



CALIFORNIA PRISON INDUSTRY AUTHORITY
REPORT TO THE LEGISLATURE
FISCAL YEAR 2009-2010

CALPIA

The California Prison Industry Authority's (CALPIA) Fiscal Year
(FY) 2009-10 Report to the Legislature is submitted pursuant to
Chapter 1549, Statutes of 1982 as embodied in paragraph 2808 (k)
of the California Penal Code.

Edmund G. Brown Jr.
Governor
State of California

California Prison Industry Authority

Prison Industry Board
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The Penal Code established the California Prison Industry Authority (CALPIA) to:

- Develop and operate manufacturing, agricultural, and service enterprises that provide work opportunities for inmates under the jurisdiction of the California Department of Corrections and Rehabilitation (CDCR), and serve governmental agencies with products and services commensurate with their needs.
- Create and maintain working conditions within enterprises, as much like those which prevail in private industry as possible, to assure inmates assigned therein the opportunity to work productively to earn funds, and to acquire or improve effective work habits or occupational skills.
- Operate work programs for inmates that are self-supporting through the generation of sufficient funds from the sale of products and services to pay all its expenses, thereby avoiding the cost of alternative inmate programming by CDCR. CALPIA receives no appropriation from the Legislature.

CALPIA manages 60 manufacturing, service and agriculture industries in 23 institutions providing employment and programming for approximately 5,500 inmates at California's penal institutions with CDCR. Administrative offices are located in Folsom, California.

Research has validated the effectiveness of vocational training and how the benefits of increased employment go far beyond people with prior convictions and their immediate families.¹ CALPIA's program goal is to produce CALPIA trained inmates that have a job skill, good work habits, and basic education, and job support in the community when they parole. Many CALPIA inmates receive industry accredited certifications that employers require.

1. Berkeley Center on Criminal Justice: Reaching a Higher Ground: Increasing Employment Opportunities for People with Prior Convictions (November 2010).

CALPIA Reduces Recidivism, Saves Money, and Increases Safety

Former inmates who participated in CALPIA programs are less likely to return to prison than general population inmates. They are significantly more likely to become productive workers that pay taxes instead of costing California taxpayers approximately \$49,000 per year¹.

The recidivism rate of CALPIA participants is an essential measure of the organization’s success. Over a three year period, beginning in FY 2005-06, CALPIA parolees return to prison on average 26 to 30 percent less often than CDCR general population parolees.

1. Legislative Analyst’s Office (March 2009) Report to Senate Budget Sub No. 4.

CALPIA REDUCES RECIDIVISM

FISCAL YEAR	TOTAL CALPIA PAROLEES	TOTAL CDCR PAROLEES	1 YEAR			2 YEARS			3 YEARS		
			CALPIA PERCENT	CDCR PERCENT	VARIANCE PERCENT	CALPIA PERCENT	CDCR PERCENT	VARIANCE PERCENT	CALPIA PERCENT	CDCR PERCENT	VARIANCE PERCENT
08/09*	1,571		27.75%								
07/08*	1,637	116,497	31.83%	42.18%	24.54%	39.71%					
06/07*	1,853	115,522	30.87%	43.20%	28.54%	43.34%	55.83%	22.39%	44.41		
05/06	1,822	108,637	32.44%	44.92%	27.80%	43.19%	58.77%	26.50%	43.63%	62.51%	30.20%

Average Variance 26.95%

Average Variance 30.20%

* Data was unavailable at the time this report was published

Moreover, CALPIA provides the state’s prison system with an effective safety management tool that reduces prison violence and idleness through productive work opportunity assignments.

CALPIA Overview

CALPIA is under the policy direction of an eleven-member board of directors that reviews and approves the annual budget and changes in operation. Administrative offices are located in Folsom, California. The goods and services produced by CALPIA's operations are sold to the State of California and other governmental entities.

CALPIA spends its revenue dollars to cover the cost of raw materials, inmate supervision, inmate payroll, transportation and distribution, capital acquisition, debt reduction, expansion, and central office administration. CALPIA reinvests profits back into the organization to expand opportunities for inmates.

In FY 2009-10, CALPIA employed more than 5,500 inmates in diverse manufacturing, service and agricultural enterprises.

CALPIA invests in rehabilitation programs for inmates, including 16 programs that offer nationally recognized accredited certification skills ranging from optometry and dental technology to laundry, commercial baking, agriculture, welding and metal stamping. Additionally, CALPIA provides Career Technical Education programs in commercial diving, carpentry, and ironworking in, partnership with trade unions who offer employment possibilities when inmates are released on parole. CALPIA inmates can also earn certificates of proficiency in occupational disciplines which validate skills and abilities acquired during employment with CALPIA.

In FY 2009-10, 1,321 CALPIA inmates received a certificate of proficiency and another 352 CALPIA inmates successfully completed an accredited certification program.

Changes in Existing Operations

During FY 2009-10, the State of California was confronted with severe fiscal hardship. CALPIA's revenues declined \$52.4 million (22.3%). Overall, revenues from 19 of 26 CALPIA enterprises declined from the prior fiscal year.

CALPIA scaled back operations in response to declining revenue. In the early months of Fiscal Year 2009-10, CALPIA closed two optical factories, two furniture factories, and one dairy. In so doing, CALPIA reduced civil service staff by 50 budgeted positions (6.7%).

Also, effective July 2009, Governor Schwarzenegger ordered state employees to take three furlough days off per month without pay (after an initial period of two days a month commencing February, 2009), thereby creating salary savings of approximately \$5.7 million

during fiscal 2009-10. Additionally, CALPIA reduced selling and administration expenses by \$4.0 million (9.7%).

Under Government Accounting Standards Board (GASB) No. 45, the State is required to recognize the cost of retiree health benefit programs on an accrual basis rather than on a pay-as-you-go basis. As one of the few state agencies required to fund Other Post-Employment Benefits (OPEB) from its own proprietary fund, CALPIA actively monitors the costs of retiree health benefits in accordance with Generally Accepted Accounting Principles and the funding policies of the State.

The State Controller, who administers GASB No. 45 accounting requirements for the State, informed CALPIA that its share of the State's net unfunded OPEB obligation for fiscal years 2008-09 and 2009-10 is \$6.3 million and \$6.0 million, respectively.

Operation and Product Development

During FY 2009-10, CALPIA refined products and services to meet current and emerging customer needs. These efforts included expanding the application of International Standards Organization (ISO) principles throughout the organization. Previously, CALPIA attained ISO certification in its furniture, modular building, and modular furniture factories.

In FY 2009-10, CALPIA upgraded the manufacturing processes in its fabric factories with the goal of becoming ISO certified in FY 2010-11. This ISO certification will enable CALPIA's fire fighting garments to meet the National Fire Protection Association (NFPA) standard, a national standard for wildland fire fighting protective clothing.

This period of challenges for California highlights the need for CALPIA to reassess its

strategies and long-term goals. In the process of creating the 2010 Strategic Business Plan, CALPIA identified opportunities to refocus its vision and establish strategic initiatives with measurable goals. This reflects CALPIA's commitment to continuous improvement.

Environmentally - Friendly Products

CALPIA is committed to adopting products and processes to reduce the impact on the environment by using sustainable approaches to its product lines. In FY 2009-10, CALPIA received Green Seal certification for six cleaning products sold in the California Green Product Line.

Green Seal is an internationally recognized organization which provides science-based environmental certification standards that are widely accepted in the competitive public marketplace. In FY 2010-11, CALPIA will offer a comprehensive cleaning product management system that facilitates the safe

handling of concentrates and produces less waste.

Phase one of Green Seal certified environmentally friendly cleaning products offered glass and multipurpose cleaners. Phase two of Green Seal certified environmentally friendly cleaning products will be launched in FY 2010-11 and consists of a restroom cleaner, floor cleaner, floor stripper and floor finish. Plans to expand CALPIA's green cleaning product system will continue to meet market demand.

In FY 2010-11 CALPIA will offer refurbished print and fax toner cartridges. These eco-friendly toner cartridges are priced significantly less than new toner cartridges and reduce waste produced by government entities.

Telemedicine Modular Buildings

In FY 2009-10 CALPIA completed the design phase for Telemedicine facilities, a new addi-

tion to the CALPIA Modular Building Enterprise. These dedicated on-site buildings reduce programmatic, transportation, and correctional overtime costs by providing state of the art facilities for off-site, remote medical examinations. CALPIA factory modular buildings require 70% less construction time on site, minimizing typical construction impact and daily disruptions inside prisons.

California Assistive Technology Enterprise (CATE)

CALPIA is committed to providing adaptive/assistive technologies to persons with disabilities to promote independence. The California Assistive Technology Enterprise (CATE) brings together the efforts of the Folsom Project for the Visually Impaired (FPVI) with CALPIA's vision to expand assistive technologies for the impaired community. CATE will continue to produce high quality Braille transcription services, e-text, and tactile graphics, to provide access to print related disabilities.

CALPIA launched the CATE enterprise at Folsom State Prison on May 20, 2010.

Through years of collaboration between CALPIA and the FPVI, CALPIA inmates are highly regarded in the Braille community for the accuracy of their work.

In Fiscal Year 2010-11, CATE expects to complete a contract with the California Department of Education, increase opportunities for inmate staff to expand the capacity of CATE, and add new products and technologies to enhance the program and increase inmate skills.

American Board of Opticianry

Optician

American Institute of Baking

Type: Science of Baking

Bread/Rolls

Cake/Sweet Goods

Foundations

Ingredient Technician

American Welding Society

Type: **Mig**

Gas Metal Arc Welding (GMAW) -1

Type: **Tig**

Gas Tungsten Arc Welding (GTAW) -1

Gas Tungsten Arc Welding (GTAW) -2

Gas Tungsten Arc Welding (GTAW) -3

California Dept of Food & Ag.

Pasteurizer License

Sampler/Weigher License

California Dept of Health Services

Final Inspector

Electronics Technicians Association

Customer Service Specialist

Certified Electronics Technician

Industrial Journeyman

Federal Communication Control

Hyster

Forklift Operator Certification

Association for Linen Management

Certified Linen Technician

Certified Washroom Technician

Certified Laundry Linen Manager

National Institute of Metalworking Skills

Machining, Level I

Metal Forming, Level I

Metal Stamping, Level II

National Restaurant Association

ServSafe Essentials

ServSafe Employee Guide

INDUSTRY ACCREDITATIONS - CREATING A READY WORKFORCE

National Restaurant Association

ServSafe Essentials

ServSafe Employee Guide

North American Technician Excellence

	Installation	Service
HVAC Type:	A/C	A/C
	Air Dist.	Air Dist.
	Heat Pumps	Heat Pumps
	Gas Heat	Gas Heat
	Oil Heat	Oil Heat

Printing Industries of America

Sheetfed Offset Press

Web Offset Press

Bindery

Productivity Training Corporation

Dental Technician

Stiles Machinery Inc.

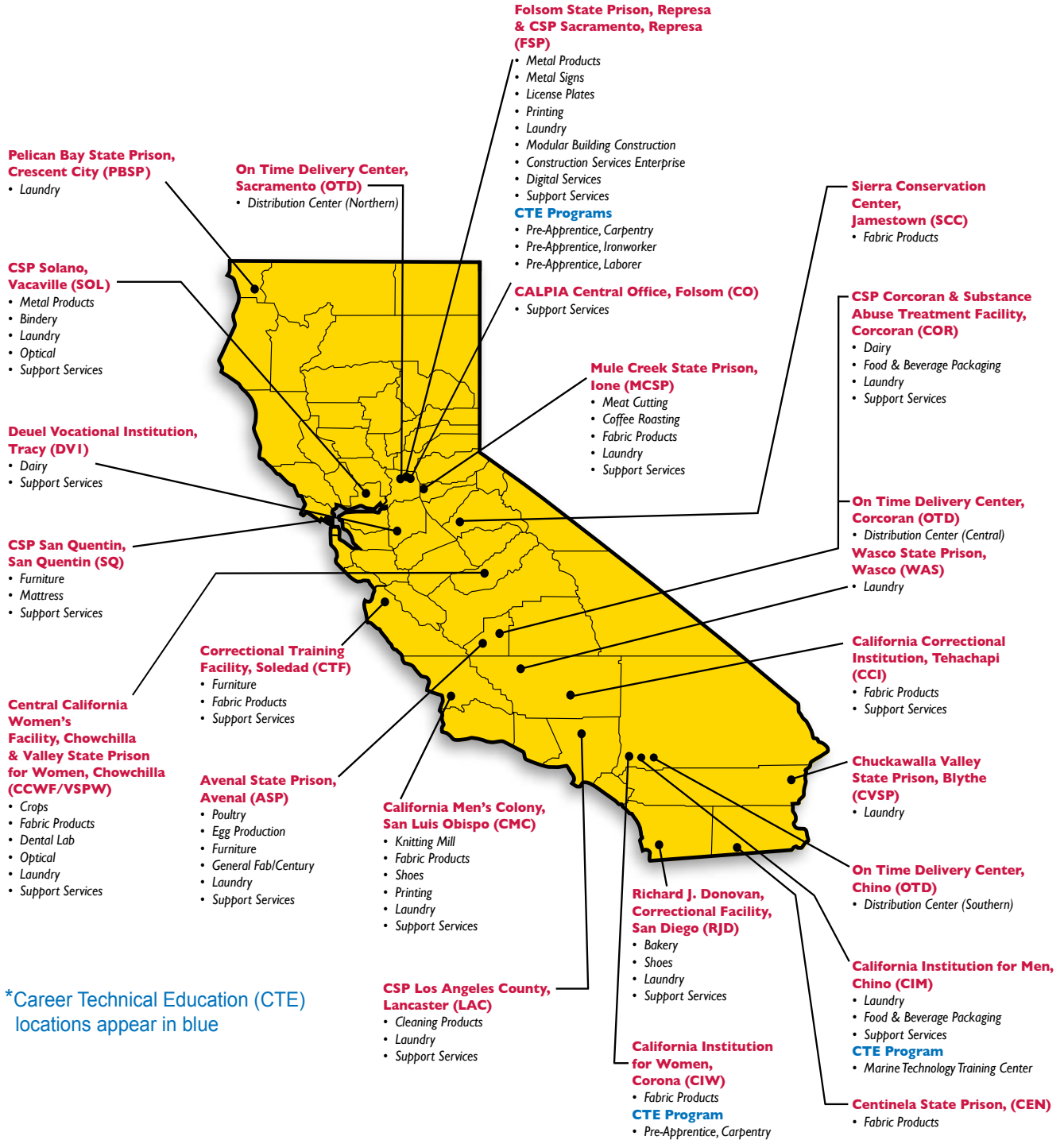
Intermediate Weeke Machining

Center Programing

Select Stiles Breeding Corporation

Artificial Insemination License

CALPIA Enterprises and Career Technical Education Locations (CTE)



SALES AND EXPENSES

Sales (In Thousands)	FY 2008-09 Audited Actual	FY 2009-10 Audited Actual	FY 2010-11 Proposed Mid-Year Revise
Manufacturing	\$123,185	\$86,407	\$73,550
Services	80,326	66,631	64,770
Agricultural	30,722	28,773	28,500
Total Revenue	\$234,233	\$181,811	\$166,820
Expenses (In Thousands)			
Cost of Goods Sold			
Manufacturing	\$101,745	\$68,855	\$53,059
Services	55,078	46,295	46,102
Agricultural	29,481	24,850	25,288
Total Cost of Goods Sold	\$186,304	\$140,000	\$124,449
Gross Profit	\$47,929	\$41,811	\$42,371
Selling & Administration Expenses (In Thousands)			
Prison Industry Board	\$162	\$126	\$184
Executive Division			
Executive Management	387	439	315
Legal	540	943	707
Public Affairs	129	129	130
Operations Division			
Operations Management	3,044	2,461	2,543
Industrial Services Branch	2,200	2,238	1,593
Inmate Employability Program	464	339	1,159
Marketing Division	4,060	3,353	3,444
Joint Venture/Free Venture	439	367	697
Administrative Services Division	8,657	7,732	8,123
Human Resources	1,092	959	1,015
Staff Development	359	295	905
Career Technical Education Programs (CTE)	3,280	2,020	3,086
Reimbursements			
CTE	(3,086)	(1,543)	(800)
Joint/Free	(637)	(670)	(697)
IEP	0	0	(378)
Total Central Office	21,090	19,188	22,026
Distribution/Transportation	13,727	11,346	10,491
OPEB	6,001	6,316	6,318
Total Selling & Administration	\$40,818	\$36,850	\$38,835
Operating Income/(Loss)	\$7,111	\$4,961	\$3,536
Non-Operating Revenues/Expenses	(\$150)	(\$1,680)	(\$494)
Net Gain/(Loss)	\$6,961	\$3,281	\$3,042

SALES BY ENTERPRISE

Enterprise	FY 2008-09	FY 2009-10	FY 2010-11 Proposed Mid-Year Revise
Manufacturing			
Furniture	\$19,547,224	\$12,998,752	\$8,000,000
Metal Products	3,908,571	4,844,423	4,000,000
License Plates	10,904,074	11,022,264	10,000,000
General Fabrication	17,226,231	12,612,758	7,000,000
Bindery	3,636,349	2,066,681	3,200,000
Knitting Mill	1,785,709	1,992,224	1,900,000
Fabric Products	26,587,531	21,420,228	22,000,000
Silk Screen	54,242	43,318	0
Shoes	5,450,382	4,819,811	5,250,000
Mattresses	2,598,542	2,890,369	2,700,000
Cleaning Products	6,157,438	7,132,310	7,800,000
Modular Construction	25,328,947	4,564,250	1,700,000
TOTAL	\$123,185,240	\$86,407,388	\$74,850,000
Services			
Meat Cutting	\$10,792,831	\$9,881,991	\$9,450,000
Bakery	3,442,818	3,398,686	3,300,000
Coffee Roasting	2,305,585	2,100,153	2,300,000
Food & Beverage Packaging	16,120,041	15,129,659	15,960,000
Metal Signs	1,324,069	1,133,797	1,070,000
Printing	7,573,647	6,190,498	7,100,000
Dental Lab	607,289	583,790	500,000
Digital Services	5,766	33,423	250,000
Laundry	16,665,143	15,784,548	15,000,000
Optical	21,488,391	12,394,351	9,740,000
Construction Services	0	0	100,000
TOTAL	\$80,325,581	\$66,630,896	\$64,770,000
Agricultural			
Dairy/Farm	\$15,193,773	\$14,444,550	\$14,200,000
Crops	1,341,100	1,428,491	1,600,000
Poultry	6,746,286	6,027,188	6,300,000
Egg Production	7,441,017	6,872,704	6,400,000
TOTAL	\$30,722,176	\$28,772,933	\$28,500,000
SALES TOTAL	\$234,232,997	\$181,811,217	\$168,120,000

INMATE LABOR BY LOCATION

Average Monthly Filled Inmate Assignments			
Location	FY 2008-09	FY 2009-10	FY 2010-11 Proposed Mid-Year Revise
California Institution for Men	202	241	324
California Men's Colony	664	620	705
R. J. Donovan Correctional Facility	428	282	298
Correctional Training Facility	592	375	390
Avenal State Prison	553	482	587
Deuel Vocational Institution	251	186	175
Folsom State Prison/CSP Sacramento	686	544	706
San Quentin State Prison	323	292	215
California Institution for Women	158	178	185
California Correctional Institution	305	270	277
California State Prison, Solano	657	410	603
Mule Creek State Prison	387	350	397
Corcoran State Prison/Substance Abuse Treatment Facility	516	382	370
Chuckawalla Valley State Prison	58	52	54
Pelican Bay State Prison	120	35	26
Sierra Conservation Center	131	125	150
Central California Women's Facility/Valley State Prison for Women	438	406	448
California State Prison, Lancaster	99	91	101
Wasco State Prison	76	86	73
Centinela State Prison	74	69	48
Central Office	32	29	52
Total	6,750	5,505	6,184

CALIFORNIA PRISON INDUSTRY AUTHORITY

(A Component Unit of the
State of California)

ANNUAL FINANCIAL REPORT

Years Ended June 30, 2010 and 2009

CALIFORNIA PRISON INDUSTRY AUTHORITY
(A Component Unit of the State of California)

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INDEPENDENT AUDITOR'S REPORT

To the California Prison Industry Authority Board
Folsom, California

We have audited the accompanying balance sheets of California Prison Industry Authority ("CALPIA"), a component unit of the State of California, as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of CALPIA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CALPIA as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2010 on our consideration of CALPIA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

The management's discussion and analysis on pages 3 through 13 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Maciej Gini & O'Connell LLP

Sacramento, California
December 21, 2010

**CALIFORNIA PRISON INDUSTRY AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (Unaudited)**

INTRODUCTION – CALIFORNIA PRISON INDUSTRY AUTHORITY

The following Management Discussion and Analysis (“MD&A”) applies only to the activities of the California Prison Industry Authority (“CALPIA”) and should be read in conjunction with the basic financial statements and related footnotes.

CALPIA is a proprietary component unit of the State of California (State) and is accounted for in the Prison Industries Revolving Fund, which is an internal service fund in the State’s basic financial statements. CALPIA does not receive a State appropriation.

Chapter 1549, Statutes of 1982, created CALPIA as a semi-autonomous state agency. The statutory purposes of the CALPIA are to:

- Develop and operate manufacturing, agricultural, and service enterprises that provide work opportunities for inmates under the jurisdiction of the California Department of Corrections and Rehabilitation (“CDCR”);
- Create and maintain working conditions within enterprises, as much like those which prevail in private industry as possible, to assure inmates the opportunity to work productively to earn wages, and to acquire or improve effective work habits or occupational skills;
- Operate a work program for inmates that is self-supporting through the sale of products and services and reduces the cost of operation of the CDCR.

CALPIA is under the policy direction of an eleven-member board of directors, which reviews and approves the annual budget for the CALPIA. CALPIA manages over 60 manufacturing, service, and agricultural factories in 23 institutions. Administrative offices are located in Folsom, California. The goods and services produced by CALPIA’s operations are sold principally to departments of the State of California and other governmental entities. CDCR is CALPIA’s largest customer and accounted for 61% of all sales in each of the fiscal years ended June 30, 2010 and 2009.

Overview

During fiscal 2010, the entire State of California was mired in a fiscal crisis which had not been experienced since the Great Depression. Although the Legislature enacted the fiscal 2010 State Budget in February 2009, the deteriorating economy required revisions to that spending plan before the budget year started. Virtually no program in state government was spared. CALPIA was directly affected by the elimination of the optical benefit for adult Medi-Cal patients, the prescriptions for which were filled at four of CALPIA's factories. Overall, having achieving record sales levels in the previous year, CALPIA's revenues declined \$52.4 million (22.3%) in fiscal 2010.

Notwithstanding the enormous challenges of the business environment, CALPIA management re-dedicated itself to strategic planning in fiscal year 2010. The 2010 edition of the CALPIA Strategic Business Plan emphasizes the dual priorities of providing inmate rehabilitation and operating a self-sufficient business while enumerating objectives, and strategies to accomplish the mission of CALPIA. With respect to both programmatic and business goals, CALPIA can point to numerous achievements in fiscal 2010.

In financial terms, CALPIA recorded a net profit of \$3.3 million in fiscal 2010. While nineteen of 26 enterprises endured decreases in sales from the prior year, CALPIA adjusted by scaling back operations. In the early months of fiscal 2010, CALPIA closed two optical factories, two furniture factories, and one dairy. In so doing, CALPIA reduced civil service staff by 50 budgeted positions (6.7%). Also, effective July 2009, Governor Schwarzenegger ordered state workers to take three days off a month without pay (after an initial period of two days off a month commencing February 2009), thereby creating salary savings of approximately \$5.7 million during fiscal 2010. Additionally, CALPIA reduced selling and administration expenses by \$4.0 million (9.7%), inclusive of the effect of Governmental Accounting Standards Board (GASB) Statement No. 45 (GASB No. 45)—*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*.

Under GASB No. 45, the State is required to recognize the cost of retiree health benefit programs on an accrual basis rather than on a pay as you go basis. The State Controller, who administers GASB No. 45 accounting requirements for the State, informed CALPIA that its share of the State's net unfunded OPEB obligation for fiscal years 2010 and 2009 is \$6.3 million and \$6.0 million, respectively. CALPIA recorded these amounts as a "selling and administrative" expense on the operating statement in addition to the actual payments made for OPEB. The State does not maintain a separate pool of assets to finance future retiree healthcare benefits. As one of the few state agencies required to fund the OPEB obligation from its own proprietary fund, CALPIA actively monitors the costs of retiree health benefits in accordance with Generally Accepted Accounting Principles and the funding policies of the State. As of June 30, 2010, the CALPIA balance sheet reflects a net OPEB obligation of \$19.0 million.

During fiscal 2010, CALPIA continued making strides to refine products and services in order to meet current and emerging customer needs. These efforts included expanding the application of International Standards Organization (ISO) principles throughout the organization. In preceding years, CALPIA attained ISO certification in its furniture, modular building, and modular furniture factories. In fiscal 2010, CALPIA upgraded the manufacturing processes in its fabric factories with the goal of becoming ISO certified in fiscal 2011. This ISO certification will enable

Overview (continued)

CALPIA's fire fighting garments to meet the National Fire Protection Association (NFPA) standard, a national standard for wild land fire fighting protective clothing. Also in fiscal 2010, CALPIA completed Green Seal certification for a large segment of its cleaning products----glass cleaner and multipurpose cleaner concentrates. Founded in 1989, Green Seal provides science-based environmental certification standards that are widely accepted in the competitive public marketplace. Implementing and maintaining quality standards affirms CALPIA's commitment to producing superior products and also positions CALPIA to attract additional customers.

As discussed above, CALPIA was not created solely to be a business enterprise. CALPIA distinguishes itself as a state program by providing inmates work opportunities and skills they will require to re-enter society as productive citizens. In fiscal 2010, CALPIA employed more than 5,400 inmates in diverse manufacturing, service and agricultural enterprises. CALPIA invests in rehabilitation programs for inmates, including 16 programs that offer nationally recognized accredited certification skills ranging from optometry and dental technology to laundry, commercial baking, agriculture, welding and metal stamping. Additionally, CALPIA provides Career Technical Education programs in commercial diving, carpentry, and ironworking in partnership with trade unions who offer employment possibilities when inmates are released on parole. CALPIA inmates can also earn certificates of proficiency in occupational disciplines which may be utilized upon parole to validate skills and abilities acquired during employment with CALPIA. In fiscal 2010, thirteen hundred twenty-one (1,321) CALPIA inmates received a certificate of proficiency and another three hundred fifty-two (352) CALPIA inmates successfully completed an accredited certification program. CDCR assists these efforts by reimbursing CALPIA for approximately half of its vocational and CTE program costs. Moreover, research indicates that CALPIA saves the state money, both by enhancing the safety of prisons and by demonstrating lower recidivism rates among those inmates who work in its programs.

Looking forward, California's budget situation is not likely to recover for several years. Though the Penal Code mandates state agencies to purchase goods and services from CALPIA, in times of economic uncertainty, CALPIA faces mounting legislative challenges. In fiscal 2010, the State Legislature considered three separate bills that would have adversely affected CALPIA's public safety mission. Two bills would have eliminated the mandate for state agencies to purchase goods manufactured by CALPIA by allowing them to enter into contracts with California certified small businesses, micro businesses, or disabled veteran business enterprises to purchase goods currently manufactured by CALPIA. Another bill would have allowed CDCR to enter into purchase contracts for locally produced perishable goods in counties with a population of less than 50,000 that are provided at a lower price than CALPIA, thereby eliminating the existing mandate that state agencies purchase needed products from CALPIA if produced by CALPIA. Through CALPIA's intensive efforts to educate legislators regarding its essential mission and the related cost savings to the General Fund, none of the bills passed. However, CALPIA is ever mindful of producing quality goods and services at a reasonable cost.

In developing the 2010 Strategic Business Plan, CALPIA has taken a significant step towards charting a course for the coming years. CALPIA envisions a future of successful and innovative business enterprises, supported by a dedicated and qualified workforce, working in partnership with loyal and satisfied customers that create the best opportunities for the rehabilitation of inmate workers.

Condensed Balance Sheet

The following table presents the condensed balance sheets for CALPIA as of June 30, 2010, 2009 and 2008:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets			
Cash and cash equivalents	\$ 54,884,348	\$ 44,059,867	\$ 60,207,601
Accounts receivable	10,474,952	11,258,815	13,713,014
Due from state general fund	21,000,000	20,800,000	-
Inventories	43,057,538	49,114,484	55,832,218
Capital assets, net	47,903,931	50,307,712	52,552,900
Other assets	293,961	372,427	828,748
Total assets	<u>\$ 177,614,730</u>	<u>\$ 175,913,305</u>	<u>\$ 183,134,481</u>
Liabilities			
Accounts payable and accrued liabilities	\$ 19,566,841	\$ 21,890,749	\$ 24,178,207
Deferred revenue	4,753,759	10,534,685	31,035,693
Worker's compensation liability	14,878,827	14,669,927	12,062,775
Net OPEB Obligation	18,954,000	12,638,000	6,637,000
Total liabilities	<u>58,153,427</u>	<u>59,733,361</u>	<u>73,913,675</u>
Net Assets			
Invested in capital assets	47,903,931	50,307,712	52,552,900
Unrestricted net assets	71,557,372	65,872,232	56,667,906
Total net assets	<u>119,461,303</u>	<u>116,179,944</u>	<u>109,220,806</u>
Total liabilities and net assets	<u>\$ 177,614,730</u>	<u>\$ 175,913,305</u>	<u>\$ 183,134,481</u>

Assets

Total assets increased by \$1.7 million at June 30, 2010 compared to June 30, 2009, which is explained by a \$10.8 million increase in cash and cash equivalents, offset by a \$6.1 million decrease in inventories, a \$2.4 million decrease in capital assets, and a \$6 million combined decrease in accounts receivable, due from state general fund and other assets.

Assets (Continued)

Total assets decreased by \$7.2 million at June 30, 2009 compared to June 30, 2008, which is explained by a \$16.1 million decrease in cash and cash equivalents, a \$6.7 million decrease in inventories, a \$2.2 million decrease in capital assets, a \$3.0 million combined decrease in accounts receivable and other assets, offset by a \$20.8 million increase in due from state general fund.

The \$10.8 million increase in cash and cash equivalents at June 30, 2010 is explained by the positive cash flows from operating activities of \$17.8 million and investing activities of \$.3 million, offset by the net outflow of \$.2 million in a short term loan to the state general fund and \$7.1 million from capital asset acquisitions and disposals.

The decrease in inventories is the outcome of utilizing on-hand inventory to satisfy decreasing production demands in the current year as well as devaluing inventory in the amount of \$.7 million for slow moving and obsolete inventory items. The decrease in capital assets is attributable to the disposal of older equipment throughout CALPIA as well as the recognition of a \$1.1 million impairment loss in factories which were closed in the current and prior fiscal years.

The \$16.1 million decrease in cash and cash equivalents at June 30, 2009 is explained by the positive cash flows from operating activities of \$11.0 million and investing activities of \$0.8 million, offset by the net outflow of \$20.8 million in a short-term loan to the state general fund and \$7.1 million from capital asset acquisitions and disposals.

The \$20.8 million increase in due from state general fund at June 30, 2009 reflects a short-term loan authorized by the State Controller's Office for cash management purposes. The decrease in inventories is the result of utilizing on-hand inventories from the prior year to satisfy current year production demands, particularly in the furniture, license plates, and general fabrication enterprises. The decrease in capital assets is attributable to reduced capital outlays and depreciation, as well as the disposal of older equipment.

Liabilities

Total liabilities decreased by \$1.6 million at June 30, 2010 compared to June 30, 2009. The net liability for Other Post Employment Benefits (OPEB) increased by \$6.3 million, while deferred revenue and accounts payable and accrued liabilities decreased by \$5.8 and \$2.3 million, respectively. In addition, the liability for workers' compensation reserves increased \$.2 million.

Total liabilities decreased by \$14.2 million at June 30, 2009 compared to June 30, 2008. This is mainly explained by a \$6.0 million increase in the liability for Other Post Employment Benefits (OPEB) offset by a \$20.5 million decrease in deferred revenue. Additionally, accounts payable decreased by \$2.3 million and workers' compensation reserves increased by \$2.6 million.

The State annually allocates a portion of retiree health benefit costs to the Prison Industries Revolving Fund. Prior to fiscal year 2008, the State was on a "pay-as-you-go" allocation and funding policy. Effective with fiscal year 2008, in accordance with the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment*

Benefits Other Than Pensions (OPEB), the State changed its allocation methodology to recognize the annual required contribution to the plan which is determined by an actuarial valuation which

Liabilities (Continued)

estimates the present value of future retiree healthcare benefits earned during the employee's working lifetime, including an amortization of the value of unfunded retiree healthcare benefits attributable to employee service earned in prior fiscal years. The State Controller's Office has determined that CALPIA's annual required OPEB contribution for fiscal 2010 is \$9.6 million. Of this amount, CALPIA contributed \$3.3 million; the balance of \$6.3 million was accrued as a net OPEB long term liability.

CALPIA's annual required OPEB contribution for fiscal 2009 was \$9.4 million. Of this amount, CALPIA contributed \$3.4 million; the balance of \$6.0 million was accrued as a net OPEB long term liability.

The \$5.8 million decrease in deferred revenue at June 30, 2010 is primarily attributable to the liquidation of prior year advances received from CDCR for the construction of modular buildings and from the Department of Transportation for office furniture.

The \$20.5 million decrease in deferred revenue at June 30, 2009 corresponds principally to the recognition in revenue of a prior year advance received from CDCR for the construction of modular buildings.

Condensed Statements of Revenues, Expenses and Changes in Net Assets

The following table presents the condensed statements of revenues, expenses and changes in net assets for the years ended June 30, 2010, 2009 and 2008.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Operating revenues	\$ 181,811,217	\$ 234,232,997	\$ 209,531,760
Cost of goods sold	<u>139,999,941</u>	<u>186,304,080</u>	<u>170,446,971</u>
Gross profit	41,811,276	47,928,917	39,084,789
Selling and administrative expenses	<u>36,849,774</u>	<u>40,819,994</u>	<u>42,611,357</u>
Operating income (loss)	4,961,502	7,108,923	(3,526,568)
Non-operating (expenses) revenues, net	<u>(1,680,143)</u>	<u>(149,785)</u>	<u>570,697</u>
Increase (decrease) in net assets	3,281,359	6,959,138	(2,955,871)
Net assets at beginning of year	<u>116,179,944</u>	<u>109,220,806</u>	<u>112,176,677</u>
Net assets at end of year	<u><u>\$ 119,461,303</u></u>	<u><u>\$ 116,179,944</u></u>	<u><u>\$ 109,220,806</u></u>

Operating Revenues

As presented in the table below, CALPIA sales dropped markedly in fiscal year 2010 compared to fiscal year 2009, decreasing by \$52.4 million (22.4%) from \$234.2 million to \$181.8 million. Each sector of CALPIA's enterprises experienced declining revenues. Sales in the manufacturing enterprises declined by \$36.8 million (30.0%); sales in the service enterprises declined by \$13.7 million (17.0%); and sales in the agricultural enterprises declined by \$1.9 million (6.3%). This outcome shows that state agencies had considerably less discretionary funds available during fiscal 2010. The decrease also reflects that CALPIA benefited from unprecedented sales in fiscal 2009, a period in which revenues jumped \$24.7 million (11.8%) over the prior year. In fact, when comparing sales between fiscal years 2008 and 2010, revenues decreased by \$27.7 million (13.2%).

In manufacturing, the sales of modular buildings decreased \$20.8 million (82.0%) in fiscal year 2010, while the combined sales of the furniture, general fabrication (modular office systems), fabric products, and bindery factories decreased by \$17.9 million. The reduction in modular building sales reflects both the weakening economy and the fact that CALPIA completed major projects for CDCR in fiscal 2009. The lesser sales in all other enterprises epitomize the limited budgets of state agencies during a depressed economy. On a positive note, sales improved in cleaning products by \$1.0 million (15.8%), which is the result of growing awareness throughout the state of CALPIA's green cleaning products, including glass and multipurpose concentrates and dispensers.

Optical sales decreased by \$9.1 million (42.3%) in fiscal year 2010 or 66.4% of the total sales decrease in the service enterprises. The legislature amended Welfare and Institutions Code Section 14131.10 to eliminate Medi-Cal coverage of adult optometric services, effective July 1, 2009. Under a contract with the Department of Health Care Services, CALPIA served as the fabricating laboratory for glasses related to this benefit. As previously stated, in response to the change in Medi-Cal benefits, CALPIA closed two optical factories--San Diego and Pelican Bay--in fiscal year 2010. These factories processed prescription glasses through the first quarter of the fiscal 2010; therefore, the full effect of the loss in Medi-Cal revenues will not be realized until fiscal 2011. It should be noted that CALPIA will continue to provide optical services to Medi-Cal beneficiaries under the age of 21.

Sales increased \$24.7 million (11.8%) in fiscal year 2009 from \$209.5 million to \$234.2 million. Overall, sales in the manufacturing and service enterprises increased by \$16.6 million (15.5%) and \$8.7 million (12.1%), respectively, whereas sales in the agricultural enterprises decreased by \$0.5 million (1.7%).

In manufacturing, the combined sales of furniture, metal products, and license plates decreased \$10.4 million (23.2%) in fiscal year 2009. This outcome reflects that state agencies had fewer discretionary funds to spend for the second consecutive year, after CALPIA recorded unprecedented sales levels in these enterprises in fiscal year 2007. Offsetting these decreases, were momentous sales in the modular construction and general fabrication enterprises, whose revenues increased by \$19.4 million (326.5%) and \$4.5 million (35.0%), respectively. These

Operating Revenues (continued)

increases are primarily attributable to capital outlay purchases from the CDCR, Department of Transportation, and the Department of Motor Vehicles. Cleaning products revenues also showed a significant increase of \$2.4 million (63.5%), which is a result of expanded marketing of CALPIA's newer cleaning and sanitizing products and their related dispensing systems.

Of the \$8.7 million sales increase in fiscal year 2009 in service enterprises, \$4.9 million (56.8%) occurred in food packaging, \$1.3 million (8.3%) occurred in laundry, and \$1.5 million (16.7%) occurred in the bakery and coffee enterprises. The increases are primarily explained by customer demand for newer products - cookies, peanut butter and jelly, instant coffee, juice products - as well as a full year of price adjustments in the service and agricultural enterprises, which were implemented in the fourth quarter of fiscal year 2008.

Operating Revenues by Product Line	2010	2009	2008
Manufacturing:			
Furniture	\$ 12,998,752	\$ 19,547,224	\$ 24,767,204
Metal products	4,844,423	3,908,571	6,404,143
License plates	11,022,264	10,904,074	13,559,436
General fabrication	12,612,758	17,226,231	12,754,302
Bindery	2,066,681	3,636,349	2,959,896
Knitting mill	1,992,224	1,785,709	2,055,710
Fabric products	21,420,228	26,587,531	26,918,554
Silk screening	43,318	54,242	73,352
Shoe factory	4,819,811	5,450,382	4,497,770
Mattress factory	2,890,369	2,598,542	2,932,994
Cleaning products	7,132,309	6,157,438	3,767,089
Modular construction	4,564,250	25,328,947	5,938,451
Total manufacturing	86,407,387	123,185,240	106,628,901
Services:			
Meat cutting	9,881,990	10,792,831	10,677,467
Bakery	3,398,686	3,442,818	2,759,052
Coffee roasting	2,100,153	2,305,585	1,539,216
Food packaging	15,129,659	16,120,041	11,198,080
Metal signs	1,133,797	1,324,069	1,115,772
Printing	6,190,498	7,573,647	7,468,526
Dental lab	583,790	607,289	520,381
Digital services	33,423	5,766	-
Laundry	15,784,548	16,665,143	15,392,253
Optical	12,394,351	21,488,391	20,986,880
Total services	66,630,895	80,325,580	71,657,627
Agriculture:			
Dairy/farm	14,444,550	15,193,773	15,456,923
Crops	1,428,491	1,341,100	1,470,246
Poultry	6,027,188	6,746,286	6,290,546
Egg production	6,872,706	7,441,018	8,027,517
Total agriculture	28,772,935	30,722,177	31,245,232
Total operating revenues	\$ 181,811,217	\$ 234,232,997	\$ 209,531,760

Cost of Goods Sold

Cost of goods sold decreased by \$46.3 million (24.9%) in fiscal year 2010 from \$186.3 million to \$140.0 million. As a percentage of sales, cost of goods sold were 77.0% and 79.5% in fiscal years 2010 and 2009, respectively. The decrease in cost of goods sold is the primary consequence of decreased sales throughout the organization. Corresponding to decreases in sales and cost of goods sold, gross profit also decreased by \$6.1 million (12.8%). The decrease in gross profit is explained by a \$3.9 million decrease in manufacturing enterprises, a \$4.9 million decrease in service enterprises, offset by a \$2.7 million increase in agricultural enterprises. Specifically, in manufacturing enterprises, gross profit decreased by \$2.7 million in general fabrication and \$2.2 million in modular construction, while gross profit increased by \$1.2 million in cleaning products. In the service enterprises, gross profit decreased by \$4.0 million in optical. In the agricultural enterprises, gross profit increased by \$1.8 million in dairy. Notwithstanding the dramatic sales decreases in fiscal year 2010, CALPIA's gross profit as a percentage of sales (gross margin percentage) improved slightly because of pricing adjustments and cost containment measures, including closing factories. Of note, Governor Schwarzenegger ordered three furlough days per month for the state workforce for the entire 2010 fiscal year, which created salary savings compared to the prior year. (In fiscal year 2009, Governor Schwarzenegger initiated two unpaid furlough days, effective February 2009.) Additionally, the assessment CALPIA receives for statewide administrative costs decreased by \$1.0 million in fiscal year 2010 from \$4.2 million to \$3.2 million.

Cost of goods sold increased by \$15.9 million (9.3%) in fiscal year 2009 from \$170.4 million to \$186.3 million. As a percentage of sales, cost of goods sold were 79.5% and 81.3% in fiscal years 2009 and 2008, respectively. The increase in cost of goods sold is the primary consequence of increased sales in the manufacturing enterprises. CALPIA's overall profit margin improved in those areas that experienced the greatest sales increases. Of the total \$8.8 million net increase in gross profit during fiscal year 2009, \$2.6 million was in modular construction, \$1.9 million was in general fabrication, and \$3.6 million was in food packaging.

CALPIA undertook a major effort to adjust prices in the latter part of fiscal year 2008, particularly in the service and agricultural enterprises. This effort significantly contributed toward a positive change in profit margin in fiscal years 2009 and 2010.

Selling and Administrative Expenses

Fiscal year 2010 selling and administrative expenses consist of distribution and transportation charges of \$11.3 million, central office costs of \$19.2 million, and a charge for Other Post Employment Benefits of \$6.3 million. Overall, selling and administrative expenses decreased by \$4.0 million (9.7%) in fiscal year 2010 from \$40.8 million to \$36.8 million. The decrease is primarily explained by reduced payroll costs as a result of furloughs and reduced freights costs as a consequence of fewer sales.

Selling and administrative expenses decreased by \$1.8 million (4.2%) in fiscal year 2009 from \$42.6 million to \$40.8 million. This decrease is the outcome of a \$1.8 million reduction in distribution and transportation costs. CALPIA achieved this savings due to reduced freight costs associated with fewer sales in the furniture enterprises. Additional savings have been achieved through efficiencies in the distribution program, including increased utilization of CALPIA trucks over common carriers.

Non-Operating Revenues (Expenses)

Non-operating revenues and expenses (net) increased by \$1.5 million in fiscal year 2010 compared to fiscal year 2009. In accordance with GASB Statement No. 42—*Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries*—CALPIA recorded a \$1.1 million loss during fiscal year 2010 in connection with the carrying value of fixed assets at facilities which have been closed during the past two fiscal years.

Non-operating revenues and expenses (net) decreased \$0.7 million in fiscal year 2009 compared to fiscal year 2008, which is primarily attributable to a decrease in interest income from \$1.4 million to \$0.6 million.

CALIFORNIA PRISON INDUSTRY AUTHORITY

BALANCE SHEETS

June 30, 2010 and 2009

ASSETS

CURRENT ASSETS	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 42,935,617	\$ 34,559,867
Cash designated for capital assets expenditures	11,948,731	9,500,000
Accounts receivable	4,916,290	5,259,591
Related party receivable	5,558,662	5,999,224
Inventories	43,057,538	49,114,484
Due from state general fund	21,000,000	20,800,000
Interest receivable	68,736	110,348
Other	225,225	262,079
Total current assets	<u>129,710,799</u>	<u>125,605,593</u>
Capital assets, net	<u>47,903,931</u>	<u>50,307,712</u>
 TOTAL ASSETS	 <u>\$ 177,614,730</u>	 <u>\$ 175,913,305</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES		
Accounts payable	\$ 8,491,762	\$ 10,627,914
Accrued expenses and other liabilities	11,075,079	11,262,835
Workers' compensation liability-current portion	2,383,232	2,051,832
Deferred revenue	4,753,759	10,534,685
TOTAL CURRENT LIABILITIES	<u>26,703,832</u>	<u>34,477,266</u>
 LONG TERM LIABILITIES		
Workers' compensation liability	12,495,595	12,618,095
Net OPEB obligation	18,954,000	12,638,000
TOTAL LONG TERM LIABILITIES	<u>31,449,595</u>	<u>25,256,095</u>
 TOTAL LIABILITIES	 <u>58,153,427</u>	 <u>59,733,361</u>
 NET ASSETS		
Invested in capital assets	47,903,931	50,307,712
Unrestricted net assets	71,557,372	65,872,232
TOTAL NET ASSETS	<u>119,461,303</u>	<u>116,179,944</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 177,614,730</u>	 <u>\$ 175,913,305</u>

See Notes to Basic Financial Statements

CALIFORNIA PRISON INDUSTRY AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Manufacturing	\$ 86,407,387	\$ 123,185,240
Services	66,630,895	80,325,580
Agriculture	28,772,935	30,722,177
TOTAL OPERATING REVENUES	<u>181,811,217</u>	<u>234,232,997</u>
COST OF GOODS SOLD	<u>139,999,941</u>	<u>186,304,080</u>
GROSS PROFIT	41,811,276	47,928,917
SELLING AND ADMINISTRATIVE EXPENSES	<u>36,849,774</u>	<u>40,819,994</u>
OPERATING INCOME	<u>4,961,502</u>	<u>7,108,923</u>
NON-OPERATING REVENUES (EXPENSES)		
Interest income	280,134	557,436
Interest expense	(18,786)	(30,485)
Loss from disposal of capital assets	(1,730,195)	(627,686)
Other expenses	<u>(211,296)</u>	<u>(49,050)</u>
TOTAL NON-OPERATING (EXPENSES) REVENUES	<u>(1,680,143)</u>	<u>(149,785)</u>
Change in net assets	3,281,359	6,959,138
NET ASSETS - BEGINNING OF YEAR	<u>116,179,944</u>	<u>109,220,806</u>
NET ASSETS - END OF YEAR	<u>\$ 119,461,303</u>	<u>\$ 116,179,944</u>

See Notes to Basic Financial Statements

CALIFORNIA PRISON INDUSTRY AUTHORITY

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2010 and 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$ 176,814,154	\$ 216,186,189
Cash receipts from interfund services provided by the reporting entity	2,229,343	4,118,278
Cash payments for interfund services used by the reporting entity	(11,162,631)	(10,928,790)
Cash payments to employees for services	(51,721,301)	(59,159,461)
Cash payments to suppliers of goods and services	(98,151,300)	(139,207,773)
Cash payments for other services	<u>(211,296)</u>	<u>(49,050)</u>
Net cash provided by operating activities	<u>17,796,969</u>	<u>10,959,393</u>
 CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Due from state general fund	(200,000)	(20,800,000)
Interest expense	<u>(18,786)</u>	<u>(30,485)</u>
Net cash flows used in noncapital financing activities	<u>(218,786)</u>	<u>(20,830,485)</u>
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisitions of capital assets	(7,551,749)	(7,735,749)
Proceeds from sale of capital assets	476,301	641,605
Net cash flows used in capital and related financing activities	<u>(7,075,448)</u>	<u>(7,094,144)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	<u>321,746</u>	<u>817,502</u>
Net increase (decrease) in cash and cash equivalents	10,824,481	(16,147,734)
Cash and cash equivalents at beginning of year	<u>44,059,867</u>	<u>60,207,601</u>
Cash and cash equivalents at end of year	<u>\$ 54,884,348</u>	<u>\$ 44,059,867</u>

See Notes to Basic Financial Statements

CALIFORNIA PRISON INDUSTRY AUTHORITY
STATEMENTS OF CASH FLOWS (CONTINUED)

Years Ended June 30, 2010 and 2009

	2010	2009
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 4,961,502	\$ 7,108,923
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	7,749,035	8,711,646
Other fees	(211,296)	(49,050)
Net effect of changes in:		
Accounts receivable	783,863	2,454,199
Inventories	6,056,944	6,717,734
Other assets	36,854	196,255
Accounts payable	(2,136,152)	(2,764,288)
Accrued expenses and other liabilities	(187,756)	476,830
Workers' compensation liability	208,900	2,607,152
Deferred revenue	(5,780,925)	(20,501,008)
Net OPEB obligation	6,316,000	6,001,000
Net cash provided by operating activities	\$ 17,796,969	\$ 10,959,393

See Notes to Basic Financial Statements

CALIFORNIA PRISON INDUSTRY AUTHORITY
Notes to Basic Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(1) ORGANIZATION

The California Prison Industry Authority (“CALPIA”) was established in 1983, as the successor to the California Correctional Industries (“CCI”). It is under the policy direction of an eleven-member board of directors (“Prison Industry Board”) and is a component unit of the State of California. CALPIA manages over 60 manufacturing, service, and agriculture factories in 23 institutions that employ inmates at California’s penal institutions within the California State Department of Corrections and Rehabilitation (“CDCR”). Administrative offices are located in Folsom, California. The products manufactured by CALPIA’s operations are sold principally to departments of the State of California and other governmental entities.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting - CALPIA uses the accrual basis of accounting. Under this method, revenues and receivables are recorded when earned, and expenses and liabilities are recorded when incurred.

Governmental Accounting Standards Board (“GASB”) Statement No. 20 (“GASB No. 20”), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, CALPIA’s proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board (“APB”) Opinions, and Accounting Research Bulletins (“ARB”) of the Committee of Accounting Procedures. CALPIA has elected not to apply applicable FASB pronouncements issued subsequent to November 30, 1989.

Revenue Recognition - Revenues and receivables are recorded when earned, usually upon the shipment of orders, other than modular furniture and building construction. Revenue on modular furniture and building construction is recognized using the percentage-of-completion method of accounting, in accordance with Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Under this method, CALPIA recognizes revenue at the end of each period using output measures in terms of results achieved, to measure the extent of progress toward completion under the contract, on the basis of units of work completed.

Cash and cash equivalents - Cash consists of deposits in the custody of the State of California Treasurer. CALPIA’s deposits are subject to the California Government Code and the State Treasurer’s Office investment policy for the Pooled Money Investment Account (“PMIA”). Cash not required for current use is invested in the Surplus Money Investment Fund (“SMIF”), while non-SMIF funds are held in operating accounts, all of which are part of the State Treasurer’s pooled investment program.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

These funds are invested through the PMIA and at the direction of the Pooled Money Investment Board, which provides regulatory oversight of such funds. PMIA moneys are limited by State statute to the following investments: U.S. governmental securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest-bearing time deposits in California banks and savings and loans, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposits, and other investments.

The investments in SMIF are reported at amortized cost, which approximates fair value. As of June 30, 2010 and 2009, the weighted average maturity of PMIA investments administered by the State Treasurer's Office was approximately 203 days and 235 days, respectively. Weighted averaged maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from the evaluation date to stated maturity. Neither SMIF nor PMIA are rated by credit rating agencies.

Interest earned on cash invested in the SMIF and other pooled funds is prorated to CALPIA based on its average daily balance.

At June 30, 2010, \$51,070,000 was invested in SMIF and \$3,814,348 was held in operating accounts in the State Treasury pooled investment program. At June 30, 2009 \$38,924,000 was invested in SMIF and \$5,135,867 was held in operating accounts in the State Treasury pooled investment program. Cash and cash equivalents include cash on hand and temporary cash investments (including SMIF and funds designated for property and equipment acquisitions) with original or remaining maturities of three months or less.

Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB No. 3* ("GASB No. 40") requires that governmental entities provide disclosures regarding deposit and investment credit risk, custodial credit risk, interest rate risk, and concentration of credit risk. Funds deposited in an external investment pool cannot be categorized under GASB No. 40 as the funds are commingled with other depositors. Additional information regarding investment risks, including interest rate risk, credit risk and concentration of credit risk of the PMIA can be found in the State's basic financial statements included in its comprehensive annual financial report.

Cash designated for capital asset expenditures - CALPIA segregates its cash which is designated as to use. Designated funds at June 30, 2010 and 2009 represent designations of cash by the Prison Industry Board for certain capital expenditures. The Board designated funds amounting to \$11,948,731 and \$9,500,000 for certain capital expenditures to be made during the years ended June 30, 2011 and 2010, respectively.

Concentrations of credit risk - Financial instruments which potentially expose CALPIA to concentrations of credit risk consist primarily of trade accounts receivable.

CALPIA's customer base includes departments of the State of California and other governmental entities. CDCR is the largest customer of CALPIA and accounted for approximately 61% of sales in each of the years ended June 30, 2010 and 2009. As of June 30, 2010 and 2009, CDCR accounted for 53% of total accounts receivable. Management does not believe significant credit risk exists at June 2010 and 2009, as the goods and services produced by CALPIA's operations are sold principally to departments of the State of California and other governmental entities.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CALPIA and other state and local agencies' deposits are held in the pooled money account in the custody of the State Treasurer's Office, in which the deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

Accounts receivable - CALPIA has no formal policy regarding the extension of credit and does not use an allowance for doubtful accounts because their customer base is primarily made up of state and local government agencies. Non-trade receivables are approximately \$403,875 and \$465,913 as of June 2010 and 2009, respectively. Historically, CALPIA has not experienced significant losses related to accounts receivable.

Due from state general fund - During the course of normal operations, the State Controller's Office periodically loans funds from CALPIA's deposits held in the custody of the State Treasurer to the state general fund on a short-term basis for cash management reasons. These transactions are reported as "due from state general fund." As of June 30, 2010 and 2009, due from state general fund totaled \$21,000,000 and \$20,800,000, respectively.

Inventories - Inventories are stated at the lower of cost (as determined using the average cost method) or market. Inventories consist of raw materials, components and subassemblies and finished goods held for sale.

Capital assets - Capital assets are stated at historical cost, net of accumulated depreciation. CALPIA has established a threshold of \$5,000 for capitalization of depreciable assets. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives range from 5 to 20 years for equipment, 5 to 30 years for buildings and leasehold improvements, 2 to 3 years for livestock, and 20 years for orchards.

Interest expense (net of interest income on unexpended debt proceeds) related to the cost of construction of certain assets is capitalized whenever debt is outstanding and the assets are constructed for use by CALPIA. Capitalized interest is amortized over the related assets' estimated useful lives. Expenditures for repairs and maintenance are charged to operations as incurred. CALPIA did not recognize any capitalized interest expense for the years ended June 30, 2010 and 2009.

In the ordinary course of business, CALPIA opens and closes manufacturing facilities based on economic conditions and industry demand for products. Based on CALPIA's closure policy, management may recommend that the factory remain idle if at a later date it is probable that product demand will increase resulting in the factory being reactivated. If management determines not to reactivate a factory, CALPIA will take one of the following actions: (1) determine if the factory has alternative uses, (2) transfer equipment to operating factories, or (3) pursue other alternatives for disposal. Factories which are closed temporarily are retained in the property accounts as idle facilities and are not depreciated during the temporary closure.

For those facilities which have been closed and will be transferred to CDCR, the related assets are transferred at net book value and a gain or loss is recognized upon the transfer.

Asset impairment - As required by GASB Statement No. 42, management periodically reviews long lived assets for impairments whenever events or changes in circumstances indicate that the service utility of an asset has declined significantly and unexpectedly.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2010 and 2009

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impaired capital assets are written down to reduce the related assets to the lower of carrying value or fair value. At June 30, 2010, CALPIA determined that there were capital assets with a net book value of \$1,141,402 that were impaired and recorded an impairment charge of \$1,141,402 for the year ended June 30, 2010. There were no impaired capital assets for the year ended June 30, 2009.

Compensated absences - It is CALPIA's policy to accrue for personal leave time, holiday pay and vacation pay that has been earned but not yet taken by employees. A liability for compensated absences is accrued when incurred and reported in accrued liabilities on the balance sheet. CALPIA employees are not compensated for unused sick leave, but instead are credited with pension service time for unused sick leave. Accordingly, such convertible sick leave is not reflected in the accrued liability for compensated absences. Instead, it is reflected over time in the employer's pension contribution.

Deferred revenue - Deferred revenues represent advance payments from state agencies for the future delivery of products and services.

Net Assets - The difference between assets and liabilities in the balance sheet is labeled as Net Assets and is subdivided into two categories as follows:

Invested in capital assets - This component of net assets consists of capital assets, net of accumulated depreciation and amortization.

Unrestricted - This component of net assets consists of net assets not restricted for any project or any other purpose.

Operating and non-operating activities - Operating revenues are charges to customers for sales of products and services. Operating expenses consist of cost of sales and selling and administrative expenses. Selling and administrative expenses are comprised of distribution and transportation costs, central office costs, and the annual net unfunded OPEB obligation. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses. Distribution and transportation costs include shipping and handling costs related to the delivery of merchandise sold by CALPIA. For the years ended June 30, 2010 and 2009, such costs were \$11,345,950 and \$13,727,200, respectively.

Use of estimates in the preparation of financial statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New accounting pronouncements - Effective July 1, 2009, CALPIA adopted the provisions of GASB Statement No 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51). This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets are not capitalizable until certain criteria are met. Outlays incurred prior to meeting these criteria are expensed as incurred. The adoption of GASB 51 did not have a material impact on results of operations, cash flows or financial position.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2010 and 2009

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. The adoption of GASB No. 51 did not have a material impact on CALPIA's results of operations, cash flows or financial position.

(3) INVENTORIES

Inventories consist of the following:

	June 30,	
	2010	2009
Raw materials	\$25,488,788	\$28,265,029
Work-in-process	8,527,688	11,346,193
Finished goods	9,041,062	9,503,262
Total inventories	\$43,057,538	\$49,114,484

(4) CAPITAL ASSETS

A summary of changes in capital assets during fiscal years 2010 and 2009 is as follows:

	Balance June 30, 2009	Additions	Deletions	Balance June 30, 2010
Capital assets, not being depreciated:				
Construction in process	-	\$ 48,128	-	\$ 48,128
Total capital assets, not being depreciated	-	48,128	-	48,128
Capital assets, being depreciated:				
Equipment	\$108,530,749	4,635,778	\$(10,429,349)	102,737,178
Buildings and leasehold improvements, net of transfers	38,085,040	1,150,961	(1,717,064)	37,518,937
Livestock	5,275,060	1,716,882	(1,928,000)	5,063,942
Orchards	874,716	-	-	874,716
Intangible assets	-	3,352,863	-	3,352,863
Total capital assets, being depreciated	152,765,565	10,856,484	(14,074,413)	149,547,636
Accumulated depreciation and amortization	(102,457,853)	(7,749,035)	8,515,055	(101,691,833)
Capital assets, net	\$50,307,712	\$3,155,577	\$(5,559,358)	\$47,903,931

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(4) CAPITAL ASSETS (CONTINUED)

	<u>Balance</u> <u>June 30, 2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2009</u>
Equipment	\$108,059,631	\$4,904,875	\$(4,433,757)	\$108,530,749
Buildings and leasehold improvements, net of transfers	37,607,055	646,958	(168,973)	38,085,040
Livestock	5,117,354	2,232,706	(2,075,000)	5,275,060
Orchards	923,506	(48,790)	-	874,716
	<hr/>	<hr/>	<hr/>	<hr/>
Total	151,707,546	7,735,749	(6,677,730)	152,765,565
Accumulated depreciation and amortization	<hr/> (99,154,646) <hr/>	<hr/> (8,711,646) <hr/>	<hr/> 5,408,439 <hr/>	<hr/> (102,457,853) <hr/>
Capital assets, net	<u>\$52,552,900</u>	<u>\$(975,897)</u>	<u>\$(1,269,291)</u>	<u>\$50,307,712</u>

Depreciation expense for the years ended June 30, 2010 and 2009 was \$7,749,035 and \$8,711,646, respectively. Depreciation expense includes amortization of intangible assets.

The Prison Industry Board authorized the closure of certain factories in fiscal 2010 because of excess capacity and reduced customer demand for products that were manufactured by such factories. Management has identified certain factory equipment held at the closed factories that will be relocated and placed in service at other factories to replace older equipment currently in service and improve operational efficiency. All other factory equipment and leasehold improvements held at the closed factories, for which management has no plans for continued use, were determined to be impaired capital assets. For the years ended June 30, 2010 and 2009, the impairment loss recognized on capital assets held at the various closed factories totaled \$1,141,401 and \$0, respectively. The impairment loss has been reported as a loss from disposal of capital assets in the statements of revenues, expenses, and changes in net assets. Management does not consider this event to be unusual in nature or infrequent in occurrence, as defined in APB Opinion 30.

(5) ACCRUED EXPENSES AND OTHER LIABILITIES

	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Accrued leave time	\$9,004,672	\$8,142,997
Support charges due to CDCR	1,180,731	2,096,898
Inmate pay	310,060	369,246
Personal services	290,836	334,548
Sales and use tax	283,558	255,057
Accrued service and expenses	<hr/> 5,222 <hr/>	<hr/> 64,089 <hr/>
Total accrued expenses and other liabilities	<u>\$11,075,079</u>	<u>\$11,262,835</u>

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2010 and 2009

(6) WORKERS' COMPENSATION LIABILITY

CALPIA is exposed to risk of loss related to torts, theft of, damage to, and destruction of assets, injuries to employees, and natural disasters. The State of California self-insures its workers' compensation claims. CALPIA's workers' compensation claims are administered by the State Compensation Insurance Fund as part of the overall State program. CALPIA currently reports claims, expenses and liabilities when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported and related loss adjustment expenses. Consulting actuaries assist CALPIA in determining its liability for workers' compensation self-insured claims.

The amount of these liabilities was a discounted value of \$14,878,827 and \$14,669,927 at June 30, 2010 and 2009, respectively. The interest rate used to discount the value of the liabilities for the years ended June 30, 2010 and 2009, was 3.5%. This liability represents CALPIA's best estimate of its ultimate exposure based on available actuarial information.

<u>Fiscal Year</u>	<u>Beginning of Fiscal Year Liability</u>	<u>Current Year Claims and Changes in Estimates</u>	<u>Claims Payments</u>	<u>Legal and Administrative Expenses Paid</u>	<u>End of Fiscal Year Liability</u>
2009-2010	\$14,669,927	\$2,592,132	\$(1,990,131)	\$(393,101)	\$14,878,827
2008-2009	\$12,062,775	\$4,658,982	\$(1,609,324)	\$(442,508)	\$14,669,927

(7) DEFINED BENEFIT PENSION PLAN

Plan description - The State is a member of the California Public Employee's Retirement System ("CalPERS"), an agent multiple-employer pension system, which provides a contributory defined-benefit pension for substantially all State employees. CALPIA is included in the State Industrial and Safety Categories within CalPERS, thereby limiting the availability of certain CALPIA pension data. CalPERS functions as an investment and administrative agent for participating public agencies within the State of California. Departments and agencies within the State of California, including CALPIA, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies.

CalPERS issues a publicly available Comprehensive Annual Financial Report that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing CalPERS, Central Supply, P.O. Box 942715, Sacramento, California 94229-2705, or by logging onto the CalPERS web site at www.calpers.ca.gov/.

The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require 10 years of credited service. Employees who retire at or after 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivors benefit options which reduce a retiree's unmodified benefit are available.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(7) DEFINED BENEFIT PENSION PLAN (CONTINUED)

Funding policy - Active members who participate in Social Security under the State Industrial Tier 1 category are required to contribute 5% of their annual covered salary after excluding the first \$513 of gross monthly pay. Active members who do not participate in Social Security under the State Safety & Industrial Tier 1 categories are required to contribute 6% of their annual covered salary after excluding the first \$317 of gross monthly pay. Active members who participate in Social Security under the State Industrial Tier 2 category are not required to make contributions to CalPERS.

CALPIA is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2010 was 17.251% and 18.099% for State Industrial and Safety categories, respectively. The required employer contribution rate for the fiscal year ended June 30, 2009 was 17.236% and 18.411% for State Industrial and Safety categories, respectively. The contribution requirements of the plan members are established by State statute and the employer contributions rate is established and may be amended by CalPERS.

Annual pension costs - For the years ended June 30, 2010, 2009 and 2008, CALPIA's annual pension cost and CALPIA's actual contribution amounted to \$5,128,593, \$6,078,739, and \$6,501,948 respectively. The required contribution for State Industrial and Safety categories for the 2010 fiscal year was determined as part of the June 30, 2008, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected salary increases that vary by duration of service ranging from 3.45 to 9.55%, (c) 3.25% overall payroll growth, and (d) 3.0% inflation adjustment.

The actuarial value of CALPIA's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a 15 year period. The plan's unfunded actuarial accrued liability (or excess assets) is being amortized as a level of percentage of projected payroll on a closed basis. The remaining amortization periods at June 30, 2008 the date of the most recent actuarial valuation, were 20 to 30 years for both the State Industrial Plans and 20 to 30 years for State Safety Plans.

(8) POSTEMPLOYMENT BENEFITS OTHER THAN PENSION

Plan description - CALPIA employees are employees of the State of California (the State). Consequently, CALPIA employees participate in the State pension and other postemployment benefit (OPEB) plans. The State OPEB plan is a single-employer defined benefit plan. A separate actuarial valuation was not performed for CALPIA. The State's OPEB plan does not issue a separate report.

The State provides medical, prescription drug, and dental benefits (healthcare benefits) to retired statewide employees. The authority for establishing and amending benefits lies with CalPERS and the State Legislature while the authority for establishing and amending the funding policy lies solely with the Legislature.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(8) POSTEMPLOYMENT BENEFITS OTHER THAN PENSION (CONTINUED)

Funding policy - The State has historically been on a "pay-as-you-go" funding and allocation policy; however, pursuant to the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, (GASB No. 45) effective for fiscal year 2008, the State amended its allocation methodology to include amortization of its accumulated unfunded postemployment obligations. The State has determined CALPIA's June 30, 2010 and 2009 funding requirements as well as its related 2010 and 2009 contribution credit. The amount allocated to CALPIA at June 30, 2010 and 2009 representing the annual OPEB cost was \$9,590,000 and \$9,422,000 respectively. Of this amount, \$3,274,000 was contributed for 2010 and the balance of \$6,316,000 was accrued as a liability. The contribution made for 2009 was \$3,421,000 and the balance of \$6,001,000 was accrued as a liability.

Annual OPEB cost and Net OPEB obligation - The State of California's annual other postemployment benefit cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined by the State in accordance with the parameters of GASB No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The State determines the allocation for CALPIA based upon the relationship of active employee health benefit costs for CALPIA as compared to the total State active employee health benefit costs. The following table shows the components of CALPIA's allocation of the State's annual OPEB cost for the year, the amount credited to the plan, and changes in the net OPEB obligation as of June 30:

	<u>2010</u>	<u>2009</u>
Annual required contribution	\$9,527,000	\$9,389,000
Interest on net OPEB obligation	515,000	267,000
Adjustment to annual required contribution	<u>(452,000)</u>	<u>(234,000)</u>
Annual OPEB cost (expense)	9,590,000	9,422,000
Contributions made	<u>(3,274,000)</u>	<u>(3,421,000)</u>
Increase in net OPEB obligation	6,316,000	6,001,000
Net OPEB obligation - beginning of year	<u>12,638,000</u>	<u>6,637,000</u>
Net OPEB obligation - end of year	<u>\$18,954,000</u>	<u>\$12,638,000</u>

CALPIA's allocation of the annual OPEB cost, the percentage of annual OPEB costs contributed to the plan, and the net OPEB obligation for 2010, 2009 and 2008 were as follows:

Fiscal Year Ended June 30,	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2010	\$9,590,000	34.1%	\$18,954,000
2009	\$9,422,000	36.3%	\$12,638,000
2008	\$10,086,000	34.2%	\$6,637,000

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2010 and 2009

(8) POSTEMPLOYMENT BENEFITS OTHER THAN PENSION (CONTINUED)

Based on information provided to CALPIA by the State of California, in the June 30, 2009 actuarial valuation, the individual entry-age normal cost method was used. A pay-as-you go funding scenario was used by the State of California. Under the pay-as-you-go funding scenario, the State is assumed to finance retiree healthcare benefits from assets available in the general fund. The State's actuarial assumptions included a 4.5% investment rate of return and an annual healthcare cost trend rate of actual increases for 2010 and of 9.0% in 2011, initially, decreasing each year over the next seven years until the ultimate rate of 4.5% is reached. Both rates included a 3.0% annual inflation assumption. Annual wage inflation is assumed to be 3.25%. The UAAL is being amortized as a level percentage of projected payroll on an open basis over thirty years.

The schedule of funding progress and employer contributions for the State of California for the year ended June 30, 2010 can be found in the State's basic financial statements included in its comprehensive annual financial report.

(9) RELATED PARTY TRANSACTIONS

Related party transactions with CDCR consisted of the follow for fiscal ended June 30:

	<u>2010</u>	<u>2009</u>
Assets:		
Accounts receivable	\$5,558,662	\$5,999,224
Liabilities:		
Accrued expenses and other liabilities	(1,180,731)	(2,096,898)
Deferred revenue	(2,175,729)	(5,780,714)
Revenues:		
Sales	110,726,793	142,908,536
Expenses:		
Support charges paid	(5,271,998)	(5,532,902)

The secretary of CDCR is the chairman of the Prison Industry Board. The accounts receivable is for the sale of goods and services delivered to CDCR. The accrued expenses and other liabilities represent expenses incurred for rent and utilities associated with the space owned by CDCR, and used by CALPIA to operate the inmate work programs. The deferred revenue primarily consists of payments received in advance of future delivery of goods and services.

CALPIA has transactions with other agencies of the state of California in addition to CDCR. As of June 30, 2010 and 2009, CALPIA had accounts receivable from other state agencies of \$4,072,227 and \$4,440,943, respectively.

CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)
For the Fiscal Years Ended June 30, 2010 and 2009

(10) CONTINGENCIES

Litigation - Three California state employees' unions (CASE, SEIU and IUOE) had filed civil actions challenging the legality of the furloughs imposed on state employees by Governor Schwarzenegger that went into effect in February 2009. The petition filed by the plaintiffs alleged that the furloughs were imposed in violation of state law and that the Governor lacked the authority to impose the furloughs on the employees. CALPIA and several other state agencies were defendants in the legal proceedings brought by the above plaintiffs. CALPIA's management, in consultation with its legal counsel, determined a potential material loss contingency was reasonably possible and disclosed its estimated exposure of \$5,077,000 for the year ended June 30, 2009. However, in fiscal 2010 the State Supreme Court overturned lower court rulings and ruled in favor of the Governor's authority to impose furloughs. Therefore, no loss contingency has been accrued or disclosed as of June 30, 2010.

CALPIA is involved in various other legal actions arising in the ordinary course of business. In the opinion of management, after consulting with legal counsel, CALPIA intends to defend these cases vigorously and believes that the ultimate liability, if any, will not be material to the financial position of CALPIA.

(11) COMMITMENTS

Warranties - CALPIA provides a warranty on its office and miscellaneous furniture and bedding products for a period of five years. CALPIA has not established a reserve for warranty expense. The effect on operations is deemed by management to be immaterial. Such costs are expensed when incurred

Rental payments - Future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year and expiring in 2012 as of June 30, 2010, are as follows:

<u>Fiscal Year Ended June 30,</u>	<u>Real Estate</u>
2011	\$570,096
2012	<u>195,048</u>
Total	<u>\$765,144</u>

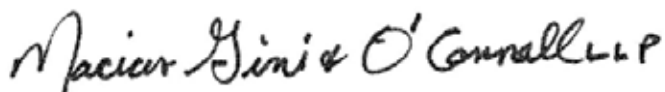
Total rental expense for all operating leases except those with terms of a month or less was \$591,645 and \$770,993 for the years ended June 30, 2010 and 2009, respectively.

SUPPLEMENTAL INFORMATION

**INDEPENDENT AUDITOR'S REPORT
ON SUPPLEMENTAL INFORMATION**

To the California Prison Industry Authority Board
Folsom, California

We have audited the basic financial statements of California Prison Industry Authority ("CALPIA") as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated December 21, 2010. Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplemental Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows as of and for the years ended June 30, 2010 and 2009, classified, in accordance with the State Controller's Office Instructions (collectively the "SCO financial statements") are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Sacramento, California
December 21, 2010

**CALIFORNIA PRISON INDUSTRY AUTHORITY
INTERNAL SERVICE FUND**

**BALANCE SHEETS
CLASSIFIED IN ACCORDANCE WITH THE STATE CONTROLLER'S INSTRUCTIONS**

June 30, 2010 and 2009
(in thousands)

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
CURRENT ASSETS		
Cash and pooled investments	\$ 54,884	\$ 44,060
Receivables, (net)	969	2,051
Due from other funds	30,176	29,829
Due from other governments	400	289
Prepaid items	225	262
Inventories, at cost	43,057	49,114
TOTAL CURRENT ASSETS	129,711	125,605
NONCURRENT ASSETS		
Nondepreciable capital assets:		
Construction in process	48	-
Depreciable capital assets:		
Buildings	5,666	6,053
Leasehold improvements	31,852	32,032
Equipment	102,737	108,531
Livestock	5,064	5,275
Orchards	875	875
Intangible assets	3,353	-
TOTAL CAPITAL ASSETS	149,595	152,766
Accumulated depreciation:		
Buildings	(3,092)	(2,991)
Leasehold improvements	(22,268)	(21,977)
Equipment	(72,549)	(76,012)
Livestock	(682)	(889)
Orchards	(629)	(589)
Intangible assets	(2,471)	-
TOTAL ACCUMULATED DEPRECIATION	(101,691)	(102,458)
TOTAL NONCURRENT ASSETS	47,904	50,308
TOTAL ASSETS	\$ 177,615	\$ 175,913
<u>LIABILITIES AND NET ASSETS</u>		
CURRENT LIABILITIES		
Accounts payable and other	\$ 8,492	\$ 11,395
Due to other funds	2,065	2,352
Deferred revenue	4,754	10,535
Compensated absences payable	9,005	8,143
Other current liabilities	2,388	2,052
TOTAL CURRENT LIABILITIES	26,704	34,477
NONCURRENT LIABILITIES		
Net OPEB obligation	18,954	12,638
Other non-current liabilities	12,496	12,618
TOTAL NONCURRENT LIABILITIES	31,450	25,256
TOTAL LIABILITIES	58,154	59,733
NET ASSETS		
Invested in capital assets	47,904	50,308
Unrestricted net assets	71,557	65,872
TOTAL NET ASSETS	119,461	116,180
TOTAL LIABILITIES AND NET ASSETS	\$ 177,615	\$ 175,913

**CALIFORNIA PRISON INDUSTRY AUTHORITY
INTERNAL SERVICE FUND**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
CLASSIFIED IN ACCORDANCE WITH THE STATE
CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2010 and 2009
(in thousands)

OPERATING REVENUES	<u>2010</u>	<u>2009</u>
Services and sales	\$ 181,811	\$ 234,233
OPERATING EXPENSES		
Personal services	(59,073)	(68,019)
Supplies	(2,130)	(3,203)
Services and charges	(107,898)	(147,190)
Depreciation	(7,749)	(8,712)
Total operating expenses	<u>(176,850)</u>	<u>(227,124)</u>
OPERATING INCOME (LOSS)	<u>4,961</u>	<u>7,109</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	280	557
Interest expense	(19)	(30)
Loss on disposal of capital assets	(1,730)	(628)
Other expense	(211)	(49)
Total nonoperating (expenses) revenues	<u>(1,680)</u>	<u>(150)</u>
Change in net assets	3,281	6,959
NET ASSETS AT BEGINNING OF YEAR	<u>116,180</u>	<u>109,221</u>
NET ASSETS AT END OF YEAR	<u>\$ 119,461</u>	<u>\$ 116,180</u>

**CALIFORNIA PRISON INDUSTRY AUTHORITY
INTERNAL SERVICE FUND**

**STATEMENTS OF CASH FLOWS
CLASSIFIED IN ACCORDANCE WITH THE STATE
CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2010 and 2009
(in thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 176,814	\$ 216,186
Receipts from interfund services provided	2,229	4,118
Payments for interfund services used	(11,163)	(10,929)
Payments to employees	(51,721)	(59,159)
Payments to suppliers	(98,151)	(139,208)
Payments for other services	(211)	(49)
Net cash provided by operating activities	17,797	10,959
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Change in interfund receivable	(200)	(20,800)
Interest expense	(19)	(30)
Net cash flows used in noncapital financing activities	(219)	(20,830)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisitions of capital assets	(7,552)	(7,736)
Proceeds from sale of capital assets	476	642
Net cash flows used in capital and related financing activities	(7,076)	(7,094)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	322	817
Net increase (decrease) in cash and pooled investments	10,824	(16,148)
Cash and pooled investments, beginning of year	44,060	60,208
Cash and pooled investments, end of year	\$ 54,884	\$ 44,060

**CALIFORNIA PRISON INDUSTRY AUTHORITY
INTERNAL SERVICE FUND**

**STATEMENTS OF CASH FLOWS
CLASSIFIED IN ACCORDANCE WITH THE STATE
CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2010 and 2009
(in thousands)

RECONCILIATION OF OPERATING INCOME TO NET CASH	<u>2010</u>	<u>2009</u>
PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 4,961	\$ 7,109
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	7,749	8,712
Other fees	(211)	(49)
Net effect of changes in:		
Receivables	1,082	2,127
Due from other funds	(188)	314
Due from other governments	(111)	13
Prepaid items	37	196
Inventories	6,057	6,718
Accounts payable and other	(2,903)	(2,799)
Due to other funds	(287)	294
Deferred revenue	(5,781)	(20,501)
Other current liabilities	336	841
Compensated absences payable	862	217
Other liabilities	<u>6,194</u>	<u>7,767</u>
 Total adjustments	 <u>12,836</u>	 <u>3,850</u>
 Net cash provided by operating activities	 <u>\$ 17,797</u>	 <u>\$ 10,959</u>

**INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the California Prison Industry Authority Board
Folsom, California

We have audited the basic financial statements of California Prison Industry Authority (“CALPIA”) as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated December 21, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CALPIA’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CALPIA’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CALPIA’s internal control over financial reporting.

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.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we considered to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CALPIA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*.

We noted certain other matters that we will report to management of CALPIA in a separate letter.

This report is intended solely for the information and use of management, the Prison Industry Authority Board, and others within CALPIA, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Macieir Gini & O'Connell LLP".

Sacramento, California
December 21, 2010

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