	41	57
Property, plant and equipment, net	$ 52,942	$ 58,929

Depreciation and amortization expense totaled $7,247 and $8,294 for the fiscal years ended September 30, 2017 and 2016, respectively. During fiscal years 2017 and 2016, FPI invested $3,143 and $2,349, respectively, for the purchase and construction of property, plant and equipment.

(Dollars in Thousands)

As a result of FPI capacity consolidation in fiscal year 2017, a number of buildings no longer being used for production were fully impaired. That resulted in an increase in accumulated depreciation, thus reducing overall net value of Property, plant and equipment. Impairment related losses totaled $793 and $7,351 for the fiscal years ended September 30, 2017 and 2016, respectively.

Note 7. Other Accrued Expenses

Other accrued expenses consist of the following:

As of September 30,	2017	2016
Materials in transit	$ 856	$ 574
Relocation travel expense	386	510
FECA liabilities – current portion	1,690	2,019
Financial audit expense	752	591
Telecommunication expense	971	1,148
Utilities	711	727
Product Warranties	327	364
Intra-Departmental Agreements	537	1,453
Vendor Invoices	5,783	2,591
Other expense	111	123
Other accrued expenses	$ 12,124	$ 10,100

Note 8. Business Segments

FPI's businesses are organized, managed and internally reported as six operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Office Furniture, Recycling, and Services. FPI is not dependent on any single product as a primary revenue source; however, it is currently predominately dependent on the federal government market for the sale of its products and services. FPI's net sales for the fiscal years ended September 30, 2017 and 2016 for each of its business segments is presented for comparative purposes:

(Dollars in Thousands)

Net Sales

For the fiscal years ended September 30,	**2017**	**2016**
Business Segment		
Agribusiness	$ 6,225	$ 5,795
Clothing and Textiles	126,382	196,097
Electronics	159,955	126,999
Office Furniture	113,791	120,488
Recycling	11,816	13,904
Services	35,594	35,122
Net sales	$ 453,763	$ 498,405

Regulatory Compliance

FPI's ability to add or to expand production of a specified mandatory product is regulated by the Federal Prison Industries Reform Act ("the Act"). The Act provides specific guidelines to FPI regarding its methodology for evaluating and reporting new or expanded products. FPI also has procedures for competitive and non-mandatory items it produces. Finally, publication of annual decisions of the FPI Board of Directors and semi-annual sales disclosures are mandated under the Act.

Note 9. Intra-Department of Justice (DOJ) / Intragovernmental Financial Activities

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

Relationship with the Federal Bureau of Prisons

FPI and the BOP have a unique relationship in that the nature of their combined missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP, who has jurisdiction over all federal penal correctional institutions, is the Commissioner of Federal Prison Industries. General management of FPI is provided by the Chief Executive Officer who also serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI. In accordance with Managerial Cost Accounting Concepts a reasonable estimate of these costs as provided by the BOP is included in general expense and other income of FPI for the fiscal years ended September 30, 2017 and 2016, 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, 2017 and 2016, the accrued FECA liabilities as charged to FPI, approximated $1,690 and $2,019, 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 $23,653 and $24,303 as of September 30, 2017 and 2016, respectively.

FPI as a Government corporation records FECA liability balance provided by the Department of Labor calculated using a methodology different from application of the current spot rate. The FECA liability would be approximately $750 and $2,268 larger for the fiscal years ended 2017 and 2016, respectively, using the current spot rate.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS), the Federal Employee Retirement System (FERS) or the Federal Employee Retirement System-Revised Annuity Employees (FERS-RAE) System. For employees covered by the CSRS, (those employees hired prior to January 1, 1984), for fiscal years ended September 30, 2017 and 2016, FPI contributed approximately 7 percent (for normal retirement) or 7.5 percent (for hazardous duty retirement) of each employee's salary, respectively. CSRS covered employees do not have Federal Insurance Contribution Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered by the FERS, (generally those employees hired between January 1, 1984 and December 31, 2012), FPI contributed (for normal retirement) 13.7 percent for fiscal years ended September 30, 2017 and 2016. FPI contributed (for hazardous retirement) 30.1 percent for fiscal years ended September 30, 2017 and 2016. For employees covered by the FERS-RAE, (generally those employees hired on or after January 1, 2013), FPI contributed (for normal retirement) 11.9 percent for fiscal years ended September 30, 2017 and 2016. FPI contributed (for hazardous duty retirement) 28.4 percent for the fiscal years ended September 30, 2017 and 2016.

Under FERS and FERS-RAE, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift savings plan). Under the thrift plan, an employee may contribute (tax deferred) to an investment fund, up to $18,000 of salary for the fiscal years ended September 30, 2017 and 2016. FPI then matches this amount up to 4 percent in addition to an automatic 1 percent that is contributed for all FERS and FERS-RAE employees. Those employees that elected to remain under CSRS after January 1, 1984 continue to receive benefits in place, and may also contribute (tax deferred) up to $18,000 of their salary to the thrift plan for the fiscal years ended September 30, 2017 and 2016, but with no automatic or matching amount contributed by FPI.

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

FPI's contribution to both plans was approximately $16,491 and $20,417 for the fiscal years ended September 30, 2017 and 2016, 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 $818 and $1,049 in the fiscal years ended September 30, 2017 and 2016, 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 $6,504 and $7,746 for the fiscal years ended September 30, 2017 and 2016, 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 $3,142 and $4,474 during the fiscal years ended September 30, 2017 and 2016, respectively, were determined by OPM utilizing cost factors to estimate the cost of providing post-retirement benefits to current employees. However, because of the offsetting credit, which is reflected as other income on the Statements of

(Dollars in Thousands)

Operations and Cumulative Results of Operations, the recording of these costs has no impact on reported net income or cash flows.

Future post-retirement health care and life insurance benefit costs are not reflected as a liability on FPI's financial statements, as such costs are expected to be funded in future periods by OPM.

Note 10. Sales and Marketing, General and Administrative Expenses

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

Fiscal years ended September 30,	**2017**	**2016**
Salaries, wages and benefits	$ 29,019	$ 30,924
Permanent change of station expense	974	405
Purchases of minor equipment	362	407
Contract services	8,722	11,109
Bad debt expense	137	(263)
Credit card service fees	646	664
Travel	914	746
Personal computer expense	1,260	331
Accident compensation	864	2,453
Financial audit	1,330	1,173
Marketing	444	966
Depreciation	1,296	1,436
Loss on disposition of assets	1,108	7,447
Telecommunication expense	2,534	2,537
Other expense	(4,246)	(3,793)
Imputed pension costs	818	1,049
Imputed post-retirement health care and life insurance cost	3,142	4,474
Imputed operating costs	18,507	18,109
Sales and marketing, general and administrative expenses	$ 67,831	$ 80,174

Other expense is comprised primarily of inmate wages, maintenance agreements, and distributions to factory operations. FPI distributes certain General and Administrative expenses that benefit all locations to the individual factory levels. These charges include computer licenses and fees, civilian and inmate accident compensation, and check charges. These charges totaled $7.7 million for fiscal year 2017 and $8.7 million for fiscal year 2016. Contract services consist primarily of consulting and sales and marketing fees.

(Dollars in Thousands)

Note 11. Commitments and Contingencies

Legal Contingencies

FPI is party to various administrative proceedings, legal actions, and claims. The balance sheet includes an estimated liability for those legal actions where management and the FPI General Counsel consider adverse decisions "probable" and amounts are reasonably estimable. Legal actions where management and the FPI General Counsel consider adverse decisions reasonably possible and the amounts are reasonably estimable, should not result in judgments which would have a material, adverse effect on the organization's financial statements. Furthermore, there are cases where amounts have not been accrued or disclosed because the amounts of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is considered remote.

Lease Commitments

FPI leases certain facilities, machinery, vehicles and office equipment under noncancelable capital and operating lease agreements that expire over future periods. Many of these lease agreements provide FPI with the option (after initial lease term) to either purchase the leased item at the then fair value or to renew the lease for additional periods of time. As of September 30, 2017 and 2016, future capital lease payments due total $88 and $125, and future operating lease commitments total $56 and $81, 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,***	**2017**	**2016**
Balance at the beginning of the period	$ 364	$ 362
Accruals for warranties issued during the period	453	361
Settlements made (in cash or in kind) during the period	(490)	(359)
Balance at the end of the period	$ 327	$ 364

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:

Fiscal years ended September 30,	**2017**	**2016**
Congressional limitation on expenses	$ 2,695	$ 2,700
Expenses incurred subject to Congressional limitation	$ 2,203	$ 2,353

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