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

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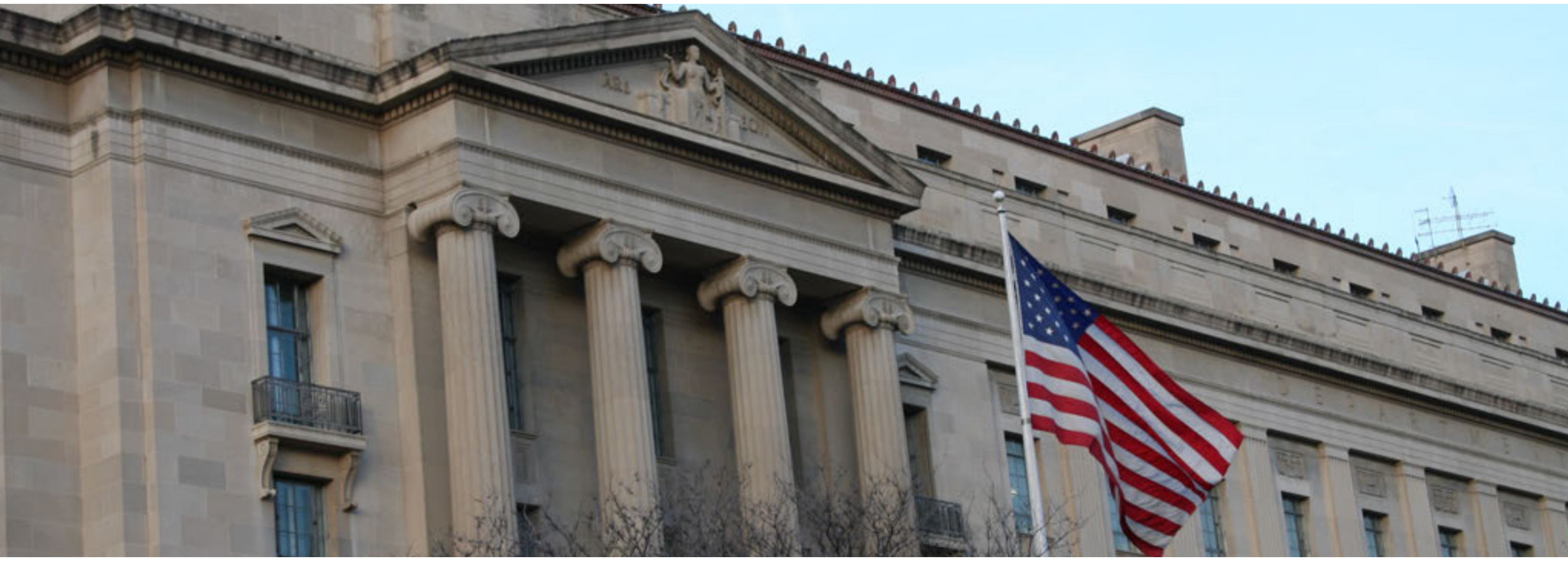

Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2018

Audit Division 19-04

December 2018

Commentary and Summary

Audit of the Federal Prison Industries, Inc. Annual Financial Statements Fiscal Year 2018

Objective

Pursuant to 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 or contract an independent auditor to perform an audit of the Federal Prison Industries, Inc.'s (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

KPMG LLP (KPMG) found that the FPI's financial statements are fairly presented as of and for the year ended September 30, 2018. An unmodified opinion was issued. The Independent Auditors' Report did not report any material weaknesses or instances of non-compliance.

The OIG reviewed KPMG's report and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with Government Auditing Standards, was not intended to enable us to express, and we do not express, an opinion on the FPI's financial statements, conclusions about the effectiveness of internal control, conclusions on whether the FPI's financial management systems substantially complied with FFMIA, or conclusions on compliance and other matters. KPMG is responsible for the attached auditors' report dated November 5, 2018, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG 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 performed the FPI's audit in accordance with auditing standards generally accepted in the United States of America. The fiscal year (FY) 2018 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 2017, the FPI also received an unmodified opinion on its financial statements (OIG Audit Division Report No. 18-04).

KPMG neither identified any material weaknesses, nor reported any significant deficiencies in the Independent Auditors' Report.

No instances of non-compliance or other matters were identified during the audit that are required to be reported under Government Auditing Standards. Additionally, KPMG's tests disclosed no instances in which the FPI's financial management systems did not substantially comply with FFMIA.

AUDIT OF THE
FEDERAL PRISON INDUSTRIES, INC.
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 2018

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U.S. Department of Justice

UNICOR

Federal Prison Industries, Inc.

Washington, DC 20534

November 5, 2018

We are pleased to present the Federal Prison Industries, Inc.'s (FPI) Fiscal Year 2018 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's Commentary and Summary, and the Independent Auditors' reports on the Corporation's financial statements, internal controls over financial reporting and compliance, and other matters. FPI's financial statements received an unmodified audit opinion, and no significant deficiencies or material weaknesses were reported by the Independent Auditors.

FPI was established by statute and Executive Order 6917 in 1934, signed by President Roosevelt to provide educational opportunities 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 providing inmates with job training and practical work skills for reentry success. FPI continues to place emphasis on reaching as many inmates as possible by focusing on employment of inmates within three years of release. As one of the Bureau of Prisons'(BOP's) most important inmate anti-recidivism programs, FPI employed over 17,000 inmates throughout FY 2018. In recent years, emphasis has been placed on assisting FPI inmates in completing nationally recognized certificate programs, including DOL apprenticeships.

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 repatriating work opportunities otherwise being performed outside of the United States. FPI has built on its progress by 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. We are also appreciative of the outstanding contributions and dedication of FPI staff as well as the continued outstanding support and leadership provided by the Board of Directors.

Hugh J. Hurwitz	Gary M. Simpson
Acting Director	*Chief Executive Officer*
Federal Bureau of Prisons	*Federal Prison Industries, Inc.*
Acting Commissioner of FPI	

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 2018, FPI operated in seven business segments: Agribusiness, Clothing and Textiles, Electronics, Fleet, Office Furniture, Recycling, and Services. FPI has agricultural, industrial and service operations at 57 factories and 2 farms located at 51 prison facilities as of September 30, 2018. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased primarily from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed primarily by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

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

Financial Structure

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

FPI sells products and services to the majority of federal departments, agencies, and bureaus. FPI's largest federal government customers for fiscal year 2018 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 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 2018 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.

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 84 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 decreased $3.2 million due to a $15.6 million increase in inventory, a $27.5 million decrease in deferred revenue, and a $13.7 million decrease in accounts payable and accrued expenses. Net income of $14.0 million, along with a decrease of $32.7 million in investments, partially offset the decreases to cash.

Investments

During fiscal year 2018, FPI redeemed $53.3 million in investments, and invested an additional $20.4 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 $1.7 million during fiscal year 2018. The net accounts receivable balance of $34.1 million represents 71.4% of total revenue for the month of September 2018. FPI’s average days to collect for 2018 were approximately 20.9 days. The accounts receivable balance over sixty days old represented 11.5% of the total balance as of September 2018.

Liabilities

Total Liabilities decreased by $41.2 million during fiscal year 2018. The primary contributor was a $27.5 million decrease in deferred revenue. The decrease 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 increased by $65.7 million while total cost of revenue increased $61.1 million. The increase in revenue resulted from an increase in Sales of $49.1 million. The largest business segment showing an increase in sales was Fleet with an increase of $68.9 million. The sales increase was partially offset by decreased sales in the Office Furniture business segment of $24.4 million. The fiscal year 2018 net income decreased $2.9 million from 2017.

Business Segments

In fiscal year 2018, FPI's businesses were organized, managed, and internally reported as seven operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Fleet, Office Furniture, Recycling, and Services. FPI redefined its business segments from six categories to seven in fiscal year 2018. The Fleet business segment was previously consolidated into the Electronics business segment. As a result, net sales for fiscal year 2017 for Electronics and Fleet have been reclassified for comparative purposes. 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	**2018**	**2017**
Net Sales	$6,647	$6,225
Earnings	$256	$(230)
Clothing and Textiles		
Net Sales	$121,702	$126,382
Earnings	$17,933	$21,287
Electronics		
Net Sales	$44,655	$41,445
Earnings	$3,883	$3,450
Fleet		
Net Sales	$187,416	$118,510
Earnings	$8,558	$2,033
Office Furniture		
Net Sales	$89,433	$113,791
Earnings	$7,754	$12,607
Recycling		
Net Sales	$15,726	$11,816
Earnings	$7,382	$4,008
Services		
Net Sales	$37,259	$35,594
Earnings	$8,267	$6,986
Factory Total		
Net Sales	$502,838	$453,763
Earnings	$54,033	$50,141

Possible Future Effects of Existing Events and Conditions

During fiscal year 2018, FPI realized earnings for the third consecutive year. The total cash and investment balance decreased $35.9 million during fiscal year 2018, to a total balance of $319.4 million. Net inventory increased $15.6 million to $121.7 as a result of the $304.5 million backlog of orders. The 2018 sales were slightly ahead of plan (+3%) and greater than 2017 levels (+11%).

In fiscal years 2019 and beyond, FPI will continue to seek new business growth opportunities to expand the number of FPI inmate jobs. The FPI five year plan is to grow sales by 16% in 2019 and 5% per annum thereafter through 2023, and reach $20 million in earnings by 2020 which is the long term sustaining goal.

New Business/ Repatriation

During fiscal year 2018, FPI entered into a three year, sales agent agreement with Research On Investment (ROI) Inc. ROI is an international firm located in Montreal Canada. ROI's function is to develop lead generation for all of FPI business groups, more specifically under the repatriation business model. In 2018, FPI launched 13 new projects into production. These projects are forecasted to generate $6.7 million in annual sales requiring 380 inmate jobs. Additionally, there are 25 projects in the pipeline under negotiation. On a probability adjusted basis, FPI anticipates an additional $10.5 million in annual sales with the potential of 600 inmate jobs. Looking forward into 2019, our focus will be concentrated in three areas: (1) Leverage opportunities with companies reshoring work back to US. Due to the recent import tariff changes, more companies are attempting to develop assembly type operations in the US, (2) Expanding electronics recycling opportunities based upon the considerable growth anticipated over the next several years, and (3) Greater emphasis on US-based services. FPI is continuing its relationship with the Department of Commerce and the SelectUSA program in order to expand Repatriation programs.

Inmate Employment Goals

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 2018, 33% of FPI inmates were within 3 years of their release, exceeding the target of 30%. The inmate annual employment goal for 2018 was 16,613. Actual 2018 results were 17,041 (+3% vs goal). By 2023, the 5 year goal is annual inmate employment of 20,895 or a 23% increase over 2018. This will require business growth of $100 million as well as Job Share and Training goals of 10% and 10%, respectively, to achieve this.

Inmate Training and Certification

In addition to the 10% training goal mentioned above, in 2018, emphasis was placed on Nationally Recognized Inmate Certification Programs such as American Society of Quality – Certified Quality Improvement Associate, Commercial Drivers License and SAP Certification programs. We are also working to evaluate additional programs such as DOL Apprenticeships and the Manufacturing Skills Standards Council (MSSC) Certified Production and Certified Logistics Technicians. We believe that having nationally recognized certifications can enhance a former inmate's employment prospects upon release and further reduce recidivism. In 2018, 564 inmates completed nationally recognized certifications. There are almost 1,000 inmates currently in nationally recognized certification programs. Our plan is to double this number in 2019.

Independent Auditors' Report

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

Independent Auditors' Report

Inspector General
U.S. Department of Justice

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

Report on the 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, 2018 and 2017, 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 the 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. 19-01, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-01 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Management's Discussion and Analysis section is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied by us 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*

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2018, 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.

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. 19-01.

We also performed tests of the FPI's 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) the United States Government Standard General Ledger at the transaction level.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the FPI's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 5, 2018

Principal Financial Statements and Related Notes

See Independent Auditors' Report

Federal Prison Industries, Inc.

Balance Sheets

As of September 30, *(DOLLARS IN THOUSANDS)*	2018	2017
Assets		
Current:		
Cash and cash equivalents	$ 103,496	$ 106,733
Accounts receivable, net	34,137	35,834
Short term investments	48,194	53,089
Inventories, net	121,671	106,024
Other assets	8,131	11,525
Total current assets	315,629	313,205
Investments	167,690	195,447
Property, plant and equipment, net	51,066	52,942
Total long term assets	218,756	248,389
Total Assets	$ 534,385	$ 561,594
Liabilities and United States Government Equity		
Current:		
Accounts payable	$ 34,892	$ 48,900
Deferred revenue	110,914	138,386
Accrued salaries and wages	4,671	4,354
Accrued annual leave	4,548	4,374
Other accrued expenses	14,303	12,124
Total current liabilities	169,328	208,138
FECA actuarial liability	21,297	23,653
Total Liabilities	190,625	231,791
United States Government Equity		
Initial capital	4,176	4,176
Contributed capital	6,905	6,905
Cumulative results of operations	332,679	318,722
Total United States Government Equity	343,760	329,803
Total Liabilities and United States Government Equity	$ 534,385	$ 561,594

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)*		2018		2017
Revenue:				
Net sales	$	502,838	$	453,763
Other revenue		139,136		122,522
Total revenue		641,974		576,285
Cost of revenue:				
Cost of sales		450,887		402,541
Cost of other revenue		133,760		120,983
Total cost of revenue		584,647		523,524
Gross profit		57,327		52,761
Operating expenses:				
Sales and marketing		3,233		3,152
General and administrative		75,847		64,679
Total operating expenses		79,080		67,831
Loss from operations		(21,753)		(15,070)
Interest income		4,802		3,082
Interest expense		(8)		(8)
Other income, net		30,916		28,817
Net income/ (loss)		13,957		16,821
Cumulative results of operations, beginning of fiscal year		318,722		301,901
Cumulative results of operations, end of fiscal year	$	332,679	$	318,722

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)*		2018		2017
CASH FLOWS FROM OPERATING ACTIVITIES				
Net Income	$	13,957	$	16,821
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		6,708		7,247
Amortization of discount or premium on investments		(243)		610
Loss on disposal of property, plant and equipment		2,399		1,883
Changes in:				
Accounts receivable		1,697		10,468
Inventories		(15,647)		113
Other assets		3,394		(9,926)
Accounts payable and accrued expenses		(13,694)		12,761
Deferred revenue		(27,472)		34,591
Net cash provided by (used in) operating activities		(28,901)		74,568
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchases of property, plant and equipment		(7,077)		(3,102)
Construction-in-progress of plant facilities		(155)		(41)
Investments redeemed		53,307		69,035
Purchase of investments		(20,411)		(104,055)
Net cash used in investing activities		25,664		(38,163)
Net increase (decrease) in cash and cash equivalents		(3,237)		36,405
Cash and cash equivalents, beginning of fiscal year		106,733		70,328
Cash and cash equivalents, end of fiscal year	$	103,496	$	106,733

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 (fiscal year 2018 percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (48%), the Department of Homeland Security (20%), the Department of Justice (13%), the Social Security Administration (5%), and the General Services Administration (2%). 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 57 factories and 2 farms located at 51 prison facilities that employed 10,726 and 10,599 inmates as of September 30, 2018 and 2017, respectively.

Note 2. Summary of Significant Accounting Policies

Basis of Accounting

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

Basis of Presentation

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

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 2018, 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, 2018 and 2017, 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. At September 30, 2018 and 2017, FPI's allowance for doubtful accounts is stated at approximately $621 and $836.

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, 2018 and 2017 was $18,701 and $15,820, respectively.

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 office performs a review as though the vendor is a public customer, to include performing a due diligence review to assess risk and a review of applicant financial statements. A letter of credit is obtained as needed based on the results of this review. The FPI Controller approves advances prior to their disbursement. Advances are reduced by offset to the vendor invoice as goods are delivered.

Revenue Recognition

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 furniture products, building rental income 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 5, 2018.

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,	**2018**	**2017**
Amortized cost	$ 215,884	$ 248,536
Gross unrealized holding gains	9	32
Gross unrealized holding losses	(4,550)	(619)
Fair Value of Investments	$ 211,343	$ 247,949

The investments above held by FPI at September 30, 2018 and 2017 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, 2018:

	Amortized Cost	Fair Value
Due in one year or less	$ 48,194	$ 47,941
Due after one year through five years	147,984	144,119
Due after five years or more	19,706	19,283
	$ 215,884	**$ 211,343**

All of the notes held by FPI at September 30, 2018 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, 2018.

Note 4. Accounts Receivable, Net

Accounts receivable, net consists of the following:

As of September 30,	**2018**	**2017**
Intragovernmental receivables	$ 27,613	$ 30,365
Interest receivable – investments	1,152	732
Private sector receivables	5,993	5,573
	34,758	36,670
Less allowance for doubtful accounts	621	836
Accounts receivable, net	$ 34,137	$ 35,834

FPI incurred bad debt expense of ($60) and $138, respectively, for the fiscal years ended September 30, 2018 and 2017.

(Dollars in Thousands)

Note 5. Inventories, Net

Inventories, net consists of the following:

As of September 30,		**2018**		**2017**
Raw materials	$	72,382	$	61,163
Work-in-process		19,244		17,901
Finished sub-assemblies		5,724		5,428
Finished goods		24,683		25,860
Finished goods – acceptance contracts		2,751		7,738
		124,784		118,090
Less inventory allowance		3,113		12,066
Inventories, net	$	121,671	$	106,024

Approximately $2,751 of FPI's fiscal year 2018 and $7,738 of its fiscal year 2017 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,		**2018**		**2017**
Buildings and improvements	$	172,888	$	172,147
Machinery and equipment		95,108		101,230
Livestock		3,237		3,014
Computer hardware		2,261		3,116
Computer software		8,885		7,600
		282,379		287,107
Less accumulated depreciation		231,468		234,206
		50,911		52,901
Construction in progress		155		41
Property, plant and equipment, net	$	51,066	$	52,942

Depreciation and amortization expense totaled $6,708 and $7,247 for the fiscal years ended September 30, 2018 and 2017, respectively. During fiscal years 2018 and 2017, FPI invested $7,231 and $3,143, respectively, for the purchase and construction of property, plant and equipment.

(Dollars in Thousands)

A number of buildings and machinery no longer being used for production were written down or disposed. That resulted in an increase in accumulated depreciation, thus reducing overall net value of property, plant and equipment. The related losses totaled $1,651 and $793 for the fiscal years ended September 30, 2018 and 2017, respectively.

Note 7. Other Accrued Expenses

Other accrued expenses consist of the following:

As of September 30,	**2018**	**2017**
Materials in transit	$ 418	$ 856
Relocation travel expense	798	386
FECA liabilities – current portion	1,674	1,690
Financial audit expense	697	752
Telecommunication expense	2,185	971
Utilities	888	711
Product Warranties	327	327
Intra-Departmental Agreements	680	537
Vendor Invoices	6,499	5,783
Other expense	137	111
Other accrued expenses	$ 14,303	$ 12,124

Note 8. Business Segments

FPI's businesses are organized, managed and internally reported as seven operating segments based on products and services. These segments are Agribusiness, Clothing and Textiles, Electronics, Fleet, Office Furniture, Recycling, and Services. FPI redefined its business segments from six categories to seven in fiscal year 2018. The Fleet business segment was previously consolidated into the Electronics business segment. As a result, net sales for fiscal year 2017 for Electronics and Fleet have been reclassified for comparative purposes. 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, 2018 and 2017 for each of its business segments is presented for comparative purposes:

(Dollars in Thousands)

Net Sales

For the fiscal years ended September 30,	**2018**	**2017**
Business Segment		
Agribusiness	$ 6,647	$ 6,225
Clothing and Textiles	121,702	126,382
Electronics	44,655	41,445
Fleet	187,416	118,510
Office Furniture	89,433	113,791
Recycling	15,726	11,816
Services	37,259	35,594
Net sales	$ 502,838	$ 453,763

Regulatory Compliance

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

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

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

Relationship with the Federal Bureau of Prisons

FPI and the BOP have a unique relationship in that the nature of their combined missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP, who has jurisdiction over all federal penal correctional institutions, is the Commissioner of Federal Prison Industries. General management of FPI is provided by the Chief Executive Officer who also serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI. In accordance with Managerial Cost Accounting Concepts an estimate of these costs as provided by the BOP is included in general expense and other income of FPI for the fiscal years ended September 30, 2018 and 2017, 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, 2018 and 2017, the accrued FECA liabilities as charged to FPI, approximated $1,674 and $1,690, respectively.

FPI is required by generally accepted accounting principles (GAAP) to account for future workers' compensation costs not yet paid. These costs include employees' medical expenses, payments for continuation of wages, estimated liability of death, and DOL administrative fees. The liability amount is determined by discounting the projected annual benefit payments using Treasury spot rates. FPI's estimated future liability approximated $21,297 and $23,653 as of September 30, 2018 and 2017, respectively.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS), the Federal Employee Retirement System (FERS) or the Federal Employee Retirement System-Revised Annuity Employees (FERS-RAE) System. For employees covered by the CSRS, (those employees hired prior to January 1, 1984), for fiscal years ended September 30, 2018 and 2017, 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, 2018 and 2017. FPI contributed (for hazardous retirement) 30.1 percent for fiscal years ended September 30, 2018 and 2017. 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, 2018 and 2017. FPI contributed (for hazardous duty retirement) 28.4 percent for the fiscal years ended September 30, 2018 and 2017.

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 $18,500 and $18,000 of salary for the fiscal years ended September 30, 2018 and 2017, respectively. 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 $18,500 and $18,000 of their salary to the thrift plan for the fiscal years ended September 30, 2018 and 2017, respectively, 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 $15,598 and $16,491 for the fiscal years ended September 30, 2018 and 2017, 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 $629 and $818 in the fiscal years ended September 30, 2018 and 2017, 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 $6,228 and $6,504 for the fiscal years ended September 30, 2018 and 2017, 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 $4,004 and $3,142 during the fiscal years ended September 30, 2018 and 2017, respectively, were determined by OPM utilizing cost factors to estimate the cost of providing post-retirement benefits to current employees. However, because of the offsetting credit, which is reflected as other income on the Statements of Operations and Cumulative Results of Operations, the recording of these costs has no impact on reported net income or cash flows.

(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 10. Sales and Marketing, General and Administrative Expenses

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

Fiscal years ended September 30,	**2018**	**2017**
Salaries, wages and benefits	$ 28,611	$ 29,019
Permanent change of station expense	1,448	974
Purchases of minor equipment	456	362
Contract services	12,971	8,722
Bad debt expense	(60)	137
Credit card service fees	570	646
Travel	1,181	914
Personal computer expense	822	1,260
Accident compensation	(765)	864
Financial audit	1,222	1,330
Marketing	3,233	444
Depreciation	1,245	1,296
Gain on disposition of assets	(16)	-
Loss on disposition of assets	1,793	1,108
Telecommunication expense	3,517	2,534
Other expense	(221)	(4,246)
Imputed pension costs	629	818
Imputed post-retirement health care and life insurance cost	4,004	3,142
Imputed operating costs	18,440	18,507
Sales and marketing, general and administrative expenses	$ 79,080	$ 67,831

Other expense is comprised primarily of gainsharing awards for staff and inmates, sales consulting fees, 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 both fiscal years 2018 and 2017. 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. As of September 30, 2018 and 2017, legal contingencies total $500 and $0, respectively.

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, 2018 and 2017, future capital lease payments due total $73 and $88, and future operating lease commitments total $24 and $56, 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,***	**2018**	**2017**
Balance at the beginning of the period	$ 327	$ 364
Accruals for warranties issued during the period	45	453
Settlements made (in cash or in kind) during the period	(45)	(490)
Balance at the end of the period	$ 327	$ 327

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,	**2018**	**2017**
Congressional limitation on expenses	$ 2,700	$ 2,695
Expenses incurred subject to Congressional limitation	$ 1,920	$ 2,203

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