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Company to qualify as a REIT with respect to its 1999 taxable year. See Note 15 for a further discussion of the Company's Senior Bank Credit Facility.

In a further attempt to address the capital and liquidity constraints facing the Company and Operating Company, as well as concerns regarding the corporate structure and management of the Company, management elected to pursue strategic alternatives for the Company, including a restructuring led by a group of institutional investors consisting of an affiliate of Fortress Investment Group LLC and affiliates of The Blackstone Group ("Fortress/Blackstone"). Shortly after announcing the proposal led by Fortress/Blackstone, the Company received an unsolicited proposal from Pacific Life Insurance Company ("Pacific Life"). Fortress/Blackstone elected not to match the terms of the proposal from Pacific Life. Consequently, the securities purchase agreement with Fortress/Blackstone was terminated, and the Company entered into an agreement with Pacific Life. The Pacific Life securities purchase agreement was mutually terminated by the parties after Pacific Life was unwilling to confirm that a waiver and amendment of the Senior Bank Credit Facility obtained in June 2000 satisfied the terms of the agreement with Pacific Life. The Company also terminated the services of one of its financial advisors. See Note 21 for further information regarding the Company's 2001 settlement of disputes arising from its previous agreements with Fortress/Blackstone, Pacific Life, and the Company's financial advisor.

Consequently, the Company determined to pursue a comprehensive restructuring without a third-party equity investment, and approved a series of agreements providing for the comprehensive restructuring of the Company. As further discussed in Note 15, the Restructuring included obtaining amendments to, and a waiver of existing defaults under, the Company's Senior Bank Credit Facility in June 2000 (the "June 2000 Waiver and Amendment"). The June 2000 Waiver and Amendment resulted from the financial condition of the Company and Operating Company, the transactions undertaken by the Company and Operating Company in an attempt to resolve the liquidity issues of the Company and Operating Company, and the previously announced restructuring transactions. In obtaining the June 2000 Waiver and Amendment, the Company agreed to complete certain transactions which were incorporated as covenants to the June 2000 Waiver and Amendment. Pursuant to these requirements, the Company was obligated to complete the Restructuring, including the Operating Company Merger, as further discussed in Note 3; the amendment of its charter to remove the requirements that it elect to be taxed as a REIT commencing with its 2000 taxable year, as further discussed in Note 16; the restructuring of management; and the distribution of shares of Series B Cumulative Convertible Preferred Stock, $0.01 par value per share (the "Series B Preferred Stock"), in satisfaction of the Company's remaining 1999 REIT distribution requirement, as further discussed in Notes 14 and 19. As further discussed in Note 3, the June 2000 Waiver and Amendment also permitted the acquisitions of PMSI and JJFMSI. The Restructuring provided for a simplified corporate and financial structure while eliminating conflicts arising out of the landlord-tenant and debtor-creditor relationship that existed between the Company and Operating Company.

In order to address existing and potential events of default under the Company's convertible subordinated notes resulting from the Company's financial condition and as a result of the proposed restructurings, during the second quarter of 2000, the Company obtained waivers and amendments to the provisions of the note purchase agreements governing the notes, as further discussed in Note 15. In order to address existing and potential events of default under the Operating Company's revolving credit facility resulting from the financial condition of Operating Company and certain restructuring transactions, during the first quarter of 2000, Operating Company obtained a waiver of events of default, as further discussed in Note 15.

During the third quarter of 2000, the Company named a new president and chief executive officer, followed by a new chief financial officer in the fourth quarter. At the Company's 2000 annual meeting of stockholders held during the fourth quarter of 2000, the Company's stockholders elected a newly constituted board of directors of the Company, including a majority of independent directors. During 2001, one of these directors resigned from the board of directors, while two additional directors were appointed to the board of directors, resulting in a ten-member board.

Following the completion of the Operating Company Merger and the acquisitions of PMSI and JJFMSI, during the fourth quarter of 2000, the Company's new management conducted strategic assessments; developed a strategic operating plan to improve the Company's financial position; developed revised projections for 2001; and evaluated the utilization of existing facilities, projects under development, excess land parcels, and identified certain of these non-strategic assets for sale. As a result of these assessments, the Company recorded non-cash impairment losses totaling $508.7 million, as further discussed in Note 8.

As further discussed in Note 15, during the fourth quarter of 2000, the Company obtained a consent and amendment to its Senior Bank Credit Facility to replace existing financial covenants. During the first quarter of 2001, the Company also obtained amendments to the Senior Bank Credit Facility, as further discussed in Note 15, to modify the financial covenants to take into consideration any loss of EBITDA, or earnings before interest, taxes, depreciation and amortization, as further defined in the terms of the Senior Bank Credit Facility, that may result from certain asset dispositions during 2001 and subsequent periods and to permit the issuance of indebtedness in partial satisfaction of its obligations in the stockholder litigation settlement. Also, during the first quarter of 2001, the Company amended the provisions to the note purchase agreement governing its $30.0 million convertible subordinated notes to replace previously existing financial covenants, as further discussed in Note 15, in order to remove existing defaults and attempt to remain in compliance during 2001 and subsequent periods.

Additionally, the Company also has certain non-financial covenants which must be met in order to remain in compliance with its debt agreements. For example, the Company's Senior Bank Credit Facility contained a non-financial covenant requiring the Company to consummate the securitization of lease payments (or other similar transaction) with respect to the Company's Agecroft facility located in Salford, England. On April 10, 2001, the Company consummated the Agecroft transaction through the sale of all of the issued and outstanding capital stock of Agecroft Properties, Inc., a wholly-owned subsidiary of the Company, thereby fulfilling the Company's covenant requirements with respect to the Agecroft transaction.

The Senior Bank Credit Facility also contains a non-financial covenant requiring the Company to provide the lenders with audited financial statements within 90 days of the Company's fiscal year end, subject to an additional five-day grace period. Due to the Company's attempts to close the Agecroft transaction discussed above, the Company did not provide the audited financial statements within the required time period. However, the Company obtained a waiver from the lenders under the Senior Bank Credit Facility of this financial reporting requirement. This waiver also cured the resulting cross-default under the Company's $41.1 million convertible subordinated notes.

Additional non-financial covenants, among others, included a requirement to use commercially reasonable efforts to (i) raise $100.0 million through equity or asset sales (excluding the securitization of lease payments or other similar transaction with respect to the Agecroft facility) on or before June 30, 2001, and (ii) register shares into which the $41.1 million convertible subordinated notes are convertible. The Company had considered a distribution of rights to purchase common or preferred stock to the Company's existing stockholders, or an equity

investment in the Company from an outside investor. However, the Company determined that it was not commercially reasonable to issue additional equity or debt securities, other than those securities for which the Company had already contractually agreed to issue, including primarily the issuance of shares of the Company's common stock in connection with the settlement of the Company's stockholder litigation, as more fully discussed in Note 21. Further, as a result of the Company's restructuring during the third and fourth quarters of 2000, prior to the completion of the audit of the Company's 2000 financial statements and the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2000 with the Securities and Exchange Commission (the "SEC") on April 17, 2001, the Company was unable to provide the SEC with the requisite financial information required to be included in a registration statement. Therefore, even if the Company had been able to negotiate a public or private sale of its equity securities on commercially reasonable terms, the Company's inability to obtain an effective registration statement with respect to such securities prior to April 17, 2001 would have effectively prohibited any such transaction. Moreover, the terms of any private sale of the Company's equity securities likely would have included a requirement that the Company register with the SEC the resale of the Company's securities issued to a private purchaser thereby also making it impossible to complete any private issuance of its securities. Due to the fact that the Company would have been unable to obtain an effective registration statement, and therefore, would have been unable to effect any public issuance of its securities (or any private sale that included the right of resale), any actions prior to April 17, 2001 to complete a capital raising event through the sale of equity or debt securities would have been futile.

Although the Company would technically have been able to file a registration statement with the SEC following April 17, 2001, the Company believes that various market factors, including the depressed market price of the Company's common stock immediately preceding April 17, 2001, the pending reverse stock split required to maintain the Company's continued New York Stock Exchange ("NYSE") listing, and the uncertainty regarding the Company's maturity of the revolving loans under the Senior Bank Credit Facility, made the issuance of additional equity or debt securities commercially unreasonable.

Because the issuance of additional equity or debt securities was deemed unreasonable, the Company determined that the sale of assets represented the most effective means by which the Company could satisfy the covenant. During the first and second quarters of 2001, the Company completed the sale of its Mountain View Correctional Facility for approximately $24.9 million and its Pamlico Correctional Facility for approximately $24.0 million, respectively. During the fourth quarter of 2001, the Company completed the sale of its Southern Nevada Women's Correctional Facility for approximately $24.1 million, and is actively pursuing the sales of additional assets. See Note 9 for further discussion of these sales. As a result of the foregoing, the Company believes it demonstrated commercially reasonable efforts to complete the $100.0 million capital raising event as of June 30, 2001. Under terms of the December 2001 Amendment and Restatement to the Senior Bank Credit Facility, as defined in Note 15, the Company's obligation to complete the capital raising event was removed.

Following the filing of the Company's Form 10-K in April 2001, the Company commenced negotiations with MDP Ventures IV LLC and affiliated purchasers (collectively, "MDP"), the holders of the Company's $41.1 million convertible subordinated notes, with respect to an amendment to the registration rights agreement to defer the Company's obligations to use its best efforts to file and maintain the registration statement to register the shares into which the $41.1 million convertible notes are convertible. MDP later informed the Company that it would not complete such an amendment. As a result, the Company completed and filed a shelf registration

statement with the SEC on September 13, 2001, which became effective on September 26, 2001, in compliance with this obligation.

The revolving loan portion of the Senior Bank Credit Facility was to mature on January 1, 2002. As part of management's strategic operating plan to improve the Company's financial position, the Company committed to a plan of disposal for certain long-lived assets. During 2001, the Company received net proceeds of approximately $138.7 million through the sale of such assets. During 2001, the Company paid-down $189.0 million in total debt through a combination of cash generated from asset sales and internally generated cash. Additionally, assets with an aggregate carrying value of $22.3 million were held for sale as of December 31, 2001. The Company may also pursue the sale of additional assets; however, there can be no assurance that any sales will be completed. The Company expects to use anticipated proceeds from any such future asset sales to pay-down additional amounts outstanding under the Senior Bank Credit Facility.

The Company believes that utilizing sale proceeds to pay-down debt and the generation of $138.6 million of operating income during 2001 has improved its leverage ratios and overall financial position, which has improved its ability to renew and refinance maturing indebtedness.

As further discussed in Note 15, in December 2001, the Company completed an amendment and restatement of its existing Senior Bank Credit Facility (the "December 2001 Amendment and Restatement"). As part of the December 2001 Amendment and Restatement, the existing $269.4 million revolving portion of the Senior Bank Credit Facility, which was scheduled to mature on January 1, 2002, was replaced with a term loan of the same amount maturing on December 31, 2002, to coincide with the maturity of the other loans under the Senior Bank Credit Facility.

The Company believed, and continues to believe, that a short-term extension of the revolving portion of the Senior Bank Credit Facility was in its best interests for a longer-term financing strategy, particularly due to difficult market conditions for the issuance of debt securities following the terrorist attacks on September 11, 2001, and during the fourth quarter of 2001. Additionally, the Company believed that certain terms of the December 2001 Amendment and Restatement, including primarily the removal of prior restrictions to pay cash dividends on shares of its Series A Preferred Stock, including all dividends in arrears, as further discussed in Notes 14 and 19, would result in an improvement to its credit ratings, enhancing the terms of a more comprehensive refinancing. Further, the Company believes that the successful pursuit of additional transactions that would not be completed by January 1, 2002, such as the sale of additional assets and a potential contract award from the Federal Bureau of Prisons ("BOP") for 1,500 inmates under the BOP's Criminal Alien Requirement II, or CAR II, could improve the terms of a more comprehensive refinancing.

Management has prepared financial projections for 2002, which indicate the Company will continue to remain compliant with its debt covenants. In addition, management continues to pursue additional asset sales and new contract awards. Based upon these additional factors, management has begun pursuing alternatives to refinance the Senior Bank Credit Facility scheduled to mature December 31, 2002. The Company believes that it will be able to complete a refinancing of the Senior Bank Credit Facility during the first half of 2002 through senior secured bank debt or through a combination of senior secured bank debt and senior unsecured debt even without the sale of additional assets or the BOP contract award. However, there can be no assurance that the Company will be able to meet its financial projections for 2002, sell additional assets, obtain a new contract from the BOP or complete a refinancing of the Senior Bank Credit Facility prior to its maturity on December 31, 2002, on commercially reasonable or any other terms. Unsuccessful attempts to refinance the Senior Bank Credit Facility, or events of default which result in the

acceleration of all or a portion of the Company's outstanding debt, would have a material adverse effect on the Company's liquidity and financial position. The Company does not have sufficient working capital resources to satisfy its debt obligations in the event it cannot complete a refinancing prior to December 31, 2002.

Due to certain cross-default provisions contained in certain of the Company's debt instruments (as further discussed in Note 15), if the Company were to be in default under the Senior Bank Credit Facility and if the lenders under the Senior Bank Credit Facility elected to exercise their rights to accelerate the Company's obligations under the Senior Bank Credit Facility, such events could result in the acceleration of all or a portion of the outstanding principal amount of the Company's $100.0 million senior notes or the Company's aggregate $70.0 million convertible subordinated notes, which would have a material adverse effect on the Company's liquidity and financial position. Additionally, under the Company's $40.0 million convertible subordinated notes, even if the lenders under the Senior Bank Credit Facility did not elect to exercise their acceleration rights upon a default under the Senior Bank Credit Facility permitting acceleration, the holders of the $40.0 million convertible subordinated notes could require the Company to repurchase such notes. The Company does not have sufficient working capital to satisfy its debt obligations in the event of an acceleration of all or a substantial portion of the Company's outstanding indebtedness.

## 3. MERGER TRANSACTIONS

### The 1999 Merger

On December 31, 1998, immediately prior to the 1999 Merger, Old CCA sold to Operating Company all of the issued and outstanding capital stock of certain wholly-owned corporate subsidiaries of Old CCA, certain management contracts and certain other assets and liabilities, and the Company and Operating Company entered into a series of agreements as more fully described in Note 6. In exchange, Old CCA received a $137.0 million promissory note payable by Operating Company (the "CCA Note") and 100% of the non-voting common stock of Operating Company. The non-voting common stock represented a 9.5% economic interest in Operating Company and was valued at the implied fair market value of $4.8 million. The Company succeeded to these interests as a result of the 1999 Merger. The sale to Operating Company generated a deferred gain of $63.3 million. See Note 6 for discussion of the accounting for the CCA Note, the deferred gain and for discussion of other relationships between the Company and Operating Company.

On December 31, 1998, immediately prior to the 1999 Merger, Old CCA sold to a newly-created company, Prison Management Services, LLC ("PMS, LLC"), certain management contracts and certain other assets and liabilities relating to government-owned adult prison facilities. In exchange, Old CCA received 100% of the non-voting membership interest in PMS, LLC, valued at the implied fair market value of $67.1 million. On January 1, 1999, PMS, LLC merged with PMSI and all PMS, LLC membership interests were converted into a similar class of stock in PMSI. The Company succeeded to this ownership interest as a result of the 1999 Merger. The sale to PMSI generated a deferred gain of $35.4 million.

On December 31, 1998, immediately prior to the 1999 Merger, Old CCA sold to a newly-created company, Juvenile and Jail Facility Management Services, LLC ("JJFMS, LLC"), certain management contracts and certain other assets and liabilities relating to government-owned jails and juvenile facilities, as well as Old CCA's international operations. In exchange, Old CCA received 100% of the non-voting membership interest in JJFMS, LLC valued at the implied fair market value of $55.9 million. On January 1, 1999, JJFMS, LLC merged with JJFMSI and all JJFMS, LLC membership interests were converted into a similar class of stock in JJFMSI. The Company

succeeded to this ownership interest as a result of the 1999 Merger. The sale to JJFMSI generated a deferred gain of $18.0 million.

On December 31, 1998, Old CCA merged with and into New Prison Realty. In the 1999 Merger, each share of Old CCA's common stock was converted into the right to receive 0.875 share of New Prison Realty's common stock. On January 1, 1999, Old Prison Realty merged with and into New Prison Realty in the 1999 Merger. In the 1999 Merger, Old Prison Realty shareholders received 1.0 share of common stock or 8.0% Series A Cumulative Preferred Stock ("Series A Preferred Stock") of the Company in exchange for each Old Prison Realty common share or 8.0% Series A Cumulative Preferred Share.

The first step of the 1999 Merger was accounted for as a reverse acquisition of New Prison Realty by Old CCA, with the second step of the 1999 Merger representing an acquisition of Old Prison Realty by New Prison Realty. As such, Old CCA's assets and liabilities have been carried forward at historical cost, and the provisions of reverse acquisition accounting prescribe that Old CCA's historical financial statements be presented as the Company's historical financial statements prior to January 1, 1999. The historical equity section of the financial statements and earnings per share have been retroactively restated to reflect the Company's equity structure, including the exchange ratio and the effects of the differences in par values of the respective companies' common stock. However, Old Prison Realty's assets and liabilities acquired in the second step of the 1999 Merger have been recorded at their estimated fair market value, as required by Accounting Principles Board Opinion No. 16, "Business Combinations" ("APB 16").

**The 2000 Operating Company Merger and Restructuring Transactions**

In order to address liquidity and capital constraints, the Company entered into a series of agreements providing for the comprehensive restructuring of the Company. As a part of this Restructuring, the Company entered into an agreement and plan of merger with Operating Company, dated as of June 30, 2000, providing for the Operating Company Merger.

Effective October 1, 2000, New Prison Realty and Operating Company completed the Operating Company Merger in accordance with an agreement and plan of merger, after New Prison Realty's stockholders approved the agreement and plan of merger on September 12, 2000. In connection with the completion of the Operating Company Merger, New Prison Realty amended its charter to, among other things:

- remove provisions relating to its qualification as a REIT for federal income tax purposes commencing with its 2000 taxable year,
- change its name to "Corrections Corporation of America," and
- increase the amount of its authorized capital stock.

Following the completion of the Operating Company Merger, Operating Company ceased to exist, and the Company and its wholly-owned subsidiary began operating collectively under the "Corrections Corporation of America" name. Pursuant to the terms of the agreement and plan of merger, the Company issued approximately 0.8 million shares (as adjusted for the reverse stock split in May 2001) of its common stock valued at approximately $10.6 million to the holders of Operating Company's voting common stock at the time of the completion of the Operating Company Merger.

On October 1, 2000, immediately prior to the completion of the Operating Company Merger, the Company purchased all of the shares of Operating Company's voting common stock held by the Baron Asset Fund ("Baron") and Sodexho Alliance S.A., a French société anonyme ("Sodexho"), the holders of approximately 34% of the outstanding common stock of Operating Company, for an aggregate of $16.0 million in non-cash consideration, consisting of an aggregate of approximately 1.1 million shares of the Company's common stock. In addition, the Company issued to Baron warrants to purchase approximately 142,000 shares of the Company's common stock at an exercise price of $0.01 per share and warrants to purchase approximately 71,000 shares of the Company's common stock at an exercise price of $14.10 per share in consideration for Baron's consent to the Operating Company Merger. The warrants issued to Baron were valued at approximately $2.2 million. In addition, in the Operating Company Merger, the Company assumed the obligation to issue up to approximately 75,000 shares of its common stock, at an exercise price of $33.30 per share, pursuant to the exercise of warrants to purchase common stock previously issued by Operating Company. The number of common shares and per share amounts described above have been retroactively restated to reflect the reduction in common shares and corresponding increase in the per share amounts resulting from the reverse stock split in May 2001, as further discussed in Note 5.

Also on October 1, 2000, immediately prior to the Operating Company Merger, the Company purchased an aggregate of 100,000 shares of Operating Company's voting common stock for $200,000 cash from D. Robert Crants, III and Michael W. Devlin, former executive officers and directors of the Company, pursuant to the terms of severance agreements between the Company and Messrs. Crants, III and Devlin. The cash proceeds from the purchase of the shares of Operating Company's voting common stock from Messrs. Crants, III and Devlin were used to immediately repay a like portion of amounts outstanding under loans previously granted to Messrs. Crants, III and Devlin by the Company. The Company also purchased 300,000 shares of Operating Company's voting common stock held by Doctor R. Crants, the former chief executive officer of the Company and Operating Company, for $600,000 cash. Under the original terms of the severance agreements between the Company and each of Messrs. Crants, III and Devlin, Operating Company was to make a $300,000 payment for the purchase of a portion of the shares of Operating Company's voting common stock originally held by Messrs. Crants, III and Devlin on December 31, 1999. However, as a result of restrictions on Operating Company's ability to purchase these shares, the rights and obligations were assigned to and assumed by Doctor R. Crants. In connection with this assignment, Mr. Crants received a loan in the aggregate principal amount of $600,000 from PMSI, the proceeds of which were used to purchase the 300,000 shares of Operating Company's voting common stock owned by Messrs. Crants, III and Devlin. The cash proceeds from the purchase by the Company of the shares of Operating Company's voting common stock from Mr. Crants were used to immediately repay the $600,000 loan previously granted to Mr. Crants by PMSI.

The Operating Company Merger was accounted for using the purchase method of accounting as prescribed by APB 16. Accordingly, the aggregate purchase price of $75.3 million was allocated to the assets purchased and liabilities assumed (identifiable intangibles included a workforce asset of approximately $1.6 million, a contract acquisition costs asset of approximately $1.5 million and a contract values liability of approximately $26.1 million) based upon the estimated fair value at the date of acquisition. The aggregate purchase price consisted of the value of the Company's common stock and warrants issued in the transaction, the Company's net carrying amount of the CCA Note as of the date of acquisition (which has been extinguished), the Company's net carrying amount of deferred gains and receivables/payables between the Company and Operating Company as of the date of acquisition, and capitalized merger costs. The excess of the aggregate purchase price over the assets purchased and liabilities assumed of $87.0 million was reflected as goodwill. See Note 4 regarding amortization of the Company's intangibles.

As a result of the Restructuring, all existing Operating Company Leases, the Tenant Incentive Agreement, the Trade Name Use Agreement, the Right to Purchase Agreement, the Services Agreement and the Business Development Agreement (each as defined in Note 6) were cancelled. In addition, all outstanding shares of Operating Company's non-voting common stock, all of which shares were owned by the Company, were cancelled in the Operating Company Merger.

In connection with the Restructuring, in September 2000 a wholly-owned subsidiary of PMSI purchased 85% of the outstanding voting common stock of PMSI which was held by Privatized Management Services Investors, LLC, an outside entity controlled by a director of PMSI and members of the director's family, for a cash purchase price of $8.0 million. In addition, PMSI and its wholly-owned subsidiary paid the chief manager of Privatized Management Services Investors, LLC $150,000 as compensation for expenses incurred in connection with the transaction, as well as $125,000 in consideration for the chief manager's agreement not to engage in a business competitive to the business of PMSI for a period of one year following the completion of the transaction. Also in connection with the Restructuring, in September 2000 a wholly-owned subsidiary of JJFMSI purchased 85% of the outstanding voting common stock of JJFMSI which was held by Correctional Services Investors, LLC, an outside entity controlled by a director of JJFMSI, for a cash purchase price of $4.8 million. In addition, JJFMSI and its wholly-owned subsidiary paid the chief manager of Correctional Services Investors, LLC $250,000 for expenses incurred in connection with the transaction.

As a result of the acquisitions of PMSI and JJFMSI on December 1, 2000, all shares of PMSI and JJFMSI voting and non-voting common stock held by the Company and certain subsidiaries of PMSI and JJFMSI were cancelled. In connection with the acquisition of PMSI, the Company issued approximately 128,000 shares of its common stock (as adjusted for the reverse stock split in May 2001) valued at approximately $0.6 million to the wardens of the correctional and detention facilities operated by PMSI who were the remaining shareholders of PMSI. Shares of the Company's common stock owned by the PMSI wardens are subject to vesting and forfeiture provisions under a restricted stock plan. In connection with the acquisition of JJFMSI, the Company issued approximately 160,000 shares of its common stock (as adjusted for the reverse stock split in May 2001) valued at approximately $0.7 million to the wardens of the correctional and detention facilities operated by JJFMSI who were the remaining shareholders of JJFMSI. Shares of the Company's common stock owned by the JJFMSI wardens are subject to vesting and forfeiture provisions under a restricted stock plan.

The acquisition of PMSI was accounted for using the purchase method of accounting as prescribed by APB 16. Accordingly, the aggregate purchase price of $43.2 million was allocated to the assets purchased and liabilities assumed (identifiable intangibles included a workforce asset of approximately $0.5 million, a contract acquisition costs asset of approximately $0.7 million and a contract values asset of approximately $4.0 million) based upon the estimated fair value at the date of acquisition. The aggregate purchase price consisted of the net carrying amount of the Company's investment in PMSI less the Company's net carrying amount of deferred gains and receivables/payables between the Company and PMSI as of the date of acquisition, and capitalized merger costs. The excess of the aggregate purchase price over the assets purchased and liabilities assumed of $12.2 million was reflected as goodwill. See Note 4 regarding amortization of the Company's intangibles.

The acquisition of JJFMSI was also accounted for using the purchase method of accounting as prescribed by APB 16. Accordingly, the aggregate purchase price of $38.2 million was allocated to the assets purchased and liabilities assumed (identifiable intangibles included a workforce asset of approximately $0.5 million, a contract acquisition costs asset of approximately $0.5 million and a

contract values liability of approximately $3.1 million) based upon the estimated fair value at the date of acquisition. The aggregate purchase price consisted of the net carrying amount of the Company's investment in JJFMSI less the Company's net carrying amount of deferred gains and receivables/payables between the Company and JJFMSI as of the date of acquisition, and capitalized merger costs. The excess of the aggregate purchase price over the assets purchased and liabilities assumed of $11.4 million was reflected as goodwill. See Note 4 regarding amortization of the Company's intangibles.

As a part of the Restructuring, CCA (UK) Limited, a company incorporated in England and Wales ("CCA UK") and a wholly-owned subsidiary of JJFMSI, sold its 50% ownership interest in two international subsidiaries, Corrections Corporation of Australia Pty. Ltd., an Australian corporation ("CCA Australia"), and U.K. Detention Services Limited, a company incorporated in England and Wales ("UKDS"), to Sodexho on November 30, 2000 and December 7, 2000, respectively, for an aggregate cash purchase price of $6.4 million. Sodexho already owned the remaining 50% interest in each of CCA Australia and UKDS. The purchase price of $6.4 million included $5.0 million for the purchase of UKDS and $1.4 million for the purchase of CCA Australia. JJFMSI's book basis in UKDS was $3.4 million, which resulted in a $1.6 million gain in the fourth quarter of 2000. JJFMSI's book basis in CCA Australia was $5.0 million, which resulted in a $3.6 million loss, which was recognized as a loss on sale of assets during the third quarter of 2000. In connection with the sale of CCA UK's interest in CCA Australia and UKDS to Sodexho, Sodexho granted JJFMSI an option to repurchase a 25% interest in each entity at any time prior to September 11, 2002 for aggregate cash consideration of $4.0 million if such option is exercised on or before February 11, 2002, and for aggregate cash consideration of $4.2 million if such option is exercised after February 11, 2002 but prior to September 11, 2002. These options were terminated during the second quarter of 2001.

The following unaudited pro forma operating information presents a summary of comparable results of combined operations of the Company, Operating Company, PMSI and JJFMSI for the years ended December 31, 2000 and 1999 as if the Operating Company Merger and acquisitions of PMSI and JJFMSI had collectively occurred as of the beginning of the periods presented. The unaudited information includes the dilutive effects of the Company's common stock issued in the Operating Company Merger and the acquisitions of PMSI and JJFMSI as well as the amortization of the intangibles recorded in the Operating Company Merger and the acquisition of PMSI and JJFMSI, but excludes: (i) transactions or the effects of transactions between the Company, Operating Company, PMSI and JJFMSI including rental payments, licensing fees, administrative service fees and tenant incentive fees; (ii) the Company's write-off of amounts under lease arrangements; (iii) the Company's recognition of deferred gains on sales of contracts; (iv) the Company's recognition of equity in earnings or losses of Operating Company, PMSI and JJFMSI; (v) non-recurring merger costs expensed by the Company; (vi) strategic investor fees expensed by the Company; (vii) excise taxes accrued by the Company in 1999 related to its status as a REIT; and (viii) the Company's provisions for changes in tax status in both 1999 and 2000. The per share amounts have also been retroactively restated to reflect the one-for-ten reverse stock split of the Company's common stock in May 2001. The unaudited pro forma operating information is presented for comparison purposes only and does not purport to represent what the Company's results of operations actually would have been had the Operating Company Merger and acquisitions of PMSI and JJFMSI, in fact, collectively occurred at the beginning of the periods presented.

| | Pro Forma for the Year Ended December 31, | |
|---|---|---|
| | 2000 | 1999 |
| | (unaudited) | (unaudited) |
| | (in thousands, except per share data) | |
| Revenue | $ 891,680 | $ 782,335 |
| Operating loss | $ (481,026) | $ (10,167) |
| Net loss available to common stockholders | $ (578,174) | $ (57,844) |
| Net loss per common share: | | |
| Basic | $ (39.04) | $ (4.23) |
| Diluted | $ (39.04) | $ (4.23) |

The unaudited pro forma information presented above does not include adjustments to reflect the dilutive effects of the fourth quarter of 2000 conversion of the Company's Series B Preferred Stock into approximately 9.5 million shares of the Company's common stock (as adjusted for the reverse stock split in May 2001) as if those conversions occurred at the beginning of the periods presented. Additionally, the unaudited pro forma information does not include the dilutive effects of the Company's potentially issuable common shares such as convertible debt and equity securities, options and warrants as the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128") prohibit the inclusion of the effects of potentially issuable shares in periods that a company reports losses from continuing operations. The unaudited pro forma information also does not include the dilutive effects of the expected issuance of an aggregate of approximately 4.7 million shares of the Company's common stock (as adjusted for the reverse stock split in May 2001) in connection with the settlement of the Company's stockholder litigation.

## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The combined and consolidated financial statements include the accounts of the Company on a consolidated basis with its wholly-owned subsidiaries as of and for each period presented. The Company's results of operations for 1999 reflect the operating results of the Company as a REIT. Management believes the comparison between 2001 and 2000, and between 2000 and prior years is not meaningful because the 2000 financial condition, results of operations and cash flows reflect the operation of the Company as a subchapter C corporation, which, for the period from January 1, 2000 through September 30, 2000, included real estate activities between the Company and Operating Company during a period of severe liquidity problems, and as of October 1, 2000, also includes the operations of the correctional and detention facilities previously leased to and managed by Operating Company. In addition, the Company's financial condition, results of operations and cash flows as of and for the year ended December 31, 2000 also include the operations of the Service Companies as of December 1, 2000 (acquisition date) on a consolidated basis. For the period January 1, 2000 through August 31, 2000, the investments in the Service Companies were accounted for and were presented under the equity method of accounting. For the period from September 1, 2000 through November 30, 2000, the investments in the Service Companies were accounted for on a combined basis due to the repurchase by the wholly-owned subsidiaries of the Service Companies of the non-management, outside stockholders' equity interest in the Service Companies during September 2000. The resulting increase in the Company's assets and liabilities as of September 1, 2000 as a result of combining the balance sheets of PMSI and JJFMSI has been treated as a non-cash transaction in the accompanying combined statement of cash flows for the year ended December 31, 2000, with the September 1, 2000 combined cash balances of PMSI and JJFMSI ($22.0 million) included in "cash and cash equivalents, beginning of year." Consistent with the Company's previous financial statement presentations, the Company has presented its economic

interests in each of PMSI and JJFMSI under the equity method for all periods prior to September 1, 2000. All material intercompany transactions and balances have been eliminated in combining the consolidated financial statements of the Company and its wholly-owned subsidiaries with the respective financial statements of PMSI and JJFMSI.

Although the Company's consolidated results of operations and cash flows presented in the accompanying 2000 financial statements are presented on a combined basis with the results of operations and cash flows of PMSI and JJFMSI for the period from September 1, 2000 through November 30, 2000, the Company did not control the assets and liabilities of either PMSI or JJFMSI. Additionally, the Company was only entitled to receive dividends on its non-voting common stock upon declaration by the respective boards of directors of PMSI and JJFMSI.

For the entire year 2001, the Company's consolidated results of operations and cash flows reflect the results of the Company as a business specializing in owning, operating and managing prisons and other correctional facilities and providing prisoner transportation services for governmental agencies.

**Cash and Cash Equivalents**

The Company considers all liquid debt instruments with a maturity of three months or less at the time of purchase to be cash equivalents.

**Restricted Cash**

Restricted cash at December 31, 2001 was $12.5 million, of which $7.0 million represents cash collateral for a guarantee agreement and $5.5 represents cash collateral for outstanding letters of credit. Restricted cash at December 31, 2000 was $9.2 million, of which $7.0 million represents cash collateral for a guarantee agreement and $2.2 million represents cash collateral for outstanding letters of credit.

**Property and Equipment**

Property and equipment is carried at cost. Assets acquired by the Company in conjunction with acquisitions are recorded at estimated fair market value in accordance with the purchase method of accounting prescribed by APB 16. Betterments, renewals and extraordinary repairs that extend the life of an asset are capitalized; other repair and maintenance costs are expensed. Interest is capitalized to the asset to which it relates in connection with the construction of major facilities. The cost and accumulated depreciation applicable to assets retired are removed from the accounts and the gain or loss on disposition is recognized in income. Depreciation is computed over the estimated useful lives of depreciable assets using the straight-line method. Useful lives for property and equipment are as follows:

| | |
|---|---|
| Land improvements | 5 – 20 years |
| Buildings and improvements | 5 – 50 years |
| Equipment | 3 – 5 years |
| Office furniture and fixtures | 5 years |

**Assets Held for Sale**

Assets held for sale are carried at the lower of cost or estimated fair value less estimated cost to sell. Depreciation is suspended during the period held for sale.

**Intangible Assets**

Intangible assets primarily include goodwill, value of workforce, contract acquisition costs, and contract values established in connection with certain business combinations. Goodwill represents the cost in excess of the net assets of businesses acquired. Goodwill is amortized into amortization expense over fifteen years using the straight-line method. However, as further discussed under recent accounting pronouncements herein, goodwill will no longer be subject to amortization beginning January 1, 2002. Value of workforce, contract acquisition costs (both included in other non-current assets in the accompanying consolidated balance sheets) and contract values (included in other non-current liabilities in the accompanying consolidated balance sheets) represent the estimated fair values of the identifiable intangibles acquired in the Operating Company Merger and in the acquisitions of the Service Companies. Value of workforce is amortized into amortization expense over estimated useful lives ranging from 23 to 38 months using the straight-line method. Contract acquisition costs and contract values are generally amortized into amortization expense using the interest method over the lives of the related management contracts acquired, which range from three to 227 months. The Company evaluates the realizability of the carrying value of its intangible assets when events suggest that an impairment may have occurred. The Company determines if a potential impairment of intangible assets exists based on the estimated undiscounted value of expected future operating cash flows in relation to the carrying values. The Company does not believe that impairments of intangible assets have occurred. As further discussed under recent accounting pronouncements herein, effective January 1, 2002, the Company will test goodwill for impairment using a fair-value based approach. The Company also periodically evaluates whether changes have occurred that would require revision of the remaining estimated useful lives of intangible assets.

**Accounting for the Impairment of Long-Lived Assets**

In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of" ("SFAS 121"), the Company evaluates the recoverability of the carrying values of its long-lived assets, other than intangibles, when events suggest that an impairment may have occurred. In these circumstances, the Company utilizes estimates of undiscounted cash flows to determine if an impairment exists. If an impairment exists, it is measured as the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset. See Note 8 for discussion of impairment of long-lived assets.

**Investment in Direct Financing Leases**

Investment in direct financing leases represents the portion of the Company's management contracts with certain governmental agencies that represent capitalized lease payments on buildings and equipment. The leases are accounted for using the financing method and, accordingly, the minimum lease payments to be received over the term of the leases less unearned income are capitalized as the Company's investments in the leases. Unearned income is recognized as income over the term of the leases using the interest method.

**Investment in Affiliates**

Investments in affiliates that are equal to or less than 50%-owned over which the Company cannot exercise significant influence are accounted for using the equity method of accounting. For the period from January 1, 1999 through August 31, 2000, the investments in the Service Companies were accounted for under the equity method of accounting. For the period from September 1, 2000

through November 30, 2000, the investments in the Service Companies are presented on a combined basis due to the repurchase by the wholly-owned subsidiaries of the Service Companies of the non-management, outside stockholders' equity interest in the Service Companies during September 2000.

### Debt Issuance Costs

Debt issuance costs, which are included in other assets in the consolidated balance sheets, are amortized into interest expense on a straight-line basis, which is not materially different than the interest method, over the term of the related debt.

### Deferred Gains on Sales of Contracts

Deferred gains on sales of contracts were generated as a result of the sale of certain management contracts to Operating Company, PMSI and JJFMSI. The Company previously amortized these deferred gains into income in accordance with SEC Staff Accounting Bulletin No. 81, "Gain Recognition on the Sale of a Business or Operating Asset to a Highly Leveraged Entity." The deferred gain from the sale to Operating Company was to be amortized concurrently with the receipt of the principal payments on the CCA Note, over a six-year period beginning December 31, 2003. As of the date of the Operating Company Merger, the Company had not recognized any of the deferred gain from the sale to Operating Company. The deferred gains from the sales to PMSI and JJFMSI had been amortized over a five-year period commencing January 1, 1999, which represented the average remaining lives of the contracts sold to PMSI and JJFMSI, plus any contractual renewal options. Effective with the Operating Company Merger and the acquisitions of PMSI and JJFMSI, the Company applied the unamortized balances of the deferred gains on sales of contracts in accordance with the purchase method of accounting under APB 16.

### Management and Other Revenue

The Company maintains contracts with certain governmental entities to manage their facilities for fixed per diem rates or monthly fixed rates. The Company also maintains contracts with various federal, state and local governmental entities for the housing of inmates in company-owned facilities at fixed per diem rates. These contracts usually contain expiration dates with renewal options ranging from annual to multi-year renewals. Most of these contracts have current terms that require renewal every two to five years. Additionally, most facility management contracts contain clauses which allow the government agency to terminate a contract without cause, and are generally subject to legislative appropriations. The Company expects to renew these contracts for periods consistent with the remaining renewal options allowed by the contracts or other reasonable extensions; however, no assurance can be given that such renewals will be obtained. Fixed monthly rate revenue is recorded in the month earned and fixed per diem revenue is recorded based on the per diem rate multiplied by the number of inmates housed during the respective period. The Company recognizes any additional management service revenues when earned. Certain of the government agencies also have the authority to audit and investigate the Company's contracts with them. For contracts that actually or effectively provide for certain reimbursement of expenses, if the agency determines that the Company has improperly allocated costs to a specific contract, the Company may not be reimbursed for those costs and could be required to refund the amount of any such costs that have been reimbursed.

### Rental Revenue

Rental revenues are recognized based on the terms of the Company's leases. Tenant incentive fees paid to lessees, including Operating Company prior to the Operating Company Merger, have been deferred and amortized as a reduction of rental revenue over the term of related leases. During 1999, due to Operating Company's financial condition, as well as the proposed merger with Operating Company and the proposed termination of the Operating Company Leases in connection therewith, the Company wrote-off the tenant incentive fees due to Operating Company, totaling $65.7 million for the year ended December 31, 1999. Tenant incentive fees due to Operating Company during 2000 totaling $11.9 million were expensed as incurred.

### Self -funded Insurance Reserves

The Company is significantly self-insured for employee health, workers' compensation, and automobile liability insurance. As such, the Company's insurance expense is largely dependent on claims experience and the Company's ability to control its claims experience. The Company has consistently accrued the estimated liability for employee health based on its history of claims experience and time lag between the incident date and the date the cost is reported to the Company. The Company has accrued the estimated liability for workers' compensation and automobile insurance based on a third-party actuarial valuation of the outstanding liabilities. These estimates could change in the future.

### Income Taxes

Income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). SFAS 109 generally requires the Company to record deferred income taxes for the tax effect of differences between book and tax bases of its assets and liabilities. For the year ended December 31, 1999, the Company elected to qualify as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). As a result, the Company was generally not subject to income tax on its taxable income at corporate rates to the extent it distributed annually at least 95% of its taxable income to its shareholders and complied with certain other requirements. Accordingly, no provision was made for income taxes in the accompanying 1999 consolidated financial statements. The Company's election of REIT status for the taxable year ended December 31, 1999 is subject to review by the Internal Revenue Service ("IRS"), generally for a period of three years from the date of filing of its 1999 tax return. In connection with the Restructuring, on September 12, 2000, the Company's stockholders approved an amendment to the Company's charter to remove provisions requiring the Company to elect to qualify and be taxed as a REIT for federal income tax purposes effective January 1, 2000. The Company has been taxed as a taxable subchapter C corporation beginning with its taxable year ended December 31, 2000.

Prior to the 1999 Merger, Old CCA operated as a taxable corporation for federal income tax purposes since its inception. Subsequent to the 1999 Merger the Company elected to change its tax status to a REIT effective with the filing of its 1999 federal income tax return. Although the Company recorded a provision for income taxes during 1999 reflecting the removal of net deferred tax assets on the Company's balance sheet as of December 31, 1998, as a REIT, the Company was not subject to federal income taxes, so long as the Company continued to qualify as a REIT under the Code. Therefore, no income tax provision was incurred, nor benefit realized, relating to the Company's operations for the year ended December 31, 1999. However, in order to qualify as a REIT, the Company was required to distribute the accumulated earnings and profits of Old CCA. See Note 14 for further information. In connection with the Restructuring, the Company's

stockholders approved an amendment to the Company's charter to, among other things, remove provisions relating to the Company's operation and qualification as a REIT for federal income tax purposes commencing with its taxable year ended December 31, 2000. The Company recognized an income tax provision during the third quarter of 2000 for establishing net deferred tax liabilities in connection with the change in tax status, net of a valuation allowance applied to certain deferred tax assets. The Company expects to continue to operate as a taxable corporation in future years.

As further described in Note 16, as of December 31, 2001, the Company's deferred tax assets totaled approximately $150.5 million. Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of the future tax benefits related to deferred tax assets is dependent on many factors, including the Company's ability to generate taxable income within the net operating loss carryforward period. Since the change in tax status in connection with the Restructuring in 2000, and as of December 31, 2001, the Company has provided a valuation allowance to reserve the deferred tax assets in accordance with SFAS 109. The valuation allowance was recognized based on the weight of available evidence indicating that it was more likely than not that the deferred tax assets would not be realized. This evidence primarily consisted of, but was not limited to, recurring operating losses for federal tax purposes.

The Company's assessment of the valuation allowance could change in the future. Removal of the valuation allowance in whole or in part would result in a non-cash reduction in income tax expense during the period of removal. To the extent no reserve is established for the Company's deferred tax assets, the financial statements would reflect a provision for income taxes at the applicable federal and state tax rates on income before taxes.

**Foreign Currency Transactions**

During 2000, a wholly-owned subsidiary of the Company entered into a 25-year property lease with Agecroft Prison Management, Ltd. ("APM") in connection with the construction and development of the Company's Agecroft facility, located in Salford, England. The Company also extended a working capital loan to the operator of this facility. These assets along with various other short-term receivables are denominated in British pounds; consequently, the Company adjusts these receivables to the current exchange rate at each balance sheet date and recognizes the unrealized currency gain or loss in current period earnings. Realized foreign currency gains or losses are recognized in operating expenses as payments are received. On April 10, 2001, the Company sold its interest in the Agecroft facility. However, the Company retained its 50% interest in APM, which has a management contract for the Agecroft facility. The Company retained and will continue to record foreign currency transaction gains and losses on the working capital loan.

**Fair Value of Derivative and Financial Instruments**

*Derivative Instruments*

The Company may enter into derivative financial instrument transactions in order to mitigate its interest rate risk on a related financial instrument. The Company accounts for these derivative financial instruments in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which became effective January 1, 2001. SFAS 133, as amended, requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. The Company has entered into an interest rate swap agreement on $325.0 million of floating rate debt on the Senior Bank Credit Facility. The Company has elected not to attempt to meet the hedge

accounting criteria for the interest rate swap agreement. The Company estimates the fair value of its interest rate swap agreements using option-pricing models that value the potential for interest rate swap agreements to become in-the-money through changes in interest rates during the remaining term of the agreements. A negative fair value represents the estimated amount the Company would have to pay to cancel the contract or transfer it to other parties.

At December 31, 2001, the Company also had a derivative instrument associated with the issuance of a $26.1 million promissory note due in 2009. The terms of the note, which allow the principal balance to fluctuate dependent on the trading price of the Company's common stock, create a derivative instrument that is accounted for under the provisions of SFAS 133. As a result of the extinguishment of the note in full in January 2002, management estimated the fair value of this derivative to approximate the face amount of the note. The derivative asset offsets the face amount of the note in the consolidated balance sheet as of December 31, 2001.

*Financial Instruments*

To meet the reporting requirements of Statement of Financial Accounting Standards No. 107, "Disclosures About Fair Value of Financial Instruments" ("SFAS 107"), the Company calculates the estimated fair value of financial instruments using quoted market prices of similar instruments or discounted cash flow techniques. At December 31, 2001 and 2000, there were no differences between the carrying amounts and the estimated fair values of the Company's financial instruments, other than as follows (in thousands):

| | December 31, | | | |
|---|---|---|---|---|
| | 2001 | | 2000 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Investment in direct financing leases | $ 19,340 | $ 22,317 | $ 24,877 | $ 17,541 |
| Debt | $ (963,600) | $ (974,039) | $ (1,152,570) | $ (844,334) |
| Interest rate swap agreement | $ (13,564) | $ (13,564) | $ - | $ (5,023) |

## Use of Estimates in Preparation of Financial Statements

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

## Concentration of Credit Risks

The Company's credit risks relate primarily to cash and cash equivalents, restricted cash, accounts receivable and investment in direct financing leases. Cash and cash equivalents and restricted cash are primarily held in bank accounts and overnight investments. The Company's accounts receivable and investment in direct financing leases represent amounts due primarily from governmental agencies. The Company's financial instruments are subject to the possibility of loss in carrying value as a result of either the failure of other parties to perform according to their contractual obligations or changes in market prices that make the instruments less valuable.

Approximately 93% of the Company's revenue for the year ended December 31, 2001 relates to amounts earned under federal, state and local government management contracts, respectively. Approximately 28% and 58% of the Company's revenue was from federal and state governments, respectively, for the year ended December 31, 2001. Management revenue from the BOP represents approximately 13% of total revenue for 2001. No other customer generated more than 10% of total revenue.

**Comprehensive Income**

Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" establishes standards for reporting and displaying comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income encompasses all changes in stockholders' equity except those arising from transactions with stockholders.

The Company reports comprehensive income in the consolidated statements of stockholders' equity. Comprehensive income (loss) was equivalent to the Company's reported net income (loss) for the years ended December 31, 2000 and 1999.

**Recent Accounting Pronouncements**

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 142 addresses accounting and reporting standards for acquired goodwill and other intangible assets and supersedes Accounting Principles Board Opinion No. 17, "Intangible Assets". Under SFAS 142, goodwill and intangible assets with indefinite useful lives will no longer be subject to amortization, but instead will be tested for impairment at least annually using a fair-value-based approach. The impairment loss is the amount, if any, by which the implied fair value of goodwill and intangible assets with indefinite useful lives is less than their carrying amounts and is recognized in earnings. SFAS 142 also requires companies to disclose information about the changes in the carrying amount of goodwill, the carrying amount of intangible assets by major intangible asset class for those assets subject to amortization and those not subject to amortization, and the estimated intangible asset amortization expense for the next five years. As of December 31, 2001, the Company had \$104.0 million of goodwill, net of accumulated amortization of \$9.1 million reflected on the accompanying balance sheet associated with the Operating Company Merger and the acquisitions of the Service Companies completed during the fourth quarter of 2000. The Company does not have any intangible assets with indefinite useful lives. Amortization of goodwill for the year ended December 31, 2001 was \$7.6 million.

Provisions of SFAS 142 are required to be applied starting with fiscal years beginning after December 15, 2001. Because goodwill and some intangible assets will no longer be amortized, the reported amounts of goodwill and some intangible assets (as well as total assets) will not decrease at the same time and in the same manner as under previous standards. There may be more volatility in reported income than under previous standards because impairment losses may occur irregularly and in varying amounts. The impairment losses, if any, that arise due to the initial application of SFAS 142 resulting from a transitional impairment test applied as of January 1, 2002, will be reported as a cumulative effect of a change in accounting principle in the Company's statement of operations during the first quarter of 2002. Although the amount of impairment losses, if any, has not yet been determined, the initial application of SFAS 142 could have a material effect on the Company's financial statements.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS 121, and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business (as previously defined in that Opinion). SFAS 144 retains the fundamental provisions of SFAS 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS 121. Unlike SFAS 121, however, an impairment assessment under SFAS 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS 142. The provisions of SFAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. Adoption of SFAS 144 is not expected to have a material impact on the financial statements of the Company.

**Reclassifications**

Merger transaction expenses totaling $24.2 million for the year ended December 31, 2000, have been reclassified to general and administrative expense to conform with the 2001 presentation. Lease expenses totaling $2.4 million for the year ended December 31, 2000 have been reclassified to operating expenses to conform with the 2001 presentation.

## 5. REVERSE STOCK SPLIT

At the Company's 2000 annual meeting of stockholders held in December 2000, the holders of the Company's common stock approved a reverse stock split of the Company's common stock at a ratio to be determined by the board of directors of the Company of not less than one-for-ten and not to exceed one-for-twenty. The board of directors subsequently approved a reverse stock split of the Company's common stock at a ratio of one-for-ten, which was effective May 18, 2001.

As a result of the reverse stock split, every ten shares of the Company's common stock issued and outstanding immediately prior to the reverse stock split has been reclassified and changed into one fully paid and nonassessable share of the Company's common stock. The Company paid its registered common stockholders cash in lieu of issuing fractional shares in the reverse stock split at a post reverse-split rate of $8.60 per share, totaling approximately $15,000. The number of common shares and per share amounts have been retroactively restated in the accompanying financial statements and these notes to the financial statements to reflect the reduction in common shares and corresponding increase in the per share amounts resulting from the reverse stock split. In conjunction with the reverse stock split, during the second quarter of 2001, the Company amended its charter to reduce the number of shares of common stock which the Company was authorized to issue to 80.0 million shares (on a post-reverse stock split basis) from 400.0 million shares (on pre-reverse stock split basis). As of December 31, 2001, the Company had 27.9 million shares of common stock issued and outstanding (on a post-reverse stock split basis).

## 6. HISTORICAL RELATIONSHIP WITH OPERATING COMPANY

Operating Company was a private prison management company that operated, managed and leased the substantial majority of facilities owned by the Company from January 1, 1999 through September 30, 2000. As a result of the 1999 Merger and certain contractual relationships existing between the Company and Operating Company, the Company was dependent on Operating

Company for a significant source of its income. In addition, the Company was obligated to pay Operating Company tenant incentive fees and fees for services rendered to the Company in the development of its correctional and detention facilities. As of September 30, 2000 (immediately prior to the Operating Company Merger), Operating Company leased 37 of the 46 operating facilities owned by the Company.

**CCA Note**

As discussed in Note 3, the Company succeeded to the CCA Note as a result of the 1999 Merger. Interest on the CCA Note was payable annually at an interest rate of 12%. Principal was due in six equal annual installments of approximately $22.8 million beginning December 31, 2003. Ten percent of the outstanding principal of the CCA Note was personally guaranteed by the Company's former chief executive officer, who also served as the chief executive officer and a member of the board of directors of Operating Company. As of December 31, 1999, the first scheduled payment of interest, totaling approximately $16.4 million, on the CCA Note was unpaid. Pursuant to the terms of the CCA Note, Operating Company was required to make the payment on December 31, 1999; however, pursuant to the terms of a subordination agreement, dated as of March 1, 1999, by and between the Company and the agent of Operating Company's revolving credit facility, Operating Company was prohibited from making the scheduled interest payment on the CCA Note when Operating Company was not in compliance with certain financial covenants under the facility. Pursuant to the terms of the subordination agreement between the Company and the agent of Operating Company's revolving credit facility, the Company was prohibited from accelerating payment of the principal amount of the CCA Note or taking any other action to enforce its rights under the provisions of the CCA Note for so long as Operating Company's revolving credit facility remained outstanding. The Company fully reserved the $16.4 million of interest accrued under the terms of the CCA Note during 1999.

On September 29, 2000, the Company and Operating Company entered into agreements pursuant to which the Company forgave interest due under the CCA Note. The Company forgave $27.4 million of interest accrued under the terms of the CCA Note from January 1, 1999 to August 31, 2000, all of which had been fully reserved. The Company also fully reserved the $1.4 million of interest accrued for the month of September 2000. In connection with the Operating Company Merger, the CCA Note was assumed by the Company's wholly-owned subsidiary on October 1, 2000. The CCA Note has since been extinguished.

**Deferred Gain on Sale to Operating Company**

The sale to Operating Company as part of the 1999 Merger generated a deferred gain of $63.3 million. No amortization of the Operating Company deferred gain occurred during the year ended December 31, 1999 or during the period from January 1, 2000 through September 30, 2000. Effective with the Operating Company Merger on October 1, 2000, the Company applied the unamortized balance of the deferred gain on sales of contracts in accordance with the purchase method of accounting under APB 16.

**Operating Company Leases**

In order for New Prison Realty to qualify as a REIT, New Prison Realty's income generally could not include income from the operation and management of correctional and detention facilities, including those facilities operated and managed by Old CCA. Accordingly, immediately prior to the 1999 Merger, the non-real estate assets of Old CCA, including all management contracts, were sold to Operating Company and the Service Companies. On January 1, 1999, immediately after the

1999 Merger, all existing leases between Old CCA and Old Prison Realty were cancelled. Following the 1999 Merger, a substantial majority of the correctional and detention facilities acquired by New Prison Realty in the 1999 Merger were leased to Operating Company pursuant to the Operating Company Leases. The terms of the Operating Company Leases were for twelve years and could be extended at fair market rates for three additional five-year periods upon the mutual agreement of the Company and Operating Company.

As of December 31, 1999, the annual base rent with respect to each facility was subject to increase each year in an amount equal to the lesser of: (i) 4% of the annualized yearly rental payment with respect to such facility or (ii) 10% of the excess of Operating Company's aggregate gross management revenues for the prior year over a base amount of $325.0 million.

For the years ended December 31, 2000 and 1999, the Company recognized rental revenue from Operating Company of $31.0 million and $263.5 million, respectively, all of which was collected by the Company as discussed below.

During the month ended December 31, 1999, and the nine months ended September 30, 2000, due to Operating Company's liquidity position, Operating Company failed to make timely rental payments under the terms of the Operating Company Leases. As of December 31, 1999, approximately $24.9 million of rents due from Operating Company to the Company were unpaid. The terms of the Operating Company Leases provided that rental payments were due and payable on December 25, 1999. During 2000, Operating Company paid the $24.9 million of lease payments related to 1999 and $31.0 million of lease payments related to 2000. For the nine months ended September 30, 2000, the Company recognized rental revenue from Operating Company of $244.3 million and recorded a reserve of $213.3 million, resulting in recognition of net rental revenue from Operating Company of $31.0 million. The reserve was recorded due to the uncertainty regarding the collectibility of the revenue. In June 2000, the Operating Company Leases were amended to defer, with interest, rental payments originally due during the period from January 1, 2000 to September 2000, with the exception of certain installment payments. Through September 30, 2000, the Company accrued and fully reserved $8.0 million of interest due to the Company on unpaid rental payments. On September 29, 2000, the Company and Operating Company entered into agreements pursuant to which the Company forgave all unpaid rental payments, plus accrued interest, due and payable from Operating Company through August 31, 2000, including $190.8 million due under the Operating Company Leases and $7.9 million of interest due on the unpaid rental payments. The Company also fully reserved the $22.5 million of rental payments due for the month of September 2000. The Company cancelled the Operating Company Leases in connection with the Operating Company Merger.

**Tenant Incentive Arrangement**

On May 4, 1999, the Company and Operating Company entered into an amended and restated tenant incentive agreement (the "Amended and Restated Tenant Incentive Agreement"), effective as of January 1, 1999, providing for (i) a tenant incentive fee of up to $4,000 per bed payable with respect to all future facilities developed and facilitated by Operating Company, as well as certain other facilities which, although operational on January 1, 1999, had not achieved full occupancy, and (ii) an $840 per bed allowance for all beds in operation at the beginning of January 1999, approximately 21,500 beds, that were not subject to the tenant allowance in the first quarter of 1999. The amount of the amended tenant incentive fee included an allowance for rental payments to be paid by Operating Company prior to the facility reaching stabilized occupancy. The term of the Amended and Restated Tenant Incentive Agreement was four years, unless extended upon the written agreement of the Company and Operating Company. The incentive fees with Operating

Company were deferred and were to be amortized as a reduction to rental revenue over the respective lease term.

For the year ended December 1999, the Company paid tenant incentive fees of $68.6 million, with $2.9 million of those fees amortized against rental revenue. During the fourth quarter of 1999, the Company undertook a plan that contemplated either merging with Operating Company and thereby eliminating the Operating Company Leases or amending the Operating Company Leases to reduce the lease payments to be paid by Operating Company to the Company during 2000. Consequently, the Company determined that the remaining deferred tenant incentive fees under the existing lease arrangements at December 31, 1999 were not realizable and wrote-off fees totaling $65.7 million.

During the nine months ended September 30, 2000, the Company opened two facilities and expanded three facilities that were operated and leased by Operating Company. The Company expensed the tenant incentive fees due Operating Company in 2000, totaling $11.9 million, but made no payments to Operating Company in 2000 with respect to the Amended and Restated Tenant Incentive Agreement. On June 9, 2000, Operating Company and the Company amended the Amended and Restated Tenant Incentive Agreement to defer, with interest, payments to Operating Company by the Company pursuant to this agreement. At September 30, 2000, $11.9 million of payments under the Amended and Restated Tenant Incentive Agreement, plus $0.7 million of interest payments, were accrued but unpaid under the original terms of this agreement. This agreement was cancelled in connection with the Operating Company Merger on October 1, 2000, and the unpaid amounts due under this agreement, plus accrued interest, were applied in accordance with the purchase method of accounting under APB 16.

**Trade Name Use Agreement**

In connection with the 1999 Merger, Old CCA entered into a trade name use agreement with Operating Company (the "Trade Name Use Agreement"). Under the Trade Name Use Agreement, which had a term of ten years, Old CCA granted to Operating Company the right to use the name "Corrections Corporation of America" and derivatives thereof, subject to specified terms and conditions therein. The Company succeeded to this interest as a result of the 1999 Merger. In consideration for such right under the terms of the Trade Name Use Agreement, Operating Company was to pay a licensing fee equal to (i) 2.75% of the gross revenue of Operating Company for the first three years, (ii) 3.25% of Operating Company's gross revenue for the following two years, and (iii) 3.625% of Operating Company's gross revenue for the remaining term, provided that after completion of the 1999 Merger the amount of such fee could not exceed (a) 2.75% of the gross revenue of the Company for the first three years, (b) 3.5% of the Company's gross revenue for the following two years, and (c) 3.875% of the Company's gross revenue for the remaining term.

For the years ended December 31, 2000 and 1999, the Company recognized income of $7.6 million and $8.7 million, respectively, from Operating Company under the terms of the Trade Name Use Agreement, all of which was collected. This agreement was cancelled in connection with the Operating Company Merger.

**Right to Purchase Agreement**

On January 1, 1999, immediately after the 1999 Merger, the Company and Operating Company entered into a Right to Purchase Agreement (the "Right to Purchase Agreement") pursuant to which Operating Company granted to the Company a right to acquire, and lease back to Operating Company at fair market rental rates, any correctional or detention facility acquired or developed and owned by Operating Company in the future for a period of ten years following the date inmates are

first received at such facility. The initial annual rental rate on such facilities was to be the fair market rental rate as determined by the Company and Operating Company. Additionally, Operating Company granted the Company a right of first refusal to acquire any Operating Company-owned correctional or detention facility should Operating Company receive an acceptable third party offer to acquire any such facility. The Company did not purchase any assets from Operating Company under the Right to Purchase Agreement, which was cancelled in connection with the Operating Company Merger.

**Services Agreement**

On January 1, 1999, immediately after the 1999 Merger, the Company entered into a services agreement (the "Services Agreement") with Operating Company pursuant to which Operating Company agreed to serve as a facilitator of the construction and development of additional facilities on behalf of the Company for a term of five years from the date of the Services Agreement. In such capacity, Operating Company agreed to perform, at the direction of the Company, such services as were customarily needed in the construction and development of correctional and detention facilities, including services related to construction of the facilities, project bidding, project design and governmental relations. In consideration for the performance of such services by Operating Company, the Company agreed to pay a fee equal to 5% of the total capital expenditures (excluding the incentive fee discussed below and the 5% fee herein referred to) incurred in connection with the construction and development of a facility, plus an amount equal to approximately $560 per bed for facility preparation services provided by Operating Company prior to the date on which inmates are first received at such facility. The board of directors of the Company subsequently authorized payments, and pursuant to an amended and restated services agreement, dated as of March 5, 1999 (the "Amended and Restated Services Agreement"), the Company agreed to pay up to an additional 5% of the total capital expenditures (as determined above) to Operating Company if additional services were requested by the Company. A majority of the Company's development projects during 1999 and 2000 were subject to a fee totaling 10%.

Costs incurred by the Company under the Amended and Restated Services Agreement were capitalized as part of the facilities' development cost. Costs incurred under the Amended and Restated Services Agreement and capitalized as part of the facilities' development cost totaled $41.6 million for the year ended December 31, 1999, and $5.6 million for the nine months ended September 30, 2000.

On June 9, 2000, Operating Company and the Company amended the Amended and Restated Services Agreement to defer, with interest, payments to Operating Company by the Company pursuant to this agreement. At September 30, 2000, $5.6 million of payments under the Amended and Restated Services Agreement, plus $0.3 million of interest payments, were accrued but unpaid under the original terms of this agreement. This agreement was cancelled in connection with the Operating Company Merger and the unpaid amounts due under the agreement, plus accrued interest, were applied in accordance with the purchase method of accounting under APB 16.

**Business Development Agreement**

On May 4, 1999, the Company entered into a four year business development agreement (the "Business Development Agreement") with Operating Company, which provided that Operating Company would perform, at the direction of the Company, services designed to assist the Company in identifying and obtaining new business. Pursuant to the agreement, the Company agreed to pay to Operating Company a total fee equal to 4.5% of the total capital expenditures (excluding the amount of the tenant incentive fee and the services fee discussed above as well as the 4.5% fee)

incurred in connection with the construction and development of each new facility, or the construction and development of an addition to an existing facility, for which Operating Company performed business development services.

Costs incurred by the Company under the Business Development Agreement were capitalized as part of the facilities' development cost. Costs incurred under the Business Development Agreement and capitalized as part of the facilities' development cost totaled $15.0 million for the year ended December 31, 1999. No costs were incurred under the Business Development Agreement during 2000. On June 9, 2000, Operating Company and the Company amended this agreement to defer, with interest, any payments to Operating Company by the Company pursuant to this agreement. This agreement was cancelled in connection with the Operating Company Merger.

## 7. PROPERTY AND EQUIPMENT

At December 31, 2001, the Company owned 43 real estate properties, including 39 correctional, detention and juvenile facilities, three of which the Company leases to other operators, two corporate office buildings, and two correctional and detention facilities under construction. Two of the 39 correctional and detention facilities the Company owns are substantially idle. Additionally, at December 31, 2001, the Company managed 28 correctional and detention facilities owned by government agencies and sub-leased an alternative educational facility for at-risk juveniles. Two of the properties owned by the Company are held for sale and are classified as such on the accompanying balance sheet as of December 31, 2001.

Property and equipment, at cost, consists of the following:

| | December 31, | |
|---|---|---|
| | **2001** | 2000 |
| | (in thousands) | |
| Land and improvements | $ **30,977** | $ 25,651 |
| Buildings and improvements | **1,524,286** | 1,523,560 |
| Equipment | **29,713** | 27,455 |
| Office furniture and fixtures | **20,832** | 20,270 |
| Construction in progress | **101,220** | 99,416 |
| | **1,707,028** | 1,696,352 |
| Less: Accumulated depreciation | **(133,876)** | (81,222) |
| | **$ 1,573,152** | $ 1,615,130 |

Depreciation expense was $53.1 million, $57.2 million and $44.1 million for the years ended December 31, 2001, 2000 and 1999, respectively.

Pursuant to the 1999 Merger, the Company acquired all of the assets and liabilities of Old Prison Realty on January 1, 1999, including 23 leased facilities and one real estate property under construction. The real estate properties acquired by the Company in conjunction with the acquisition of Old Prison Realty were recorded at estimated fair market value in accordance with the purchase method of accounting prescribed by APB 16, resulting in a $1.2 billion increase to real estate properties at January 1, 1999.

As of December 31, 2001, nine of the facilities owned by the Company are subject to options that allow various governmental agencies to purchase those facilities. In addition, two of the facilities are constructed on land that the Company leases from governmental agencies under ground leases. Under the terms of those ground leases, the facilities become the property of the governmental

agencies upon expiration of the ground leases. The Company depreciates these two properties over the term of the ground lease.

The Company's property and equipment, along with all other tangible and intangible assets of the Company, are pledged as collateral on the Company's Senior Bank Credit Facility. See discussion of the Senior Bank Credit Facility in Note 15.

In late 2001 and early 2002, the Company was provided notice from the Commonwealth of Puerto Rico of its intention to terminate the management contracts at the Ponce Young Adult Correctional Facility and the Ponce Adult Correctional Facility, located in Ponce, Puerto Rico, upon the expiration of the management contracts in February 2002. Although management continues to negotiate with respect to the continued operation of these facilities, the Company has begun a transition period to transfer operation of the facilities to the Commonwealth of Puerto Rico. There can be no assurance that the Company will continue to operate these facilities. The termination of the Ponce Adult Correctional Facility management contract would result in a non-cash charge of approximately $1.9 million for the write-off of the carrying value of assets associated with this management contract.

## 8. IMPAIRMENT LOSSES AND ASSETS HELD FOR SALE

As of December 31, 2001, the Company was holding for sale numerous assets, including six parcels of land, one correctional facility leased to a governmental agency, and one correctional facility leased to a private operator, with an aggregate book value of approximately $22.3 million. Additionally, the Company has had discussions with various parties regarding the potential sale of additional assets. The Company expects to use the net proceeds from any such sales to repay outstanding indebtedness. However, there can be no assurance that the Company will complete any such sales.

SFAS 121 requires impairment losses to be recognized for long-lived assets used in operations when indications of impairment are present and the estimate of undiscounted future cash flows is not sufficient to recover asset carrying amounts. Under terms of the June 2000 Waiver and Amendment, the Company was obligated to complete the Restructuring, including the Operating Company Merger, and complete the restructuring of management through the appointment of a new chief executive officer and a new chief financial officer. The June 2000 Waiver and Amendment also permitted the acquisitions of PMSI and JJFMSI in connection with the Restructuring. During the third quarter of 2000, the Company named a new president and chief executive officer, followed by the appointment of a new chief financial officer during the fourth quarter. At the Company's 2000 annual meeting of stockholders held during the fourth quarter of 2000, the Company's stockholders elected a newly constituted board of directors of the Company, including a majority of independent directors.

Following the completion of the Operating Company Merger and the acquisitions of PMSI and JJFMSI, during the fourth quarter of 2000, after considering the Company's financial condition, the Company's new management developed a strategic operating plan to improve the Company's financial position and developed revised projections for 2001 to evaluate various potential transactions. Management also conducted strategic assessments and evaluated the Company's assets for impairment. Further, the Company evaluated the utilization of existing facilities, projects under development, and excess land parcels, and identified certain of these non-strategic assets for sale.

In accordance with SFAS 121, the Company estimated the undiscounted net cash flows for each of its properties and compared the sum of those undiscounted net cash flows to the Company's investment in each property. Through its analyses, the Company determined that eight of its correctional and detention facilities and the long-lived assets of the transportation business had been impaired. For these properties, the Company reduced the carrying values of the underlying assets to their estimated fair values, as determined based on anticipated future cash flows discounted at rates commensurate with the risks involved. The resulting impairment loss totaled $420.5 million.

During the fourth quarter of 2000, as part of the strategic assessment, the Company's management committed to a plan of disposal for certain long-lived assets of the Company. In accordance with SFAS 121, the Company recorded losses on these assets based on the difference between the carrying value and the estimated net realizable value of the assets. The Company estimated the net realizable values of certain facilities and direct financing leases held for sale based on outstanding offers to purchase and appraisals, as well as by utilizing various financial models, including discounted cash flow analyses, less estimated costs to sell each asset. The resulting impairment loss for these assets totaled $86.1 million.

Included in property and equipment were costs associated with the development of potential facilities. Based on the Company's strategic assessment during the fourth quarter of 2000, management decided to abandon further development of these projects and expense any amounts previously capitalized. The resulting expense totaled $2.1 million.

During the third quarter of 2000, the Company's management determined either not to pursue further development or to reconsider the use of certain parcels of property in California, Maryland and the District of Columbia. Accordingly, the Company reduced the carrying values of the land to their estimated net realizable value, resulting in an impairment loss totaling $19.2 million.

In December 1999, based on the poor financial position of the Operating Company, the Company determined that three of its correctional and detention facilities located in the state of Kentucky and leased to Operating Company were impaired. In accordance with SFAS 121, the Company reduced the carrying values of the underlying assets to their estimated fair values, as determined based on anticipated future cash flows discounted at rates commensurate with the risks involved. The resulting impairment loss totaled $76.4 million.

## 9. ACQUISITIONS AND DIVESTITURES

In April 1999, the Company purchased the Eden Detention Center in Eden, Texas for $28.1 million. Prior to the Operating Company Merger, the facility had been leased to Operating Company under lease terms substantially similar to the Operating Company Leases.

In June 1999, the Company incurred a loss of $1.6 million as a result of a settlement with the State of South Carolina for property previously owned by Old CCA. Under the settlement, the Company, as the successor to Old CCA, received $6.5 million in three installments by June 30, 2001 for the transferred assets. The net proceeds were approximately $1.6 million less than the surrendered assets' depreciated book value.

In December 1999, the Company incurred a loss of $0.4 million resulting from a sale of a newly constructed facility in Florida. Construction on the facility was completed by the Company in May 1999. In accordance with the terms of the management contract between Old CCA and Polk County, Florida, Polk County exercised an option to purchase the facility. Net proceeds of $40.5 million were received by the Company.

During 2000, the contract to manage one of the Company's facilities located in Kentucky expired and was not renewed. Subsequent to the non-renewal of the contract, the Company sold the facility for a net sales price of approximately $1.0 million, resulting in a gain on sale of approximately $0.6 million during 2000, after writing-down the carrying value of this asset by $7.1 million in 1999. Also, during 2000, Operating Company and the contracting party mutually agreed to cancel the management contracts on two facilities located in North Carolina. In March 2001, the Company sold one of these facilities, the Mountain View Correctional Facility, located in Spruce Pine, North Carolina, which was classified as held for sale under contract as of December 31, 2000, for a net sales price of approximately $24.9 million. On June 28, 2001, the Company sold the other of these facilities, the Pamlico Correctional Facility, located in Bayboro, North Carolina, which was classified as held for sale as of December 31, 2000, for a net sales price of approximately $24.0 million. The net proceeds from both of these sales were used to pay-down a like portion of amounts outstanding under the Company's Senior Bank Credit Facility.

On April 10, 2001, the Company sold its interest in the Agecroft facility, located in Salford, England, which was classified as held for sale as of December 31, 2000, for a net sales price of approximately $65.7 million through the sale of all the issued and outstanding capital stock of Agecroft Properties, Inc., a wholly-owned subsidiary of the Company. The net proceeds from the sale were used to pay-down a like portion of amounts outstanding under the Senior Bank Credit Facility.

On October 3, 2001, the Company sold its Southern Nevada Women's Correctional Facility, a facility located in Las Vegas, Nevada, which was classified as held for sale during the second quarter of 2001, for a net sales price of approximately $24.1 million. The net proceeds were used to pay-down a like portion of amounts outstanding under the Senior Bank Credit Facility. Subsequent to the sale, the Company continues to manage the facility pursuant to a contract with the State of Nevada.

As of December 31, 2001, the Company was holding for sale two additional correctional facilities and various parcels of undeveloped land with an aggregate carrying value of $22.3 million. There can be no assurance that the Company will be able to complete the sale of any of these assets, or that the net proceeds received from these sales will achieve expected levels.

## 10. INVESTMENTS IN AFFILIATES

In connection with the 1999 Merger, Old CCA received 100% of the non-voting common stock in each of PMSI and JJFMSI, valued at the implied fair market values of $67.1 million and $55.9 million, respectively. The Company succeeded to these interests as a result of the 1999 Merger. The Company's ownership of the non-voting common stock of PMSI and JJFMSI entitled the Company to receive, when and if declared by the boards of directors of the respective companies, 95% of the net income, as defined, of each company as cash dividends. Dividends were cumulative if not declared. For the years ended December 31, 2000 and 1999, the Company received cash dividends from PMSI totaling approximately $4.4 million and $11.0 million, respectively. For the years ended December 31, 2000 and 1999, the Company received cash dividends from JJFMSI totaling approximately $2.3 million and $10.6 million, respectively.

The following operating information presents a combined summary of the results of operations of PMSI and JJFMSI for the period January 1, 2000 through November 30, 2000 and for the year ended December 31, 1999 (in thousands):

| | January 1, 2000 - November 30, 2000 | Year ended December 31, 1999 |
|---|---|---|
| Revenue | $ 279,228 | $ 288,289 |
| Net income (loss) before taxes | $ (588) | $ 12,851 |

During 2000 and prior to the acquisition of PMSI and JJFMSI on December 1, 2000, PMSI and JJFMSI (collectively) recorded approximately $27.3 million in charges related to agreements with the Company and Operating Company. Of these charges, approximately $5.4 million were fees paid under a trade name use agreement, approximately $9.9 million were fees paid under an administrative service agreement and approximately $12.0 million were fees paid under an indemnification agreement with the Company.

Under the terms of the indemnification agreements with the Company, effective September 29, 2000, each of PMSI and JJFMSI agreed to pay the Company $6.0 million in exchange for full indemnity by the Company for any and all liabilities incurred by PMSI and JJFMSI in connection with the settlement or disposition of litigation known as *Prison Acquisition Company, LLC v. Prison Realty Trust, Inc., et al.* described in Note 21 herein. The combined and consolidated results of operations of the Company were unaffected by the indemnification agreements.

As previously discussed in Note 4, the combined and consolidated financial statements reflect the results of operations of PMSI and JJFMSI under the equity method of accounting from January 1, 1999 through August 31, 2000, on a combined basis from September 1, 2000 through November 30, 2000, and consolidated for the month of December 2000.

As discussed in Note 3, the Company's 9.5% non-voting interest in Operating Company had been recorded in the 1999 Merger at its implied value of $4.8 million. In accordance with the provisions of APB 18, the Company applied the recognized equity in losses of Operating Company of $19.3 million for the year ended December 31, 1999, first to reduce the Company's recorded investment in Operating Company of $4.8 million to zero and then to reduce the carrying value of the CCA Note by the amount of the recognized equity in losses in excess of $4.8 million. The Company's recognized equity in losses related to its investment in Operating Company for the nine months ended September 30, 2000 of $20.6 million were applied to reduce the carrying value of the CCA Note.

For the years ended December 31, 2000 and 1999, equity in earnings (losses) and amortization of deferred gains were approximately $11.6 million in losses and $3.6 million in earnings, respectively. For the year ended December 31, 2000, the Company recognized equity in losses of PMSI and JJFMSI of approximately $12,000 and $870,000, respectively. In addition, for the year ended December 31, 2000, the Company recognized equity in losses of Operating Company of approximately $20.6 million. For 2000, the amortization of the deferred gain on the sales of contracts to PMSI and JJFMSI was approximately $6.5 million and $3.3 million, respectively. For the year ended December 31, 1999, the Company recognized equity in earnings of PMSI and JJFMSI of approximately $4.7 million and $7.5 million, respectively. In addition, for the year ended December 31, 1999, the Company recognized equity in losses of Operating Company of approximately $19.3 million. For 1999, the amortization of the deferred gain on the sales of contracts to PMSI and JJFMSI was approximately $7.1 million and $3.6 million, respectively.

For the year ended December 31, 2001, equity in loss was approximately $0.4 million. The loss resulted from the Company's interest in APM, an entity holding the management contract for the Agecroft facility under a 25-year prison management contract with an agency of the U.K. government. Agecroft, located in Salford, England, was previously constructed and owned by a

wholly-owned subsidiary of the Company, which was sold in April 2001, as further discussed in Note 9. As discussed in Note 4, the Company has extended a working capital loan to APM, which totaled $5.6 million, including accrued interest, as of December 31, 2001.

## 11. INVESTMENT IN DIRECT FINANCING LEASES

At December 31, 2001, the Company's investment in a direct financing lease represents net receivables under a building and equipment lease between the Company and a governmental agency.

A schedule of future minimum rentals to be received under the direct financing lease in years subsequent to December 31, 2001, is as follows (in thousands):

| | | |
|---|---|---|
| 2002 | $ | 2,793 |
| 2003 | | 2,793 |
| 2004 | | 2,793 |
| 2005 | | 2,793 |
| 2006 | | 2,793 |
| Thereafter | | 28,621 |
| Total minimum obligation | | 42,586 |
| Less unearned interest income | | (23,246) |
| Less current portion of direct financing lease | | (467) |
| Investment in direct financing leases | $ | 18,873 |

As discussed in Note 8, during the fourth quarter of 2000, the Company's management committed to a plan of disposal for certain long-lived assets of the Company, including the Agecroft facility and the D.C. Correctional Treatment Facility, both previously classified as investments in direct financing leases. The Company estimated the fair values of these direct financing leases held for sale based on outstanding offers to purchase and discounted cash flow analyses. These direct financing leases, with estimated net realizable values totaling $85.7 million at December 31, 2000, were classified on the consolidated balance sheet as assets held for sale as of December 31, 2000. The investment in the D.C. Correctional Treatment Facility was reclassified to an investment in direct financing lease during 2001 from assets held for sale because the Company was unable to achieve an acceptable sales price. Also during 2001, the Company identified the direct financing lease of Southern Nevada Women's Correctional Facility as a non-strategic asset and entered into discussions with a potential buyer of this facility. During 2001, the Company sold its interest in the Agecroft facility and Southern Nevada Women's Correctional Facility, as further discussed in Note 9.

During the years ended December 31, 2001, 2000 and 1999, the Company recorded interest income of $4.3 million, $10.1 million, and $3.4 million, respectively, under all direct financing leases.

## 12. OTHER ASSETS

Other assets consist of the following (in thousands):

| | December 31, 2001 | December 31, 2000 |
|---|---|---|
| Debt issuance costs, less accumulated amortization of $40,698 and $21,502 | $ 24,915 | $ 37,099 |
| Notes receivable | 6,271 | 6,703 |
| Value of workforce, net | 1,132 | 2,425 |
| Contract acquisition costs, net | 905 | 2,190 |
| Deposits | 2,680 | 1,630 |
| Other | 690 | 1,692 |
| | $ 36,593 | $ 51,739 |

## 13. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following (in thousands):

| | December 31, 2001 | December 31, 2000 |
|---|---|---|
| Stockholder litigation settlements | $ 5,998 | $ 75,406 |
| Other accrued litigation | 18,148 | 41,114 |
| Trade accounts payable | 15,891 | 26,356 |
| Accrued salaries and wages | 19,687 | 14,183 |
| Accrued workers' compensation | 14,818 | 12,508 |
| Accrued property taxes | 14,578 | 13,638 |
| Accrued interest | 12,392 | 5,765 |
| Other | 43,645 | 54,342 |
| | $ 145,157 | $ 243,312 |

## 14. DISTRIBUTIONS TO STOCKHOLDERS

On March 22, 2000, the board of directors of the Company declared a quarterly dividend on the Company's Series A Preferred Stock of $0.50 per share to preferred stockholders of record on March 31, 2000. These dividends were paid on April 17, 2000. In connection with the June 2000 Waiver and Amendment, the Company was prohibited from declaring or paying any further dividends with respect to its outstanding Series A Preferred Stock until such time as the Company raised at least $100.0 million in equity. Dividends with respect to the Series A Preferred Stock continued to accrue under the terms of the Company's charter until such time as payment of such dividends was permitted under the terms of the Senior Bank Credit Facility. Under the terms of the Company's charter, in the event dividends are unpaid and in arrears for six or more quarterly periods, the holders of the Series A Preferred Stock have the right to vote for the election of two additional directors to the board of directors. During the third quarter of 2001, the Company received a consent and waiver from its lenders under the Senior Bank Credit Facility, which allowed the Company's board of directors to declare a cash dividend on September 28, 2001. As a result of the board's declaration, the holders of the Company's Series A Preferred Stock received $0.50 on October 15, 2001 for every share of the Series A Preferred Stock they held on the record date. Approximately $2.2 million was paid on October 15, 2001, as a result of this dividend.

As further discussed in Note 15, on December 7, 2001, the Company completed an amendment and restatement of its existing Senior Bank Credit Facility. As a result of the December 2001 Amendment and Restatement, certain financial and non-financial covenants were amended, including the removal of prior restrictions on the Company's ability to pay cash dividends on shares of its issued and outstanding Series A Preferred Stock. Under the terms of the December 2001 Amendment and Restatement, the Company is permitted to pay quarterly dividends, when declared by the board of directors, on the shares of its issued and outstanding Series A Preferred Stock, including all dividends in arrears. Following the December 2001 Amendment and Restatement, on December 13, 2001, the Company's board of directors declared a cash dividend on the Series A Preferred Stock for the fourth quarter of 2001 and for the five quarters in arrears, payable on January 15, 2002. As a result of the board's declaration, the holders of the Company's Series A Preferred Stock received \$3.00 for every share of Series A Preferred Stock they held on the record date. The dividend was based on a dividend rate of 8% per annum of the stock's stated value of \$25.00 per share. Approximately \$12.9 million was paid on January 15, 2002, as a result of this dividend, which was accrued as of December 31, 2001.

Under the terms of the Company's charter, as in effect prior to the Restructuring, the Company was required to elect to be taxed as a REIT for federal income tax purposes for its taxable year ended December 31, 1999. The Company, as a REIT, could not complete any taxable year with accumulated earnings and profits from a taxable corporation. Accordingly, the Company was required to distribute Old CCA's earnings and profits to which it succeeded in the 1999 Merger (the "Accumulated Earnings and Profits"). For the year ended December 31, 1999, the Company made approximately \$217.7 million of distributions related to its common stock and Series A Preferred Stock. Because the Company's Accumulated Earnings and Profits were approximately \$152.5 million, and the Company's distributions were deemed to have been paid first from those Accumulated Earnings and Profits, the Company met the above-described distribution requirements. In addition to distributing its Accumulated Earnings and Profits, the Company, in order to qualify for taxation as a REIT with respect to its 1999 taxable year, was required to distribute 95.0% of its taxable income for 1999. The Company believes that this distribution requirement was satisfied by its distribution of shares of the Company's Series B Preferred Stock, as discussed below.

On September 22, 2000, the Company issued approximately 5.9 million shares of its Series B Preferred Stock in connection with its remaining 1999 REIT distribution requirement. The distribution was made to the Company's common stockholders of record on September 14, 2000, who received five shares of Series B Preferred Stock for every 100 shares of the Company's common stock held on the record date. The Company paid its common stockholders approximately \$15,000 in cash in lieu of issuing fractional shares of Series B Preferred Stock. On November 13, 2000, the Company issued approximately 1.6 million additional shares of Series B Preferred Stock in satisfaction of this REIT distribution requirement. This distribution was made to the Company's common stockholders of record on November 6, 2000, who received one share of Series B Preferred Stock for every 100 shares of the Company's common stock held on the record date. The Company also paid its common stockholders approximately \$15,000 in cash in lieu of issuing fractional shares of Series B Preferred Stock in the second distribution.

The Company recorded the issuance of the Series B Preferred Stock at its stated value of \$24.46 per share, or a total of \$183.9 million. The Company has determined the distribution made on September 22, 2000 amounted to a taxable distribution by the Company of approximately \$107.6 million. The Company has also determined that the distribution made on November 13, 2000 amounted to a taxable distribution by the Company of approximately \$20.4 million. Common stockholders who received shares of Series B Preferred Stock in the distribution generally were

required to include the taxable value of the distribution in ordinary income. Refer to Note 19 for a more complete description of the terms of Series B Preferred Stock.

On December 13, 2000, the Company's board of directors declared a paid-in-kind dividend on the shares of Series B Preferred Stock for the period from September 22, 2000 (the original date of issuance) through December 31, 2000, payable on January 2, 2001, to the holders of record of the Company's Series B Preferred Stock on December 22, 2000. As a result of the board's declaration, the holders of the Company's Series B Preferred Stock were entitled to receive approximately 3.3 shares of Series B Preferred Stock for every 100 shares of Series B Preferred Stock held by them on the record date. The number of shares to be issued as the dividend was based on a dividend rate of 12.0% per annum of the stock's stated value ($24.46 per share).

Quarterly distributions and the resulting tax classification for common stock distributions are as follows for the years ended December 31, 2001, 2000 and 1999:

| Declaration Date | Record Date | Payment Date | Distribution Per Share | Ordinary Income | Return of Capital |
|---|---|---|---|---|---|
| 03/04/99 | 03/19/99 | 03/31/99 | $ 0.60 | 100.0% | 0.0% |
| 05/11/99 | 06/18/99 | 06/30/99 | $ 0.60 | 100.0% | 0.0% |
| 08/27/99 | 09/17/99 | 09/30/99 | $ 0.60 | 100.0% | 0.0% |

Quarterly distributions and the resulting tax classification for the Series A Preferred Stock distributions are as follows for the years ended December 31, 2001, 2000 and 1999:

| Declaration Date | Record Date | Payment Date | Distribution Per Share | Ordinary Income | Return of Capital |
|---|---|---|---|---|---|
| 03/04/99 | 03/31/99 | 04/15/99 | $ 0.50 | 100.0% | 0.0% |
| 05/11/99 | 06/30/99 | 07/15/99 | $ 0.50 | 100.0% | 0.0% |
| 08/27/99 | 09/30/99 | 10/15/99 | $ 0.50 | 100.0% | 0.0% |
| 12/22/99 | 12/31/99 | 01/15/00 | $ 0.50 | 100.0% | 0.0% |
| 03/22/00 | 03/31/00 | 04/17/00 | $ 0.50 | 100.0% | 0.0% |
| 09/28/01 | 10/05/01 | 10/15/01 | $ 0.50 | 0.0% | 100.0% |
| 12/13/01 | 12/31/01 | 01/15/02 | $ 3.00 | (A) | (A) |

Quarterly distributions and the resulting tax classification for the Series B Preferred Stock distributions are as follows for the year ended December 31, 2001 and 2000:

| Declaration Date | Record Date | Payment Date | Fair Market Value Per Share | Ordinary Income | Return of Capital |
|---|---|---|---|---|---|
| 12/13/00 | 12/22/00 | 01/02/01 | $ 6.85 | 0.0% | 100.0% |
| 03/13/01 | 03/19/01 | 04/02/01 | $ 9.20 | 0.0% | 100.0% |
| 06/11/01 | 06/19/01 | 07/02/01 | $14.00 | 0.0% | 100.0% |
| 09/07/01 | 09/17/01 | 10/01/01 | $14.83 | 0.0% | 100.0% |
| 12/11/01 | 12/21/01 | 01/02/02 | $19.55 | (A) | (A) |

(A) –Will be determined based on the extent the Company has current or accumulated earnings and profits in 2002.

## 15. DEBT

Debt consists of the following:

| | December 31, | |
|---|---|---|
| | **2001** | 2000 |
| | (in thousands) | |
| $1.0 Billion Senior Bank Credit Facility: | | |
| Revolving loans, with unpaid balance due January 1, 2002, interest payable periodically at variable interest rates (10.92% at December 31, 2000), replaced with term loans during 2001. | $ - | $ 382,532 |
| Term loans, quarterly principal payments of $1.5 million through September 30, 2001, at which time the quarterly principal payment was increased to $2.2 million with unpaid balance due December 31, 2002, interest payable periodically at variable interest rates. The interest rate was 7.41% and 11.01% at December 31, 2001 and 2000, respectively. | **791,906** | 589,750 |
| Total outstanding under Senior Bank Credit Facility | **791,906** | 972,282 |
| Senior Notes, principal due at maturity in June 2006, interest payable semi-annually at 12%. | **100,000** | 100,000 |
| 10.0% Convertible Subordinated Notes, principal due at maturity in December 2008, interest payable semi-annually at 9.5% through June 30, 2000, at which time the rate was increased to 10.0%. | **40,000** | 40,000 |
| 8.0% Convertible Subordinated Notes, principal due at maturity in February 2005 with call provisions beginning in February 2003, interest payable quarterly at 7.5% through June 30, 2000, at which time the rate was increased to 8.0%. | **30,000** | 30,000 |
| $50.0 Million Revolving Credit Facility, with unpaid balance due at maturity in December 2002, interest payable at prime plus 2.25%. The interest rate was 7.0% and 11.75% at December 31, 2001 and 2000, respectively. | - | 7,601 |
| 10.0% Convertible Subordinated Notes, principal due at maturity in December 2003, interest payable semi-annually at 10.0%. | **1,114** | 1,114 |
| Other | **580** | 1,573 |
| | **963,600** | 1,152,570 |
| Less: Current portion of long-term debt | **(792,009)** | (14,594) |
| | **$ 171,591** | $ 1,137,976 |

### Senior Bank Credit Facility

*Original Credit Facility.* On January 1, 1999, in connection with the completion of the 1999 Merger, the Company obtained a $650.0 million secured credit facility (the "Credit Facility") from NationsBank, N.A., as Administrative Agent, and several U.S. and non-U.S. banks. The Credit Facility included up to a maximum of $250.0 million in tranche B term loans and $400.0 million in revolving loans, including a $150.0 million subfacility for letters of credit. The term loan required quarterly principal payments of $625,000 throughout the term of the loan with the remaining balance maturing on December 31, 2002. The revolving loans were scheduled to mature January 1, 2002. Interest rates, unused commitment fees and letter of credit fees on the Credit Facility were subject to change based on the Company's senior debt rating.

*Senior Bank Credit Facility.* On August 4, 1999, the Company completed an amendment and restatement of the Credit Facility (the "Senior Bank Credit Facility") increasing amounts available to the Company to $1.0 billion through the addition of a $350.0 million tranche C term loan, payable in equal quarterly installments of $875,000 through September 30, 2002, with the balance to be paid in full on December 31, 2002. Under the Senior Bank Credit Facility, Lehman Commercial Paper Inc. ("Lehman") became the administrative agent.

The Senior Bank Credit Facility bore interest at variable rates of interest based on a spread over an applicable base rate or the London Interbank Offering Rate ("LIBOR") (as elected by the Company), which spread was determined by reference to the Company's credit rating. Prior to the June 2000 Waiver and Amendment, the spread for the revolving loans ranged from 0.5% to 2.25% for base rate loans and from 2.0% to 3.75% for LIBOR rate loans. Prior to the June 2000 Waiver and Amendment, the spread for term loans ranged from 2.25% to 2.5% for base rate loans and from 3.75% to 4.0% for LIBOR rate loans.

During the first quarter of 2000, the ratings on the Company's bank indebtedness, senior unsecured indebtedness and Series A Preferred Stock were lowered. As a result of these reductions, the interest rate applicable to outstanding amounts under the Senior Bank Credit Facility for revolving loans was increased by 0.5%, to 1.5% over the base rate and to 3.0% over the LIBOR rate; the spread for term loans remained unchanged at 2.5% for base rate loans and 4.0% for LIBOR rate loans. The rating on the Company's indebtedness was also lowered during the second quarter of 2000, although no interest rate increase was attributable to this rating adjustment.

*June 2000 Waiver and Amendment.* Following the approval of the requisite senior lenders under the Senior Bank Credit Facility, the Company, certain of its wholly-owned subsidiaries, various lenders and Lehman, as administrative agent, executed the June 2000 Waiver and Amendment, dated as of June 9, 2000. Upon effectiveness, the June 2000 Waiver and Amendment waived or addressed all then existing events of default under the provisions of the Senior Bank Credit Facility that resulted from: (i) the financial condition of the Company and Operating Company; (ii) the transactions undertaken by the Company and Operating Company in an attempt to resolve the liquidity issues of the Company and Operating Company; and (iii) previously announced restructuring transactions. As a result of the then existing defaults, the Company was subject to the default rate of interest, or 2.0% higher than the rates discussed above, effective from January 25, 2000 until June 9, 2000. The June 2000 Waiver and Amendment also contained certain amendments to the Senior Bank Credit Facility, including the replacement of existing financial covenants contained in the Senior Bank Credit Facility applicable to the Company with new financial ratios following completion of the Restructuring. As a result of the June 2000 Waiver and Amendment, the Company began monthly interest payments on outstanding amounts under the Senior Bank Credit Facility beginning July 2000.

In obtaining the June 2000 Waiver and Amendment, the Company agreed to complete certain transactions which were incorporated as covenants in the June 2000 Waiver and Amendment. Pursuant to these requirements, the Company was obligated to complete the Restructuring, including: (i) the Operating Company Merger; (ii) the amendment of its charter to remove the requirements that it elect to be taxed as a REIT commencing with its 2000 taxable year; (iii) the restructuring of management; and (iv) the distribution of shares of Series B Preferred Stock in satisfaction of the Company's remaining 1999 REIT distribution requirement. The June 2000 Waiver and Amendment also amended the terms of the Senior Bank Credit Facility to permit (i) the amendment of the Operating Company Leases and the other contractual arrangements between the Company and Operating Company, and (ii) the merger of each of PMSI and JJFMSI with the Company, upon terms and conditions specified in the June 2000 Waiver and Amendment.

The June 2000 Waiver and Amendment prohibited: (i) the Company from settling its then outstanding stockholder litigation for cash amounts not otherwise fully covered by the Company's existing directors' and officers' liability insurance policies; (ii) the declaration and payment of dividends with respect to the Company's currently outstanding Series A Preferred Stock prior to the receipt of net cash proceeds of at least $100.0 million from the issuance of additional shares of common or preferred stock; and (iii) Operating Company from amending or refinancing its revolving credit facility on terms and conditions less favorable than Operating Company's then existing revolving credit facility. The June 2000 Waiver and Amendment also required the Company to complete the securitization of lease payments (or other similar transaction) with respect to the Company's Agecroft facility on or prior to February 28, 2001, although such deadline was extended (as described herein).

As a result of the June 2000 Waiver and Amendment, the Company is generally required to use the net cash proceeds received by the Company from certain transactions, including the following transactions, to repay outstanding indebtedness under the Senior Bank Credit Facility:

- any disposition of real estate assets; and
- the sale-leaseback of the Company's headquarters.

The Company is also required to apply a designated portion of its "excess cash flow," as such term is defined in the June 2000 Waiver and Amendment, to the prepayment of outstanding indebtedness under the Senior Bank Credit Facility.

As a result of the June 2000 Waiver and Amendment, the interest rate spreads applicable to outstanding borrowings under the Senior Bank Credit Facility were increased by 0.5%. As a result, the range of the spread for the revolving loans became 1.0% to 2.75% for base rate loans and 2.5% to 4.25% for LIBOR rate loans. The resulting range of the spread for the term loans became 2.75% to 3.0% for base rate loans and 4.25% to 4.5% for LIBOR rate loans. Based on the Company's credit rating at that time, the range of the spread for revolving loans was 2.75% for base rate loans and 4.25% for LIBOR rate loans, while the range of the spread for term loans was 3.0% for base rate loans and 4.5% for LIBOR rate loans.

*November 2000 Consent and Amendment.* During the third and fourth quarters of 2000, the Company was not in compliance with certain applicable financial covenants contained in the Company's Senior Bank Credit Facility, including: (i) debt service coverage ratio; (ii) interest coverage ratio; (iii) leverage ratio; and (iv) net worth. In November 2000, the Company obtained the consent of the requisite percentage of the senior lenders (the "November 2000 Consent and Amendment") to replace previously existing financial covenants with amended financial covenants, each defined in the November 2000 Consent and Amendment:

- total leverage ratio;
- interest coverage ratio;
- fixed charge coverage ratio;
- ratio of total indebtedness to total capitalization;
- minimum EBIDTA; and
- total beds occupied ratio.

The November 2000 Consent and Amendment further provided that the Company would be required to use commercially reasonable efforts to complete a "capital raising event" on or before June 30, 2001. A "capital raising event" was defined in the November 2000 Consent and Amendment as any combination of the following transactions, which together would result in net cash proceeds to the Company of $100.0 million:

- an offering of the Company's common stock through the distribution of rights to the Company's existing stockholders;
- any other offering of the Company's common stock or certain types of the Company's preferred stock;
- issuances by the Company of unsecured, subordinated indebtedness providing for in-kind payments of principal and interest until repayment of the Senior Bank Credit Facility;
- certain types of asset sales by the Company, including the sale-leaseback of the Company's headquarters, but excluding the securitization of lease payments (or other similar transaction) with respect to the Agecroft facility.

The November 2000 Consent and Amendment also contained limitations upon the use of proceeds obtained from the completion of such "capital raising events." The requirements relating to "capital raising events" contained in the November 2000 Consent and Amendment replaced the requirement contained in the Senior Bank Credit Facility that the Company use commercially reasonable efforts to consummate a rights offering on or before December 31, 2000.

The Company had considered a distribution of rights to purchase common or preferred stock to the Company's existing stockholders, or an equity investment in the Company from an outside investor. However, the Company determined that it was not commercially reasonable to issue additional equity or debt securities, other than those securities for which the Company had already contractually agreed to issue, including primarily the issuance of shares of the Company's common stock in connection with the settlement of the Company's stockholder litigation, as more fully discussed in Note 21. Further, as a result of the Company's restructuring during the third and fourth quarters of 2000, prior to the completion of the audit of the Company's 2000 financial statements and the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2000 with the SEC on April 17, 2001, the Company was unable to provide the SEC with the requisite financial information required to be included in a registration statement. Therefore, even if the Company had been able to negotiate a public or private sale of its equity securities on commercially reasonable terms, the Company's inability to obtain an effective SEC registration statement with respect to such securities prior to April 17, 2001 would have effectively prohibited any such transaction. Moreover, the terms of any private sale of the Company's equity securities likely would have included a requirement that the Company register with the SEC the resale of the Company's securities issued to a private purchaser thereby also making it impossible to complete any private issuance of its securities. Due to the fact that the Company would have been unable to obtain an effective registration statement, and therefore, would have been unable to make any public issuance of its securities (or any private sale that included the right of resale), any actions prior to April 17, 2001 to complete a capital raising event through the sale of equity or debt securities would have been futile.

Although the Company would have technically been able to file a registration statement with the SEC following April 17, 2001, the Company believes that various market factors, including the depressed market price of the Company's common stock immediately preceding April 17, 2001, the pending reverse stock split required to maintain the Company's continued NYSE listing, and the

uncertainty regarding the Company's maturity of the revolving loans under the Senior Bank Credit Facility, made the issuance of additional equity or debt securities commercially unreasonable.

Because the issuance of additional equity or debt securities was deemed unreasonable, the Company determined that the sale of assets represented the most effective means by which the Company could satisfy the covenant. During the first and second quarters of 2001, the Company completed the sale of its Mountain View Correctional Facility for approximately $24.9 million and its Pamlico Correctional Facility for approximately $24.0 million, respectively. During the fourth quarter of 2001, the Company completed the sale of its Southern Nevada Women's Correctional Facility for approximately $24.1 million and is actively pursuing the sales of additional assets. As a result of the foregoing, the Company believes it demonstrated commercially reasonable efforts to complete the $100.0 million capital raising event as of June 30, 2001. Under terms of the December 2001 Amendment and Restatement, further described below, the Company's obligation to complete the capital raising event was removed.

The maturities of the loans under the Senior Bank Credit Facility remained unchanged as a result of the November 2000 Consent and Amendment. No event of default was declared due to the amendment of the financial covenants obtained in connection with the November 2000 Consent and Amendment. As a result of the November 2000 Consent and Amendment, the interest rate applicable to the Company's Senior Bank Credit Facility remained unchanged from the rate stipulated in the June 2000 Waiver and Amendment. This applicable rate, however, was subject to (i) an increase of 25 basis points (0.25%) on July 1, 2001 if the Company had not prepaid $100.0 million of the outstanding loans under the Senior Bank Credit Facility, and (ii) an increase of 50 basis points (0.50%) on October 1, 2001 if the Company had not prepaid an aggregate of $200.0 million of the loans under the Senior Bank Credit Facility.

The Company satisfied the condition to prepay, prior to July 1, 2001, $100.0 million of outstanding loans under the Senior Bank Credit Facility through the application of proceeds from the sale of the Mountain View Correctional Facility, the Pamlico Correctional Facility and the completion of the Agecroft transaction, and through the lump sum pay-down of $35.0 million of outstanding loans under the Senior Bank Credit Facility with cash on hand. Although the Company applied additional proceeds from the sale of the Southern Nevada Women's Correctional Facility to further pay-down the Senior Bank Credit Facility, the Company did not satisfy the condition to prepay, prior to October 1, 2001, $200.0 million of outstanding loans under the Senior Bank Credit Facility. As a result, the interest rates under the Senior Bank Credit Facility were increased by 0.50% until the Senior Bank Credit Facility was amended and restated in December 2001, as further discussed below.

*Amendments in 2001.* In January 2001, the requisite percentage of the Company's senior lenders under the Senior Bank Credit Facility consented to the Company's issuance of a promissory note (described in Note 21) in partial satisfaction of its requirements under the definitive settlement agreements relating to the Company's then-outstanding stockholder litigation (the "January 2001 Consent and Amendment"). The January 2001 Consent and Amendment also modified certain provisions of the Senior Bank Credit Facility to permit the issuance of the promissory note.

In March 2001, the Company obtained an amendment to the Senior Bank Credit Facility which: (i) changed the date the securitization of lease payments (or other similar transaction) with respect to the Company's Agecroft facility was required to be consummated from February 28, 2001 to March 31, 2001; (ii) modified the calculation of EBITDA used in calculating the total leverage ratio, to take into effect any loss of EBITDA that may result from certain asset dispositions, and (iii)

modified the minimum EBITDA covenant to permit a reduction by the amount of EBITDA that certain asset dispositions had generated.

The securitization of lease payments (or other similar transaction) with respect to the Company's Agecroft facility did not close by the required date. However, the covenant allowed for a 30 day grace period during which the lenders under the Senior Bank Credit Facility could not exercise their rights to declare an event of default. On April 10, 2001, prior to the expiration of the grace period, the Company consummated the Agecroft transaction through the sale of all of the issued and outstanding capital stock of Agecroft Properties, Inc., a wholly-owned subsidiary of the Company, and used the net proceeds to pay-down the Senior Bank Credit Facility, thereby fulfilling the Company's covenant requirements with respect to the Agecroft transaction.

The Senior Bank Credit Facility also contains a covenant requiring the Company to provide the lenders with audited financial statements within 90 days of the Company's fiscal year-end, subject to an additional five-day grace period. Due to the Company's attempts to close the Agecroft transaction, the Company did not provide the audited financial statements within the required time period. However, the Company obtained a waiver from the lenders under the Senior Bank Credit Facility of this financial reporting requirement. This waiver also cured the resulting cross-default under the Company's $41.1 million convertible subordinated notes. During the third quarter of 2001, the Company also obtained waivers from the lenders under the Senior Bank Credit Facility to permit the settlement of the Fortress/Blackstone litigation, as further described in Note 21, and to pay a one-time dividend with respect to the Series A Preferred Stock, which was paid on October 15, 2001 as discussed in Note 14.

*December 2001 Amendment and Restatement.* During December 2001, the Company completed an amendment and restatement of the Senior Bank Credit Facility (the "December 2001 Amendment and Restatement"). As part of the December 2001 Amendment and Restatement, the existing $269.4 million revolving portion of the Senior Bank Credit Facility, which was to mature on January 1, 2002, was replaced with a term loan of the same amount maturing on December 31, 2002, to coincide with the maturity of other term loans under the Senior Bank Credit Facility.

Pursuant to terms of the December 2001 Amendment and Restatement, all loans under the Senior Bank Credit Facility bear interest at a variable rate of 5.5% over LIBOR, or 4.5% over the base rate, at the Company's option, through June 30, 2002. Following June 30, 2002, the applicable interest rate for all loans under the Senior Bank Credit Facility will increase to 6.5% over LIBOR, or 5.5% over the base rate, at the Company's option. In the event the Company is unable to refinance the entire Senior Bank Credit Facility prior to July 1, 2002, the Company will also be required to pay the lenders under the Senior Bank Credit Facility an additional fee equal to 1.0% of the amounts then outstanding under the Senior Bank Credit Facility.

As a result of the December 2001 Amendment and Restatement, certain financial and non-financial covenants were amended, including the removal of prior restrictions on the Company's ability to pay cash dividends on shares of the Company's issued and outstanding Series A Preferred Stock, including all dividends in arrears. Subsequent to December 31, 2001, the Company paid $12.9 million to shareholders of Series A Preferred Stock. See Note 14 for further discussion of distributions to stockholders.

At December 31, 2001, the Company believes it was in compliance with all covenants under the Senior Bank Credit Facility. Management has prepared financial projections for 2002, which indicate the Company will continue to remain compliant with its debt covenants. In addition, management continues to pursue additional asset sales and new contract awards. Based upon these

additional factors, management has begun pursuing alternatives to refinance the Senior Bank Credit Facility scheduled to mature December 31, 2002.

The Company believes that it will be able to complete a refinancing of the Senior Bank Credit Facility during the first half of 2002 through senior secured bank debt or through a combination of senior secured bank debt and senior unsecured debt even without the sale of additional assets or contract awards. However, there can be no assurance that the Company will be able to meet its financial projections for 2002, sell additional assets, obtain new contract awards or complete a refinancing of the Senior Bank Credit Facility prior to its maturity on December 31, 2002, on commercially reasonable or other terms. Unsuccessful attempts to refinance the Senior Bank Credit Facility, or events of default which result in the acceleration of all or a substantial portion of the Company's outstanding debt, would have a material adverse effect on the Company's liquidity and financial position. The Company does not have sufficient working capital resources to satisfy it debt obligations in the event of an acceleration of all or a substantial portion of the Company's outstanding debt. The Senior Bank Credit Facility is secured by all of the Company's tangible and intangible assets.

During 1999, the Company incurred costs of $59.2 million in consummating the Credit Facility and the Senior Bank Credit Facility transactions, including $41.2 million related to the amendment and restatement. The Company wrote-off $9.0 million of expenses related to the Credit Facility upon completion of the amendment and restatement, in addition to $5.6 million of other debt financing costs written-off in 1999. During 2000 the Company incurred and capitalized approximately $9.0 million in consummating the June 2000 Waiver and Amendment, and $0.5 million for the November 2000 Consent and Amendment. During 2001, the Company incurred and capitalized approximately $5.8 million in consummating the 2001 December Amendment and Restatement.

In accordance with the terms of the Senior Bank Credit Facility, the Company entered into certain swap arrangements guaranteeing that it will not pay an index rate greater than 6.51% on outstanding balances of at least $325.0 million through December 31, 2002. The effect of these arrangements is recognized in interest expense and in the change in fair value of derivative instruments, as further described in Note 17.

**$100.0 Million Senior Notes**

On June 11, 1999, the Company completed its offering of $100.0 million aggregate principal amount of 12% Senior Notes due 2006 (the "Senior Notes"). Interest on the Senior Notes is paid semi-annually in arrears, and the Senior Notes have a seven year non-callable term due June 1, 2006. Net proceeds from the offering were approximately $95.0 million, after deducting expenses payable by the Company in connection with the offering. The Company used the net proceeds from the sale of the Senior Notes for general corporate purposes and to repay revolving bank borrowings under the Senior Bank Credit Facility. At any time prior to June 1, 2002, the Company may, at its option, on any one or more occasions redeem up to 35% of the aggregate principal at a redemption price equal to 112% of the principal amount thereof, with the proceeds of one or more equity offerings, subject to certain restrictions.

The Company has made all required interest payments under the terms of the Senior Notes, and currently believes it is in compliance with all of its covenants. The indenture governing the Senior Notes contains cross-default provisions, as further discussed below.

**$41.1 Million Convertible Subordinated Notes**

On January 29, 1999, the Company issued $20.0 million of convertible subordinated notes due December 2008, with interest payable semi-annually at 9.5%. This issuance constituted the second tranche of a commitment by the Company to issue an aggregate of $40.0 million of convertible subordinated notes, with the first $20.0 million tranche issued in December 1998 under substantially similar terms. The convertible subordinated notes (the "$40.0 Million Convertible Subordinated Notes") require that the Company revise the conversion price as a result of the payment of a dividend or the issuance of stock or convertible securities below market price. Additionally, the notes are non-callable but are redeemable on or following January 1, 2005, at a redemption price equal to 100% of the principal amount thereof.

During the first and second quarters of 2000, certain existing or potential events of default arose under the provisions of the note purchase agreement relating to the $40.0 Million Convertible Subordinated Notes as a result of the Company's financial condition and a "change of control" arising from the Company's execution of certain securities purchase agreements with respect to the proposed restructuring. This "change of control" gave rise to the right of MDP, the holder of the notes, to require the Company to repurchase the notes at a price of 105% of the aggregate principal amount of such notes within 45 days after the provision of written notice by such holders to the Company. In addition, the Company's defaults under the provisions of the note purchase agreement gave rise to the right of the holders of such notes to require the Company to pay an applicable default rate of interest of 20.0%. In addition to the default rate of interest, as a result of the events of default, the Company is obligated, under the original terms of the $40.0 Million Convertible Subordinated Notes, to pay the holders of the notes contingent interest sufficient to permit the holders to receive a 15.0% rate of return (increased by 0.5%, as further discussed below), excluding the effect of the default rate of interest, on the $40.0 million principal amount. The contingent interest is payable upon each of December 31, 2003 and upon repayment of the notes, unless the holders of the notes elect to convert the notes into the Company's common stock under the terms of the note purchase agreement or unless the price of the Company's common stock meets or exceeds a "target price" as defined in the note purchase agreement. Such contingent interest was retroactive to the date of issuance of the notes. The contingent interest accrual as of December 31, 2001 amounted to $8.7 million.

In order to address the events of default discussed above, on June 30, 2000, the Company and MDP executed a waiver and amendment to the provisions of the note purchase agreement governing the notes. This waiver and amendment provided for a waiver of all existing events of default under the provisions of the note purchase agreement. In addition, the waiver and amendment to the note purchase agreement amended the economic terms of the notes to increase the applicable interest rate of the notes by 0.5% per annum from 9.5% to 10.0%, and adjusted the conversion price of the notes to a price equal to 125% of the average high and low sales price of the Company's common stock on the NYSE for a period of 20 trading days immediately following the earlier of (i) October 31, 2000 or (ii) the closing date of the Operating Company Merger. The waiver and amendment also increased the contingent interest rate to 15.5% retroactive to the date of issuance of the notes. In addition, the waiver and amendment to the note purchase agreement provided for the replacement of financial ratios applicable to the Company. The conversion price for the notes has been established at $11.90 (as adjusted for the reverse-stock split in May 2001), subject to adjustment in the future upon the occurrence of certain events, including the payment of dividends and the issuance of stock at below market prices by the Company. Under the terms of the waiver and amendment, the distribution of the Company's Series B Preferred Stock during the fourth quarter of 2000 did not cause an adjustment to the conversion price of the notes. In addition, the Company does not believe that the distribution of shares of the Company's common stock in connection with the settlement of

all outstanding stockholder litigation against the Company, as further discussed in Note 21, will cause an adjustment to the conversion price of the notes. MDP, however, has indicated its belief that such an adjustment is required. At an adjusted conversion price of $11.90 (as adjusted for the reverse stock split in May 2001), the $40.0 Million Convertible Subordinated Notes are convertible into approximately 3.4 million shares (as adjusted for the reverse stock split in May 2001) of the Company's common stock.

In connection with the waiver and amendment to the note purchase agreement, the Company issued additional convertible subordinated notes containing substantially similar terms in the aggregate principal amount of $1.1 million (collectively with the $40.0 Million Convertible Subordinated Notes, the "$41.1 Million Convertible Subordinated Notes"), which amount represented all interest owed at the default rate of interest through June 30, 2000. These additional notes were convertible, at an adjusted conversion price of $11.90 (as adjusted for the reverse-stock split in May 2001), into an additional 0.1 million shares (as adjusted for the reverse-stock split in May 2001) of the Company's common stock. After giving consideration to the issuance of these additional notes, the Company has made all required interest payments under the $40.0 Million Convertible Subordinated Notes. On January 14, 2002, MDP converted the $1.1 million convertible subordinated notes into approximately 0.1 million shares of common stock.

Under the terms of the registration rights agreement between the Company and the holders of the $41.1 Million Convertible Subordinated Notes, the Company is required to use its best efforts to file and maintain with the SEC an effective shelf registration statement covering the future sale by the holders of the shares of common stock to be used upon conversion of the notes. As a result of the completion of the Restructuring, as previously discussed herein, the Company was unable to file such a registration statement with the SEC prior to the filing of the Company's 2000 Form 10-K with the SEC on April 17, 2001. Following the filing of the Company's Form 10-K, the Company commenced negotiations with MDP with respect to an amendment to the registration rights agreement to defer the Company's obligations to use its best efforts to file and maintain the registration statement. MDP later informed the Company that it would not complete such an amendment. As a result, the Company completed and filed a shelf registration statement with the SEC on September 13, 2001, which became effective September 26, 2001, in compliance with this obligation.

The Company currently believes it is in compliance with all covenants under the provisions of the $40.0 Million Convertible Subordinated Notes, as amended. There can be no assurance, however, that the Company will be able to remain in compliance with all covenants under the provisions of the $40.0 Million Convertible Subordinated Notes. The provisions of the note purchase agreement governing the $40.0 Million Convertible Subordinated Notes contain cross-default provisions as further discussed below.

**$30.0 Million Convertible Subordinated Notes**

The Company's $30.0 million convertible subordinated notes due February 2005 (the "$30.0 Million Convertible Subordinated Notes"), which were issued to PMI Mezzanine Fund, L.P. ("PMI") on December 31, 1998, require that the Company revise the conversion price as a result of the payment of a dividend or the issuance of stock or convertible securities below market price.

Certain existing or potential events of default arose under the provisions of the note purchase agreement relating to the Company's $30.0 Million Convertible Subordinated Notes as a result of the Company's financial condition and as a result of the Restructuring. However, on June 30, 2000, the Company and PMI executed a waiver and amendment to the provisions of the note purchase

agreement governing the notes. This waiver and amendment provided for a waiver of all existing events of default under the revisions of the note purchase agreement. In addition, the waiver and amendment to the note purchase agreement amended the economic terms of the notes to increase the applicable interest rate of the notes by 0.5% per annum, from 7.5% to 8.0%, and adjusted the conversion price of the notes to a price equal to 125% of the average closing price of the Company's common stock on the NYSE for a period of 30 trading days immediately following the earlier of (i) October 31, 2000 or (ii) the closing date of the Operating Company Merger. In addition, the waiver and amendment to the note purchase agreement provided for the replacement of financial ratios applicable to the Company.

The conversion price for the notes has been established at $10.68 (as adjusted for the reverse stock split in May 2001), subject to adjustment in the future upon the occurrence of certain events, including the payment of dividends and the issuance of stock at below market prices by the Company. Under the terms of the waiver and amendment, the distribution of the Company's Series B Preferred Stock during the fourth quarter of 2000 did not cause an adjustment to the conversion price of the notes. However, the distribution of shares of the Company's common stock in connection with the settlement of all outstanding stockholder litigation against the Company, as further discussed in Note 21, will cause an adjustment to the conversion price of the notes in an amount to be determined at the time shares of the Company's common stock are distributed pursuant to the settlement. However, the ultimate adjustment to the conversion ratio will depend on the number of shares of the Company's common stock outstanding on the date of issuance of the shares pursuant to the stockholder litigation settlement. In addition, since all of the shares have not been issued simultaneously, multiple adjustments to the conversion ratio will be required. The Company currently estimates that the $30.0 Million Convertible Subordinated Notes will be convertible into approximately 3.4 million shares (as adjusted for the reverse stock split in May 2001) of the Company's common stock once all of the shares under the stockholder litigation settlement have been issued.

At any time after February 28, 2004, the Company may require the holder of the notes to convert all or a portion of the principal amount of the indebtedness into shares of common stock if, at such time, the current market price of the common stock has equaled or exceeded 150% of the conversion price for 45 consecutive trading days.

At December 31, 2000, the Company was in default under the terms of the note purchase agreement governing the $30.0 Million Convertible Subordinated Notes. The default related to the Company's failure to comply with the total leverage ratio financial covenant. However, in March 2001, the Company and PMI executed a waiver and amendment to the provisions of the note purchase agreement governing the notes. This waiver and amendment provided for a waiver of all existing events of default under the provisions of the note purchase agreement and amended the financial covenants applicable to the Company.

The Company has made all required interest payments under the $30.0 Million Convertible Subordinated Notes. The Company currently believes it is in compliance with all covenants under the provisions of the $30.0 Million Convertible Subordinated Notes, as amended. There can be no assurance, however, that the Company will be able to remain in compliance with all of the covenants under the provisions of the $30.0 Million Convertible Subordinated Notes. The provisions of the note purchase agreement governing the $30.0 Million Convertible Subordinated Notes contain cross-default provisions as further discussed below.

## $50.0 Million Revolving Credit Facility

On September 15, 2000, Operating Company entered into a $50.0 million revolving credit facility with Lehman (the "Operating Company Revolving Credit Facility"). This facility, which bears interest at an applicable prime rate, plus 2.25%, was secured by the accounts receivable and all other assets of Operating Company. This facility, which matures on December 31, 2002, was assumed by a wholly-owned subsidiary of the Company in connection with the Operating Company Merger. As of December 31, 2001, the Company had no outstanding balance on the facility.

## Other Debt Transactions

At December 31, 2001 and 2000, the Company had $5.5 million and $2.2 million in letters of credit, respectively. The letters of credit were issued to secure the Company's workers' compensation insurance policy, performance bonds and utility deposits. The Company is required to maintain cash collateral for the letters of credit.

The Company capitalized interest of $8.3 million and $37.7 million in 2000 and 1999, respectively. No interest was capitalized during 2001.

Debt maturities for the next five years and thereafter are (in thousands):

| | |
|---|---|
| 2002 | $ 792,009 |
| 2003 | 1,228 |
| 2004 | 126 |
| 2005 | 30,139 |
| 2006 | 100,098 |
| Thereafter | 40,000 |
| | $ 963,600 |

## Cross-default Provisions

The provisions of the Company's debt agreements related to the Senior Bank Credit Facility, the $40.0 Million Convertible Subordinated Notes, the $30.0 Million Convertible Subordinated Notes and the Senior Notes contain certain cross-default provisions. Any events of default under the Senior Bank Credit Facility which give rise to the ability of the lenders under the Senior Bank Credit Facility to exercise their acceleration rights result in an event of default under the Company's $40.0 Million Convertible Subordinated Notes. Any events of default under the Senior Bank Credit Facility that results in the lenders' actual acceleration of amounts outstanding thereunder also result in an event of default under the Company's $30.0 Million Convertible Subordinated Notes and the Senior Notes. Additionally, any events of default under the $40.0 Million Convertible Subordinated Notes, the $30.0 Million Convertible Subordinated Notes and the Senior Notes which give rise to the ability of the holders of such indebtedness to exercise their acceleration rights also result in an event of default under the Senior Bank Credit Facility.

If the Company were to be in default under the Senior Bank Credit Facility, and if the lenders under the Senior Bank Credit Facility elected to exercise their rights to accelerate the Company's obligations under the Senior Bank Credit Facility, such events could result in the acceleration of all or a portion of the Company's $40.0 Million Convertible Subordinated Notes, the $30.0 Million Convertible Subordinated Notes and the Senior Notes, which would have a material adverse effect on the Company's liquidity and financial position. Additionally, under the Company's $40.0 Million Convertible Subordinated Notes, even if the lenders under the Senior Bank Credit Facility

did not exercise their acceleration rights, the holders of the $40.0 Million Convertible Subordinated Notes could require the Company to repurchase such notes upon an event of default under the Senior Bank Credit Facility permitting acceleration. The Company does not have sufficient working capital to satisfy its debt obligations in the event of an acceleration of all or a substantial portion of the Company's outstanding indebtedness.

## 16. INCOME TAXES

Prior to 1999, Old CCA, the Company's predecessor by merger, operated as a taxable subchapter C corporation. The Company elected to change its tax status from a taxable corporation to a REIT effective with the filing of its 1999 federal income tax return. As of December 31, 1998, the Company's balance sheet reflected $83.2 million in net deferred tax assets. In accordance with the provisions of SFAS 109, the Company provided a provision for these deferred tax assets, excluding any estimated tax liabilities required for prior tax periods, upon completion of the 1999 Merger and the election to be taxed as a REIT. As such, the Company's results of operations reflect a provision for income taxes of $83.2 million for the year ended December 31, 1999. However, due to New Prison Realty's tax status as a REIT, New Prison Realty recorded no income tax provision or benefit related to operations for the year ended December 31, 1999.

In connection with the Restructuring, on September 12, 2000 the Company's stockholders approved an amendment to the Company's charter to remove provisions requiring the Company to elect to qualify and be taxed as a REIT for federal income tax purposes effective January 1, 2000. As a result of the amendment to the Company's charter, the Company is taxed as a taxable subchapter C corporation beginning with its taxable year ended December 31, 2000. In accordance with the provisions of SFAS 109, the Company was required to establish current and deferred tax assets and liabilities in its financial statements in the period in which a change of tax status occurs. As such, the Company's benefit for income taxes for the year ended December 31, 2000 includes the provision associated with establishing the deferred tax assets and liabilities in connection with the change in tax status during the third quarter of 2000, net of a valuation allowance applied to certain deferred tax assets.

The provision (benefit) for income taxes is comprised of the following components (in thousands):

| | For the years ended December 31, | | |
|---|---|---|---|
| | **2001** | 2000 | 1999 |
| **Current provision (benefit)** | | | |
| Federal | $ - | $ (26,593) | $ - |
| State | **4,667** | 586 | - |
| | **4,667** | (26,007) | - |
| **Deferred provision (benefit)** | | | |
| Federal | **(3,169)** | (19,739) | 74,664 |
| State | **(362)** | (2,256) | 8,536 |
| | **(3,531)** | (21,995) | 83,200 |
| **Provision (benefit) for income taxes** | **$ 1,136** | $ (48,002) | $ 83,200 |

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2001 and 2000, are as follows (in thousands):

| | 2001 | 2000 |
|---|---|---|
| **Current deferred tax assets:** | | |
| Asset reserves and liabilities not yet deductible for tax | $ 17,333 | $ 24,894 |
| Less valuation allowance | (17,333) | (24,894) |
| Net total current deferred tax assets | $ - | $ - |
| **Noncurrent deferred tax assets:** | | |
| Asset reserves and liabilities not yet deductible for tax | $ 10,394 | $ 4,634 |
| Tax over book basis of certain assets | 21,799 | 41,923 |
| Net operating loss carryforwards | 82,369 | 56,115 |
| Other | 18,632 | 8,743 |
| Total noncurrent deferred tax assets | 133,194 | 111,415 |
| Less valuation allowance | (133,194) | (111,415) |
| Net noncurrent deferred tax assets | - | - |
| **Noncurrent deferred tax liabilities:** | | |
| Book over tax basis of certain assets | 4,975 | 6,556 |
| Basis difference in sale of investment | 49,839 | 49,839 |
| Other | 1,697 | 55 |
| Total noncurrent deferred tax liabilities | 56,511 | 56,450 |
| Net noncurrent deferred tax liabilities | $ 56,511 | $ 56,450 |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of the future tax benefits related to deferred tax assets is dependent on many factors, including the Company's ability to generate taxable income within the net operating loss carryforward period. Management has considered these factors in assessing the valuation allowance for financial reporting purposes. In accordance with SFAS 109, the Company has provided a valuation allowance to reserve the deferred tax assets. At December 31, 2001, the Company had net operating loss carryforwards for income tax purposes totaling approximately $211.2 million available to offset future taxable income. The carryforward period begins expiring in 2009.

A reconciliation of the income tax expense (benefit) at the statutory income tax rate and the effective tax rate as a percentage of pretax income (loss) for the years ended December 31, 2001 and 2000 is as follows:

| | 2001 | 2000 |
|---|---|---|
| Statutory federal rate | 35.0% | (35.0)% |
| State taxes, net of federal tax benefit | 4.0 | (4.0) |
| Puerto Rico taxes | 10.5 | - |
| Change in tax status | - | 12.5 |
| Permanent differences (primarily related to stockholder litigation and sale of a subsidiary) | (51.6) | 5.9 |
| Change in valuation allowance | 6.1 | 12.2 |
| Other items, net | 0.2 | 2.2 |
| | 4.2% | (6.2)% |

On March 9, 2002, the "Job Creation and Worker Assistance Act of 2002" was signed into law. Among other changes, the law extends the net operating loss carryback period to five years from two years for net operating losses arising in tax years ending in 2001 and 2002, and allows use of net operating loss carrybacks and carryforwards to offset 100% of the alternative minimum taxable income. The Company experienced net operating losses during 2001 resulting primarily from the sale of assets at prices below the tax basis of such assets. Under terms of the new law, the Company will be able to utilize its net operating losses to offset taxable income generated in 1997 and 1996. As a result of this tax law change in 2002, the Company will be due an income tax refund of approximately $30.0 million, which will be reflected as an income tax benefit during the first quarter of 2002.

## 17. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

SFAS 133, as amended, establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133, as amended, requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS 133, as amended, was issued in June 1998, and was effective for fiscal quarters of fiscal years beginning after June 15, 2000. The Company adopted SFAS 133, as amended, effective January 1, 2001. The Company's derivative instruments include an interest rate swap agreement and an 8.0%, $26.1 million promissory note due in 2009, issued December 31, 2001, in conjunction with the settlement in federal court of a series of stockholder lawsuits against the Company and certain of its existing and former directors and executive officers, as further discussed in Note 21. Upon issuance, the Company's derivative instruments will also include an 8.0%, $2.9 million promissory note due in 2009, expected to be issued in conjunction with the issuance of shares of common stock to plaintiffs arising from the state court portion of the stockholder litigation settlement. The issuance of these shares, and consequently the promissory note, is expected to occur during the first half of 2002.

In accordance with the terms of the Senior Bank Credit Facility, the Company entered into certain swap arrangements in order to hedge the variable interest rate associated with portions of the debt. The swap arrangements fix LIBOR at 6.51% (prior to the applicable spread) on outstanding balances of at least $325.0 million through December 31, 2002. The difference between the floating rate and the swap rate is recognized in interest expense.

The Company has elected not to attempt to meet the hedge accounting criteria for the interest rate swap agreement under SFAS 133, as amended, and has reflected in earnings the change in the estimated fair value of the interest rate swap agreement. As of December 31, 2001, due to a reduction in interest rates since entering into the swap agreement, the interest rate swap agreement had a negative fair value of $13.6 million. This negative fair value consists of a transition adjustment of $5.0 million for the reduction in the fair value of the interest rate swap agreement from its inception through the adoption of SFAS 133 on January 1, 2001 reflected in other comprehensive income (loss) effective January 1, 2001 and a decrease in the fair value of the swap agreement of $8.6 million reflected in earnings for the year ended December 31, 2001.

In accordance with SFAS 133, as amended, the Company recorded an $11.1 million non-cash charge for the change in fair value of the interest rate swap agreement for the year ended December 31, 2001, which includes $2.5 million for amortization of the transition adjustment. The unamortized transition adjustment at December 31, 2001 of $2.5 million is expected to be included in earnings as a non-cash charge, along with a corresponding increase to stockholders' equity through accumulated comprehensive income, over the remaining term of the swap agreement. The non-cash charge of $11.1 million for the year ended December 31, 2001 is expected to reverse into

earnings through increases in the fair value of the swap agreement, prior to the maturity of the swap agreement on December 31, 2002, unless the swap is terminated in conjunction with a refinancing of the Senior Bank Credit Facility. However, for each quarterly period prior to the maturity of the swap agreement, the Company will continue to adjust the swap agreement to its estimated fair value potentially resulting in additional non-cash charges or gains.

On December 31, 2001, approximately 2.8 million shares of the Company's common stock were issued, along with a $26.1 million promissory note, in conjunction with the final settlement of the federal court portion of the stockholder litigation settlement. Under the terms of the promissory note, the note and accrued interest became extinguished in January 2002 once the average closing price of the common stock exceeded a "termination price" equal to $16.30 per share for fifteen consecutive trading days following the issuance of such note. The terms of the note, which allow the principal balance to fluctuate dependent on the trading price of the Company's common stock, create a derivative instrument that must be valued and accounted for under the provisions of SFAS 133. As a result of the extinguishment of the note in January 2002, management has estimated the fair value of this derivative to approximate the face amount of the note, resulting in an asset being recorded in the fourth quarter of 2001. The derivative asset offsets the face amount of the note in the consolidated balance sheet as of December 31, 2001.

The state court portion of the stockholder litigation settlement has not yet been completed; however, the settlement is expected to result in the issuance of approximately 0.3 million additional shares of the Company's common stock and a $2.9 million subordinated promissory note, which may also be extinguished if the average closing price of the Company's common stock meets or exceeds $16.30 per share for fifteen consecutive trading days following the note's issuance and prior to its maturity in 2009. Additionally, to the extent the Company's common stock price does not meet the termination price, the note will be reduced by the amount that the shares of common stock issued to the plaintiffs appreciate in value in excess of $4.90 per share, based on the average trading price of the stock following the date of the note's issuance and prior to the maturity of the note. If the remaining promissory note is issued under the current terms, in accordance with SFAS 133, as amended, the Company will reflect in earnings the change in the estimated fair value of the derivative included in the promissory note from quarter to quarter. Since the Company has reflected the maximum obligation of the contingency associated with the state court portion of the stockholder litigation in the accompanying consolidated balance sheet as of December 31, 2001, the issuance of the note is currently expected to have a favorable impact on the Company's consolidated financial position and results of operations initially; thereafter, the financial statement impact will fluctuate based on changes in the Company's stock price. However, the impact cannot be determined until the promissory note is issued and an estimated fair value of the derivative included in the promissory note is determined.

## 18. EARNINGS (LOSS) PER SHARE

In accordance with SFAS 128, basic earnings per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. For the Company, diluted earnings per share is computed by dividing net income (loss), as adjusted, by the weighted average number of common shares after considering the additional dilution related to convertible subordinated notes, restricted common stock plans, and stock options and warrants.

A reconciliation of the numerator and denominator of the basic earnings per share computation to the numerator and denominator of the diluted earnings per share computation is as follows (in thousands, except per share data, which has also been adjusted for the reverse stock split in May 2001):

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| NUMERATOR | | | |
| Basic and Diluted | | | |
| Net income (loss) available to common stockholders | **$ 5,670** | $ (744,308) | $ (81,254) |
| DENOMINATOR | | | |
| Basic | | | |
| Weighted average common shares outstanding | **24,380** | 13,132 | 11,510 |
| Diluted: | | | |
| Weighted average common shares outstanding | **24,380** | 13,132 | 11,510 |
| Stock options and warrants | **371** | - | - |
| Stockholder litigation | **3,402** | - | - |
| Restricted stock | **239** | - | - |
| Weighted average shares and assumed conversion-diluted | **28,392** | 13,132 | 11,510 |
| Basic earnings (loss) per share | **$ 0.23** | $ (56.68) | $ (7.06) |
| Diluted earnings (loss) per share | **$ 0.20** | $ (56.68) | $ (7.06) |

For the year ended December 31, 2001, the Company's convertible subordinated notes were convertible into 6.8 million shares of common stock (as adjusted for the reverse stock split in May 2001), using the if-converted method. These incremental shares were excluded from the computation of diluted earnings per share for the year ended December 31, 2001, as the effect of their inclusion was anti-dilutive.

For the years ended December 31, 2000 and 1999, the Company's stock options and warrants were convertible into 0.1 million shares of common stock (as adjusted for the reverse stock split in May 2001), using the treasury stock method. For the years ended December 31, 2000 and 1999, the Company's convertible subordinated notes were convertible into 6.3 million and 0.3 million shares of common stock, respectively (as adjusted for the reverse stock split in May 2001), using the if-converted method. These incremental shares were excluded from the computation of diluted earnings per share for the years ended December 31, 2000 and 1999 as the effect of their inclusion was anti-dilutive.

## 19. STOCKHOLDERS' EQUITY

### Common Stock

On January 11, 1999, the Company filed a Registration Statement on Form S-3 to register an aggregate of $1.5 billion in value of its common stock, preferred stock, common stock rights, warrants and debt securities for sale to the public (the "Shelf Registration Statement"). Proceeds from sales under the Shelf Registration Statement were to be used for general corporate purposes, including the acquisition and development of correctional and detention facilities. During 1999, the Company issued and sold approximately 6.7 million shares of its common stock under the Shelf Registration Statement, resulting in net proceeds to the Company of approximately $120.0 million. The Shelf Registration Statement is not available for further use by the Company.

On May 7, 1999, the Company registered 10.0 million shares of the Company's common stock for issuance under the Company's Dividend Reinvestment and Stock Purchase Plan (the "DRSPP"). The DRSPP provided a method of investing cash dividends in, and making optional monthly cash purchases of, the Company's common stock, at prices reflecting a discount between 0% and 5% from the market price of the common stock on the NYSE. During 1999, the Company issued approximately 1.3 million shares under the DRSPP, with substantially all of these shares issued under the DRSPP's optional cash feature, resulting in proceeds of $12.3 million. The Company has suspended the DRSPP.

At the Company's 2000 annual meeting of stockholders held in December 2000, the holders of the Company's common stock approved a reverse stock split of the Company's common stock at a ratio to be determined by the board of directors of the Company of not less than one-for-ten and not to exceed one-for-twenty. The board of directors subsequently approved a reverse stock split of the Company's common stock at a ratio of one-for-ten, which was effective May 18, 2001.

As a result of the reverse stock split, every ten shares of the Company's common stock issued and outstanding immediately prior to the reverse stock split has been reclassified and changed into one fully paid and nonassessable share of the Company's common stock. The Company paid its registered common stockholders cash in lieu of issuing fractional shares in the reverse stock split at a post reverse-split rate of $8.60 per share, totaling approximately $15,000. The number of common shares and per share amounts have been retroactively restated in the accompanying financial statements and these notes to the financial statements to reflect the reduction in common shares and corresponding increase in the per share amounts resulting from the reverse stock split. In conjunction with the reverse stock split, during the second quarter of 2001, the Company amended its charter to reduce the number of shares of common stock which the Company was authorized to issue to 80.0 million shares (on a post-reverse stock split basis) from 400.0 million shares (on a pre-reverse stock split basis). As of December 31, 2001, the Company had 27.9 million shares of common stock issued and outstanding (on a post-reverse stock split basis).

During 1995, Old CCA authorized the issuance of 29,500 shares of common stock (as adjusted for the reverse stock split in May 2001) to certain key employees as a deferred stock award. The award was to fully vest ten years from the date of grant based on continuous employment with the Company. The Company had been expensing the $3.7 million of awards over the ten-year vesting period. Due to the resignation or termination of these employees, these shares (along with an additional 23,500 shares issued pursuant to an adjustment resulting from the issuance and subsequent conversion of shares of the Series B preferred stock as discussed below) became fully vested; therefore the Company expensed the unamortized portion of the award, totaling approximately $1.8 million, during 2000.

**Series A Preferred Stock**

Upon its formation in 1998, the Company authorized 20.0 million shares of $0.01 par value preferred stock, of which 4.3 million shares are designated as Series A Preferred Stock.

As discussed in Note 3, in connection with the 1999 Merger, Old Prison Realty shareholders received one share of Series A Preferred Stock of the Company in exchange for each Old Prison Realty Series A Cumulative Preferred Share. Consequently, the Company issued 4.3 million shares of its Series A Preferred Stock on January 1, 1999. The shares of the Company's Series A Preferred Stock are redeemable at any time by the Company on or after January 30, 2003 at $25.00 per share, plus dividends accrued and unpaid to the redemption date. Shares of the Company's Series A Preferred Stock have no stated maturity, sinking fund provision or mandatory redemption and are

not convertible into any other securities of the Company. Dividends on shares of the Company's Series A Preferred Stock are cumulative from the date of original issue of such shares and are payable quarterly in arrears on the fifteenth day of January, April, July and October of each year, to shareholders of record on the last day of March, June, September and December of each year, respectively, at a fixed annual rate of 8.0%.

As discussed in Notes 14 and 15, in connection with the June 2000 Waiver and Amendment, the Company was prohibited from declaring or paying any dividends with respect to the Series A Preferred Stock until such time as the Company had raised at least $100.0 million in equity. As a result, the Company had not declared or paid any dividends on its shares of Series A Preferred Stock since the first quarter of 2000. Dividends continued to accrue under the terms of the Company's charter until the Company received a consent and waiver from its lenders under the Senior Bank Credit Facility in September 2001, which allowed the Company's board of directors to declare a one-time dividend on the issued and outstanding Series A Preferred Stock, which was paid on October 15, 2001.

In connection with the December 2001 Amendment and Restatement of the Senior Bank Credit Facility, certain financial and non-financial covenants were amended, including the removal of prior restrictions on the Company's ability to pay cash dividends on shares of its issued and outstanding Series A Preferred Stock. Under the terms of the December 2001 Amendment and Restatement, the Company is permitted to pay quarterly dividends on the shares of its issued and outstanding Series A Preferred Stock, including all dividend in arrears. See Note 14 for further information on distributions on the Company's shares of Series A Preferred Stock.

**Series B Preferred Stock**

In order to satisfy the REIT distribution requirements with respect to its 1999 taxable year, during 2000 the Company authorized an additional 30.0 million shares of $0.01 par value preferred stock, designated 12.0 million shares of such preferred stock as Series B Preferred Stock and subsequently issued approximately 7.5 million shares to holders of the Company's common stock as a stock dividend.

The shares of Series B Preferred Stock issued by the Company provide for cumulative dividends payable at a rate of 12% per year of the stock's stated value of $24.46. The dividends are payable quarterly in arrears, in additional shares of Series B Preferred Stock through the third quarter of 2003, and in cash thereafter, provided that all accrued and unpaid cash dividends have been made on the Company's Series A Preferred Stock. The shares of the Series B Preferred Stock are callable by the Company, at a price per share equal to the stated value of $24.46, plus any accrued dividends, at any time after six months following the later of (i) three years following the date of issuance or (ii) the 91st day following the redemption of the Company's Senior Notes. The shares of Series B Preferred Stock were convertible into shares of the Company's common stock during two conversion periods: (i) from October 2, 2000 to October 13, 2000; and (ii) from December 7, 2000 to December 20, 2000, at a conversion price based on the average closing price of the Company's common stock on the NYSE during the 10 trading days prior to the first day of the applicable conversion period, provided, however, that the conversion price used to determine the number of shares of the Company's common stock issuable upon conversion of the Series B Preferred Stock could not be less than $1.00. The number of shares of the Company's common stock that were issued upon the conversion of each share of Series B Preferred Stock was calculated by dividing the stated price ($24.46), plus accrued and unpaid dividends as of the date of conversion of each share of Series B Preferred Stock, by the conversion price established for the conversion period.

Approximately 1.3 million shares of Series B Preferred Stock issued by the Company on September 22, 2000 were converted during the first conversion period in October 2000, resulting in the issuance of approximately 2.2 million shares of the Company's common stock (as adjusted for the reverse stock split in May 2001). The conversion price for the initial conversion period was established at $1.48.

Approximately 2.9 million shares of Series B Preferred Stock issued by the Company on November 13, 2000 were converted during the second conversion period in December 2000, resulting in the issuance of approximately 7.3 million shares of the Company's common stock (as adjusted for the reverse stock split in May 2001). The conversion price for the second conversion period was established at $1.00. The shares of Series B Preferred Stock currently outstanding, as well as any additional shares issued as dividends, are not and will not be convertible into shares of the Company's common stock.

During 2001, the Company issued 452,000 shares of Series B Preferred Stock in satisfaction of the regular quarterly distributions. Additionally, as of December 31, 2001, the Company has accrued approximately $3.0 million of distributions on Series B Preferred Stock. See Note 14 for further information on distributions on the Company's shares of Series B Preferred Stock.

During 2001, the Company issued 0.2 million shares of Series B Preferred Stock under two Series B Preferred Stock restricted stock plans (the "Series B Restricted Stock Plans"), which were valued at $2.0 million on the date of the award. The restricted shares of Series B Preferred Stock were granted to certain of the Company's key employees and wardens. Under the terms of Series B Restricted Stock Plans, the shares in the key employee plan vest in equal intervals over a three-year period expiring in May 2004, while the shares in the warden plan vest all at one time in May 2004. During the year ended December 31, 2001, the Company expensed $0.4 million, net of forfeitures, relating to the Series B Restricted Stock Plans.

**Stock Warrants**

In connection with the Operating Company Merger, the Company issued warrants for approximately 213,000 shares (as adjusted for the reverse stock split in May 2001) of the Company's common stock to acquire the voting common stock of Operating Company. The warrants issued allow the holder to purchase approximately 142,000 shares of the Company's common stock at an exercise price of $0.01 per share (as adjusted for the reverse stock split in May 2001) and approximately 71,000 shares of the Company's common stock at an exercise price of $14.10 per share (as adjusted for the reverse stock split in May 2001). These warrants expire September 29, 2005. Also in connection with the Operating Company Merger, the Company assumed the obligation to issue up to approximately 75,000 shares of its common stock, at a price of $33.30 per share (as adjusted for the reverse stock split in May 2001), through their expiration date on December 31, 2008.

**Treasury Stock**

Treasury stock was recorded in 1999 related to the cashless exercise of stock options.

**Stock Option Plans**

The Company has equity incentive plans under which, among other things, incentive and non-qualified stock options are granted to certain employees and non-employee directors of the Company by the compensation committee of the Company's board of directors. The options are