

<DOCUMENT>

<TYPE>10-K405

<SEQUENCE>1

<FILENAME>form10-k\_11125.txt

<DESCRIPTION>FORM 10-K (YEAR ENDED 12/31/2001)

<TEXT>

=====

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

OR

[\_] Transition Report to Section 13 or 15(d) of the Securities Exchange  
Act of 1934 For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No.: 0-23038

CORRECTIONAL SERVICES CORPORATION

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

11-3182580

-----  
(State of other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer  
Identification No.)

1819 MAIN STREET, SARASOTA, FLORIDA

34236

-----  
(Address of principal executive office)

-----  
(Zip Code)

Registrant's telephone number, including area code: (941) 953-9199

Securities registered pursuant to Section 12(b) of the Act:

None.

Securities registered pursuant to Section 12(g) of the Act:

Title of each class

-----  
Common Stock, par value \$.01 per share

Name of each exchange on which registered

-----  
Nasdaq National Market

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405

of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock (Common Stock) held by non-affiliates of the Registrant as of the close of business on March 15, 2002 was approximately \$18,279,495 based on the closing sale price of the common stock on the Nasdaq National Market consolidated tape on that date.

Number of shares outstanding of each of the Registrant's classes of Common Stock, as of the close of business on March 15, 2002:

|                               |                   |
|-------------------------------|-------------------|
| Common Stock, \$.01 par value | 10,155,275 Shares |
|-------------------------------|-------------------|

=====

<PAGE>

## TABLE OF CONTENTS

|                                                                  | PAGE |
|------------------------------------------------------------------|------|
| PART I                                                           |      |
| Item 1 Business .....                                            | 4    |
| Item 2 Properties .....                                          | 13   |
| Item 3 Legal Proceedings .....                                   | 13   |
| Item 4 Submission of Matters to a Vote of Security Holders ..... | 16   |

## PART II

|         |                                                                                                |    |
|---------|------------------------------------------------------------------------------------------------|----|
| Item 5  | Market for Registrant's Common Equity and Related<br>Stockholder Matters .....                 | 17 |
| Item 6  | Selected Financial Data .....                                                                  | 18 |
| Item 7  | Management's Discussion and Analysis of Financial<br>Condition and Results of Operations ..... | 19 |
| Item 7A | Quantitative and Qualitative Disclosures About Market Risk .....                               | 28 |
| Item 8  | Financial Statements and Supplementary Data .....                                              | 29 |
| Item 9  | Changes in and Disagreements with Accountants on Accounting and<br>Financial Disclosure .....  | 29 |

## PART III

|         |                                                                   |    |
|---------|-------------------------------------------------------------------|----|
| Item 10 | Directors and Executive Officers of the Registrant .....          | 29 |
| Item 11 | Executive Compensation .....                                      | 31 |
| Item 12 | Security Ownership of Certain Beneficial Owners and Management .. | 33 |
| Item 13 | Certain Relationships and Related Transactions .....              | 34 |

## PART IV

|         |                                                                  |    |
|---------|------------------------------------------------------------------|----|
| Item 14 | Exhibits, Financial Statement Schedules, and Reports on Form 8-K | 36 |
|---------|------------------------------------------------------------------|----|

Signature Page ..... 38

2

&lt;PAGE&gt;

## SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and 21E of the Securities Exchange Act of 1934, as amended, which are not historical facts and involve risks and uncertainties. These include statements regarding the expectations, beliefs, intentions or strategies regarding the future. The Company intends that all forward-looking statements be subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the Company's views as of the date they are made with respect to future events and financial performance, but are subject to many uncertainties and risks which could cause the actual results of the Company to differ materially from any future results expressed or implied by such forward-looking statements. Examples of such uncertainties and risks include, but are not limited to: fluctuations in occupancy levels and labor costs; the ability to sell assets or enter into sale lease-back transactions; the ability to secure both new contracts and the renewal of existing contracts; the availability of financing; the ability to reduce various operating costs; and public resistance to privatization. Additional risk factors include those discussed in reports filed by the Company from time to time on Forms 10-K, 10-Q and 8-K. The Company does not undertake any obligation to update any forward-looking statements.

3

&lt;PAGE&gt;

## PART I

## ITEM 1. BUSINESS.

## GENERAL

Correctional Services Corporation ("CSC" or the "Company") was incorporated in Delaware on October 28, 1993 to acquire all of the outstanding capital stock of a number of affiliated corporations engaged in the operation of correctional and detention facilities. CSC later acquired Youth Services International ("YSI"), a leading national provider of private educational, developmental and rehabilitative programs to adjudicated juveniles, through a merger accounted for as a pooling of interests. In the merger, CSC issued 3,114,614 shares of CSC common stock in exchange for all of the outstanding common stock of YSI. The merger closed March 31, 1999.

The combined Company is one of the largest and most comprehensive providers of juvenile rehabilitative services with 25 facilities and approximately 3,700 juveniles in its care. In addition, the Company is a leading developer and operator of adult correctional facilities, operating 11 facilities representing approximately 4,300 beds. On a combined basis, as of December 31, 2001, the Company provided services in 15 states and Puerto Rico, representing approximately 8,000 beds including aftercare services.

Revenues for the year ended December 31, 2001 were \$174.4 million versus \$210.8 million in 2000. Contribution from operations was \$13.1 million for 2001 compared to \$25.2 million in 2000, with a net loss of \$5.9 million or \$(0.58) per diluted share compared to net income of \$5.8 million or \$0.51 per diluted share in the similar period of 2000. Diluted shares were 10.2 million and 11.4 million in 2001 and 2000, respectively.

CSC operates a wide range of correctional facilities targeted toward solving the specialized needs of governmental agencies. CSC's adult/community corrections

division specializes in facilities that service, among other populations:

- o substance abuse offenders;
- o parole violators;
- o pre-trial detainees;
- o sex offenders; and
- o community correctional program residents.

CSC's juvenile division operates largely under the YSI brand name and focuses on facilities that provide:

- o intensive treatment programs that include educational and vocational services;
- o treatment for habitual offenders;
- o specialized female services;
- o detention services;
- o sexual behavior disorder treatment programs;
- o substance abuse programs;
- o academy training programs;
- o high impact treatment programs; and
- o legislatively mandated boot camps.

CSC believes its programs, by instilling the qualities of self-respect, respect for others and their property, personal responsibility and family values, can help reduce the recidivism rate of program participants and hopefully help to prevent adult incarceration. To that end, CSC's juvenile programs are comprised of four major components: education; vocational training; socialization; and recreation. Behavioral management principles intended to dramatically change the thinking and behavior of program participants are consistently applied throughout each segment of programming in order to teach participants basic life skills, while reinforcing the principle that success begins with appropriate, acceptable behavior.

&lt;PAGE&gt;

In addition to providing fundamental residential services for adult and juvenile offenders, CSC has developed a broad range of programs intended to reduce recidivism, including: basic, special, and vocational education; substance abuse treatment and counseling; life skills training; behavioral modification counseling; and comprehensive aftercare programs. In all of its facilities, CSC strives to provide the highest quality services designed to reduce recidivism. CSC continually evaluates and audits its programs and believes the reputation of its programs will lead to continued business opportunities.

CSC is also a leading provider of design and construction services for juvenile and adult correctional facilities, including project consulting, the design, development and construction of new correctional and detention facilities and the redesign and renovation of existing facilities. These services usually are provided in conjunction with an agreement for CSC to operate the facility upon completion of the construction or renovation.

#### OPERATIONAL DIVISIONS

CSC has organized its operations into two divisions: Adult/Community Corrections and Juvenile (YSI).

**ADULT/COMMUNITY CORRECTIONS.** At year-end 2001, the Adult/Community Corrections Division operated 11 facilities in four states, six in Texas, two in New York, two in Arizona and one in Washington, for a total of 4,300 beds. During the year 2001, revenues from the Adult/Community Corrections programs comprised 32.0% of the Company's consolidated revenue, and 54.8% of the consolidated contribution margin. During the year 2001, 12.9% of the Company's consolidated revenues were

earned from the Texas Department of Criminal Justice. In its eight secure adult facilities, CSC not only provides adult inmates with housing but also with other basic services, including health care, transportation and food service. In addition, CSC remains committed to providing a variety of rehabilitative and educational services, including community service and recreational programs for adult inmates where appropriate.

CSC's three Community Corrections facilities are non-secure residential facilities for adult male and female offenders transitioning from institutional to independent living. Qualified offenders may spend the last six months of their sentence in a community corrections program. These programs assist the offender in the reunification process with family and the community. Independent research has indicated that successful reunification can play a key role in recidivism reduction, which is the primary goal of any corrections operation. To that end, CSC provides life skills training, case management, home confinement supervision and family reunification programs from these facilities. CSC believes that community correctional facilities help reduce recidivism, result in prison beds being available for more violent offenders and, in appropriate cases, represent cost-effective alternatives for jurisdictions to prisons.

JUVENILE. The Juvenile Division operates 25 facilities in 12 states and Puerto Rico. During the year 2001, revenues from the Juvenile Division comprised 68.0% of the Company's consolidated revenues, and 45.2% of the consolidated contribution margin. During the year 2001, 11.3% and 12.7% of the Company's consolidated revenues were earned from the Florida and Maryland Departments of Juvenile Justice, respectively. The Company's juvenile facilities house youths aged 10 to 20 and represent a total of approximately 3,700 beds (excluding aftercare services provided by certain facilities outside of Georgia). CSC manages secure and non-secure juvenile offender facilities for low, medium, and high risk youths in highly structured programs, including military-style boot camps, wilderness programs, secure education and training centers, academy programs, high impact programs servicing lower level or first time offenders and

detention facilities. In addition, the Company also provides non-residential aftercare programs. The Company provides aftercare services for over 600 juveniles in the State of Georgia as well as for juveniles who have completed residential programs throughout the Company's system.

#### MARKETING AND BUSINESS DEVELOPMENT

CSC engages in extensive marketing and business development on a national basis. Marketing efforts are spearheaded by CSC's business development team in conjunction with CSC's executive officers and outside consultants.

CSC receives frequent inquiries from or on behalf of governmental agencies. Upon receiving such an inquiry, CSC determines whether there is an existing or future need for CSC's services, whether the legal and political climate is conducive to privatized correctional operations and whether or not the project is commercially viable.

#### 5

<PAGE>

#### CONTRACT AWARD PROCESS

Most governmental procurement and purchasing activities are controlled by procurement regulations that take the form of a Request for a Proposal ("RFP"), and to date most of CSC's new business has resulted from responding to these requests. Interested parties submit proposals in response to an RFP within a time period of 15 to 120 days from the time that the RFP is issued. A typical RFP requires a bidder to provide detailed information, including the services to be provided by the bidder, the bidder's experience and qualifications and the price at which the bidder is willing to provide the services. From time to time, CSC engages independent consultants to assist in responding to the RFPs.

Approximately six to eighteen months is generally required from the issuance of the RFP to the contract award.

Before responding to an RFP, CSC researches and evaluates, among other factors:

- o the current size and growth projections of the available correctional and detention population;
- o whether or not a minimum capacity level is guaranteed;
- o the willingness of the contracting authority to allow CSC to house populations of similar classification within the proposed facility for other governmental agencies; and
- o the willingness of the contracting authority to allow CSC to make adjustments in operating activities, such as work force reductions in the event the actual population is less than the contracted capacity.

Under the RFP, the bidder may be required to design and construct a new facility or to redesign and renovate an existing facility at its own cost. In such event, CSC's ability to obtain the contract award is dependent upon its ability to obtain the necessary financing or fund such costs internally.

In addition to issuing formal RFPs, governmental agencies may use a procedure known as Purchase of Services or Requests for Qualification ("RFQ"). In the case of an RFQ, the requesting agency selects a firm it believes is most qualified to provide the necessary services and then negotiates the terms of the contract, including the price at which the services are to be provided.

## MARKET

The Company believes there is a growing acceptance of privatization of governmental services. Correctional and detention functions traditionally performed by federal, state and local governments have faced continuing pressure

to control costs and reduce the number of governmental employees. Further, despite recent decreases in the overall crime and incarceration rates, the number of adults under some form of correctional supervision (including probation and parole) has grown to almost 6.5 million in 2000 (most recent available data). Additionally, incarceration costs generally grow faster than many other parts of budget items. In an attempt to address these pressures, governmental agencies responsible for correctional and detention facilities are privatizing facilities. As of June 30, 2000 (the most recent available data), privately operated prison facilities held 76,010 of 1.9 million total inmates held in custody, up 9.1% since year-end 1999. This accounted for 5.8% of all State inmates, up from 5.4% at year-end 1999.

An estimated 1.9 million inmates are held in the nation's prisons and local jails due to sentencing guidelines and the increased popularity of "3 strikes" laws. According to the Department of Justice, the prison population rose an estimated 1,585 new inmates per week, or 68%, from 1990 through midyear 2000. On December 31, 2000, State prisons were operating between full capacity and 15% above capacity, while Federal prisons were operating at 31% above capacity.

An increasing population of adolescents are reaching the age where historically they begin to commit crimes that bring them before the juvenile courts. The services that the juvenile justice system has had the greatest growth in are residential services for children committing crimes who have serious emotional and behavioral problems. The public and private sector have had to adjust to providing services for children who are dually diagnosed, have drug and alcohol addictions and/or sex offending and fire setting histories. The Company has developed treatment programs to address these growing needs, and has focused their efforts to capture a share of this growing market.

## COMPETITION

CSC competes on the basis of cost, quality and range of services offered, its experience in managing facilities, the reputation of its personnel and its ability to design, finance and construct new facilities. Some of CSC's competitors have greater resources than CSC. CSC also competes in some markets with local companies that may have a better understanding of local conditions and a better ability to gain political and public acceptance. In addition, CSC's Community Corrections and Juvenile operations compete with governmental and not-for-profit entities. CSC's main competitors include but are not limited to Corrections Corporation of America, Wackenhut Corrections Corporation, and Cornell Corrections.

## FACILITIES

CSC operates adult and juvenile pre-disposition and post-disposition secure and non-secure correctional and detention facilities and non-secure community correctional facilities for federal, state and local correctional agencies. Pre-adjudication secure detention facilities provide secure residential detention for individuals awaiting trial and/or the outcome of judicial proceedings, and for aliens awaiting deportation or the disposition of deportation hearings. Post-adjudication secure facilities provide secure incarceration for individuals who have been found guilty of a crime by a court of law. CSC operates seven types of post-adjudication facilities: 1) secure prisons (adult); 2) intermediate sanction facilities (adult); 3) high impact programs (juvenile); 4) academies (juvenile); 5) military-style boot camps (juvenile); 6) secure treatment and training facilities (adult and juvenile); and 7) sexually delinquent juvenile programs (juvenile).

Secure prisons and intermediate sanction facilities provide secure correctional services for individuals who have been found guilty of one or more offenses.

Offenders placed in intermediate sanction facilities are typically persons who have committed a technical violation of their parole conditions, but whose offense history or current offense does not warrant incarceration in a prison. Both types of facilities offer vocational training, substance abuse treatment and offense specific treatment. High impact programs provide residential placement for juveniles who are either first time offenders or who were unable to meet the terms of a non-residential placement. High impact programs are generally short term with stays of 30 to 90 days, but involve all of the rehabilitative elements of an academy program. Academies are secure facilities that range from hardware secure to staff secure. These facilities typically service juveniles who are repeat offenders and/or violent crime offenders. The academies emphasize rehabilitative programming, including individual and group treatment, education, recreation and vocational training. Boot camps provide intensely structured and regimented residential correctional services, which emphasize disciplined activities modeled after the training principles of military boot camps and stress physical challenges, fitness, discipline and personal appearance. Secure treatment and training facilities provide numerous services designed to reduce recidivism including educational and vocational training, life skills, anger control management, and substance abuse counseling and treatment. Juvenile sex offender programs are generally locked secure and involve a length of stay from 18 to 24 months.

CSC also operates non-secure residential and non-residential community corrections programs. Non-secure residential facilities, known as halfway houses, provide residential correctional services for offenders in need of less supervision and monitoring than are provided in a secure environment. Offenders in community corrections facilities are typically allowed to leave the facility to work in the immediate community and/or participate in community-based educational and vocational training programs during daytime hours. Generally, persons in community correctional facilities are serving the last six months of their sentence. Non-residential programs permit the offender to reside at home or in some other approved setting under supervision and monitoring by CSC.

Supervision may take the form of either requiring the offender to report to a correctional facility a specified number of times each week and/or having CSC employees monitor the offender on a case management basis at his/her work site and home. In the juvenile division, the non-residential programs take the form of aftercare programs. Unlike the adult division where a non-residential supervision program may replace the last part of an adult's residential supervision, the juvenile division counterpart, the aftercare program, is strictly post release. The goal of these programs, like adult community corrections, is to assist the juvenile in effecting a positive return to their families and communities. Aftercare programs provide the contact, supervision and support that is needed to further instill the principles learned by the juvenile during the longer residential program.

7

&lt;PAGE&gt;

## ADULT DIVISION

The following information is provided with respect to the facilities for which CSC had management contracts as of March 15, 2002:

&lt;TABLE&gt;&lt;CAPTION&gt;

| CONTRACTING  |                             | DESIGN   |                  |
|--------------|-----------------------------|----------|------------------|
| GOVERNMENTAL | OWNED,                      | CAPACITY |                  |
|              | FACILITY NAME, LOCATION AND |          |                  |
| AGENCY       | LEASED, OR                  | BEDS(1)  | TYPE OF FACILITY |
|              | YEAR OPERATIONS COMMENCED   |          |                  |
|              | MANAGED(2)                  |          |                  |
| -----        | -----                       | -----    | -----            |
| <S>          | <C>                         | <C>      | <C>              |

|                                                                                                 |     |                                                |               |
|-------------------------------------------------------------------------------------------------|-----|------------------------------------------------|---------------|
| <C>                                                                                             |     |                                                |               |
| Arizona State Prison, Florence<br>State Owned<br>Florence, Arizona (1997)                       | 600 | Prison                                         |               |
| Arizona State Prison, Phoenix West<br>State Owned<br>Phoenix, Arizona (1996)                    | 400 | Prison                                         |               |
| Bronx Community Corrections Center<br>Bureau Leased<br>Bronx, New York (1996)<br>Prisons        | 148 | Residential Community<br>Correctional Facility | Federal<br>of |
| Brooklyn Community Correctional Center<br>Bureau Leased<br>Brooklyn, New York (1989)<br>Prisons | 150 | Residential Community<br>Correctional Facility | Federal<br>of |
| Dickens County Correctional Center<br>State Managed<br>Spur, Texas (1998)                       | 489 | Long Term Detention                            |               |
| Fort Worth Community Corrections Center<br>State Leased<br>Fort Worth, Texas (1994)             | 200 | Residential<br>Correctional Facility           |               |
| Frio County Jail<br>County/State/Federal Part-Leased/<br>Pearsall, Texas (1997)<br>Part-Owned   | 391 | Jail/Long Term<br>Detention                    |               |

|                                                                                              |     |                                          |             |
|----------------------------------------------------------------------------------------------|-----|------------------------------------------|-------------|
| Grenada County Jail<br>County Managed<br>Grenada, Mississippi (1998) (3)                     | 160 | Jail                                     |             |
| Jefferson County Downtown Jail<br>County/State Managed<br>Beaumont, Texas (1998)             | 500 | Jail/Long Term<br>Detention              |             |
| Newton County Correctional Facility<br>State/Federal Managed<br>Newton, Texas (1998)         | 872 | Prison                                   |             |
| Salinas Treatment Center<br>Commonwealth of Leased<br>Salinas, Puerto Rico (2000)(4)<br>Rico | 144 | Secure Treatment Facility                | Puerto Rico |
| Seattle INS Detention Center<br>INS Managed<br>Seattle, Washington (1989)                    | 150 | Secure Detention<br>Facility             |             |
| South Texas Intermediate Sanction<br>State Managed<br>Facility<br>Houston, Texas (1993)      | 450 | Secure Intermediate<br>Sanction Facility |             |

- (1) Design capacity is based on the physical space available presently, or licensure for offender or residential beds in compliance with relevant regulations and contract requirements. In certain cases, the management contract for a facility provides for a lower number of beds.

&lt;PAGE&gt;

- (2) A managed facility is a facility for which CSC provides management services pursuant to a management contract with the applicable governmental agency but, unlike a leased or owned facility, CSC has no property interest in the facility.
- (3) As part of the Company's restructuring initiative, the Company plans on closing the facility during 2002, and consequently it has been excluded from the Company's facility and contracted bed totals discussed throughout this filing.
- (4) The Company is in negotiations to sell the property to the Commonwealth of Puerto Rico, which is currently financed through the Company's operating lease-financing facility. The property is idle as of March 15, 2002. It is unknown if the Company will secure a management contract to operate the facility, in conjunction with the sale. The outcome of the negotiations is uncertain as of March 15, 2002. Consequently, it has been excluded from the Company's facility and contracted bed totals discussed throughout this filing.

&lt;TABLE&gt;&lt;CAPTION&gt;

JUVENILE DIVISION

| CONTRACTING<br>GOVERNMENTAL<br>AGENCY | OWNED,<br>FACILITY NAME, LOCATION AND<br>LEASED, OR<br>YEAR OPERATIONS COMMENCED<br>MANAGED(2) | DESIGN              |                  |     |
|---------------------------------------|------------------------------------------------------------------------------------------------|---------------------|------------------|-----|
|                                       |                                                                                                | CAPACITY<br>BEDS(1) | TYPE OF FACILITY |     |
| ----                                  | -----                                                                                          | -----               | -----            | --  |
| <S>                                   |                                                                                                | <C>                 | <C>              | <C> |
| <C>                                   |                                                                                                |                     |                  |     |

|                                                                                                    |     |                                                                      |        |
|----------------------------------------------------------------------------------------------------|-----|----------------------------------------------------------------------|--------|
| Bartow Youth Training Center<br>State Managed<br>Bartow, Florida (1995)                            | 74  | Secure & Residential<br>Treatment Facility                           |        |
| Bayamon Treatment Center<br>Commonwealth of Managed<br>Bayamon, Puerto Rico (1998)<br>Puerto Rico  | 141 | Secure Treatment<br>Facility                                         |        |
| Bell County Youth Training Center<br>County Managed<br>Killeen, Texas (1997)                       | 96  | Secure Detention<br>Facility                                         |        |
| Bill Clayton Detention Center<br>State Managed<br>Littlefield, Texas (2000)                        | 152 | Secure Treatment<br>Facility                                         |        |
| Chamberlain Academy<br>State/ Owned<br>Chamberlain, South Dakota (1993)<br>Federal                 | 78  | Non Secure<br>Academy Facility                                       | Multi- |
| Charles Hickey School<br>State Managed<br>Baltimore, Maryland(1993)                                | 355 | Secure Academy/High<br>Impact/Detention and Sex<br>Offender Facility |        |
| Colorado County Boot Camp<br>County/ Part Owned/<br>Eagle Lake, Texas (1998)<br>State Part Managed | 156 | Secure Detention<br>Facility                                         | Multi- |

|                                                                                      |         |     |                                                                     |        |
|--------------------------------------------------------------------------------------|---------|-----|---------------------------------------------------------------------|--------|
| Cypress Creek Academy<br>State<br>Lecanto, Florida (1997)                            | Managed | 100 | Secure Academy<br><br>Facility                                      |        |
| Dallas County Secure Post<br>County<br>Adjudication Facility<br>Dallas, Texas (1998) | Managed | 96  | Secure Treatment<br><br>Facility                                    |        |
| Dallas Youth Academy<br>County<br>Dallas, Texas (1998)                               | Managed | 96  | Secure Treatment<br><br>Facility                                    |        |
| Elmore Academy<br>State<br>Elmore, Minnesota (1998)                                  | Owned   | 150 | Non Secure Academy Facility                                         | Multi- |
| Forest Ridge Youth Services<br>State<br>Wallingford, Iowa (1993)                     | Owned   | 140 | Non Secure Female Academy<br><br>Facility                           | Multi- |
| </TABLE>                                                                             |         |     |                                                                     |        |
| 9                                                                                    |         |     |                                                                     |        |
| <PAGE>                                                                               |         |     |                                                                     |        |
| <TABLE><CAPTION>                                                                     |         |     |                                                                     |        |
| <S>                                                                                  |         |     |                                                                     |        |
| <C>                                                                                  |         |     |                                                                     |        |
| Genesis Treatment Agency<br>City/<br>Newport News, Virginia (1997)                   | Owned   | 51  | Secure Sexual Delinquent<br><br>Juveniles Treatment<br><br>Facility | Multi- |
| County                                                                               |         |     |                                                                     |        |

|                                                                                                      |     |                                    |        |
|------------------------------------------------------------------------------------------------------|-----|------------------------------------|--------|
| Hemphill County Juvenile Detention<br>County Leased<br>Center<br>Canadian, Texas (1994)              | 100 | Secure Boot Camp<br>Facility       |        |
| Hillsborough Academy<br>State Managed<br>Tampa, Florida (1997)                                       | 25  | Secure Sexual Offender<br>Facility |        |
| JoAnn Bridges Academy<br>State Managed<br>Greenville, Florida (1998)                                 | 30  | Secure Female Academy<br>Facility  |        |
| Judge Roger Hashem Juvenile Justice Center<br>County/ Managed<br>Rockdale, Texas (1997) (3)<br>State | 64  | Secure Detention<br>Facility       | Multi- |
| Keweenaw Academy<br>State Subleased<br>Mohawk, Michigan (1997)                                       | 160 | Non Secure Academy Facility        |        |
| Okaloosa County Juvenile Residential<br>State Managed<br>Facility<br>Okaloosa, Florida (1998)        | 64  | Secure Treatment<br>Facility       |        |
| Paulding Regional Youth<br>State Managed<br>Detention Center<br>Paulding, Georgia (1999)             | 126 | Secure Detention<br>Facility       |        |

|                                                                                |     |                                                   |        |
|--------------------------------------------------------------------------------|-----|---------------------------------------------------|--------|
| Polk City Youth Training Center<br>State Managed<br>Polk City, Florida (1997)  | 350 | Secure Treatment<br><br>Facility                  |        |
| Reflections Treatment Agency<br>State Leased<br>Knoxville, Tennessee (1992)    | 52  | Secure Sexual Offender<br><br>Facility            |        |
| Snowden Cottage Academy<br>State Managed<br>Wilmington, Delaware (1997)        | 18  | Non Secure Academy Facility                       |        |
| Springfield Academy<br>State/Federal Owned<br>Springfield, South Dakota (1993) | 108 | Non Secure Academy Facility                       |        |
| Summit View Youth Facility<br>State Managed<br>Las Vegas, Nevada (2000) (4)    | 96  | Secure Treatment<br><br>Facility                  |        |
| Tarkio Academy<br>State Subleased<br>Tarkio, Missouri (1994)                   | 302 | Secure Academy Sexual<br><br>Offender Facility    | Multi- |
| Texarkana Boot Camp<br>County/ Leased<br>Texarkana, Texas (1998)<br>State      | 124 | Secure Boot Camp<br><br>Detention<br><br>Facility | Multi- |
| Victor Cullen Academy<br>State Managed                                         | 225 | Secure Academy Facility                           |        |

Sabillasville, Maryland (1992) (5)

</TABLE>

10

<PAGE>

- (1) Design capacity is based on the physical space available presently, or licensure for offender or residential beds in compliance with relevant regulations and contract requirements. In certain cases, the management contract for a facility provides for a lower number of beds.
- (2) A managed facility is a facility for which CSC provides management services pursuant to a management contract with the applicable governmental agency but, unlike a leased or owned facility, CSC has no property interest in the facility.
- (3) As part of the Company's restructuring initiative, the Company closed the facility in March 2002, and consequently it has been excluded from the Company's facility and contracted bed totals discussed throughout this filing.
- (4) As part of the Company's restructuring initiative, the Company closed the facility in January 2002, and consequently it has been excluded from the Company's facility and contracted bed totals discussed throughout this filing.
- (5) Subsequent to December 31, 2001, the Company reached an agreement with Maryland Department of Juvenile Justice to close the facility, effective April 30, 2002. The facility has been excluded from the facility and contracted beds totals discussed throughout this filing.

#### FACILITY CHANGES DURING THE YEAR 2001

During 2001, the Company discontinued its operations of the following facilities:

- 1) Chanutte Transition Center (Juvenile);
- 2) Medina County Detention Center (Juvenile);
- 3) Tarrant County Community Correctional Facility (Adult);
- 4) Caldwell Juvenile Justice Center (Juvenile).

The Company ceased operations of the Medina County Detention Center due to lack of occupancy. The Chanutte Transition Center and Caldwell Juvenile Justice Center were closed in conjunction with the Company's restructuring initiative, discussed later. The State of Texas elected to cease operations of the Tarrant County Community Correctional Facility, ending the Company's management agreement with the County.

In addition, during 2001, the Company reached agreements to discontinue its operations of three additional juvenile facilities in 2002. The Company discontinued operations of the Summit View Youth Correctional Center in January 2002, and the Judge Roger Hashem Juvenile Justice Center in March 2002, and will discontinue its operation of the Victor Cullen Academy on April 30, 2002.

#### FACILITY MANAGEMENT CONTRACTS

CSC is primarily compensated on the basis of the population in each of its facilities on a fixed rate per inmate per day; however, some contracts have a minimum revenue guarantee. Invoices are generally sent on a monthly basis detailing the population for the prior month. Occupancy rates for facilities tend to be low when first opened or when expansions are first available. However, after a facility passes the start-up period, typically three months, the occupancy rate tends to stabilize.

CSC is required by its contracts to maintain certain levels of insurance coverage for general liability, workers' compensation, vehicle liability and property loss or damage. CSC is also required to indemnify the contracting

agencies for claims and costs arising out of CSC's operations and in certain cases, to maintain performance bonds.

As is standard in the industry, CSC's contracts are short term in nature, generally ranging from one to three years and containing multiple renewal options. Most facility contracts also generally contain clauses that allow the governmental agency to terminate a contract with or without cause, and are subject to legislative appropriation of funds.

#### OPERATING PROCEDURES

CSC is responsible for the overall operation of each facility under its management, including staff recruitment, general administration of the facility, security of inmates and employees, supervision of the offenders, and facility maintenance. CSC, either directly or through subcontractors, also provides health care, including medical, dental and psychiatric services, and food service.

11

<PAGE>

CSC's contracts generally require CSC to operate each facility in accordance with all applicable local, state and federal laws, and rules and regulations. In addition, adult facilities are generally required to adhere to the guidelines of the American Correctional Association ("ACA"). The ACA standards, designed to safeguard the life, health and safety of offenders and personnel, describe specific objectives with respect to administration, personnel and staff training, security, medical and health care, food service, inmate supervision and physical plant requirements. CSC believes the benefits of operating its facilities in accordance with ACA standards include improved management, better defense against lawsuits by offenders alleging violations of civil rights, a

more humane environment for personnel and offenders and measurable criteria for upgrading programs, personnel and the physical plant on a continuous basis. Several of our facilities are fully accredited by the ACA and certain other facilities currently are being reviewed for accreditation. It is the Company's goal to obtain and maintain ACA accreditation for all of its adult facilities, and for its juvenile facilities when applicable.

#### FACILITY DESIGN AND CONSTRUCTION

In addition to its facility management services, CSC also consults with various governmental entities to design and construct new correctional and detention facilities and renovate older facilities to provide enhanced services to the population. CSC manages all of the facilities it has designed and constructed or redesigned and renovated.

Pursuant to CSC's design, construction and management contracts, it is responsible for overall project development and completion. Typically, CSC develops the conceptual design for a project, then hires architects, engineers and construction companies to complete the development. When designing a particular facility, CSC utilizes, with appropriate modifications, prototype designs CSC has used in developing other projects. Management of CSC believes that the use of such prototype designs allows it to reduce cost overruns and construction delays.

#### EMPLOYEES

At February 28, 2002, CSC had approximately 3,800 employees, consisting of corporate and facility employees. Each of CSC's facilities is led by an experienced facility administrator or executive director. Other facility personnel include administrative, security, medical, food service, counseling,

classification and educational and vocational training personnel. CSC conducts background screening checks and drug testing on potential facility employees. Some of the services rendered at certain facilities, such as medical services, education or food service are provided by third-party contractors.

## EMPLOYEE TRAINING

All jurisdictions require corrections officers and youth workers to complete a specified amount of training. Generally, CSC employees must undergo at least 160 hours of paid training before being allowed to work in a position that will bring them in contact with offenders or detainees. This training consists of approximately 40 hours relating to CSC policies, operational procedures, management philosophy and ethics, and compliance training, and 120 hours relating to legal issues, rights of offenders and detainees, techniques of communication and supervision, improvement of interpersonal skills, and job training relating to the specific tasks to be held. The Company believes that its training programs meet or exceed the applicable licensing requirements.

In addition to the comprehensive pre-service training, all Company personnel are required to complete annual mandatory 40-hour in-service training. Many of the required annual training topics include the requirements specified in the American Correctional Associations' Standards for Adult and Juvenile Facilities. Some of these topics are: use of force or behavior management programs; security procedures; suicide precautions; interpersonal communications; cultural sensitivity; first aid and CPR; and safety procedures. In addition to satisfying ACA standards/guidelines for in-service training, all facilities include specific, specialized training that may be mandated by the contracting agency; such as an overview of the criminal justice or juvenile justice system.

The Company is committed to providing quality training programs for newly hired employees to prepare them for a challenging and rewarding career in the Criminal

Justice or Juvenile Justice field. It also provides continuing education training to veteran employees to maintain their proficiencies and adherence to the Company's commitment to provide quality service to its contracting agencies.

12

<PAGE>

## INSURANCE

Each management contract with a governmental agency requires CSC to maintain certain levels of insurance coverage for general liability, workers' compensation, vehicle liability and property loss or damage and to indemnify the contracting agency for claims and costs arising out of CSC's operations.

CSC currently maintains primary general liability insurance in the amount of \$3,000,000 and a primary excess liability policy in the amount of \$2,000,000, and an excess umbrella policy in the amount of \$25,000,000, covering itself and each of its subsidiaries, as well as automobile liability insurance, employment practices liability insurance, workers' compensation insurance, and property and casualty insurance, in addition to other special forms of insurance. There can be no assurance that the aggregate amount and kinds of CSC's insurance are adequate to cover all occurrences or that insurance will be available in the future. In addition, CSC is unable to secure insurance for some unique business risks, which may include, but not be limited to, some types of punitive damages in states where it is prohibited by law.

## REGULATION

Generally, providers of correctional services must comply with a variety of applicable federal, state and local regulations, including educational, health care and safety regulations administered by a variety of regulatory authorities.

Management contracts frequently include extensive reporting requirements. In addition, many federal, state and local governments are required to follow competitive bidding procedures before awarding a contract. Certain jurisdictions may also require the successful bidder to award subcontracts on a competitive bid basis and to subcontract to varying degrees with businesses owned by women or minorities.

## ITEM 2. PROPERTIES.

The Company leases office space for its corporate headquarters in Sarasota, Florida. Additionally, the Company leases office space for a regional office in New York, New York.

The Company also leases the space for the following facilities: Hemphill County Juvenile Detention Center, Chanutte Transition Center, Reflections Treatment Agency, Tarkio Academy, Keweenaw Academy, Texarkana Boot Camp, Frio County Jail, Brooklyn Community Correctional Center, Bronx Community Correctional Center, Fort Worth Community Corrections Center, and Salinas Treatment Center (which is financed through the Company's operating lease-financing facility).

The Company owns its facilities located in Florence, Arizona; Phoenix, Arizona; Chamberlain, South Dakota; Springfield, South Dakota; Elmore, Minnesota; portions of the Frio County, Texas facility; Forest Ridge, Iowa; portions of Eagle Lake, Texas expansion; and Newport News, Virginia.

During 2001, the Company also reached an agreement to sell the property owned by the Company in Bryan, Texas, from which the Company formerly operated the Los Hermanos Ranch program (which it closed in November 1999), for \$450,000. The Company expects to close this sale on or about April 1, 2002.

The Company also owns, or leases pursuant to its operating lease-financing

facility with Fleet National Bank, the following properties, which were acquired by the Company in anticipation of future development projects, were never developed and are now being marketed for sale. These properties are located in Belle Glade, Florida, Mangonia Park, Florida and Eagle Lake, Texas.

### ITEM 3. LEGAL PROCEEDINGS.

In the ordinary course of its business, the Company routinely is named as a defendant in legal proceedings filed against the Company by inmates of, or participants in, the facilities and programs operated by the Company, in which it is alleged that the Company has been negligent in some aspect of the operation of its business and/or violated the civil rights of particular inmates or program participants. The Company also is routinely named as a respondent and/or defendant in lawsuits and proceedings before the United States Equal Employment Opportunity Commission and/or the equivalent agencies of the jurisdictions in which the Company conducts business, in which it is alleged that the Company is liable under theories of unlawful discrimination, wrongful discharge and other employment-related theories. The Company believes that most of these types of claims and charges are without merit and/or that the Company has meritorious defense to the claims and charges, and vigorously defends against these types of actions. The Company also

13

<PAGE>

has procured liability insurance to protect the Company against these types of claims and charges. The Company believes that, except as described below, the insurance coverage available to the Company for these claims and charges should be adequate to protect the Company from any material exposure in any given matter, even if the outcome of the matter is unfavorable to the Company. However, if all, or a substantial number of these claims, are resolved

unfavorably to the Company, the insurance coverage available to the Company would not be sufficient to satisfy all of the claims currently pending against the Company, and such a result would have a material adverse effect on the Company's results of operations, financial condition and liquidity.

In addition, in the ordinary course of business, the Company also is named, on occasion, as a defendant in proceedings initiated by third party suppliers of goods or services in which it is alleged that the Company has breached some aspect of a contractual agreement with those parties. There are several such suits currently pending against the Company. The Company does not have insurance coverage for these types of claims; however, except as described below, the Company does not consider any of these matters to be material to the Company, either individually or in the aggregate, or outside the normal course of its business.

The Company has determined that the following matters should be deemed material to the Company under applicable SEC regulations, because either: (a) the claims asserted against the Company in these matters involve amounts that exceed 10% of the Company's current assets on a consolidated basis as of December 31, 2001: (b) the amount sought from the Company exceeds the amount of insurance available to the Company for the claim: or (c) the claims asserted against the Company in these matters involve amounts that exceed 10% of the Company's current assets on a consolidated basis as of December 31, 2001, and the Company does not have insurance coverage available with respect to the claim:

1. BROWN, SAMSON, ET AL., V. ESMOR CORRECTIONAL SERVICES, INC., ESMOR, INC., ESMOR NEW YORK STATE CORRECTIONAL FACILITIES, INC., ESMOR MANAGEMENT, INC., ESMOR MANHATTAN, INC, ESMOR BROOKLYN, INC., ESMOR NEW JERSEY, INC., JAMES SLATTERY AND AARON SPEISMAN, Superior Court of the State of New York, No. 8654/96; removed to US District Court for the Southern District of New York; transferred to the US District Court for the District of New Jersey; DASILVA, JOAQUIN, ET AL., V. ESMOR CORRECTIONAL SERVICES, PORT

AUTHORITY OF NEW YORK, ET AL., Superior Court of New Jersey, No. UNNL 1285-96; removed to US District Court for the District of New Jersey; JAMA, HAWA ABDI, ET AL. V. ESMOR CORRECTIONAL SERVICES, INC., ET AL., US District Court for the District of New Jersey, No. 973093.

In March 1996, several former detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey filed suit in the Supreme Court of the State of New York, County of Bronx on behalf of themselves and others similarly situated, alleging personal injuries and property damage purportedly caused by the negligent and intentional acts of CSC, in which the plaintiffs in the suit claimed \$500,000,000 each in compensatory and punitive damages. This suit was removed to the United States District Court, Southern District of New York, in April 1996. In July 1996, seven detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey and certain of their spouses filed suit in the Superior Court of New Jersey, County of Union, seeking \$10,000,000 each in damages arising from alleged mistreatment of the detainees. This suit was removed to the United States District Court, District of New Jersey, in August 1996. In July 1997, another group of former detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey filed suit in the United States District Court for the District of New Jersey. The suit claims violations of civil rights, personal injury and property damage allegedly caused by the negligent and intentional acts of CSC. No monetary damages have been stated. Through stipulation, the parties have agreed to try these actions in the United States District Court for the District of New Jersey in order to streamline the discovery process, minimize costs and avoid inconsistent rulings. These matters are currently in the discovery stages of the proceeding. Although the Company believes that it has meritorious defenses to the claims made in these actions, and is vigorously pursuing its defense of these claims, the aggregate amount of the damages claimed by the plaintiffs in these cases substantially exceeds the amount of

insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

14

<PAGE>

2. ALEXANDER, RICKEY, ET AL. V. CORRECTIONAL SERVICES CORPORATION, UNIDENTIFIED CSC EMPLOYEES, KNYVETTE REYES, R.N., DR. SAMUEL LEE, D.O., & Tony Schaffer, Esq., in the 236th Judicial District Court, Tarrant County, Cause No. 236-187481-01.

In May, 2001, the plaintiffs, the estate and parents of Bryan Alexander, a former inmate at the Tarrant County Correctional Facility in Mansfield, Texas (which formerly was operated by the Company), brought a wrongful death action, in which it has been alleged that the Company's negligent and intentional acts, as well as the negligent and intentional acts of the other named defendants, proximately caused the death of Bryan Alexander on January 9, 2001. Plaintiffs' original Complaint sought \$300,000,000 in compensatory damages and unspecified punitive damages. Plaintiffs subsequently amended their Complaint to delete their demand for \$300,000,000 in compensatory damages in lieu of a pleading that seeks unspecified compensatory and punitive damages in amounts to be proved at trial. This case is currently in the discovery stages of the proceeding. The Company believes that it has meritorious defenses to the claims made by the plaintiffs in this case and is vigorously pursuing its defense; however, the amount of the damages originally claimed by the plaintiffs in this case substantially exceeds the amount of insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

3. BAILEY, JOANNE; BARNES, SHEA; BERG, IDA; BURROLA, THERESA; COAN, BERTHA; DUNHAM, SHEILA; HAWKINSON, ALVIN; HEREDIA, MICHAEL; HOOEE, LOJANN; JAMES, ANDREW; LEWIS, FREDERICK; LYONS, FRANK; ROGERS, LARSON; VARGAS, CYNTHIA; AND WEBB, CHRISTOPHER VS. CSC & Unknown Persons 1-100, U.S. District Court, District of New Mexico, No. CIV-00 0005 JP/DJS.

Plaintiffs, each a former employee of the McKinley County Jail in Gallup, New Mexico, allege various causes of action against CSC relating to their employment with CSC and subsequent termination from employment with CSC. Plaintiffs originally sought an unspecified amount of compensatory and punitive damages from the Company, but, in December 2001, presented demands to the Company in the aggregate amount of approximately \$9,000,000. The Company believes that it has meritorious defenses to the claims made by the plaintiffs in this case and is vigorously pursuing its defense; however, the amount of the damages originally claimed by the plaintiffs in this case substantially exceeds the amount of insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

4. CITY OF TALLULAH V. TRANS-AMERICAN DEVELOPMENT ASSOC. & CORRECTIONAL SERVICES CORPORATION, 6th Judicial District Court Madison Parish, LA, Case No. 2001 000146.

In June, 2001, the City of Tallulah filed suit against Trans-American Development Assoc. & Correctional Services Corporation, alleging that either or both parties are obligated to continue to pay to the City an annual "management fee" of \$150,000 related to the Tallulah Correctional Center for Youth, despite the fact that neither party is currently operating the facility. The Complaint filed by the City in this matter

does not specify the amount of damages that the City is seeking, but, based on the theory outlined in the City's complaint, the Company has estimated that the City likely will seek approximately \$3,250,000 in this case. The Company believes that the City's case against the Company is wholly without merit and is vigorously defending against this claim. However, in light of the fact that this matter is not covered by any form of insurance available to the Company, and given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

5. STATE OF ARIZONA V. CORRECTIONAL SERVICES CORPORATION, CORRECTIONAL MEDICAL SERVICES, INC. ET AL., in the Superior Court of the State of AZ, in and for the County of Maricopa, No. CV2000-000205.

During 2001, the State of Arizona filed suit against the Company and the other named defendants, including Correctional Medical Services, Inc. (CMS), the Company's medical services provider at the Arizona RTC/DWI Private Prison in Phoenix, Arizona, in which the State seeks indemnification from the named defendants for any and all damages and losses suffered or incurred by the State in connection with a case captioned, VALDEZ, JOSE, MARTINEZ, ZACARIAS & EDWARDA, PARENTS, V. MARICOPA COUNTY, CORRECTIONAL MEDICAL SERVICES, INC., ARIZONA DEPARTMENT OF CORRECTIONS, STATE OF ARIZONA, CORRECTIONAL SERVICES CORPORATION, ET AL., which was tried before a jury in the

<PAGE>

Superior Court of the State of Arizona in and for the County of Maricopa in September, 2001. The Valdez case was brought by a former inmate at the Phoenix facility whose eyesight deteriorated to near total blindness while

he was in the custody of the State of Arizona, and incarcerated at various facilities, including the Phoenix facility operated by the Company. At trial, the jury awarded \$6,500,000 in damages against the State of Arizona (pursuant to an agreement reached with the plaintiffs prior to trial, the Company was not a defendant at the trial of this action and the amount of the jury's award was reduced to \$5,000,000). The State now seeks indemnification for the full amount of the jury award and other costs and expenses associated with that case. The Company believes that it has meritorious defenses to the State's claims, and that the ultimate liability for the claims made in this matter should lie with CMS or the other named defendants in the suit, and has asserted similar claims for indemnification from CMS and the other named defendants. Hearings and the trial on the State's claims and the Company's claims against the other defendants are scheduled to occur in 2002. This matter is covered by the Company's general liability insurance policy. However, the Company recently learned that CMS' insurance carrier is in receivership, thereby raising the possibility that CMS may not have sufficient insurance proceeds available to it to satisfy the State's claims. In that event, the Company's insurance carrier would be obligated, pursuant to the Company's contract with the State, to satisfy the State's claims. The effect of this scenario would be to reduce the amount of insurance coverage available to the Company for other claims arising under the same insurance policy.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The 2001 Annual Meeting of Stockholders of Correctional Services Corporation was held on October 5, 2001. At the meeting, two (2) proposals were considered and voted upon with the following results:

<TABLE><CAPTION>

- (1) To elect seven (7) directors to serve until the next annual

## meeting of stockholders; Results:

| BROKER  | NAME              | VOTES CAST | VOTES CAST |
|---------|-------------------|------------|------------|
| ABSTAIN | NON VOTES         | IN FAVOR   | AGAINST    |
| -----   | -----             | -----      | -----      |
| <C>     | <S>               | <C>        | <C>        |
| 0       | Stuart M. Gerson  | 9,489,738  | 41,083     |
| 0       | Shimmie Horn      | 9,489,738  | 41,083     |
| 0       | James F. Slattery | 9,489,738  | 41,083     |
| 0       | Aaron Speisman    | 9,489,738  | 41,083     |
| 0       | Richard P. Staley | 9,489,738  | 41,083     |
| 0       | Melvin T. Stith   | 9,489,738  | 41,083     |
| 0       | Bobbie L. Huskey  | 9,489,738  | 41,083     |

- (2) To ratify the reappointment of Grant Thornton, LLP as Independent Auditors of the Company for the year ending December 31, 2001.

## Results:

NUMBER OF VOTES  
CAST IN FAVOR

NUMBER OF VOTES  
CAST AGAINST

ABSTAIN

-----  
 9,493,717  
 -----

-----  
 25,736  
 -----

-----  
 11,368  
 -----

&lt;/TABLE&gt;

16

&lt;PAGE&gt;

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The common stock of CSC is traded on the Nasdaq National Market. Such quotations represent inter-dealer prices without retail markup, markdown or commission, and may not necessarily represent actual transactions. The following table sets forth, for the calendar quarters indicated, the high and low closing sale prices per share on the Nasdaq National Market, based on published financial sources.

|      |                     | CSC COMMON<br>STOCK<br>SALE PRICE (\$) |      |
|------|---------------------|----------------------------------------|------|
|      |                     | HIGH                                   | LOW  |
| 2000 |                     |                                        |      |
|      | First Quarter.....  | 5.25                                   | 3.75 |
|      | Second Quarter..... | 5.88                                   | 2.78 |
|      | Third Quarter.....  | 5.00                                   | 3.13 |
|      | Fourth Quarter..... | 3.88                                   | 1.63 |
| 2001 |                     |                                        |      |
|      | First Quarter.....  | 3.13                                   | 2.13 |
|      | Second Quarter..... | 2.78                                   | 2.00 |
|      | Third Quarter.....  | 2.65                                   | 1.80 |

Fourth Quarter..... 2.50 1.65

On February 25, 2002, there were 360 holders of record and approximately 1,500 beneficial shareholders registered in nominee and street name. The Company paid no cash dividends in the years ended December 31, 2001 and 2000.

17

<PAGE>

# ITEM 6. SELECTED FINANCIAL DATA.

The information below is only a summary and should be read in conjunction with Correctional Services Corporation's historical financial statements and related notes (in thousands except per share data).

<TABLE><CAPTION>

|                                |            | Year Ended December |            |            |
|--------------------------------|------------|---------------------|------------|------------|
|                                |            | 2001                | 2000       | 1999       |
| 31,                            |            |                     |            |            |
| 1998 (1)                       | 1997       |                     |            |            |
| -----                          |            | -----               |            |            |
| <S>                            |            | <C>                 | <C>        | <C>        |
| <C>                            | <C>        |                     |            |            |
| Revenues                       |            | \$ 174,418          | \$ 210,812 | \$ 233,918 |
| \$ 188,454                     | \$ 175,933 |                     |            |            |
| -----                          |            | -----               |            |            |
| Operating expenses             |            | 160,885             | 185,447    | 205,662    |
| 166,443                        | 149,389    |                     |            |            |
| Startup costs (1)              |            | 406                 | 155        | 1,177      |
| 8,171                          | 211        |                     |            |            |
| General and administrative (2) |            | 13,207              | 13,344     | 13,555     |
| 20,769                         | 17,704     |                     |            |            |

|                                                  |          |         |         |
|--------------------------------------------------|----------|---------|---------|
| Restructuring and impairment                     | 4,356    | -       | -       |
| -                                                | -        | -       | -       |
| Loss contract costs                              | 1,150    | -       | -       |
| -                                                | -        | -       | -       |
| Merger costs and related restructuring charges   | -        | -       | 12,052  |
| 1,109                                            | -        | -       | -       |
| Loss on sale of behavioral health                | -        | -       | -       |
| -                                                | 20,898   | -       | -       |
| Other operating (income) expenses                | 1,313    | (1,115) | 1,874   |
| 2,327                                            | -        | -       | -       |
| -----                                            |          |         |         |
| Operating income (loss)                          | (6,899)  | 12,981  | (402)   |
| (10,365)                                         | (12,269) | -       | -       |
| Interest expense, net (2)                        | (2,183)  | (3,483) | (3,413) |
| (2,961)                                          | (2,844)  | -       | -       |
| -----                                            |          |         |         |
| Income (loss) before income taxes, extraordinary |          |         |         |
| gain on extinguishment of debt and               |          |         |         |
| cumulative change in accounting principle        | (9,082)  | 9,498   | (3,815) |
| (13,326)                                         | (15,113) | -       | -       |
| Income tax benefit (provision)                   | 3,202    | (3,710) | (429)   |
| 1,593                                            | 1,062    | -       | -       |
| -----                                            |          |         |         |
| Income (loss) before extraordinary gain on       |          |         |         |
| extinguishment of debt and cumulative effect     |          |         |         |
| of change in accounting principle                | (5,880)  | 5,788   | (4,244) |
| (11,733)                                         | (14,051) | -       | -       |
| Extraordinary gain on extinguishment of debt,    |          |         |         |
| net of tax of \$467                              | -        | -       | 716     |

|                                                                     |            |          |           |
|---------------------------------------------------------------------|------------|----------|-----------|
| -                                                                   | -          |          |           |
| Cumulative effect of change in accounting, net<br>of tax of \$3,180 | -          | -        | -         |
| (4,863)                                                             | -          |          |           |
| -----                                                               |            |          |           |
| Net earnings (loss)                                                 | \$ (5,880) | \$ 5,788 | \$(3,528) |
| \$(16,596)      \$(14,051)                                          |            |          |           |
| =====                                                               |            |          |           |
| Net earnings (loss) per share:                                      |            |          |           |
| Basic                                                               | \$ (0.58)  | \$ 0.51  | \$ (0.31) |
| \$ (1.53)      \$ (1.32)                                            |            |          |           |
| Diluted                                                             | \$ (0.58)  | \$ 0.51  | \$ (0.31) |
| \$ (1.53)      \$ (1.32)                                            |            |          |           |
| BALANCE SHEET DATA:                                                 |            |          |           |
| Working capital (deficit) (3)                                       | \$ (7,855) | \$18,831 | \$22,281  |
| \$ 23,167      \$ 29,663                                            |            |          |           |
| Total assets                                                        | 86,083     | 96,775   | 111,198   |
| 125,314      120,750                                                |            |          |           |
| Long-term debt, net of current portion                              | 314        | 16,338   | 32,944    |
| 44,064      33,379                                                  |            |          |           |
| Shareholders' equity                                                | 47,645     | 53,738   | 50,738    |
| 51,006      65,503                                                  |            |          |           |
| </TABLE>                                                            |            |          |           |
| -----                                                               |            |          |           |

- (1) The 1998 amounts include the effect of the adoption of the AICPA Statement of Position 98-5, Accounting for Startup Costs.
- (2) Certain reclassifications have been made to the 1997 through 2000 balances to conform to the 2001 presentation.
- (3) The working capital deficit for the year ended December 31, 2001 includes amounts outstanding under the Company's credit facility

agreement, as the agreement matures in August 2002. Although the Company is in discussions with its bank to extend the maturity date or to seek alternate sources of long-term financing, there can be no assurances that the Company will be successful. Accordingly the entire outstanding balance on the revolving line of credit of \$16.0 million, is classified as short-term.

18

<PAGE>

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

### GENERAL

The Company is one of the largest and most comprehensive providers of juvenile rehabilitative services with 25 facilities and approximately 3,700 juveniles in its care. In addition, the Company is a leading developer and operator of adult correctional facilities operating 11 facilities representing approximately 4,300 beds. On a combined basis, as of December 31, 2001, the Company provided services in 15 states and Puerto Rico, representing approximately 8,000 beds including aftercare services.

The Company's primary source of revenue is generated from the operation of its facilities pursuant to contracts with federal, state and local governmental agencies, and management agreements with third parties that contract directly with governmental agencies. Generally, the Company's contracts are based on a daily rate per resident, some of which have guaranteed minimum payments; others provide for fixed monthly payments irrespective of the number of residents housed. In addition, the Company receives revenue for educational and aftercare services. The Company recognizes revenue at the time the Company performs the services pursuant to its contracts.

The Company typically pays all facility operating expenses, except for rent or lease payments in the case of certain government-provided facilities, or for facilities for which the Company has only a management contract. Operating expenses are principally comprised of costs directly attributable to the management of the facility and care of the residents, which include salaries and benefits of administrative and direct supervision personnel, food, clothing, medical services and personal hygiene supplies. Other operating expenses are comprised of fixed costs, which consist of rent and lease payments, utilities, insurance, depreciation and professional fees.

The Company also incurs costs as it relates to the start-up of new facilities. Such costs are principally comprised of expenses associated with the recruitment, hiring and training of staff, travel of personnel, certain legal costs and other costs incurred after a contract has been awarded.

Contribution from operations consists of revenues minus facility operating expenses and start-up costs. Contribution from operations, in general, is lower in the initial stages of a facility's operations. This is due to the need to incur a significant portion of the facility's operating expenses while the facility is in the process of attaining full occupancy.

General and administrative costs primarily consist of salaries and benefits of non-facility based personnel, insurance, professional fees, rent and utilities associated with the operation of the Company's corporate offices. In addition, general and administrative costs consist of development costs principally comprised of travel, proposal development, legal fees, and various consulting and other fees incurred prior to the award of a contract.

## RESULTS OF OPERATIONS

The following table sets forth certain operating data as a percentage of total revenues:  
<TABLE><CAPTION>

| Percentage of Total Revenues<br>Years Ended December 31, |         |         |         |
|----------------------------------------------------------|---------|---------|---------|
|                                                          | 2001    | 2000    | 1999    |
| <S>                                                      | <C>     | <C>     | <C>     |
| Revenues                                                 | 100.0 % | 100.0 % | 100.0 % |
| Facility expenses:                                       |         |         |         |
| Operating                                                | 92.3    | 88.0    | 87.9    |
| Startup costs                                            | 0.2     | -       | 0.5     |
|                                                          | 92.5    | 88.0    | 88.4    |
| Contribution from operations                             | 7.5     | 12.0    | 11.6    |
| Other operating expenses:                                |         |         |         |
| General and administrative                               | 7.6     | 6.3     | 5.8     |
| Legal settlement                                         | 0.2     | -       | -       |
| Restructuring and impairment                             | 2.5     | -       | -       |
| Loss contract costs                                      | 0.7     | -       | -       |
| Loss (gain) on sale of assets                            | 0.5     | (0.5)   | -       |

|                                                                                    |        |       |        |
|------------------------------------------------------------------------------------|--------|-------|--------|
| Merger costs and related restructuring charges                                     | -      | -     | 5.2    |
| Write-off of deferred financing costs                                              | -      | -     | 0.8    |
|                                                                                    | -----  | ----- | -----  |
|                                                                                    | 11.5   | 5.8   | 11.8   |
|                                                                                    | -----  | ----- | -----  |
| Operating income (loss)                                                            | (4.0)  | 6.2   | (0.2)  |
| Interest expense, net                                                              | (1.2)  | (1.7) | (1.4)  |
|                                                                                    | -----  | ----- | -----  |
| Income (loss) before income taxes and extraordinary gain on extinguishment of debt | (5.2)  | 4.5   | (1.6)  |
| Income tax benefit (provision)                                                     | 1.8    | (1.8) | (0.2)  |
|                                                                                    | -----  | ----- | -----  |
| Income (loss) before extraordinary gain on extinguishment of debt                  | (3.4)  | 2.7   | (1.8)  |
| Extraordinary gain on extinguishment of debt, net of tax                           | -      | -     | 0.3    |
|                                                                                    | -----  | ----- | -----  |
| Net income (loss)                                                                  | (3.4)% | 2.7%  | (1.5)% |
|                                                                                    | =====  | ===== | =====  |

&lt;/TABLE&gt;

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

Revenue decreased by \$36.4 million or 17.3% for the year ended December 31, 2001 to \$174.4 million compared to the same period in 2000. The decrease was primarily due to:

- o An increase of \$5.2 million generated from a full twelve months of revenue for two facilities opened in 2000 (248 beds), and
- o An increase of \$3.1 million from per diem rate increases at existing facilities, offset by;
- o A decrease of \$34.6 million from the discontinuance of 13 programs (459 beds in 4 facilities discontinued in 2001, and 2,993 beds in 9 facilities discontinued in 2000),
- o A net decrease of \$8.7 million generated from net occupancy level decreases in existing facilities,
- o A decrease of \$1.4 million in other revenues due to fulfillment of a contract with a third party related to the sale of assets in December 1995 at the Company's Elizabeth, New Jersey facility, and the cessation of rental income related to the sale of the Tampa Bay Academy.

Operating expenses decreased \$24.6 million or 13.2% for the year ended December 31, 2001 to \$160.9 million compared to the same period in 2000 primarily due to the closing of the 13 facilities mentioned above.

20

<PAGE>

As a percentage of revenues, operating expenses increased to 92.3% for the twelve months ended December 31, 2001 from 88.0% for the twelve months ended December 31, 2000. Although the Company made significant improvements in cost control initiatives, operating expenses as a percentage of revenue increased due to the rising costs of healthcare decreased occupancy levels, and the Company's inability to decrease fixed costs at the facilities, including, rent, certain

administrative salaries, and depreciation expense, accordingly.

Startup costs were \$406,000 for the twelve months ended December 31, 2001 compared to \$155,000 for the twelve months ended December 31, 2000. Startup costs for the twelve months ended December 31, 2001, related primarily to the startup of the Salinas, Puerto Rico facility and the relocation of the Genesis Treatment Program to the Newport News, Virginia property. As of December 31, 2001, the Salinas, Puerto Rico facility had not begun operations. The Company is in discussions with the Puerto Rican government to determine the future of the facility, which may consist of the operation of the facility, the sale of the facility, or a combination thereof.

General and administrative expenses decreased to \$13.2 million for the twelve months ended December 31, 2001, compared to \$13.3 million for the twelve months ended December 31, 2000. As a percentage of revenues, general and administrative expenses increased to 7.6% for the twelve months ended December 31, 2001 from 6.3% for the same period in 2000. The increase is due to the restructuring initiative formulated during the third quarter of 2001, and the decreased revenues due to the closed facilities and population decreases on a same facility basis of 7.3%. The Company recorded charges of approximately \$7.9 million related to corporate restructuring and asset impairments, losses on contracts of facilities to be closed, and other charges included in general and administrative expenses as follows:

|                                                                  |            |
|------------------------------------------------------------------|------------|
| Severance pay                                                    | \$ 205,000 |
| Provision for early termination of a lease                       | 270,000    |
| Impairment of assets                                             | 3,881,000  |
| Loss contract costs                                              | 1,150,000  |
| Other charges included in general and<br>administrative expenses | 2,373,000  |

-----  
\$7,879,000  
=====

As part of the restructuring initiative, the Company formulated a plan to consolidate and restructure its corporate office, sell certain assets, and close seven facilities through August 31, 2002. The Company recorded a restructuring and impairment charge of \$4.4 million consisting of severance for terminated employees (\$205,000); lease termination costs at a facility closed under the plan (\$270,000); and a \$3.9 million impairment of assets related to the facilities being closed and assets held primarily for future use, where plans have been abandoned. The Company expects the restructuring plan initiatives to be completed by August 31, 2002. Based on management's analysis of its contract obligations, the Company has recorded costs of approximately \$1.1 million for contracts that will require the Company incur losses to fulfill the contracts. These facilities are included in those scheduled for closure.

Other charges included in general and administrative expenses include \$1.3 million of additional accounts receivable allowance primarily for receivables which have been in dispute over a number of years, including a receivable from a non-profit entity, and \$1.1 million related to reserves established for legal obligations, and management's estimate of the results of agency audits. This increase to general and administrative expenses was partially offset by cost reductions from strategies to reduce general and administrative expenses, implemented during the first quarter of 2001, and the fourth quarter results of the restructuring initiative. General and administrative expenses decreased to 5.1% of revenues for the three months ended December 31, 2001, compared to 7.7% for the same period in 2000.

In addition to less significant settlements included in general and

administrative expenses, the Company recorded a \$375,000 legal settlement related to the Mansfield, Texas facility. The settlement was paid in April 2001. The settlement paid by the Company exceeded the amount of its insurance deductible, as certain facts of the case caused the third party insurer to dispute the enforceability of its policy with the Company. Consequently, the Company agreed with the third party insurer to pay \$375,000.

The Company recorded a loss on the sale of assets of \$938,000. The loss relates primarily to the sale of the 489-bed Dickens County facility, and the sale of both airplanes previously used to transport residents from the various contracting jurisdictions to the facilities in the Midwest region. The Company sold the 489 bed Dickens County Correctional Facility in Dickens, Texas, which had been held in the operating lease-financing facility, to the host county. The net proceeds from the sale were approximately \$10.7 million, which were used to reduce the Company's

21

<PAGE>

obligations under its operating lease-financing facility. The Company recorded a loss on this sale of approximately \$441,000 in the third quarter of 2001. The Company continues to operate the facility under a management agreement with the County. The Company also recorded a loss of approximately \$370,000 on the sale of two airplanes that were used to transport residents to and from the Company's Midwest facilities.

Interest expense, net of interest income, was \$2.2 million for the twelve months ended December 31, 2001 compared to \$3.5 million for the twelve months ended December 31, 2000, a net decrease in interest expense of \$1.3 million. This decrease resulted from payments made on the Company's credit facility, decreasing the outstanding balance on the revolver and delayed drawdown credit facilities by approximately \$6.7 million from December 31, 2000 to December 31,

2001. Additionally the weighted-average interest rate decreased from 9.2% to 6.3% over the same period.

For the twelve months ended December 31, 2001, the Company recognized an income tax benefit of \$3.2 million compared to an income tax provision of \$3.7 million for the twelve months ended December 31, 2000.

#### YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

Revenue decreased by \$23.1 million or 9.9% for the year ended December 31, 2000 to \$210.8 million compared to the same period in 1999. The decrease was primarily due to:

- o An increase of \$1.3 million generated from the opening of 2 juvenile facilities (248 beds).
- o A net increase of \$8.6 million generated from per diem rate and net occupancy level increases in existing facilities.
- o A decrease of \$33.0 million from the discontinuance of 16 programs (911 beds in 7 facilities discontinued in 2000, and 1,701 beds in 9 facilities discontinued in 1999.)

Operating expenses decreased \$20.2 million or 9.8% for the year ended December 31, 2000 to \$185.4 million compared to the same period in 1999 primarily due to the closing of the 16 facilities mentioned above.

As a percentage of revenues, operating expenses remained relatively constant, increasing to 88.0% for the twelve months ended December 31, 2000 from 87.9% for the twelve months ended December 31, 1999. Other factors impacting operating expenses were increased labor, insurance and utility costs.

Startup costs were \$155,000 for the twelve months ended December 31, 2000 compared to \$1.2 million for the twelve months ended December 31, 1999. Startup costs for the twelve months ended December 31, 2000 were incurred related to the Salinas, Puerto Rico (144 beds) and Las Vegas, Nevada (96 beds) facilities. Startup for the twelve months ended December 31, 1999, related to the startup of the South Fulton, Georgia facility (288 beds), 300-bed expansion of the Crowley, Colorado facility and the 45 bed expansion of the Bayamon, Puerto Rico treatment facility.

General and administrative expenses decreased to \$13.3 million for the twelve months ended December 31, 2000 from \$13.6 million for the twelve months ended December 31, 1999. The decrease of \$211,000 in general and administrative expenses was primarily attributable to lower costs associated with the full effect of the YSI merger and a lower level of operations, partially offset by a \$927,000 increase in the reserve recorded against accounts receivable, including \$700,000 reserved against a receivable from a not-for-profit entity.

As a percentage of revenues, general and administrative expenses increased to 6.3% for the twelve months ended December 31, 2000 from 5.8% for the twelve months ended December 31, 1999. The increase in general and administrative expenses as a percentage of revenue is a result of the items noted above and the decrease in revenues related to the discontinued operations at the facilities noted above.

During the first quarter of 1999, the Company recorded merger costs and related restructuring charges of approximately \$12.1 million (\$9.2 million, after taxes or \$0.82 per share) for direct costs related to the merger with YSI and certain other costs resulting from the restructuring of the newly combined operations. Direct merger costs consisted primarily of fees to investment bankers, attorneys, accountants, financial advisors and printing and other direct costs. Restructuring charges included severance and change in control payments made to certain former officers and employees of YSI; losses associated with the

write-off of the carrying value of the software used by YSI, which will not be used by the Company and computer equipment that is incompatible with that used by the Company; and miscellaneous other costs which included the cancellation of lease agreements and other long-term commitments.

In September 1999, the Company wrote off \$1.9 million of unamortized deferred financing costs associated with the Company's previously established credit facility, which was repaid in full on September 1, 1999.

The Company recognized a gain on the sale of assets of \$1.1 million during the year-ended December 31, 2000 primarily related to the discontinuance of operations at the Crowley, Colorado and McCloud, Oklahoma facilities, and the sale of

<PAGE>

undeveloped land in Pacific, Washington. These gains were partially offset by the loss on the sale of the Tampa Bay Academy and the write-off of leasehold improvements due to the closure of the Manhattan, New York facility.

Interest expense, net of interest income, was \$3.5 million for the twelve months ended December 31, 2000 compared to \$3.4 million for the twelve months ended December 31, 1999, a net increase in interest expense of \$100,000. This increase resulted from a decrease in interest income as the Company used available funds to repay debt and repurchase common stock and increases in the Company's borrowing rates during 2000.

For the twelve months ended December 31, 2000, the Company recognized an income tax provision of \$3.7 million compared to an income tax provision of \$429,000 for the twelve months ended December 31, 1999. The provision in 1999 principally arose from nondeductible permanent differences and the recognition of a

valuation allowance for certain deferred tax assets. Additionally, \$467,000 related to the extraordinary gain on extinguishment of debt associated with the YSI 7% Convertible Debt, was recognized for the twelve months ended December 31, 1999.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company has historically financed its operations through bank borrowings, private placements, the sale of public securities and cash generated from operations.

The Company had a working capital deficit at December 31, 2001 of \$7.9 million compared to working capital of \$18.8 million at December 31, 2000. The Company's current ratio decreased to 0.8 at December 31, 2001, from 1.7 at December 31, 2000. The decrease in the current ratio is primarily attributable to the classification of senior debt as current, as the Company's financing facility is scheduled to mature in August 2002.

Net cash of \$12.5 million was provided by operating activities for the year ended December 31, 2001 as compared to \$9.7 million provided by operations for the year ended December 31, 2000.

Net cash of \$4.9 million was used by investing activities during the year ended December 31, 2001 as compared to \$652,000 provided during the year ended December 31, 2000. The \$5.6 million increase in cash used was primarily attributable to the purchase of the Newport News property. Net cash provided by investing activities for the year ended December 31, 2000, was primarily attributable to the sale of the Crowley, CO and McCloud, OK facilities, and the Tampa Bay Academy.

During 2001, the Company effected the sale of a facility leased under it's

operating lease-financing facility. The net proceeds of \$10.7 million were paid directly to the lienholder.

Net cash of \$6.8 million was used in financing activities in the year ended December 31, 2001 as compared to \$17.3 million used in financing activities in the year ended December 31, 2000. During 2001 the Company's primary financing activities primarily consisted of net repayments of senior debt of \$6.7 million.

During 2000 the Company's primary financing activities consisted of:

- o Net repayment of senior debt of \$750,000.
- o Repayment of subordinated debt of \$14.2 million.
- o Repurchase of common stock of \$2.8 million.

At December 31, 2001 the Company had \$16.0 million outstanding under the revolving line of credit with \$2.5 million in availability, and \$14.0 million outstanding under the operating lease-financing facility. As of the June 30, 2001 amendment, there is no additional funding available under the operating lease-financing facility. The operating lease-financing facility and the associated assets are not included in the consolidated financial statements of the Company as this financing facility is treated as an operating lease in accordance with STATEMENT OF FINANCIAL ACCOUNTING STANDARDS (SFAS) NO. 13, ACCOUNTING FOR LEASES.

During 2001, the Company's Credit Agreement and Master Agreement (the "Agreements") with a syndication of banks led by Fleet National Bank (successor to Summit Bank) were amended effective as of the end of the quarters ended June 30, 2001, September 30, 2001 and December 31, 2001, as a result of the Company's realization that it likely would not be able to comply with the terms of certain financial covenants contained in the Agreements, unless those covenants were amended. Accordingly, as a result of the amendments to the Agreements made

throughout 2001, the Company remained in compliance with all its loan covenants during 2001 and remained in compliance with those covenants, as amended, as of December 31, 2001. The Company agreed, in connection with the amendment to the Agreements made in 2001, that there would be no further financing available to the Company under the operating lease-financing facility aspect of the Agreements.

The revolving line of credit, as amended, and the operating lease-financing facility provided to the Company under the Agreements mature on August 31, 2002. Although the Company is in discussions with its bank to extend the maturity date

23

<PAGE>

of the credit facilities provided under the Agreement and is seeking alternate sources of long-term financing, there can be no assurances that the Company will be successful in either extending the maturity date of its obligations under the Agreements or in obtaining alternative sources of financing. Accordingly, the entire outstanding balance on the revolving line of credit of \$16.0 million, is classified as short-term. Additionally, the Company will be required to pay the lessor of its operating lease-financing facility approximately \$14.0 million upon the termination of its operating lease-financing facility, based on the current terms of the agreement.

The Company expects to continue to have cash needs as it relates to financing start-up costs in connection with new contracts that would improve the profitability of the Company. There can be no assurances that the Company's operations together with amounts available under the revolving line of credit will continue to be sufficient to finance its existing level of operations, fund start-up costs and meet its debt service obligations. Also, a decline in the Company's financial performance, as a result of decreased occupancy or increases in operational expenses could negatively impact the Company's ability to meet

its financial covenants included in the Agreement, as amended. If the Company is unable to generate sufficient cash flow from operations or meet its covenant requirements, it may be required to further amend or restructure its Agreement, sell additional assets or obtain additional financing. There can be no assurance that the Company will be able to obtain further amendments to the Agreements, sell additional assets or obtain additional financing.

As mentioned above, the Company sold one of its facilities during the third quarter 2001 and continues to operate the facility under a management agreement. It is in negotiations to sell one additional facility, which is encumbered by the Agreement. This sale through municipal revenue bonds is expected to generate approximately \$8 million, which will be utilized to reduce the Company's borrowings under its Credit Agreement. The Company intends to continue operating the facility under a management agreement negotiated during the transaction. There can be no assurances that the Company will be successful in these negotiations.

#### TREASURY STOCK

On October 20, 2000, the Company announced that its Board of Directors had authorized a share repurchase program of up to \$10.0 million. The repurchases are funded from the proceeds of asset sales and excess cash flow. The Company repurchased 93,000 shares and 1.1 million shares during the years ended December 31, 2001 and 2000, respectively, at a cost of \$214,000 and \$2.8 million, respectively.

#### NEW ACCOUNTING PRONOUNCEMENTS

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, BUSINESS COMBINATIONS, and SFAS 142, GOODWILL AND INTANGIBLE ASSETS. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for

the year beginning January 1, 2002; however certain provisions of that Statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS 142. The Company will adopt these new standards, effective January 1, 2002. The Company analyzed net goodwill at the juvenile division reporting level, as of January 1, 2002, and has determined there is no expected impairment of goodwill as of January 1, 2002. The Company recognized amortization expense related to goodwill of \$370,000, \$370,000 and \$362,000 for the twelve months ended December 31, 2001, 2000 and 1999, respectively.

In July 2001, the FASB issued SFAS No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement applies to all entities. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. This Statement is for financial statements issued for fiscal years beginning after June 15, 2002. The Company has evaluated the impact of the adoption of this standard on its financial position and results of operations, and does not believe the effect, if any, to be significant.

In August 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes FASB Statement No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF. The provisions of the statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company has evaluated the impact of the adoption of this standard on its financial position and results of operations, and does not believe the effect, if any, to be significant.

&lt;PAGE&gt;

## RISK FACTORS

Investors should carefully consider the following factors that may affect future results, together with the other information contained in this Annual Report on Form 10-K, in evaluating the Company before purchasing its securities. In particular, prospective investors should note that this Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and that actual results could differ materially from those contemplated by such statements. See "Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995" on page 3 of this Annual Report on Form 10-K. The factors listed below represent certain important risks the Company believes could cause such results to differ and are not intended to represent a complete list of the general or specific risks that may affect the Company. It should be recognized that other risks may be significant, presently or in the future, and the risks set forth below may affect the Company to a greater extent than indicated.

DECREASES IN OCCUPANCY LEVELS AT OUR FACILITIES OR RISING COSTS MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.

While the non-personnel cost structures of the facilities we operate are relatively fixed, a substantial portion of our revenues are generated under facility management contracts with government agencies that specify a net rate per day per inmate or a per diem rate, with no minimum guaranteed occupancy levels. Under this per diem rate structure, a decrease in occupancy levels may have a material adverse effect on our financial condition, results of operations and liquidity. We are dependent upon the governmental agencies with which we have management contracts to provide inmates for, and maintain the occupancy level of, our managed facilities. We cannot control those occupancy levels. In

addition, our ability to estimate and control our costs with respect to all of these contracts is critical to our profitability.

During 2001, the Company experienced a significant decline in the occupancy levels of certain of its facilities, which has caused its contributions from operations to decline. Occupancy levels may decline at the Company's facilities in the future and facilities might not reach occupancy levels required to produce profitability. In addition, personnel expenses are a material cost of the Company's operation.

THE NON-RENEWAL OR TERMINATION OF OUR FACILITY MANAGEMENT CONTRACTS, WHICH GENERALLY RANGE FROM ONE TO THREE YEARS, COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.

As is typical in our industry, our facility management contracts are short-term, generally ranging from one to three years, with renewal or extension options as well as termination for convenience clauses in favor of the contracting governmental agency. Many YSI contracts renew annually. Additionally, the Company received approximately 37% of its 2001 consolidated revenue from three agencies: Maryland and Florida Departments of Juvenile Justice, and the Texas Department of Criminal Justice. Our facility management contracts may not be renewed or our customers may terminate such contracts in accordance with their right to do so. The non-renewal or termination of any of these contracts could materially adversely affect our financial condition, results of operations and liquidity, including our ability to secure new facility management contracts from others. Of the multi-year contracts in place as of December 31, 2001, ten contracts representing approximately 2,674 beds are up for renewal in 2002.

A contracting governmental agency often has a right to terminate a facility contract with or without cause by giving us adequate notice. At times a contracting government agency may notify us that we are not in compliance with

certain provisions of a facility contract. Our failure to cure any such noncompliance could result in termination of the facility contract, which could materially adversely affect our financial condition, results of operations and liquidity. If a governmental agency does not receive necessary appropriations, it could terminate its contract or reduce the management fee payable to us. Even if funds are appropriated, delays in payments may occur which could have a material adverse effect on our financial condition, results of operations and liquidity. We currently lease many of the facilities that we manage. If a management contract for a leased facility were terminated, we would continue to be obligated to make lease payments until the lease expires.

#### OUR ABILITY TO SECURE NEW CONTRACTS TO DEVELOP AND MANAGE CORRECTIONAL DETENTION FACILITIES DEPENDS ON MANY FACTORS WE CANNOT CONTROL.

Our growth is generally dependent upon our ability to obtain new contracts to develop and manage new correctional and detention facilities. This depends on a number of factors we cannot control, including crime rates and sentencing patterns

25

<PAGE>

in various jurisdictions and acceptance of privatization. Certain jurisdictions recently have required successful bidders to make a significant capital investment in connection with the financing of a particular project, a trend which will require the combined company to have sufficient capital resources to compete effectively. We may not be able to obtain these capital resources when needed.

#### FUTURE ACQUISITIONS MAY INVOLVE SPECIAL RISKS, INCLUDING POSSIBLE ADVERSE

SHORT-TERM EFFECTS ON OUR OPERATING RESULTS, DIVERSION OF MANAGEMENT'S ATTENTION FROM EXISTING BUSINESS, DEPENDENCE ON KEY PERSONNEL, UNANTICIPATED LIABILITIES AND COSTS OF AMORTIZATION OF INTANGIBLE ASSETS. ANY OF THESE RISKS COULD MATERIALLY ADVERSELY AFFECT US.

The Company also intends to grow through selective acquisitions of companies and individual facilities although there are no current plans or agreements to acquire any other companies. We may not be able to identify or acquire any new companies or facilities and we may not be able to profitably manage acquired operations. Acquisitions involve a number of special risks, including possible adverse short-term effects on our operating results, diversion of management's attention from existing business, dependence on retaining, hiring and training key personnel, risks associated with unanticipated liabilities, and the costs of amortization of acquired intangible assets, any of which could have a material adverse effect on our financial condition, results of operations and liquidity.

PUBLIC RESISTANCE TO PRIVATIZATION OF CORRECTIONAL AND DETENTION FACILITIES COULD RESULT IN OUR INABILITY TO OBTAIN NEW CONTRACTS OR THE LOSS OF EXISTING CONTRACTS.

The movement toward privatization of correctional and detention facilities has encountered resistance from certain groups, such as labor unions and others that believe that correctional and detention facility operations should only be conducted by governmental agencies. Political changes or changes in attitudes toward private correctional and detention facilities management in any market in which we will operate could result in significant changes to the previous acceptance of privatization in such market and the subsequent loss of facility management contracts. Further, some sectors of the federal government and some state and local governments are not legally permitted to delegate their traditional operating responsibilities for correctional and detention facilities to private companies.

OPPOSITION TO FACILITY LOCATION MAY ADVERSELY IMPACT THE COMPANY'S ABILITY TO DEVELOP SITES FOR NEW FACILITY LOCATIONS.

The Company's success in opening new facilities is dependent in part upon its ability to obtain facility sites that can be leased or acquired on economically favorable terms. Some locations may be in or near populous areas and, therefore, may generate legal action or other forms of opposition from residents in areas surrounding a proposed site. Certain facilities are already located in or adjacent to such areas and, in one instance, the Company abandoned its plan to expand a facility after consulting with community leaders who raised concerns about the expansion. There can be no assurance the Company will be able to open new facilities or expand existing facilities in any particular location.

OUR FAILURE TO COMPLY WITH UNIQUE GOVERNMENTAL REGULATION COULD RESULT IN MATERIAL PENALTIES OR NON-RENEWAL OR TERMINATION OF OUR FACILITY MANAGEMENT CONTRACTS.

The industry in which we operate is subject to extensive federal, state and local regulations, including education, health care and safety regulations, which are administered by many regulatory authorities. Some of the regulations are unique to our industry, and the combination of regulations we face is unique. We may not always successfully comply with these regulations, and failure to comply can result in material penalties or non-renewal or termination of our facility management contracts. Our contracts typically include extensive reporting requirements, and supervision and on-site monitoring by representatives of the contracting governmental agencies. Corrections officers and youth care workers are customarily required to meet certain training standards and, in some instances, facility personnel are required to be licensed and subject to background investigation. Certain jurisdictions also require us

to award subcontracts on a competitive basis or to subcontract with businesses owned by members of minority groups. Our businesses also are subject to operational and financial audits by the governmental agencies with which we have contracts. The outcomes of these audits could have a material adverse effect on our business, financial condition or results of operations.

26

<PAGE>

DISTURBANCES AT ONE OR MORE OF OUR FACILITIES COULD RESULT IN CLOSURE OF THESE FACILITIES BY THE RELEVANT GOVERNMENTAL ENTITIES AND A LOSS OF OUR CONTRACTS TO MANAGE THESE FACILITIES.

An escape, riot or other disturbance at one of our facilities could have a material adverse effect on our financial condition, results of operations and liquidity. Among other things, the adverse publicity generated as a result of any such event could have a material adverse effect on our ability to retain an existing contract or obtain future ones. In addition, if such an event occurs, there is a possibility that the facility where the event occurred may be shut down by the relevant governmental entity. A closure of any of our facilities could have a material adverse effect on our financial condition, results of operations and liquidity.

INSURANCE COVERAGE MAY BE INADEQUATE OR UNAVAILABLE TO COVER POTENTIAL LIABILITY RELATED TO MANAGEMENT OF CORRECTIONAL AND DETENTION FACILITIES OR ITS COSTS MAY ADVERSELY AFFECT RESULTS OF OPERATIONS.

Our management of correctional and detention facilities exposes us to potential third-party claims or litigation by prisoners or other persons for personal injury or other damages, including damages resulting from contact with our facilities, programs, personnel or students (including students who leave our

facilities without our authorization and cause bodily injury or property damage). Currently, we are subject to actions initiated by former employees, inmates and detainees alleging assault, sexual harassment, personal injury, property damage, and other injuries. In addition, our management contracts generally require us to indemnify the governmental agency against any damages to which the governmental agency may be subject in connection with such claims or litigation. We maintain insurance programs that provide coverage for certain liability risks faced by us, including personal injury, bodily injury, death or property damage to a third party where we are found to be negligent. There is no assurance, however, that our insurance will be adequate to cover potential third-party claims. In addition, we are unable to secure insurance for some unique business risks, which may include, but not be limited to, some types of punitive damages in states where it is prohibited by law.

Committed offenders often seek redress in federal courts pursuant to federal civil rights statutes for alleged violations of their constitutional rights caused by the overall condition of their confinement or by specific conditions or incidents. We may be subject to liability if any such claim or proceeding is made or instituted against us or the state with which we contract or subcontract.

The Company continues to incur increased costs for insurance. Workers' compensation and general liability insurance represent significant costs to the Company.

#### STAFF RECRUITMENT DIFFICULTIES MAY IMPACT OPERATIONS.

Many of our facilities are located in areas where there are smaller populations and/or where there are more jobs than available workers. Our choice of employees is further limited by our drug free workplace status, and licensure and other policy prohibitions against hiring individuals with past criminal histories.

However, many of our contracts require the Company to have certain numbers and certain types of employees on duty at the facility at all times. Although the Company makes rigorous efforts to recruit and retain a sufficient work force, it is sometimes unable to achieve adequate staffing without significant overtime expense. This additional expense may adversely effect the Company's results.

27

&lt;PAGE&gt;

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company's current financing is subject to variable rates of interest and is therefore exposed to fluctuations in interest rates. The Company's subordinated debt and mortgage on property accrues interest at fixed rates of interest.

The table below presents the principal amounts, weighted average interest rates, fair value and other terms, by year of expected maturity, required to evaluate the expected cash flows and sensitivity to interest rate changes. Actual maturities may differ because of prepayment rights.

&lt;TABLE&gt;&lt;CAPTION&gt;

|                                |       |       | EXPECTED MATURITY DATES |      |      |      |      |
|--------------------------------|-------|-------|-------------------------|------|------|------|------|
| THERE                          |       | FAIR  |                         |      |      |      |      |
| AFTER                          | TOTAL | VALUE | 2002                    | 2003 | 2004 | 2005 | 2006 |
| -----                          | ----- | ----- | ----                    | ---- | ---- | ---- | ---- |
| <S>                            |       |       | <C>                     | <C>  | <C>  | <C>  | <C>  |
| <C>                            | <C>   | <C>   |                         |      |      |      |      |
| Fixed rate debt (in thousands) |       |       | \$ 3                    | \$ 3 | \$ 3 | \$ 4 | \$ 4 |

|                                         |          |          |          |       |       |       |       |
|-----------------------------------------|----------|----------|----------|-------|-------|-------|-------|
| \$ 297                                  | \$ 314   | \$ 314   |          |       |       |       |       |
| =====                                   | =====    | =====    | =====    | ===== | ===== | ===== | ===== |
| Weighted average Interest               |          |          |          |       |       |       |       |
| Rate at December 31, 2001               |          |          | 10.00%   |       |       |       |       |
|                                         |          |          | =====    |       |       |       |       |
| Variable rate LIBOR debt (in thousands) |          |          |          |       |       |       |       |
| \$ -                                    | \$16,000 | \$16,000 | \$16,000 | \$ -  | \$ -  | \$ -  | \$ -  |
|                                         |          |          | =====    | ===== | ===== | ===== | ===== |
| =====                                   | =====    | =====    |          |       |       |       |       |
| Weighted average interest               |          |          |          |       |       |       |       |
| Rate at December 31, 2001               |          |          | 6.26%    |       |       |       |       |
|                                         |          |          | =====    |       |       |       |       |

&lt;/TABLE&gt;

28

&lt;PAGE&gt;

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The information required by this item is contained on Pages F-1 through F-28 hereof.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None

## PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

## Information Regarding Directors and Officers

The following table sets forth the Directors and Executive Officers of the Company, together with their respective ages and positions.

| Name                       | Age | Position with CSC                                            |
|----------------------------|-----|--------------------------------------------------------------|
| ----                       | --- | -----                                                        |
| Stuart M. Gerson (1)(2)(4) | 58  | Chairman of the Board                                        |
| James F. Slattery          | 52  | President and Chief Executive Officer                        |
| Aaron Speisman (2)(3)      | 51  | Executive Vice President and Director                        |
| Bernard A. Wagner          | 53  | Senior Vice President, Chief Financial Officer and Treasurer |
| Richard P. Staley (2)      | 70  | Senior Vice President and Director                           |
| Shimmie Horn (1)           | 29  | Director                                                     |
| Bobbie L. Huskey (1)(3)(4) | 53  | Director                                                     |
| Melvin T. Stith (2)(3)     | 55  | Director                                                     |
| Chet Borgida (1)(3)        | 57  | Director                                                     |

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee
- (3) Member of the Stock Options Committee
- (4) Member of the Ethics and Compliance Committee

Stuart M. Gerson was elected a director of CSC in June 1994, and appointed Chairman of the Board in November 2001. Since March 1993, Mr. Gerson has been a member of the law firm of Epstein Becker & Green, P.C. From January 1993 to March 1993, he was acting Attorney General of the United States. From January 1989 to January 1993, Mr. Gerson was the Assistant U.S. Attorney General for the

Civil Division of the Department of Justice.

James F. Slattery co-founded CSC in October 1987 and has been its President, Chief Executive Officer and a director since CSC's inception and Chairman from August 1994 to November 2001. Prior to co-founding CSC, Mr. Slattery had been a managing partner of Merco Properties, Inc., a hotel operation company, Vice President of Coastal Investment Group, a real estate development company, and had held several management positions with the Sheraton Hotel Corporation.

Aaron Speisman co-founded CSC in October 1987 and has been its Executive Vice President and a director since CSC's inception. From October 1987 to March 1994, Mr. Speisman also served as Chief Financial Officer of CSC. Since June 1, 1996, Mr. Speisman has been employed by CSC on a part-time basis.

Bernard A. Wagner joined the Company as Senior Vice President and Chief Financial Officer in May 2001. Since 1992, Mr. Wagner held various positions with Uniroyal Technology Corporation, most recently as Vice President and Chief Financial Officer of its High Performance Plastics, Inc. subsidiary. Prior to this position, Mr. Wagner was Director of Accounting for the company's Polycast Technology division and Director of Finance and Accounting at the corporate headquarters. Mr. Wagner is a Florida CPA.

Richard P. Staley has served as a Director since May 1994. From 1988 to 1998, Mr. Staley was the Company's Senior Vice President of Operations and in 1999 was named Senior Vice President of Strategic Planning. From 1984 to 1987,

29

<PAGE>

Mr. Staley was the Evaluation and Compliance Director for Corrections Corporation of America and, from 1953 to 1983, held various positions with the United States Department of Justice, Immigration and Naturalization Service. Mr.

Staley is a certified American Correctional Association standards auditor for jail and detention facilities.

Shimmie Horn was elected a director of CSC in June 1996. Mr. Horn is President of Iroquois Properties, Inc., a real estate holding company. Mr. Horn, received a B.A. degree in Economics from Yeshiva College in 1993, and graduated from the Benjamin Cardozo School of Law in 1996. He is the son of the late Morris Horn, the former Chairman of the Board and a founder of CSC, and Esther Horn, a principal stockholder of CSC.

Bobbie L. Huskey was a director of Youth Services International, Inc., which was acquired by CSC in March 1999, at which time Ms. Huskey became a director of the Company. Ms. Huskey has been president of Huskey & Associates since 1984 and has 29 years in corrections, specializing in juvenile justice planning, facilities and program development. She has served as a consultant to more than one-half of the states in the U.S. Ms. Huskey has hands-on experience in juvenile justice facilities, having worked with delinquent girls in a treatment facility in Kentucky and has served in executive leadership positions in corrections in Virginia, Indiana and Chicago. She has held every elective office in the American Correctional Association, including president, and was a member of the association's executive committee for 12 years. Ms. Huskey has authored numerous articles and appeared on national news programs discussing corrections and juvenile justice issues. She has won national awards including the E.R. Cass Award for outstanding achievement in the correctional field.

Melvin T. Stith was elected a director of the Company in November 1994. Since July 1991, Mr. Stith has been Dean of the Florida State University College of Business. From December 1989 to July 1991, Mr. Stith was Chairman of the Marketing Department of the Florida State University College of Business where he was also a Professor. Mr. Stith is also a director of Sprint and United Telephone of Florida.

Chet Borgida was appointed a director in November 2001. Since June 2001, Mr. Borgida has been a Senior Vice-President and Chief Financial Officer of Cross Media Marketing Corporation. From 1977 to May 2001, Mr. Borgida was a partner with Grant Thornton LLP, the Company's independent auditors.

#### COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors and persons who own more than ten percent of a registered class of the Company's equity securities (collectively, the "Reporting Persons"), to file reports of ownership and changes in ownership with the Securities and Exchange Commission and to furnish the Company with copies of these reports. The Company believes that the Reporting Persons complied with all filing requirements applicable to them during the year ended December 31, 2001.

30

<PAGE>

#### ITEM 11.EXECUTIVE COMPENSATION.

The following table sets forth a summary of the compensation paid by CSC during the three fiscal years ended December 31, 2001, 2000 and 1999 for CSC's Chief Executive Officer and for CSC's executive officers (the "Named Executives"):

<TABLE><CAPTION>

#### SUMMARY COMPENSATION TABLE

LONG-TERM

ANNUAL COMPENSATION

COMPENSATION

|                             |              |       |         |              | NUMBER       |
|-----------------------------|--------------|-------|---------|--------------|--------------|
| OF                          |              |       |         |              |              |
| SECURITIES                  | ALL OTHER    |       |         | OTHER ANNUAL |              |
| UNDERLYING                  | COMPENSATION |       | SALARY  | BONUS        | COMPENSATION |
| NAME AND PRINCIPAL POSITION | OPTIONS      | YEAR  | (\$)    | (\$)         | (\$)(4)      |
| (5)                         |              |       |         |              |              |
| -----                       |              | ----- | ----    | ----         | -----        |
| --                          | ---          |       |         |              |              |
| <S>                         |              | <C>   | <C>     | <C>          | <C>          |
| <C>                         | <C>          |       |         |              |              |
| James F. Slattery           |              | 2001  | 287,726 | 200,000      | 20,244       |
| 0                           | 7,176        |       |         |              |              |
| Chief Executive Officer     |              | 2000  | 288,744 | 160,000      | 11,808       |
| 0                           | 14,661       |       |         |              |              |
| and President               |              | 1999  | 270,000 | 200,000      | 11,815       |
| 40,000                      | 9,625        |       |         |              |              |
| Bernard A. Wagner (1)       |              | 2001  | 92,132  | 0            | 0            |
| 10,000                      | 0            |       |         |              |              |
| Senior Vice-President and   |              |       |         |              |              |
| Chief Financial Officer     |              |       |         |              |              |
| Michael C. Garretson (3)    |              | 2001  | 216,846 | 0            | 12,000(6)    |
| 0                           | 129          |       |         |              |              |
| Former Executive Vice       |              | 2000  | 213,692 | 0            | 12,000(6)    |
| 0                           | 516          |       |         |              |              |
| President and               |              | 1999  | 194,307 | 0            | 12,000(6)    |
| 0                           | 292          |       |         |              |              |
| Chief Operating Officer     |              |       |         |              |              |

|                       |      |         |        |       |
|-----------------------|------|---------|--------|-------|
| Ira M. Cotler (2)     | 2001 | 123,577 | 82,888 | 3,231 |
| 0 27                  |      |         |        |       |
| Former Executive Vice | 2000 | 208,461 | 23,334 | 6,000 |
| 0 76                  |      |         |        |       |
| President and Chief   | 1999 | 191,077 | 82,827 | 6,000 |
| 25,000 67             |      |         |        |       |
| Financial Officer     |      |         |        |       |

-----

</TABLE>

- (1) Bernard A. Wagner was elected Senior Vice-President and Chief Financial Officer on October 12, 2001. He worked in the capacity of Chief Financial Officer beginning in May 2001.
- (2) Ira M. Cotler resigned from his position as Executive Vice-President and Chief Financial Officer effective June 30, 2001.
- (3) Michael C. Garretson resigned from his position as Executive Vice-President and Chief Operating Officer, effective January 2002.
- (4) Consists of car lease payments or auto allowance.
- (5) Consists of life insurance premiums.
- (6) Consists of a housing allowance.

31

<PAGE>

#### EMPLOYMENT AGREEMENT

On September 29, 1999, CSC entered into an employment agreement with its Chief Executive Officer, James F. Slattery, replacing the existing employment agreement between the Company and Mr. Slattery dated February 17, 1998. The new agreement has a term of three years with automatic annual renewal provisions. Mr. Slattery's minimum annual compensation is \$270,000 until September 29, 2000, thereafter the base compensation will be adjusted through annual costs of living

increases of at least 3.5%. Mr. Slattery also receives use of an automobile, reimbursement of business expenses, health insurance, related benefits and a bonus equal to 5% of CSC's pre-tax profits in excess of \$1,000,000, such bonus not to exceed \$200,000.

Also, on September 29, 1999, CSC entered into a Change in Control Agreement with Mr. Slattery which provides for payments of specified benefits to Mr. Slattery in the event his employment terminates under specified circumstances following a change in control of CSC. For the purposes of this agreement, a change in control is deemed to take place whenever:

- o for any period of two consecutive years beginning on any date from and after September 29, 1999, if the Board of Directors at any time during or at the end of such period is not comprised so that a majority of the directors are either (i) individuals who constitute the Board of Directors at the beginning of such period or (ii) individuals who joined the Board during such period who were elected or nominated for election pursuant to a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved (but not including, for purposes of (i) or (ii), a director designated by a person who has entered into an agreement with the Company to effect a transaction described in clause (B) of Subsection 1(b) of the Change in Control Agreement relating to stockholder approval of a merger, share exchange or consolidation of the Company);
- o the stockholders of CSC approve a merger, share exchange or consolidation of CSC with or into any other corporation wherein immediately following such merger, the stockholders of CSC prior to the transaction own less than 51% of the outstanding voting stock of CSC (if it is the survivor of the transaction) or the surviving entity; or
- o the stockholders of CSC approve a plan of complete liquidation of CSC or an agreement for the sale or disposition by CSC of all or substantially

all CSC's assets.

Benefits made available to Mr. Slattery under the terms of the change in control agreement in the event that his employment is terminated under the above specified circumstances may include:

- o payment of his full base salary through the date of termination at the rate in effect at the time notice of termination is given, plus all other amounts and benefits to which Mr. Slattery is entitled under his employment agreement or pursuant to any plan of CSC in which he is participating at the time of termination;
- o a lump sum severance payment equal to the sum of (A) three times Mr. Slattery's annual base salary and incentive bonus in effect immediately prior to the occurrence of the change in control and (B) \$1,000,000 as payment for Mr. Slattery's agreement to extend his agreement not to compete under his employment agreement to four years following the date of termination;
- o any deferred compensation allocated or credited to Mr. Slattery or his account as of the date of termination;
- o Certain additional payments to cover any excise tax imposed by Section 4999 of the Internal Revenue Code;
- o maintenance of life, disability, accident and health insurance benefits substantially similar to those that Mr. Slattery was receiving immediately prior to the notice of termination, for the period beginning on the date of termination and ending on the earlier of (A) the end of the 36th month after the date of termination or (B) the date Mr. Slattery becomes eligible for such benefits under any plan offered by an employer with which he is employed on a full-time basis; and
- o All benefits payable to Mr. Slattery under any applicable retirement, thrift, and incentive plans as well as any other plan or agreement sponsored by CSC or any of its subsidiaries relating to retirement benefits.

## STOCK OPTIONS

The following table sets forth the value of unexercised stock options held by the Named Executives. No options were granted to or exercised by the Named Executives in 2001:

<TABLE><CAPTION>

## OPTION VALUES AT DECEMBER 31, 2001

| YEAR                      | NUMBER OF SHARES UNDERLYING OPTIONS AT | VALUE OF IN-THE MONEY OPTIONS AT |
|---------------------------|----------------------------------------|----------------------------------|
| NAME                      | YEAR END EXERCISABLE/UNEXERCISABLE     | END                              |
| EXERCISABLE/UNEXERCISABLE |                                        |                                  |
| <S>                       | <C>                                    | <C>                              |
| James F. Slattery         | 176,667/13,333                         | \$0/\$0                          |
| Mike Garretson            | 90,000/0                               | \$0/\$0                          |
| Ira Cotler                | 116,667/8,333                          | \$0/\$0                          |
| Bernard Wagner            | 0/10,000                               | \$0/\$0                          |

</TABLE>

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth the beneficial ownership of the Common Stock on February 25, 2002 by (i) each person known by the Company to own beneficially more than five percent of such shares, (ii) each director, (iii) each person named in the Summary Compensation Table under "Executive Compensation" of this Annual Report on Form 10-K, and (iv) all directors and executive officers as a group, together with their respective percentage ownership of the outstanding shares:

<TABLE><CAPTION>

NUMBER OF ACQUIRABLE PERCENT

| NAME AND ADDRESS OF BENEFICIAL OWNER                           | SHARES    | WITHIN 60 DAYS** | OUTSTANDING |
|----------------------------------------------------------------|-----------|------------------|-------------|
| -----                                                          | -----     | -----            | -----       |
| <S>                      <C>                                   | <C>       | <C>              | <C>         |
| James F. Slattery(1).....                                      | 777,245   | 176,667          | 9.4         |
| Dimension Fund Advisors, Inc (3).....                          | 719,087   | --               | 7.1         |
| Jacob May/Background America (4) .....                         | 604,100   | --               | 5.9         |
| Esther Horn(1).....                                            | 597,175   | --               | 5.9         |
| Aaron Speisman(1)(5).....                                      | 418,638   | 26,667           | 4.4         |
| Ira M. Cotler(1).....                                          | 18,518(2) | 116,667          | 1.3         |
| Michael C. Garretson(1).....                                   | --        | 90,000           | *           |
| Stuart Gerson(1).....                                          | 6,000     | 50,000           | *           |
| Bobbie L. Huskey(1).....                                       | 1,206     | 30,000           | *           |
| Melvin T. Stith(1).....                                        | --        | 30,000           | *           |
| Shimmie Horn(1).....                                           | 9,312     | 16,667           | *           |
| Richard P. Staley(1).....                                      | 11,150    | 28,667           | *           |
| Jennifer Anna Speisman 1992 Trust(1).....                      | 83,438    | --               | *           |
| Joshua Israel Speisman 1992 Trust(1).....                      | 53,438    | --               | *           |
| Bernard A. Wagner (1).....                                     | --        | 3,333            | *           |
| All officers and directors as a group<br>(ten persons)(6)..... | 1,378,945 | 550,333          | 19.0        |

</TABLE>

-----

\*        LESS THAN 1%

\*\* Consists of shares issuable upon exercise of options unless otherwise noted.

- (1)        Address is c/o Correctional Services Corporation, 1819 Main Street, Suite 1000, Sarasota, Florida 34236.
- (2)        Includes 2,612 shares of CSC common stock owned by his wife, as to which he disclaims beneficial ownership.
- (3)        Address is 1299 Ocean Avenue, 11th Floor, Santa Monica, CA 90401. In a Form 13G/A, filed February 12, 2002, Dimension Fund Advisors, Inc.

reports sole voting power to vote or direct the vote over 719,087 shares, however, disclaims any beneficial ownership of such shares.

- (4) Address is 1900 Church Street, Suite 400, Nashville, TN 32703.

33

<PAGE>

- (5) Does not include 83,438 shares of Common Stock owned by the Jennifer Anna Speisman 1992 Trust and 53,438 shares of Common Stock owned by the Joshua Israel Speisman 1992 Trust, trusts for the benefit of Mr. Speisman's children, as to which Mr. Speisman disclaims beneficial ownership.
- (6) The ten officers and directors include: Ira M. Cotler, Michael C. Garretson, Stuart M. Gerson, Shimmie Horn, Bobbie L. Huskey, James F. Slattery, Aaron Speisman, Richard P. Staley, Bernard A. Wagner, and Melvin T. Stith.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

During the year 2000, the Company subleased a building located at 12-16 East 31st Street, New York, New York from LeMarquis Operating Corp. ("LMOC"), a corporation owned 25% by Esther Horn and 8% by James F. Slattery. The Company used the space in the building for the Manhattan and New York Community Corrections programs. The Company has ceased its operations of these programs and no longer subleases these buildings.

LMOC leased this building from an unaffiliated party at a total monthly rental of approximately \$33,000. As a result of the lease negotiations, under a sublease dated as of January 1, 1994, since May 1, 1995, the Company had paid rent of \$18,000 per month above the rent paid by LMOC to the building's owner for a total monthly rent of approximately \$51,420. The Company invested \$739,000

in leasehold improvements and did not receive any credit, in terms of a reduction in rent or otherwise, for these improvements. The terms of this sublease were not negotiated at arm's length due to the relationship of Mrs. Horn and Mr. Slattery with both the Company and LMOC.

The negotiation of the sublease, including the renewal terms, was requested by the Representative of the Underwriters of the Company's February 2, 1994 initial public offering to substantially track the renewal terms of the Company's management contract. The negotiations were not subject to the board resolution, adopted subsequent to the negotiations, relating to affiliated transactions, although the terms were approved by all of the directors. The initial term of the Company's sublease expired April 30, 1995, and its first renewal term expired April 30, 2000. The sublease contained two additional successive five-year renewal options beginning May 1, 2000 which the Company chose not to exercise the options and instead occupied the building as a holdover tenant until its complete cessation of operations on December 31, 2000.

The Company had previously paid \$40,000 to LMOC for the renewal options. These renewal options were separately negotiated between the Board of Directors of the Company and LMOC. Mr. Slattery participated in such negotiations. Mrs. Horn and Mr. Slattery received their proportionate shares of rents received by LMOC under the terms of this sublease.

Previously, residential and commercial tenants of this building paid rent to LeMarquis Enterprise Corp. ("Enterprises"), a company owned 30% by Mrs. Horn, 28% by Mr. Slattery and 25% by Mr. Speisman, and Enterprises paid all expenses of operating the residential and commercial portions of the building as well as a portion of the overall expenses of the building. Beginning February 1994 through December 2000, all of the building's revenues, including rent from the residential and commercial tenants were received and expenses paid by the Company. The Company paid \$203,000 and \$147,000 in rent payments for the years ended December 31, 2000 and 1999.

The Company leases the entire building located at 988 Myrtle Avenue, Brooklyn, New York from Myrtle Avenue Family Center, Inc. ("MAFC") pursuant to a five-year lease which commenced January 1, 1994. The lease established a monthly rental of \$40,000 and contained three five-year renewal options. The Company is currently in its first option period, which runs from January 1, 1999 through December 31, 2003. The monthly rental payment during the first option period is \$40,000. The monthly rental for the second option period, which runs from January 1, 2004 through December 31, 2008, is \$45,000, and the monthly rental for the third option period, which runs from January 1, 2009 through December 31, 2013, is \$50,000. In addition, the Company pays taxes, insurance, repairs and maintenance on this building. MAFC is a corporation owned by Mrs. Horn (27.5%) and Messrs. Slattery (8%) and Speisman (27.5%). The terms of the lease were not negotiated at arm's length due to their relationship with MAFC and the Company. Messrs. Slattery and Speisman participated in such negotiations. The Company paid \$480,000 in rent payments for each of the years ended December 31, 2001, 2000 and 1999.

Since October 1, 1996, the Company has leased a building located at 2534 Creston Avenue, Bronx, New York from Creston Realty Associates, L.P. ("CRA"), the corporation owned 10% by Esther Horn, from which the Company operates its Bronx Community Correctional Facility. The original lease term was two years commencing October 1, 1996 and had three additional one year option periods. The Company paid \$242,000, \$201,000 and \$194,000 in rent payments for the years ended December 31, 2001, 2000 and 1999, respectively. The original term of the lease expired on September 30 2001 and the Company has occupied the premises on a month-to-month basis since that time while the Company and CRA negotiate the terms of an extension to the lease. The Company has reached an agreement in

principle with CRA on the terms of a 10-year extension to the lease, effective retroactively to October 1, 2001, which would increase the annual rent payable by the Company to \$330,000, and provide for biennial increases in annual rent up to \$450,000 per year during the term of the extension. The terms of the extension also would enable the Company to terminate the lease at the end of any lease year at its option upon payment to the landlord of the full amount of the next year's rent as an early termination fee. As with the original lease term, the Company also would pay taxes, insurance, repairs and maintenance on this building during the term of the extension. The terms of this lease were not negotiated at arm's length due to the relationship between the Company, Mrs. Horn and CRA. The Company expects to finalize the terms of this lease extension on or about April 1, 2002.

In May 2000, the Company was awarded a contract from the Federal Bureau of Prisons to operate a community corrections center, often referred to as a halfway house, in New York, New York. Subject to approval by the Bureau of Prisons, the Company planned to use a building purchased shortly thereafter by James Slattery, the Company's President and Chief Executive Officer, as the facility for the halfway house and paid for certain leasehold renovations and other costs with respect to the building. Due to community opposition, the Company was unable to use the building as a halfway house and requested that Mr. Slattery pay for all leasehold renovations, and other associated costs incurred by the Company of approximately \$558,000. As of December 31, 2001, Mr. Slattery had paid these costs in full.

Stuart M. Gerson, a director of CSC, is a member of Epstein Becker & Green, CSC's legal counsel. Epstein Becker & Green received approximately \$98,000, \$270,000 and \$397,000 in legal fees from CSC for the years ended December 31, 2001, 2000 and 1999, respectively.

On November 29, 2000, Youth Services International Real Property Partnership, L.L.C., a wholly-owned subsidiary of the Company, entered into an agreement to

sell real property located at 12012 Boyette Road, Riverview, Florida to a two-person Florida based partnership. Aaron Speisman, a director of CSC, is a member of that partnership. This contract was reviewed by the independent directors of the Company and deemed to be at arm's length. The sale closed on December 29, 2000, and the partnership agreed to pay the Company \$3,940,000. A portion of the purchase price was paid by a promissory note guaranteed by the members of the partnership in the amount of \$480,000. The promissory note was paid in full during the year ended December 31, 2001.

Pursuant to the terms of a Board of Directors resolution adopted in connection with the Company's initial public offering, all transactions between the Company and any of its officers, directors or affiliates (except for wholly-owned subsidiaries) must be approved by a majority of the unaffiliated members of the Board of Directors and be on terms no less favorable to the Company than could be obtained from unaffiliated third parties and be in connection with bona fide business purposes of the Company.

In the event the Company makes a loan to an individual affiliate (other than a short-term advance for travel, business expense, relocation or similar ordinary operating expenditure), such loan must be approved by a majority of the unaffiliated directors.

35

<PAGE>

#### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) The following documents are filed as part of this report:

(1) Financial Statements:

The consolidated statements of the Company are included on pages F-1 through F-28 of this Form 10-K.

(2) The financial statement schedules prescribed by this Item 14 are not required.

(3) Exhibits (All referenced herein to "SEC" shall mean the U.S. Securities and Exchange Commission.)

(b) None filed

(c) Exhibits:

- 2.1 Agreement and Plan of Merger, dated as of September 23, 1998, among YSI, CSC and Palm Merger Corp.(9)
- 2.2 First Amendment, dated as of January 12, 1999, to the Agreement and Plan of Merger, dated as of September 23, 1998, among YSI, CSC and Palm Merger Corp.(10)
- 2.3 Second Amendment, dated as of March 2, 1999, to the Agreement and Plan of Merger, dated as of September 23, 1998, among YSI, CSC and Palm Merger Corp.(12)
- 3.1 Certificate of Incorporation of CSC dated October 28, 1993.(1)
- 3.1.1 Copy of Certificate of Amendment of Certificate of Incorporation of CSC dated July 29, 1996.(3)
- 3.1.2 Copy of Certificate of Correction to CSC's Certificate of Incorporation.(1)
- 3.1.3 Copy of Certification of Correction to CSC's Certificate of Amendment to CSC's Certificate of Incorporation. (1)
- 3.2 CSC's By-Laws.(11)
- 4.1 Form of YSI's 7% Convertible Subordinated Debentures Due

February 1, 2006.(6)

4.2.1 Amendment to Fiscal and Paying Agency Agreement, dated March 31, 1999, by and among YSI, The Chase Manhattan Bank, N.A., New York, The Chase Manhattan Bank, N.A., London and Chase Manhattan Bank Luxembourg S.A.(7)

4.3 Indenture, dated October 15, 1996, by and between YSI and The Chase Manhattan Bank, N.A., as Trustee.

4.3.1 Amendment to Indenture, dated March 31, 1999, by and between YSI and The Chase Manhattan Bank, as Trustee.(7)

\* 10.1 CSC's 1993 Stock Option Plan, as amended.(11)

\* 10.6 Employment Agreement between CSC and Aaron Speisman.(1)

\* 10.6.1 Modification to the Employment Agreement between CSC and Aaron Speisman, dated June 13, 1996.(3)

10.17 Form of Lease between CSC and Myrtle Avenue Family Center, Inc.(1)

\* 10.25 1994 Non-Employee Director Stock Option Plan.(2)

10.44 Lease Agreement between CSC and Creston Realty Associates, L.P., dated October 1, 1996.(3)

10.61 Sublease for Sarasota, Florida office space dated April 9, 1998 between Lucent Technologies, Inc. and CSC and Landlord Consent to Sublease.(4)

10.72 Credit Agreement, dated August 31, 1999, between CSC and Summit Bank, N.A.(8)

10.72.1 First Amendment to Credit Agreement, dated November 10, 2000, between CSC and Summit Bank, N.A.(13)

10.72.2 Second Amendment to Credit agreement, dated August 15, 2001, between CSC and Fleet National Bank, successor by merger to Summit Bank.(14)

10.72.3 Third Amendment to Credit agreement, dated November 15, 2001, between CSC and Fleet National Bank, successor by merger to Summit Bank.

10.72.4 Fourth Amendment to Credit agreement, dated November 28, 2001,

between CSC and Fleet National Bank, successor by merger to Summit Bank.

- 10.73 Master Agreement, dated August 31, 1999, between CSC and Atlantic Financial Group, Ltd., Summit Bank, N.A. and SunTrust Bank.(8)

36

<PAGE>

- 10.73.1 First Amendment to Master Agreement dated August 31, 1999, between CSC and Atlantic Financial Group, Ltd., Summit Bank, N.A. and SunTrust Bank.(13)
- 10.73.2 Second Amendment to the Master Agreement, dated August 15, 2001, between CSC and Atlantic Financial Group, Ltd., Fleet National Bank, successor by merger to Summit Bank, N.A. and SunTrust Bank, Nashville, N.A.(14)
- 10.73.3 Third Amendment to Master Agreement, dated November 15, 2001, between CSC and Atlantic Financial Group, Ltd., Fleet National Bank, successor by merger to Summit Bank, N.A. and SunTrust Bank, Nashville, N.A.
- \* 10.74 Employment Agreement dated September 29, 1999 between CSC and James F. Slattery.(5)
- \* 10.75 Change in Control Agreement dated September 29, 1999 between CSC and James F. Slattery.(5)
- 21 List of Subsidiaries - See Page F-7 of This Filing
- 23.1 Consent of Grant Thornton L.L.P., CSC's independent public accountants
- (1) Incorporated by reference to exhibit of same number filed with CSC's Registration Statement on Form SB-2 (Registration No. 33-71314-NY).

- (2) Incorporated by reference to exhibit of same number filed with the initial filing of CSC's Annual Report on Form 10-KSB for the year ended December 31, 1995.
- (3) Incorporated by reference to exhibit of same number filed with CSC's Annual Report on Form-10-KSB for the year ended December 31, 1996.
- (4) Incorporated by reference to exhibit of same number filed with CSC's Form 10-Q for the three months ended March 31, 1998.
- (5) Incorporated by reference to exhibit of same number filed with CSC's Form 10-Q for the nine months ended September 30, 1999.
- (6) Incorporated by reference to exhibit of same number filed with CSC's Current Report on Form 8-K filed with the SEC on April 15, 1999.
- (7) Incorporated by reference to exhibit of same number filed with CSC's Current Report on Form 8-K filed with the SEC on April 22, 1999.
- (8) Incorporated by reference to exhibit of same number filed with CSC's Current Report on Form 8-K filed with the SEC on September 29, 1999.
- (9) Incorporated by reference to CSC's Current Report on Form 8-K, filed with the SEC on September 25, 1998.
- (10) Incorporated by reference to CSC's Current Report on Form 8-K, filed with the SEC on January 21, 1999
- (11) Incorporated by reference to exhibit of same number filed with CSC's Registration Statement on Form S-1 (Registration Number 333-6457).
- (12) Incorporated by reference to exhibit of same number filed with CSC's, Current Report on Form 8-K, filed with the SEC on March 3, 1999.
- (13) Incorporated by reference to exhibit of same number filed with CSC's Form 8-K on November 10, 2000.
- (14) Incorporated by reference to exhibit of same number filed with

CSC's Form 10-Q for the six months ended June 30, 2001.

\* Management Contract or Compensatory Plan or Arrangement.

37

<PAGE>

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CORRECTIONAL SERVICES CORPORATION  
Registrant

By: /s/ James F. Slattery

-----  
James F. Slattery, President

Dated: April 1, 2002

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature<br>-----                                  | Title<br>-----                           | Date<br>----  |
|-----------------------------------------------------|------------------------------------------|---------------|
| /s/ James F. Slattery<br>-----<br>James F. Slattery | President and Chief<br>Executive Officer | April 1, 2002 |
| /s/ Bernard A. Wagner                               | Senior Vice President,                   | April 1, 2002 |

----- Chief Financial Officer  
Bernard A. Wagner

/s/ Aaron Speisman                      Executive Vice President                      April 1, 2002  
----- and Director  
Aaron Speisman

/s/ Richard Staley                      Senior Vice President                      April 1, 2002  
----- and Director  
Richard Staley

/s/ Stuart Gerson                      Chairman of the Board                      April 1, 2002  
-----  
Stuart Gerson

/s/ Shimmie Horn                      Director                      April 1, 2002  
-----  
Shimmie Horn

/s/ Bobbie L. Huskey                      Director                      April 1, 2002  
-----  
Bobbie L. Huskey

/s/ Melvin T. Stith                      Director                      April 1, 2002  
-----  
Melvin T. Stith

/s/ Chet Borgida

Director

April 1, 2002

-----  
Chet Borgida

38

<PAGE>

## CONTENTS

|                                                                                                         | PAGE |
|---------------------------------------------------------------------------------------------------------|------|
| Report of Independent Certified Public Accountants                                                      | F-2  |
| Consolidated Balance Sheets as of December 31, 2001 and 2000                                            | F-3  |
| Consolidated Statements of Operations for the years ended<br>December 31, 2001, 2000, and 1999          | F-4  |
| Consolidated Statement of Stockholders' Equity for the years ended<br>December 31, 2001, 2000, and 1999 | F-5  |
| Consolidated Statements of Cash Flows for the years ended<br>December 31, 2001, 2000, and 1999          | F-6  |
| Notes to Consolidated Financial Statements                                                              | F-7  |

F-1

<PAGE>

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors  
Correctional Services Corporation

We have audited the accompanying consolidated balance sheets of Correctional Services Corporation and Subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Correctional Services Corporation and Subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and consolidated cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Tampa, Florida  
March 8, 2002

F-2

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(in thousands)

<TABLE><CAPTION>  
ASSETS

|                                                     | December 31, |        |
|-----------------------------------------------------|--------------|--------|
|                                                     | 2001         | 2000   |
|                                                     | -----        | -----  |
| <S>                                                 | <C>          | <C>    |
| CURRENT ASSETS                                      |              |        |
| Cash and cash equivalents                           | \$ 932       | \$ 133 |
| Restricted cash                                     | 33           | 92     |
| Accounts receivable, net                            | 25,761       | 36,976 |
| Notes receivable                                    | -            | 3,730  |
| Deferred tax asset                                  | 2,037        | 1,926  |
| Prepaid expenses and other current assets           | 1,506        | 2,673  |
|                                                     | -----        | -----  |
| Total current assets                                | 30,269       | 45,530 |
| PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS, NET | 40,978       | 39,543 |
| OTHER ASSETS                                        |              |        |
| Deferred tax asset                                  | 8,625        | 5,431  |
| Goodwill, net                                       | 679          | 1,049  |
| Other                                               | 5,532        | 5,222  |
|                                                     | -----        | -----  |

|                                                                                                                                                                                                                    |           |           |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
|                                                                                                                                                                                                                    | \$ 86,083 | \$ 96,775 |
|                                                                                                                                                                                                                    | =====     | =====     |
| LIABILITIES AND STOCKHOLDERS' EQUITY                                                                                                                                                                               |           |           |
| CURRENT LIABILITIES                                                                                                                                                                                                |           |           |
| Accounts payable                                                                                                                                                                                                   | \$ 5,798  | \$ 5,338  |
| Accrued liabilities                                                                                                                                                                                                | 13,854    | 14,682    |
| Restructuring and impairment reserve                                                                                                                                                                               | 2,462     | -         |
| Subordinated debt                                                                                                                                                                                                  | 10        | 10        |
| Current portion of senior debt                                                                                                                                                                                     | 16,000    | 6,669     |
|                                                                                                                                                                                                                    | -----     | -----     |
| Total current liabilities                                                                                                                                                                                          | 38,124    | 26,699    |
| LONG-TERM SENIOR DEBT                                                                                                                                                                                              | 314       | 16,338    |
| COMMITMENTS AND CONTINGENCIES                                                                                                                                                                                      | -         | -         |
| STOCKHOLDERS' EQUITY                                                                                                                                                                                               |           |           |
| Preferred stock, \$.01 par value, 1,000 shares authorized,<br>none issued and outstanding                                                                                                                          | -         | -         |
| Common Stock, \$.01 par value, 30,000 shares authorized,<br>11,373 and 10,155 shares issued and outstanding in 2001,<br>respectively, and 11,373 and 10,249 shares issued and<br>outstanding in 2000, respectively | 114       | 114       |
| Additional paid-in capital                                                                                                                                                                                         | 82,797    | 82,797    |
| Accumulated deficit                                                                                                                                                                                                | (32,275)  |           |
| (26,395)                                                                                                                                                                                                           |           |           |
| Treasury stock, at cost                                                                                                                                                                                            | (2,991)   |           |
| (2,778)                                                                                                                                                                                                            |           |           |
|                                                                                                                                                                                                                    | -----     | -----     |
|                                                                                                                                                                                                                    | 47,645    | 53,738    |
|                                                                                                                                                                                                                    | -----     | -----     |

|       |        |       |        |
|-------|--------|-------|--------|
| \$    | 86,083 | \$    | 96,775 |
| ===== |        | ===== |        |

&lt;/TABLE&gt;

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

F-3

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share data)

&lt;TABLE&gt;&lt;CAPTION&gt;

|                                   | Year Ended December 31, |            |            |
|-----------------------------------|-------------------------|------------|------------|
|                                   | 2001                    | 2000       | 1999       |
|                                   | -----                   | -----      | -----      |
| <S>                               | <C>                     | <C>        | <C>        |
| Revenues                          | \$ 174,418              | \$ 210,812 | \$ 233,918 |
|                                   | -----                   | -----      | -----      |
| Facility expenses:                |                         |            |            |
| Operating                         | 160,885                 | 185,447    | 205,662    |
| Startup costs                     | 406                     | 155        | 1,177      |
|                                   | -----                   | -----      | -----      |
|                                   | 161,291                 | 185,602    | 206,839    |
|                                   | -----                   | -----      | -----      |
| Contribution from operations      | 13,127                  | 25,210     | 27,079     |
| Other operating expenses:         |                         |            |            |
| General and administrative        | 13,207                  | 13,344     | 13,555     |
| Legal settlement                  | 375                     | -          | -          |
| Restructuring and impairment      | 4,356                   | -          | -          |
| Loss contract costs               | 1,150                   | -          | -          |
| Loss (gain) on disposal of assets | 938                     | (1,115)    | -          |

|                                                      |            |          |        |
|------------------------------------------------------|------------|----------|--------|
| Merger costs and related restructuring charges       | -          | -        | 12,052 |
| Write-off of deferred financing costs                | -          | -        | 1,874  |
|                                                      | -----      | -----    | -----  |
|                                                      | 20,026     | 12,229   | 27,481 |
|                                                      | -----      | -----    | -----  |
| Operating income (loss)                              | (6,899)    | 12,981   |        |
| (402)                                                |            |          |        |
| Interest expense, net                                | (2,183)    | (3,483)  |        |
| (3,413)                                              |            |          |        |
|                                                      | -----      | -----    | -----  |
| Income (loss) before income taxes and extraordinary  |            |          |        |
| gain on extinguishment of debt                       | (9,082)    | 9,498    |        |
| (3,815)                                              |            |          |        |
| Income tax (provision) benefit                       | 3,202      | (3,710)  |        |
| (429)                                                |            |          |        |
|                                                      | -----      | -----    | -----  |
| Income (loss) before extraordinary gain on           |            |          |        |
| extinguishment of debt                               | (5,880)    | 5,788    |        |
| (4,244)                                              |            |          |        |
| Extraordinary gain on extinguishment of debt, net of |            |          |        |
| tax of \$467                                         | -          | -        | 716    |
|                                                      | -----      | -----    | -----  |
| Net income (loss)                                    | \$ (5,880) | \$ 5,788 | \$     |
| (3,528)                                              |            |          |        |
|                                                      | =====      | =====    | =====  |
| Basic and diluted income (loss) per share:           |            |          |        |
| Income (loss) before extraordinary gain on           |            |          |        |
| extinguishment of debt                               | \$ (0.58)  | \$ 0.51  | \$     |
| (0.38)                                               |            |          |        |
| Extraordinary gain on extinguishment of debt         | -          | -        | 0.07   |
|                                                      | -----      | -----    | -----  |

|                                       |           |         |        |
|---------------------------------------|-----------|---------|--------|
| Net income (loss) per share           | \$ (0.58) | \$ 0.51 | \$     |
| (0.31)                                |           |         |        |
|                                       | =====     | =====   | =====  |
| Number of shares used to compute EPS: |           |         |        |
| Basic                                 | 10,181    | 11,366  | 11,219 |
| Diluted                               | 10,181    | 11,367  | 11,219 |

&lt;/TABLE&gt;

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

F-4

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(in thousands)

&lt;TABLE&gt;&lt;CAPTION&gt;

|                              | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>(Deficit) | Treasury<br>Stock |
|------------------------------|-----------------|----------------------------------|--------------------------|-------------------|
| Total                        | -----           | -----                            | -----                    | -----             |
| <S>                          | <C>             | <C>                              | <C>                      | <C>               |
| <C>                          |                 |                                  |                          |                   |
| BALANCE AT DECEMBER 31, 1998 | \$ 109          | \$ 79,552                        | \$ (28,655)              | \$ -              |
| \$ 51,006                    |                 |                                  |                          |                   |
| Exercise of stock options    | 1               | 515                              | -                        | -                 |
| 516                          |                 |                                  |                          |                   |
| Exercise of warrants         | 4               | 2,740                            | -                        | -                 |
| 2,744                        |                 |                                  |                          |                   |
| Net loss                     | -               | -                                | (3,528)                  | -                 |

(3,528)

|                                  |        |           |             |       |
|----------------------------------|--------|-----------|-------------|-------|
|                                  | -----  | -----     | -----       | ----- |
| BALANCE AT DECEMBER 31, 1999     | 114    | 82,807    | (32,183)    | -     |
| 50,738                           |        |           |             |       |
| Adjustment for overpaid warrants | -      | (10)      | -           | -     |
| (10)                             |        |           |             |       |
| Stock repurchase                 | -      | -         | -           |       |
| (2,778) (2,778)                  |        |           |             |       |
| Net income                       | -      | -         | 5,788       | -     |
| 5,788                            |        |           |             |       |
|                                  | -----  | -----     | -----       | ----- |
| BALANCE AT DECEMBER 31, 2000     | 114    | 82,797    | (26,395)    |       |
| (2,778) 53,738                   |        |           |             |       |
| Stock repurchase                 | -      | -         | -           |       |
| (213) (213)                      |        |           |             |       |
| Net loss                         | -      | -         | (5,880)     | -     |
| (5,880)                          |        |           |             |       |
|                                  | -----  | -----     | -----       | ----- |
| BALANCE AT DECEMBER 31, 2001     | \$ 114 | \$ 82,797 | \$ (32,275) | \$    |
| (2,991) \$ 47,645                |        |           |             |       |
|                                  | =====  | =====     | =====       | ===== |
| =====                            |        |           |             |       |
| </TABLE>                         |        |           |             |       |

The accompanying notes are an integral part of this financial statement.

F-5

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)

&lt;TABLE&gt;&lt;CAPTION&gt;

| December 31,<br>-----                                                                      | Years Ended |          |
|--------------------------------------------------------------------------------------------|-------------|----------|
|                                                                                            | 2001        | 2000     |
| -----                                                                                      | -----       |          |
| <S>                                                                                        | <C>         | <C>      |
| <C>                                                                                        |             |          |
| Cash flows from operating activities:                                                      |             |          |
| Net income (loss)                                                                          | \$ (5,880)  | \$ 5,788 |
| \$ (3,528)                                                                                 |             |          |
| Adjustments to reconcile net income(loss) to net cash<br>provided by operating activities: |             |          |
| Depreciation and amortization                                                              | 3,789       | 4,548    |
| 6,363                                                                                      |             |          |
| Merger related asset write down                                                            | -           | -        |
| 4,831                                                                                      |             |          |
| Deferred income tax expense (benefit)                                                      | (3,305)     | 2,930    |
| 945                                                                                        |             |          |
| Loss (gain) on disposal of fixed assets, net                                               | 938         |          |
| (1,115) 316                                                                                |             |          |
| Gain on extinguishment of debt                                                             | -           | -        |

|         |                                                                |         |       |
|---------|----------------------------------------------------------------|---------|-------|
| (1,628) |                                                                |         |       |
|         | Deferred financing costs                                       | -       | -     |
| 1,874   |                                                                |         |       |
|         | Restructuring and impairment                                   | 4,863   | -     |
| -       |                                                                |         |       |
|         | Changes in operating assets and liabilities:                   |         |       |
|         | Restricted cash                                                | 59      | 100   |
| (35)    |                                                                |         |       |
|         | Accounts receivable                                            | 11,215  |       |
| (1,208) | 2,230                                                          |         |       |
|         | Prepaid expenses and other current assets                      | 1,167   | 397   |
| 1,410   |                                                                |         |       |
|         | Accounts payable and accrued liabilities                       | (368)   |       |
| (1,709) | (6,609)                                                        |         |       |
|         |                                                                | -----   | ----- |
|         | Net cash provided by operating activities:                     | 12,478  | 9,731 |
| 6,169   |                                                                | -----   | ----- |
|         |                                                                |         |       |
|         | Cash flows from investing activities:                          |         |       |
|         | Capital expenditures                                           | (8,795) |       |
| (3,656) | (4,137)                                                        |         |       |
|         | Proceeds from the sale of property, equipment and improvements | 619     | 4,355 |
| 1,232   |                                                                |         |       |
|         | Collection of notes receivable                                 | 3,730   | -     |
| -       |                                                                |         |       |
|         | Other assets                                                   | (431)   |       |
| (47)    | 480                                                            |         |       |
|         |                                                                | -----   | ----- |
|         | Net cash provided by (used in) investing activities:           | (4,877) | 652   |

(2,425)

-----

Cash flows from financing activities:

|                                                                                          |         |        |
|------------------------------------------------------------------------------------------|---------|--------|
| Proceeds (payment) on short-term and long-term borrowings, and capital lease obligations | (6,693) |        |
| (751) 11,874                                                                             |         |        |
| Payment of subordinated debt                                                             | -       |        |
| (14,180) (17,483)                                                                        |         |        |
| Proceeds from exercise of stock options and warrants                                     | -       | -      |
| 3,260                                                                                    |         |        |
| Debt issuance costs                                                                      | -       | -      |
| (2,363)                                                                                  |         |        |
| Stock repurchase                                                                         | (213)   |        |
| (2,778) -                                                                                |         |        |
| Long-term portion of prepaid lease                                                       | 104     | 399    |
| 399                                                                                      |         |        |
| Adjustment for overpaid warrants                                                         | -       |        |
| (10) -                                                                                   |         |        |
|                                                                                          | -----   | -----  |
| Net cash used in financing activities:                                                   | (6,802) |        |
| (17,320) (4,313)                                                                         |         |        |
|                                                                                          | -----   | -----  |
| Net increase (decrease) in cash and cash equivalents                                     | 799     |        |
| (6,937) (569)                                                                            |         |        |
| Cash and cash equivalents at beginning of period                                         | 133     | 7,070  |
| 7,639                                                                                    |         |        |
|                                                                                          | -----   | -----  |
| Cash and cash equivalents at end of period                                               | \$ 932  | \$ 133 |

\$ 7,070

=====

Non-cash investing activities

Property exchanged for a note receivable  
\$ -

\$ - \$ 3,812

=====

Assets written off against restructuring reserve  
\$ -

\$ 2,401 \$ -

=====

Sale of a facility leased under the Company's operating  
lease-financing facility where proceeds were paid directly  
to the lienholder  
\$ -

\$ 10,650 \$ -

=====

Supplemental disclosures of cash flows information:

Cash paid (refunded) during the period for:

Interest  
\$ 3,712

\$ 1,720 \$ 3,846

=====

Income taxes  
\$ 8

\$ (26) \$ 872

=====

</TABLE>

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

F-6

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Correctional Services Corporation and its subsidiaries (the Company) are organized to privately operate and manage detention, and correctional facilities as well as educational, developmental and rehabilitative programs for federal, state and local government agencies.

## 1. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements as of December 31, 2001 include the accounts of Correctional Services Corporation and its wholly owned subsidiaries:

- o Esmor, Inc.
- o Esmor New Jersey, Inc.
- o CSC Management de Puerto Rico, Inc.
- o CSC UK, Ltd.
- o YSI Holdings, Inc.
- o YSI Real Property Partnership, LLP
- o YSI Investment LLC
- o YSI International Management LLC
- o FF & E, Inc.
- o Youth Services International, Inc.
- o Youth Services International of Iowa, Inc.

- o Youth Services International of Northern Iowa, Inc.
- o Youth Services International of South Dakota, Inc.
- o Youth Services International of Missouri, Inc.
- o Youth Services International of Central Iowa, Inc.
- o Youth Services International of Texas, Inc.
- o Youth Services International of Illinois, Inc.
- o Youth Services International of Michigan, Inc.

All significant intercompany balances and transactions have been eliminated.

## 2. POOLING-OF-INTERESTS BUSINESS COMBINATIONS

On March 31, 1999, the Company exchanged 3,114,614 shares of the Company's common stock for all of the common stock of Youth Services International, Inc. (YSI). The merger was accounted for as a pooling-of-interests, and accordingly, the accompanying financial statements have been retroactively adjusted to include the financial position and results of operations of YSI for 1999.

F-7

<PAGE>

### CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

During the first quarter of 1999, the Company recorded a charge to operating expenses of approximately \$12.1 million for direct costs related to the merger and certain other costs resulting from the

restructuring of the newly combined operations. In connection with the combination, the Company planned to close the YSI corporate offices in Maryland, withdraw from a facility in Iowa, and close facilities in Texas and Virginia, which were expected to result in the elimination of 350 positions. Direct merger costs consisted primarily of fees to investment bankers, attorneys, accountants, financial advisors and printing and other direct costs. Restructuring charges included severance and change in control payments made to certain former officers and employees of YSI; losses associated with the write-off of the carrying value of the software used by YSI, which will not be used by the Company and computer equipment that was incompatible with that used by the Company; and miscellaneous other costs which included the cancellation of lease agreements and other long-term commitments.

Merger costs and related restructuring charges incurred in 1999 are comprised of the following (in thousands):

|                                                   |           |
|---------------------------------------------------|-----------|
| Direct merger costs                               | \$ 4,350  |
| Restructuring charges:                            |           |
| Employee severance and change in control payments | 2,339     |
| Write-off of buildings and leasehold improvements | 2,661     |
| Write-off of software and computer equipment      | 1,749     |
| Other                                             | 953       |
|                                                   | -----     |
| Total                                             | \$ 12,052 |
|                                                   | =====     |

The Company closed the corporate facility and withdrew from the Iowa facility, which resulted in the elimination of 273 positions. The Texas and Virginia facilities were closed in 2000 and resulted in the elimination of 72 positions. At December 31, 2000, all merger and

restructuring charges had been paid as noted above, except for a \$300,000 surplus from exit costs which was recognized as a reduction in 2000 operating expenses.

### 3. USE OF ESTIMATES IN CONSOLIDATED FINANCIAL STATEMENTS

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

F-8

<PAGE>

## CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

#### 4. NEW ACCOUNTING PRONOUNCEMENTS

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, BUSINESS COMBINATIONS, and SFAS 142, GOODWILL AND INTANGIBLE ASSETS. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for the year beginning January 1, 2002; however certain provisions of that Statement apply to goodwill and other intangible assets acquired between July 1, 2001

and the effective date of SFAS 142. The Company will adopt these new standards, effective January 1, 2002. The Company analyzed net goodwill at the juvenile division reporting level, as of January 1, 2002, and has determined there is no expected impairment of goodwill as of January 1, 2002. The Company recognized amortization expense related to goodwill of \$370,000, \$370,000 and \$362,000 for the twelve months ended December 31, 2001, 2000, 1999, respectively.

In July 2001, the FASB issued SFAS No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement applies to all entities. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. This Statement is for financial statements issued for fiscal years beginning after June 15, 2002. The Company has evaluated the impact of the adoption of this standard on its financial position and results of operations, and does not believe the effect, if any, to be significant.

In August 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes FASB Statement No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF. The provisions of the statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company has evaluated the impact of the adoption of this standard on its financial position and results of operations, and does not believe the effect, if any, to be significant.

## 5. REVENUE RECOGNITION AND CONTRACT PROVISIONS

Revenues are principally derived pursuant to contracts with federal, state and local government agencies and not-for-profit entities that contract directly with governmental entities. These contracts generally provide for fixed per diem payments based upon program occupancy. Revenues on fixed per diem and management contracts are recognized as the services are performed.

One of the Company's significant programs operates under a contract whereby revenues are recognized as reimbursable costs are incurred through a gross maximum price cost reimbursement arrangement. This contract has costs, including indirect costs, subject to audit and adjustment by negotiations with government representatives. Contract revenues subject to audit relating to this contract of approximately \$15.5 million, \$15.0 million, and \$13.8 million have been recorded for the years ended December 31, 2001, 2000, and 1999, respectively, at amounts which are considered to be earned. Subsequent adjustments if any, resulting from the audit process are recorded when known or can be reasonably estimated.

Contract terms with government and not-for-profit entities generally range from one to five years in duration and expire at various dates. Most of these contracts are subject to termination for convenience by the governmental entity.

The Company performs periodic evaluations of the collectibility of its receivables and does not require collateral on its account receivable. Losses on uncollectible receivables are provided for in the financial statements based on management's expectations. Accounts receivable are presented net of an allowance for doubtful accounts of

\$2.9 million and \$1.7 million at December 31, 2001 and 2000, respectively. The Company recognized a provision for doubtful accounts of \$1.5 million, \$927,000 and \$0 for the years ended December 31, 2001, 2000 and 1999, respectively.

F-9

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

6. CASH AND CASH EQUIVALENTS

The Company considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents.

Included in the restricted cash of \$33,000 and \$92,000 at December 31, 2001 and 2000 is a major maintenance and repair reserve fund established by the Company as required by certain contracts.

7. PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Property, equipment and leasehold improvements are carried at cost. Depreciation of buildings is computed using the straight-line method over twenty and thirty year periods. Depreciation of equipment is computed using the straight-line method over a five-year period. Leasehold improvements are being amortized over the shorter of the

life of the asset or the applicable lease term (ranging from five to twenty years). For tax purposes accelerated methods of depreciation are utilized.

8. GOODWILL

Goodwill representing the excess of the cost over the net assets of acquired businesses is stated at cost and is amortized over 10 years using the straight-line method. Amortization expense for the years ended December 31, 2001, 2000, and 1999 was \$370,000, \$370,000, and \$362,000, respectively. Accumulated amortization at December 31, 2001 and 2000 was \$3.0 million and \$2.7 million, respectively. The Company will adopt the provisions of SFAS NO. 142 effective January 1, 2002. Based on the Company's evaluation of goodwill in accordance with the provisions of SFAS NO. 142, it does not anticipate impairment of the asset as of January 1, 2002.

9. ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS

The Company reviews long-lived assets and certain identifiable intangibles including goodwill to be held and used or disposed of, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company uses an estimate of the undiscounted cash flows over the remaining life of its long-lived assets in measuring whether the assets to be held and used will be realizable. An impairment loss is recognized to the extent that the sum of discounted estimated future cash flows (using the Company's incremental borrowing rate over a period of less than 30 years) that is expected to result from the use of the asset is less than the carrying value.

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

10. INCOME TAXES

The Company utilizes an asset and liability approach for financial accounting and reporting for income taxes. The primary objectives of accounting for income taxes are to (a) recognize the amount of tax payable for the current year and (b) recognize the amount of deferred tax liability or asset based on management's assessment of the tax consequences of events that have been reflected in the Company's consolidated financial statements.

11. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding. In the computation of diluted earnings per share, the weighted-average number of common shares outstanding is adjusted, when the effect is not anti-dilutive, for the effect of all common stock equivalents and the average share price for the period is used in all cases when applying the treasury stock method to potentially dilutive outstanding options.

12. STOCK BASED COMPENSATION

With respect to stock options granted to employees the Company applies the accounting method promulgated by the Accounting

Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, to measure and recognize compensation. Management has adopted the disclosure provision of the Financial Accounting Standards Board No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, for accounting related to stock options granted to employees.

13. COMPREHENSIVE INCOME

The Company's comprehensive income (loss) is equivalent to net income (loss) for the years ended December 31, 2001, 2000, and 1999.

14. RECLASSIFICATIONS

Certain reclassifications have been made to 2000 and 1999 amounts to conform to the 2001 presentation.

15. TREASURY STOCK

On October 20, 2000, the Company announced that its Board of Directors had authorized a share repurchase program of up to \$10.0 million. The repurchases are funded from the proceeds of asset sales and excess cash flow. The Company repurchased 93,000 shares and 1.1 million shares during the years ended December 31, 2001 and 2000, respectively, at a cost of \$213,000 and \$2.8 million, respectively.

16. LEGAL COSTS

The Company recognizes legal costs related to the defense or assertion of legal claims when the related services have been rendered.

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE B- FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

1. CASH AND CASH EQUIVALENTS

The carrying amount reasonably approximates fair value because of the short maturity of those instruments.

2. ACCOUNTS AND NOTES RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The carrying amount reasonably approximates fair value because of the short-term maturities of these items.

3. SUBORDINATED PROMISSORY NOTES AND LONG-TERM DEBT

The fair value of the Company's subordinated promissory notes and long-term debt is estimated based upon the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. As of December 31, 2001 and 2000 the estimated fair values of the subordinated promissory notes and long-term debt approximated their carrying values.

## NOTE C- PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following  
(in thousands):

|                                     | December 31, |          |
|-------------------------------------|--------------|----------|
|                                     | 2001         | 2000     |
| Prepaid insurance                   | \$ 211       | \$ 235   |
| Prepaid real estate taxes           | 68           | 168      |
| Prepaid and refundable income taxes | 29           | 281      |
| Prepaid rent - current portion      | 333          | 488      |
| Prepaid expenses                    | 841          | 1,149    |
| Other current assets                | 24           | 352      |
|                                     | \$ 1,506     | \$ 2,673 |
|                                     | =====        | =====    |

F-12

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE D- PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Property, equipment and leasehold improvements, at cost, consist of the  
following (in thousands):

|  | December 31, |      |
|--|--------------|------|
|  | 2001         | 2000 |

|                               |           |           |
|-------------------------------|-----------|-----------|
|                               | -----     | -----     |
| Buildings and land            | \$ 38,018 | \$ 32,055 |
| Equipment                     | 10,109    | 11,572    |
| Leasehold improvements        | 9,803     | 11,449    |
|                               | -----     | -----     |
|                               | 57,930    | 55,076    |
| Less accumulated depreciation | (16,952)  | (15,533)  |
|                               | -----     | -----     |
|                               | \$ 40,978 | \$ 39,543 |
|                               | =====     | =====     |

Depreciation expense for the years ended December 31, 2001, 2000, and 1999 was approximately \$3.4 million, \$4.1 million, and \$4.9 million, respectively.

#### NOTE E- OTHER ASSETS

Other assets consist of the following (in thousands):

|                                       | December 31, |          |
|---------------------------------------|--------------|----------|
|                                       | 2001         | 2000     |
|                                       | -----        | -----    |
| Deferred refinancing costs, net       | \$ 700       | \$ 1,038 |
| Deposits                              | 759          | 731      |
| Prepaid rent - net of current portion | 3,058        | 3,162    |
| Other                                 | 1,015        | 291      |
|                                       | -----        | -----    |
|                                       | \$ 5,532     | \$ 5,222 |

=====

## NOTE F- ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

|                                                      | December 31, |           |
|------------------------------------------------------|--------------|-----------|
|                                                      | 2001         | 2000      |
| Accrued expenses                                     | \$ 5,965     | \$ 6,194  |
| Accrued interest                                     | 204          | 16        |
| Accrued medical claims and premiums                  | 1,768        | 1,522     |
| Accrued worker's compensation claims<br>and premiums | 1,194        | 1,486     |
| Payroll and related taxes                            | 3,965        | 4,495     |
| Unearned revenue                                     | 56           | 70        |
| Other                                                | 702          | 899       |
|                                                      | \$ 13,854    | \$ 14,682 |

=====

Included in accounts payable is approximately \$2.6 million of outstanding checks in excess of cash balances for the years ended December 31, 2001 and 2000.

F-13

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE G- RESTRUCTURING AND IMPAIRMENT RESERVE

During the third quarter of 2001, the Company recorded charges of \$7.9 million related to corporate restructuring and asset impairments, losses on contracts of facilities to be closed, and other charges included in general and administrative expenses. In connection with the restructuring, the Company planned to close various facilities expected to result in the elimination of 358 positions. In the aggregate, these facilities had revenues and contributions from operations of \$13.0 million and \$(3.0) million, respectively. The related charges are as follows (in thousands):

|                                                                  |          |
|------------------------------------------------------------------|----------|
| Severance pay                                                    | \$ 205   |
| Provision for early termination of<br>a lease                    | 270      |
| Impairment of assets                                             | 3,881    |
| Loss on contracts of facilities to<br>be closed                  | 1,150    |
| Other charges included in general and<br>administrative expenses | 2,373    |
|                                                                  | -----    |
|                                                                  | \$ 7,879 |
|                                                                  | =====    |

Severance pay relates primarily to the restructuring of the Company's corporate offices, which resulted in the elimination of 19 positions. Provision for the early termination of a lease represents the Company's estimate of their liability upon termination of a lease, which expires in 2006. Charges for impairment of assets include a \$1.3 million charge related to the write-down of assets at the facilities to be closed, and a \$2.6 million charge for properties where the Company has decided to discontinue the pursuit of future usage, and is based on fair market value estimates of the properties less costs to sell. Based on management's analysis of its contract obligations, the Company has recorded

costs of approximately \$1.1 million for contracts that will require the Company incur losses to fulfill the contracts. These facilities are included in those scheduled for closure. Other charges included in general and administrative expenses include \$1.3 million of additional allowance primarily for receivables which have been in dispute over a number of years, including a receivable from a non-profit entity, and \$1.1 million related to reserves established for legal obligations and management's estimate of the results of agency audits.

The remaining reserve associated with the 2001 restructuring and impairment charges consists of the following on December 31, 2001 (in thousands):

|                            |    |       |
|----------------------------|----|-------|
| Contract loss reserves     | \$ | 439   |
| Impaired property reserves |    | 1,653 |
| Other                      |    | 370   |
|                            |    | ----- |
|                            | \$ | 2,462 |
|                            |    | ===== |

The remaining impaired property reserve balance relates to anticipated losses on expected sales of properties that are currently held in the operating lease-financing facility.

F-14

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE H - DEBT

SENIOR DEBT:

Senior debt consists of the following (in thousands):

&lt;TABLE&gt;&lt;CAPTION&gt;

December 31,

2000

2001

&lt;S&gt;

&lt;C&gt;

&lt;C&gt;

Revolving line of credit expiring August 2002. As of December 31, 2001, interest is payable at LIBOR plus 3.50% and prime plus 2.00%. The weighted-average interest rate at December 31, 2001 was 6.26%.

16,000 \$ 10,000

\$

Delayed drawdown term note, principal payments of \$1.67 million due quarterly began June 30, 2000. Paid in full in June 2001.

- 12,694

Mortgage payable due in semi-annual installments of \$17,083, which includes principal plus interest at 10% per annum, due in full October 2006, collateralized by land with a book value of \$434,000.

314 313

16,314 23,007

Less current portion

(16,000) (6,669)

-- -----

314      \$      16,338

\$

=====

&lt;/TABLE&gt;

In November 2000, the Company amended its financing arrangement ("Agreement") with Fleet National Bank, N.A. ("Fleet"), formerly Summit Bank, N.A. The amendment to the Agreement allowed the Company the option of utilizing a percentage of both: (i) excess cash flow (as defined by the Agreement) and (ii) the proceeds from the sale of certain assets, to repurchase Company stock in furtherance of the Company's stock repurchase plan (see Treasury Stock below). Borrowings under the line are subject to compliance with various financial covenants and borrowing base criteria (which were also amended). The Agreement was further amended for the quarters ended June 30, 2001, September 30, 2001 and December 31, 2001, as the Company realized that it would not comply with the unamended covenants. Accordingly, the Company is in compliance with all such amended loan covenants as of December 31, 2001. The Agreement restricts the payment of dividends.

The financing arrangement is secured by all of the assets of the Company and consists of the following components:

- o      \$21 million (as amended) revolving line of credit to be used by the Company and its subsidiaries for working capital and general corporate purposes and to finance the acquisition of facilities, properties and other businesses. At December 31, 2001 the Company had \$16.0 million outstanding under the revolving line of credit and \$2.5 million of availability.
- o      \$20 million delayed drawdown credit facility which provided the Company with additional financing to be used to fund the redemption of the

outstanding 7% Convertible Subordinated Debentures. This facility was paid in full during June 2001 and is no longer available to the Company.

- o \$14 million (as amended) in financing which may be used to purchase land and property and to finance the construction of new facilities through an operating lease arrangement. As of December 31, 2001, the Company had approximately \$14.0 million outstanding under this operating lease-financing facility. Pursuant to the June 30, 2001 amendment, there is no additional funding available under this component of the financing arrangement. The related obligations and assets are not included in the financial statements of the Company, as this financing facility is treated as an operating lease in accordance with SFAS NO. 13, ACCOUNTING FOR LEASES.

F-15

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE H - DEBT (CONTINUED)

The \$21 million revolving line of credit and the \$14 million operating lease-financing facility, as amended, mature on August 31, 2002. Although the Company is in discussions with its lender to extend the maturity date or, otherwise, to seek alternative sources of long-term financing, there can be no assurances that the Company will be successful. Accordingly the entire outstanding balance on the revolving line of credit of \$16.0 million, is classified as short-term. Additionally, the Company will be obligated to pay approximately \$14.0 million upon the termination of the operating lease-financing facility.

SUBORDINATED DEBENTURES:

Subordinated debentures consists of the following (in thousands):

|                                                                                                                     | December 31, |       |
|---------------------------------------------------------------------------------------------------------------------|--------------|-------|
|                                                                                                                     | 2001         | 2000  |
| 7% Convertible Subordinated Debentures due March 31, 2000 which includes interest payable semi-annually in arrears. | \$ 10        | \$ 10 |
| Less current portion                                                                                                | (10)         | (10)  |
|                                                                                                                     | \$ -         | \$ -  |
|                                                                                                                     | =====        | ===== |

As of December 31, 2001, \$10,000 remains outstanding pending receipt of the original Debentures from the Debenture holders.

At December 31, 2001 aggregate maturities of senior debt and subordinated debentures were as follows (in thousands):

| Year ending December 31, |           |
|--------------------------|-----------|
|                          |           |
| 2002                     | \$ 16,013 |
| 2003                     | 3         |
| 2004                     | 3         |
| 2005                     | 4         |
| 2006                     | 4         |
| Thereafter               | 297       |
|                          | -----     |
| Total                    | \$ 16,324 |

=====

F-16

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE I - RENTAL AGREEMENTS

The Company has operating leases for certain of its facilities and certain machinery and equipment which expire at various dates. Substantially all the facility leases provide for payment by the Company of all property taxes and insurance.

Future minimum rental commitments under both cancelable and non-cancelable leases as of December 31, 2001 are as follows (in thousands):

| Year ending December 31, | Total     | Related<br>Companies |
|--------------------------|-----------|----------------------|
| -----                    | -----     | -----                |
| 2002                     | \$ 17,607 | \$ 480               |
| 2003                     | 2,639     | 480                  |
| 2004                     | 1,845     | -                    |
| 2005                     | 1,085     | -                    |
| 2006                     | 823       | -                    |
| Thereafter               | 7,584     | -                    |
|                          | -----     | -----                |
|                          | \$ 31,583 | \$ 960               |
|                          | =====     | =====                |

The amounts due in 2002 include payments due under the operating lease-financing

facility as discussed in Note H.

The Company leases a facility from a related party. The lease commenced January 1, 1999 and expires December 31, 2003. Thereafter, the Company has two successive five-year options to renew. In addition to the base rent, the Company pays taxes, insurance, repairs and maintenance on this facility. The Company paid \$480,000 in rent payments for each of the years ended December 31, 2001, 2000 and 1999.

The Company leases a second facility from a related party. The lease commenced October 1, 1996 and expired September 30, 2001. The Company is in negotiations with the landlord to extend the lease, and has been on a month to month basis since the lease expired. In addition to the base rent, the Company pays taxes, insurance, repairs and maintenance on this facility. The Company paid \$242,000, \$201,000 and \$194,000 in rent payments for the years ended December 31, 2001, 2000 and 1999, respectively.

The Company leased a third building from a related party. The Company ceased operation of the facility in December 2000. The Company had been operating on a month to month basis since April 2000. The Company paid \$203,000 and \$147,000 in rent payments for the years ended December 31, 2000 and 1999.

Rental expense of operating leases and machinery and equipment for the years ended December 31, 2001, 2000, and 1999 aggregated \$6.2 million, \$6.8 million, and \$6.2 million, respectively.

F-17

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE J - INCOME TAXES

The income tax expense (benefit) consists of the following (in thousands):

|                          | Years Ended December 31, |          |          |
|--------------------------|--------------------------|----------|----------|
|                          | 2001                     | 2000     | 1999     |
| Current:                 |                          |          |          |
| Federal                  | \$ -                     | \$ 114   | \$ (335) |
| State and local          | 103                      | 666      | 286      |
| Deferred:                |                          |          |          |
| Federal, state and local | (3,305)                  | 2,930    | 945      |
|                          | \$ (3,202)               | \$ 3,710 | \$ 896   |

The following is a reconciliation of the federal income tax rate and the effective tax rate as a percentage of pre-tax income (loss):

<TABLE><CAPTION>

|                                         | Years Ended December 31, |       |         |
|-----------------------------------------|--------------------------|-------|---------|
|                                         | 2001                     | 2000  | 1999    |
| <S>                                     | <C>                      | <C>   | <C>     |
| Statutory federal rate                  | 34.0%                    | 34.0% | 34.0%   |
| State taxes, net of federal tax benefit | 4.7                      | 6.5   | 5.1     |
| Non-deductible items                    | (1.8)                    | (0.4) | (37.3)  |
| Valuation allowance and reconciliation  | (2.1)                    | (3.4) | (35.0)  |
| Other                                   | 0.5                      | 2.4   | (0.8)   |
|                                         | 35.3%                    | 39.1% | (34.0)% |

=====

&lt;/TABLE&gt;

At December 31, 2001, the Company had net operating loss carryforwards of approximately \$13.6 million, \$32.8 million and \$2.6 million for federal, state, and foreign income tax purposes, respectively, that expire in periods beginning in 2006 through 2021. At December 31, 2001, the Company also had an Alternative Minimum Tax (AMT) credit of approximately \$562,000, which does not expire.

A portion of the net operating loss carryforwards are subject to IRS Section 382 limitations and other limitations, which limit the utilization of the federal and state net operating loss carryforwards in any given year. Realization of the portion of the deferred tax asset resulting from the Company's net operating loss carryforward in certain states and Puerto Rico is not considered more likely than not. Accordingly, a valuation allowance has been established for the full amount of those deferred tax assets. The Company, after considering its pattern of profitability and its anticipated future taxable income, believes it is more likely than not that the remaining deferred tax assets will be realized.

F-18

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE J - INCOME TAXES - (CONTINUED)

Deferred income taxes reflect the tax effected impact of temporary differences between the amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. The components of the Company's deferred tax assets (liabilities) are summarized as follows (in thousands):

|                                  | December 31, |          |
|----------------------------------|--------------|----------|
|                                  | 2001         | 2000     |
| Restructuring and impairment     | \$ 1,136     | \$ -     |
| Vacation accrual                 | 214          | 284      |
| Startup and development costs    | 614          | 1,112    |
| Accrued expenses                 | 1,306        | 1,517    |
| Depreciation                     | 672          | 498      |
| Net operating loss carryforwards | 6,994        | 5,594    |
| Alternative minimum tax credit   | 562          | 562      |
| Other                            | 2,450        | 888      |
|                                  | 13,948       | 10,455   |
| Valuation allowance              | (3,286)      | (3,098)  |
|                                  | 10,662       | 7,357    |
| Less: current portion            | (2,037)      | (1,926)  |
|                                  | \$ 8,625     | \$ 5,431 |
|                                  | =====        | =====    |

## NOTE K - COMMON STOCK WARRANTS

The Company issued to individuals and sold to certain underwriters' warrants associated with the 1994 public offering and the 1995 Private Placement. The following represents all warrant activity for the years presented:

|                              | Public | Underwriter | Total  |
|------------------------------|--------|-------------|--------|
| BALANCE AT DECEMBER 31, 1999 | -      | 27,643      | 27,643 |

|                              |       |        |        |
|------------------------------|-------|--------|--------|
| Warrants expired             | -     | 27,643 | 27,643 |
|                              | ----- | -----  | -----  |
| BALANCE AT DECEMBER 31, 2000 | -     | -      | -      |
|                              | ===== | =====  | =====  |

F-19

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE L - COMMITMENTS AND CONTINGENCIES

## 1. NEW JERSEY FACILITY CLOSURE

Due to a disturbance at the Company's Elizabeth, New Jersey facility on June 18, 1995, the facility was closed and the INS moved all detainees located therein to other facilities. On December 15, 1995, the company and a publicly-traded company (the "Buyer"), which also operates and manages detention and correctional facilities, entered into an asset purchase agreement pursuant to which the Buyer purchased the equipment, inventory and supplies, contract rights and records, leasehold and land improvements of the Company's New Jersey facility for \$6.2 million. The purchase price was payable in non-interest bearing monthly installments of \$123,000 effective January 1997, the month the Buyer commenced operations of the facility. The Company has no continuing obligation with respect to the Elizabeth, New Jersey facility. According to the terms of the asset purchase agreement, the monthly payments beginning September 1999 are contingent upon the renewal of the contract by the INS and the Buyer. The INS did re-award the contract to the Buyer in 1999. The Company received monthly non-interest bearing payments of

\$123,000, beginning September 1999 through March 2001, and recognized income ratably over this period.

## 2. LEGAL MATTERS

In March 1996, several former detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey filed suit in the Supreme Court of the State of New York, County of Bronx on behalf of themselves and others similarly situated, alleging personal injuries and property damage purportedly caused by the negligent and intentional acts of CSC, in which the plaintiffs in the suit claimed \$500,000,000 each in compensatory and punitive damages. This suit was removed to the United States District Court, Southern District of New York, in April 1996. In July 1996, seven detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey and certain of their spouses filed suit in the Superior Court of New Jersey, County of Union, seeking \$10,000,000 each in damages arising from alleged mistreatment of the detainees. This suit was removed to the United States District Court, District of New Jersey, in August 1996. In July 1997, another group of former detainees in the INS Detention Center that the Company formerly operated in Elizabeth, New Jersey filed suit in the United States District Court for the District of New Jersey. The suit claims violations of civil rights, personal injury and property damage allegedly caused by the negligent and intentional acts of CSC. No monetary damages have been stated. Through stipulation, the parties have agreed to try these actions in the United States District Court for the District of New Jersey in order to streamline the discovery process, minimize costs and avoid inconsistent rulings. These matters are currently in the discovery stages of the proceeding. Although the Company believes that it has meritorious defenses to the claims made in these actions, and is vigorously pursuing its defense of these

claims, the aggregate amount of the damages claimed by the plaintiffs in these cases substantially exceeds the amount of insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

In May 2001, the plaintiffs, the estate and parents of Bryan Alexander, a former inmate at the Tarrant County Correctional Facility in Mansfield, Texas (which formerly was operated by the Company), brought a wrongful death action, in which it has been alleged that the Company's negligent and intentional acts, as well as the negligent and intentional acts of the other named defendants, proximately caused the death of Bryan Alexander on January 9, 2001. Plaintiffs' original Complaint sought \$300,000,000 in compensatory damages and unspecified punitive damages. Plaintiffs subsequently amended their Complaint to delete their demand for \$300,000,000 in compensatory damages in lieu of a pleading that seeks unspecified compensatory and punitive damages in amounts to be proved at trial. This case is currently in the discovery stages of the proceeding. The Company believes that it has meritorious defenses to the claims made by the plaintiffs in this case and is vigorously pursuing its defense; however, the amount of the damages originally claimed by the plaintiffs in this case substantially exceeds the amount of insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

Plaintiffs, each a former employee of the McKinley County Jail in Gallup, New Mexico, allege various causes of action against the Company relating to their employment with the Company and subsequent

termination from employment with the Company. Plaintiffs originally sought an unspecified amount of compensatory and punitive damages from the Company, but, in December 2001, presented demands to the Company in the aggregate amount of approximately \$9,000,000. The Company believes that it has meritorious defenses to the claims made by the plaintiffs in this case and is vigorously pursuing its defense; however, the amount of the damages originally claimed by the plaintiffs in this case substantially exceeds the amount of insurance coverage available to the Company. Therefore, given the inherent uncertainties associated with litigation, no assurance can be given that the outcome of this litigation will not have a materially adverse effect on the Company.

F-20

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE L - COMMITMENTS AND CONTINGENCIES (CONTINUED)

3. CONTRACTS

Renewal of government contracts is subject to, among other things, appropriations of funds by the various levels of government involved (federal, state or local). Also, several contracts contain provisions whereby the Company may be subject to audit by the government agencies involved. These contracts also generally contain "termination for the convenience of the government" and "stop work order" clauses which generally allow the government to terminate a contract without cause. In the event one of the Company's larger contracts is terminated, it may have a material adverse effect on the

Company's operations.

4. DISPUTED RECEIVABLE

In April 1999, immediately following the merger with YSI, a non-profit entity for whom YSI provided management services elected to discontinue all contracted services pursuant to a change in control clause of its management agreement with YSI. Upon this determination, YSI presented a final bill for management services rendered, which the non-profit entity disputed, claiming, among other things, that it had been billed incorrectly over the course of the management contract. The Company has investigated these claims and in order to avoid litigation, the Company has reached an agreement to accept \$600,000 to settle the outstanding receivables. The Company has reserved approximately \$2.2 million against the receivable due from this non-profit entity at December 31, 2001.

5. OFFICERS' COMPENSATION

The Company has an employment agreement with its President, which expires September 29, 2002 and is subject to automatic annual renewals. The contract provides for minimum annual compensation of \$270,000, cost of living increases, use of an automobile, reimbursement of business expenses, health insurance, related benefits and a bonus equal to 5% of pre-tax profits in excess of \$1.0 million, such bonus not to exceed \$200,000.

6. CONCENTRATIONS OF CREDIT RISK

The Company's contracts in 2001, 2000, and 1999 with government agencies where revenues exceeded 10% of the Company's total consolidated revenues were as follows:

&lt;TABLE&gt;&lt;CAPTION&gt;

|                                                  | Years Ended December 31, |      |      |
|--------------------------------------------------|--------------------------|------|------|
|                                                  | 2001                     | 2000 | 1999 |
| <S>                                              | <C>                      | <C>  | <C>  |
| Florida Department of Juvenile Justice           | 11%                      | 10%  | 13%  |
| Texas Department of Criminal Justice             | 13%                      | 13%  | 10%  |
| Various Other Agencies in the State of Texas     | 15%                      | 13%  | 11%  |
| State of Maryland Department of Juvenile Justice | 13%                      | 11%  | 10%  |

&lt;/TABLE&gt;

## 7. FIDUCIARY FUNDS

The Company has acted as a fiduciary disbursing agent on behalf of a governmental entity. Funds received from the governmental entity have been paid to the general contractor, which constructed the government owned facilities. The Company has no legal rights to the funds or the constructed facility, and accordingly, such funds do not appear in the accompanying financial statements.

F-21

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE L - COMMITMENTS AND CONTINGENCIES (CONTINUED)

## 8. CONSTRUCTION COMMITMENTS

The Company has no construction contracts related to ongoing projects

as of December 31, 2001.

9. LETTER OF CREDIT

In connection with the Company's workmen's compensation insurance coverage, the insurance carrier required the Company to obtain a \$269,000 letter of credit from its bank in favor of the insurance carrier. This letter of credit was released in the first quarter of 2001. In February 2001 the Company engaged a new insurance carrier. This carrier required a step-up letter of credit of \$1.4 million. In February 2002, the Company engaged the prior insurance carrier for current services. This carrier requires a step-up letter of credit of \$1.3 million.

In November 2001, the Company obtained a \$250,000 letter of credit in favor of a County with whom the Company has an operating agreement to manage their facility. The Company previously leased the facility through its operating lease-financing facility, which the County purchased through the issuance of revenue bonds in August 2001.

NOTE M - CONTRACT WITH THE STATE OF LOUISIANA

In December 1998, the Company entered into a contract with the State of Louisiana ("the State") to operate the Tallulah Correctional Center for Youth. The express terms of this contract obligated the State to maintain the facility at a full population of 686; however, in light of the conditions at the facility inherited by the Company and the State's desire to maintain the population of the facility at less than 686 juveniles on an interim basis, the Company reached an agreement with the State under which the Company would invoice the State only for the actual monthly population for a period of six-months from the commencement of operations by the Company. The Company's agreement was made in

consideration of the State's commitment to honor the terms of the contract and increase the population to the full capacity or pay for its full utilization, regardless of the actual population level, at the end of the six month period. As contemplated by the foregoing agreement, commencing in July 1999, the Company began billing the State at the 686 population level of the original contract. These invoices were disputed by the State and the Company received payment only for the actual number of juveniles housed in the facility. During this period, in order to be conservative, the Company recognized revenues for a population level of 620 (the population level the facility was approved to house by the local judicial authority prior to commencement of operations by the Company) despite its belief that it was entitled to payment assuming full utilization of the facility regardless of the court order. In September 1999, the State unexpectedly indicated it could not commit to achieve the population levels required by the contract or to pay for the full utilization of the facility as provided for in the contract during the remaining term of the contract, and subsequently, the Company discontinued operations of the facility on September 24, 1999. The Company is currently pursuing payment of all funds that would be owed under the original contract from the commencement of operation as well as damages for breach of the contract by the State. The Company did not incur any material losses in conjunction with this closure.

F-22

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE N - EARNINGS (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted income(loss) per share in accordance with SFAS No. 128:

&lt;TABLE&gt;&lt;CAPTION&gt;

|                                                            | Years Ended December 31, |          |            |
|------------------------------------------------------------|--------------------------|----------|------------|
|                                                            | 2001                     | 2000     | 1999       |
| <S>                                                        | <C>                      | <C>      | <C>        |
| Numerator:                                                 |                          |          |            |
| Net income (loss)                                          | \$ (5,880)               | \$ 5,788 | \$ (3,528) |
| Denominator:                                               |                          |          |            |
| Basic income (loss) per share:                             |                          |          |            |
| Weighted average shares outstanding                        | 10,181                   | 11,366   | 11,219     |
| Effect of dilutive securities - stock options and warrants | -                        | 1        | -          |
| Denominator for diluted income loss per share              | 10,181                   | 11,367   | 11,219     |
| Net income (loss) per common share - basic                 | \$ (0.58)                | \$ 0.51  | \$ (0.31)  |
| Net income (loss) per common share - diluted               | \$ (0.58)                | \$ 0.51  | \$ (0.31)  |

&lt;/TABLE&gt;

The effect of dilutive securities was not included in the calculation of diluted net loss per common share in 2001 and 1999, as the effect would have been anti-dilutive.

#### NOTE 0 - STOCK OPTIONS

In October 1993, the Company adopted a stock option plan (the "Stock Option Plan"). This plan as amended, provides for the granting of both: (i) incentive

stock options to employees and/or officers of the Company and (ii) non-qualified options to consultants, directors, employees or officers of the Company. The total number of shares that may be sold pursuant to options granted under the stock option plan is 1.5 million. The Company, in June 1994, adopted a Non-employee Directors Stock Option Plan, which provides for the grant of non-qualified options to purchase up to 150,000 shares of the Company's Common Stock. In May 1999, the Company adopted the 1999 Non-Employee Director Stock Option Plan, which provides for the grant of non-qualified options to purchase up to 300,000 shares of the Company's Common Stock.

Options granted under all plans may not be granted at a price less than the fair market value of the Common Stock on the date of grant (or 110% of fair market value in the case of persons holding 10% or more of the voting stock of the Company). Options granted under all plans will expire not more than ten years from the date of grant.

F-23

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 0 - STOCK OPTIONS (CONTINUED)

The Company has adopted only the disclosure provisions of SFAS No. 123. It applies APB No. 25 and related interpretations in accounting for its plans and does not recognize compensation expense for its employee and director stock based compensation plans other than for restricted stock. If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed by SFAS No. 123, the Company's net income (loss) per share would be adjusted to the pro forma amounts indicated below:

|                                         | Years Ended December 31, |          |            |
|-----------------------------------------|--------------------------|----------|------------|
|                                         | 2001                     | 2000     | 1999       |
| Net income(loss)                        |                          |          |            |
| As reported                             | \$ (5,880)               | \$ 5,788 | \$ (3,528) |
| Pro forma (unaudited)                   | (6,444)                  | 4,845    | (4,454)    |
| Income(loss) per common share - basic   |                          |          |            |
| As reported                             | \$ (0.58)                | \$ 0.51  | \$ (0.31)  |
| Pro forma (unaudited)                   | (0.63)                   | 0.43     | (0.40)     |
| Income(loss) per common share - diluted |                          |          |            |
| As reported                             | \$ (0.58)                | \$ 0.51  | \$ (0.31)  |
| Pro forma (unaudited)                   | (0.63)                   | 0.43     | (0.40)     |

The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the years ended December 31, 2001, 2000, and 1999.

|                | Years Ended December 31, |         |         |
|----------------|--------------------------|---------|---------|
|                | 2001                     | 2000    | 1999    |
| Volatility     | 75%                      | 75%     | 62%     |
| Risk free rate | 5.00%                    | 5.50%   | 5.00%   |
| Expected life  | 3 years                  | 3 years | 3 years |

The weighted average fair value of options granted during 2001, 2000, and 1999 for which the exercise price equals the market price on the grant date was \$1.16, \$2.16, and \$3.51, respectively.

F-24

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE 0 - STOCK OPTIONS - (CONTINUED)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially effect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Stock option activity during 2001, 2000, and 1999 is summarized below:

|                            | Options   | Weighted-Average<br>Exercise Price |
|----------------------------|-----------|------------------------------------|
|                            | -----     | -----                              |
| Balance, December 31, 1998 | 1,091,178 | \$ 16.58                           |
| Granted                    | 319,001   | 7.72                               |
| Exercised                  | (108,501) | 4.67                               |
| Canceled                   | (369,553) | 28.24                              |
|                            | -----     |                                    |
| Balance, December 31, 1999 | 932,125   | 10.34                              |
| Granted                    | 59,000    | 4.11                               |
| Exercised                  | -         | -                                  |

|                            |           |       |
|----------------------------|-----------|-------|
| Canceled                   | (83,875)  | 13.67 |
|                            | -----     |       |
| Balance, December 31, 2000 | 907,250   | 9.66  |
| Granted                    | 75,000    | 2.23  |
| Exercised                  | -         | -     |
| Canceled                   | (144,000) | 11.21 |
|                            | -----     |       |
| Balance, December 31, 2001 | 838,250   | 8.73  |
|                            | =====     |       |

F-25

&lt;PAGE&gt;

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## NOTE 0 - STOCK OPTIONS (CONTINUED)

The following table summarizes information concerning currently outstanding and exercisable stock options at December 31, 2001:

| Range of<br>Exercise Prices | Number<br>Outstanding | Weighted-Average<br>Remaining<br>Contractual Life<br>(Years) | Weighted-Average<br>Exercise Price |
|-----------------------------|-----------------------|--------------------------------------------------------------|------------------------------------|
| -----                       | -----                 | -----                                                        | -----                              |
| \$ 1.90 - 4.12              | 84,500                | 6.3                                                          | \$ 2.41                            |
| 4.12 - 6.18                 | 24,000                | 8.1                                                          | 4.28                               |
| 6.18 - 8.25                 | 270,000               | 7.3                                                          | 7.50                               |
| 8.25 - 10.31                | 217,500               | 3.9                                                          | 8.92                               |

|               |         |     |       |
|---------------|---------|-----|-------|
| 10.31 - 12.37 | 69,000  | 1.3 | 11.58 |
| 12.37 - 14.44 | 173,250 | 1.2 | 12.98 |
| -----         |         |     |       |
|               | 838,250 | 4.3 | 8.73  |
| =====         |         |     |       |

| Range of<br>Exercise Prices | Number<br>Exercisable | Weighted-Average<br>Exercise Price |
|-----------------------------|-----------------------|------------------------------------|
| -----                       | -----                 | -----                              |
| \$ 1.90 - 4.12              | 3,167                 | \$ 3.88                            |
| 4.12 - 6.18                 | 8,333                 | 4.30                               |
| 6.18 - 8.25                 | 180,000               | 7.50                               |
| 8.25 - 10.31                | 217,500               | 8.92                               |
| 10.31 - 12.37               | 60,667                | 11.65                              |
| 12.37 - 14.44               | 173,250               | 12.98                              |
| -----                       | -----                 | -----                              |
|                             | 642,917               | 9.79                               |
| =====                       | =====                 |                                    |

## NOTE P - EMPLOYEE BENEFIT

On July 1, 1996, the Company adopted a contributory retirement plan under Section 401(k) of the Internal Revenue Code, for the benefit of all employees meeting certain minimum service requirements. Eligible employees can contribute up to 15% of their salary but not in excess of \$10,500 in 2001 and 2000 and \$10,000 in 1999. For the years ended 2001, 2000 and 1999, the Company had two separate plans, both established prior to the merger in 1999, for CSC and YSI employees. The Company's contribution under the plan amounts to 20% of the employees' contributions for the CSC plan. The Company contributed \$119,000, \$154,000, and \$322,000 in 2001, 2000, and 1999 respectively, to the plan. No Company contributions were made to the YSI plan for the respective years. Beginning January 1, 2002, the Company has merged the plans into a single plan

for employees.

F-26

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE Q - SELF INSURANCE

The Company has obtained an aggregate excess workers' compensation policy, which limits the Company's exposure to a maximum of \$3.5 million and \$2.5 million as of December 31, 2001 and 2000, respectively. The estimated insurance liability totaling \$1.1 million and \$1.4 million on December 31, 2001 and 2000, respectively, is based upon review by the Company of claims filed through December 31, 2001, and represents the Company's estimated exposure on these claims.

The Company maintains a group health plan subject to a loss limit of \$150,000 per individual. At December 31, 2001 the plan had approximately 2,300 participants and a medical insurance liability of \$1.8 million. This liability approximates, on average, two months of claims paid during the year ended December 31, 2001 and represents the Company's estimated liability as of December 31, 2001.

NOTE R - RELATED PARTY TRANSACTIONS

In addition to related party transactions disclosed elsewhere, the Company had a note receivable as of December 31, 2000, from a limited partnership in the amount of \$480,000 related to the sale of the Tampa Bay Academy. The note was guaranteed by a member of the Board of Directors. Interest was payable quarterly beginning April 1, 2001 at the Company's quarterly weighted average interest

rate and the note was paid in full during 2001. Cash of approximately \$3.3 million was received and a loss of approximately \$1.0 million was recorded upon the sale of the Tampa Bay Academy in December 2000.

F-27

<PAGE>

CORRECTIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE R - RELATED PARTY TRANSACTIONS (CONTINUED)

In May 2000, the Company was awarded a contract from the Federal Bureau of Prisons to operate a community corrections center, often referred to as a halfway house, in New York, New York. Subject to approval by the Bureau of Prisons, the Company planned to use a building purchased shortly thereafter by the Company's President and Chief Executive Officer, as the facility for the halfway house and paid for certain leasehold renovations and other costs with respect to the building. Due to community opposition, the Company was unable to use the building as a halfway house and requested that the President/CEO pay for all leasehold renovations, and other associated costs incurred by the Company of approximately \$558,000. As of December 31, 2001, the President/CEO had paid these costs in full.

A director of CSC, is a member of a law firm which provides legal services as the Company's legal counsel. Payments to this firm amounted to approximately \$98,000, \$270,000 and \$397,000 in legal fees from the Company for the years ended December 31, 2001, 2000 and 1999, respectively.

NOTE S - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of unaudited quarterly results of operations for the years ended December 31, 2000 and 2001 (in thousands).

<TABLE><CAPTION>

| FOURTH QUARTER             |           |           | FIRST QUARTER |           | SECOND QUARTER |           | THIRD QUARTER |       |
|----------------------------|-----------|-----------|---------------|-----------|----------------|-----------|---------------|-------|
|                            |           |           | -----         |           | -----          |           | -----         |       |
|                            |           |           | 2000          | 2001      | 2000           | 2001      | 2000          |       |
| 2001                       | 2000      | 2001      | -----         | -----     | -----          | -----     | -----         | ----- |
| <S>                        |           | <C>       |               | <C>       | <C>            | <C>       | <C>           | <C>   |
| <C>                        | <C>       |           |               |           |                |           |               |       |
| Revenues                   |           |           | \$ 53,709     | \$ 45,090 | \$ 52,357      | \$ 44,394 | \$ 52,209     | \$    |
| 42,344                     | \$ 52,537 | \$ 42,590 |               |           |                |           |               |       |
| Operating Expenses         |           |           | 49,766        | 45,377    | 49,273         | 44,506    | 48,765        |       |
| 50,468                     | 50,027    | 40,966    |               |           |                |           |               |       |
|                            |           |           | -----         | -----     | -----          | -----     | -----         | ----- |
| Operating income (loss)    |           |           | 3,943         | (287)     | 3,084          | (112)     | 3,444         |       |
| (8,124)                    | 2,510     | 1,624     |               |           |                |           |               |       |
| Other income (expense)     |           |           |               |           |                |           |               |       |
| including income taxes     |           |           | (2,143)       | (280)     | (1,747)        | (309)     | (1,870)       |       |
| 2,825                      | (1,433)   | (1,217)   |               |           |                |           |               |       |
|                            |           |           | -----         | -----     | -----          | -----     | -----         | ----- |
| Net income (loss)          |           |           | \$ 1,800      | \$ (567)  | \$ 1,337       | \$ (421)  | \$ 1,574      | \$    |
| (5,299)                    | \$ 1,077  | \$ 407    |               |           |                |           |               |       |
|                            |           |           | =====         | =====     | =====          | =====     | =====         | ===== |
| Basic and diluted earnings |           |           |               |           |                |           |               |       |
| (loss) per share:          |           |           |               |           |                |           |               |       |

|                   |         |         |         |           |         |           |         |    |
|-------------------|---------|---------|---------|-----------|---------|-----------|---------|----|
| Net income (loss) |         |         | \$ 0.16 | \$ (0.06) | \$ 0.12 | \$ (0.04) | \$ 0.14 | \$ |
| (0.52)            | \$ 0.10 | \$ 0.04 |         |           |         |           |         |    |
| =====             | =====   | =====   | =====   | =====     | =====   | =====     | =====   |    |
| =====             | =====   | =====   |         |           |         |           |         |    |

&lt;/TABLE&gt;

F-28

&lt;/TEXT&gt;

&lt;/DOCUMENT&gt;