FPI BOARD OF DIRECTORS MEETING
December 15, 2021

A meeting of the Federal Prison Industries, Inc. (FPI) Board of Directors was held on December 15, 2021, via teleconference.

IN ATTENDANCE:

David Spears, Chairman
Donald R. Elliott, Vice Chairman
Lee Lofthus, Member
Audrey Roberts, Member
Dee Reardon, Member

QUORUM: A quorum was present.

ALSO IN ATTENDANCE:

Louis Milusnic, Assistant Director, Program Review Division, Federal Bureau of Prisons
Patrick T. O'Connor, Chief Executive Officer, FPI
Greg Burke, Senior Deputy Assistant Director, FPI
Marianne Cantwell, General Counsel, FPI
Stephanie Gatz, Acting Controller, FPI
David Marshall, Chief Information Officer, FPI
Valery Logan, Executive Assistant, FPI
Eric Rasmussen, Partner, KPMG (for a portion)

Chairman Spears opened up the meeting.

Mr. Milusnic sat in for Director Carvajal and provided the Board with an update on the Federal Bureau of Prisons (BOP or Bureau). The Bureau currently has a vaccination rate of approximately 80% for staff and almost 70% for inmates. Approximately 5,100 staff are pending medical or religious accommodation requests. We regularly encourage those staff to get vaccinated.

In regards to the CARES Act and FSA, there are approximately 7,700 inmates on home confinement. Since March 26, 2020, almost 35,000 inmates have been transferred to home confinement. We have expanded the home confinement criteria related to PATTERN scores and discipline records reflected in the violations that can be considered. We are trying to broaden the net for more inmates to get out on home confinement.

There is a lot of concern and information floating around about the potential return of inmates who have been sent out on home confinement. We are working with the Department of Justice (DOJ) to address those issues, especially with inmates who have lengthy sentences remaining to be served. Hopefully we will have some answers in the upcoming weeks.

We are working on medication assisted therapy (MAT) within the agency. We currently have 605 inmates participating. We are establishing seven certified opioid treatment program clinics. We anticipate operation and provisional accreditation by February 28, 2022. There has been a more than 50% reduction in opioids prescribed in the BOP since 2017. We have been working on this since before it became law. We are trying to fulfill the executive order of 2015 with regards to that.

There are some challenges that we face every day in the Bureau. Synthetic drugs and drones continue to be ongoing issues for prisons. There are several things the Bureau is working on regarding counter measures for drones and we are making some good progress. An ongoing issue for all prisons is introduction of cell phones. With drones, it makes it that much easier to introduce cell phones into prisons. The aging infrastructure is a challenge within the BOP.

Mr. Elliott asked about staff vaccination and how long staff have to get vaccinated before an action is taken. Mr. Milusnic responded that staff had a deadline of November 22, 2021, to get vaccinated or submit a reasonable accommodation request for religious or medical purposes. Those requests are currently under review.

Mr. Elliott asked how many staff have neither requested accommodation nor received the vaccine. Mr. Milusnic responded that approximately 1,400 counseling notices were sent out to staff. Mr. Elliott asked what the impact would be on FPI. Mr. Milusnic responded that these staff are spread out across the country and not all of them are in the institutions, so he does not predict a negative impact on FPI as a whole.

Mr. Lofthus noted that the DOJ as a whole has a 98.8% compliance rate (either vaccinated or have submitted a reasonable accommodation request). The BOP is not quite that high, but the BOP is working hard and has a lot of reasonable accommodations that they are answering. Department-wide, the actual vaccination rate is 90.6% as of last week, so it is quite high. Overall, we are in a solid spot compared to a lot of other organizations. On the disciplinary front, the number of staff that have done neither vaccination or sought accommodation is under 2,000. Sometime in January they may get a letter and then they will have time to respond under union agreement. We are moving in the right direction. Kudos to the BOP folks who are handling a large workforce with a lot of moving pieces.

Mr. Lofthus asked about the Bureau's current inmate population. Mr. Milusnic responded that there are 156,850 federal inmates with 134,000 in BOP facilities.

I. Chief Executive Officer Update

Inmate staffing levels have continued to remain steady in the first quarter. We are up significantly. We are running at an inmate staffing level of about 82% on a regular basis. The Bureau runs on a matrix system: red, yellow, and green. It is based on vaccination level, number of cases in an institution, and the cases per 100,000 in the local community. For the most part, what is holding us up is the number of cases in the community. We have institutions that fluctuate between yellow and green and red and yellow almost on a weekly basis based on that. Right now, two thirds are in the red, which is the most restrictive. Only 16% are in the green. Most of those are in Florida and Texas. With regard to inmate staffing, we have a 1/3, 1/3, 1/3 split among those below 80%, those in the 80-90%, and those fully staffed. The upside of COVID is that as Wardens figured out how to get FPI operations running during COVID, we are getting our operations back up quicker during other incidents.

Mr. O’Connor visited FPI’s operations at FCC Allenwood (recycling and furniture) and FCC Petersburg (printing and hanger recycling). They are both running well although the hanger plant is hampered by social distancing because it is running between yellow and red on the matrix, which requires fewer inmate workers at the table. The printing plant is a little low on work.

Mr. O’Connor met with Lehigh University regarding a program to improve cycle counts. Currently, we conduct wall-to-wall inventories at all warehouses. Mr. O’Connor mentioned that he has not worked anywhere else that does that since the late 1980’s. Lehigh is analyzing the inventories at all our warehouses, and rather than just taking a look at materials based on the value of the part, they are also taking into account other factors such as importance to production, lead time, and other characteristics. This will allow us to properly categorize inventory. They will develop a plan for each individual plant. We had a meeting with our financial management team and Lehigh as well as KPMG, because our goal is to eliminate wall-to wall inventories in two years and the audit can function based on cycle counts because they are accurate within a high level of industry standards. Mr. O’Connor also met with SAP to review lessons learned from the recent transition to SAP S/4HANA and discuss where we want to move with SAP in the future.

Mr. O’Connor discussed recent major accomplishments. He began with the KPMG Audit which was completed on time and resulted in a clean opinion. One thing we did this year that helped us get there was that we changed the inventory strategy. In the past, we were conducting all the inventories at the same time we were doing the audits in September, which was bad in two ways. One, it took up all of our Financial Management Branch (FMB) manpower at the same time we were trying to close out the year. It was also terrible for the business because we were trying to make shipments, but we couldn’t move product because we were conducting wall-to-wall inventory. This year, most of the inventories were completed in the May-June time frame when business was slower.

Mr. O’Connor discussed the launch of SAP S/4HANA on November 15, 2021. There were a few minor issues, but nothing that took more than a few days to resolve. Mr. Lofthus asked if there were any payment problems due to the changeover. Mr. O’Connor responded that there were not. We paid a lot of our vendors ahead of time so that we did not have a problem.

Mr. O’Connor discussed non-COVID challenges. He addressed supply chain shortages affecting all groups, especially Fleet with the chip shortage and Print with the paper shortage. He also addressed inflation affecting all groups and labor shortages affecting camps and some low security facilities. The release of so many inmates to home confinement and residential reentry centers (RRCs) has depleted the labor at the camps and the lows, which we count on for shipping and receiving.

Mr. Elliott stated that we used to have a pretty extensive wait list and asked if it has died off. Mr. O’Connor replied that the list has been reduced tremendously during COVID although it varies from institution to institution. The lows and camps have limited waiting lists.

Mr. O’Connor provided the Board with a review of FPI’s key performance indicators (KPIs):

KPI 1.0, Mission: The number of full-time inmate workers is lower than our fiscal year (FY) 2022 target. However, we are currently meeting our goal of having at least 30% of our inmate workers be within three years of release.

KPI 2.0, Financial Perspective: We are about 8.4% below forecasted sales levels at $55.9 million. This is largely due to a blackout period where were not able to ship in November. We should be catching up on that quickly. Instead of a profit, we currently have a net loss of $2.7 million. If we can get a few more pieces out within the next month, we should be profitable quickly.

KPI 3.0, Customer Perspective: Our on-time delivery, backlog, and delinquicies numbers have not changed much since the end of FY21. There was not a lot of movement in November and December due to in large part to the SAP S/4HANA changeover.

KPI 4.0, Internal Perspective: Our defect rate was very good, down almost 3,000 from our FY21 rate. Lost hours are lower than our target because Wardens have improved at keeping FPI operational.

KPI 5.0, Learning and Growth Perspective: Open staff vacancies are higher than anticipated, but we have been keeping a tight rein on hiring until our financial results improve. The time to fill positions, at 45 days, is just slightly over half of OPM's target of 80. On staff training we have exceeded our target. We have run a lot of courses, especially with SAP S/4HANA. FPI's recordable injury rate continues to be extremely low, making FPI one of the safest places to work in the United States.

II. Chief Financial Officer's Report

The FY22 operating plan for business group earnings before general and administrative expenses (G&A) is $51.6 million, with G&A of $65.2 million, other income of $12.5 million, and net income of less than a million. We are basically expecting to breakeven for FY22.

Year-to-date (YTD) sales are $55.9 million. The Office Furniture Group (OFG) more than doubled their planned sales by shipping product ahead of the SAP S/4HANA cutover downtime, with October sales exceeding $10 million. The Fleet Business Group (FBG) has sales at about half of the forecasted amount. FBG expects to see rebounding sales, with almost $10 million in sales in the first two weeks of December already shipped to customers. The Clothing and Textiles Group (CTG) had sales of $18.5 million. CTG expects to remain below expected sales levels for the next few months as work winds down at Atlanta and ramps up at other factories, as supply chain issues affect incoming materials, and delinquencies persist. The other groups' YTD sales are close to the respective plans.

The YTD business group earnings before G&A (through November) are $3.1 million, G&A is at $8.5 million, other income is at $2.3 million, and investment income continues to be low. The year to date net loss is $2.7 million.

The business groups are profitable before G&A with the exception of the Electronics Business Group (EBG) and the Agribusiness Group (ABG). YTD business group earnings before G&A exceed forecasted levels by $200,000.

Inventory has continued to trend downward due to supply chain issues mostly in fleet, however the corporate backlog is still over $500 million with delinquencies persisting. Cash is steady despite the payment of several weeks of invoices on the cutover payment run. FPI's accounts receivable (AR) balance is below the same period last year mostly due to the SAP S/4HANA cutover downtime slowing down outgoing shipments.

III. SAP S/4HANA Update

We went live with SAP S/4HANA on the planned November 15th date. The go-live went smoothly, although we are currently working through some bug fixes. Most bug fixes did not impact operations. Bug fixes that impact operations are prioritized with daily meetings. An issues log has been developed and distributed. Weekly meetings with all parties will be held until all issues are resolved. User training will be an ongoing effort to adapt to the new system. Data transfer for financial and business operations was successful.

Mr. Elliott asked if the training was conducted in house or if we rely on outside sources. Mr. Marshall responded that we have a mix. We have some in house and we also have an SAP training guide. Where our operations are more specific, we provide internal training, but for general activities there is training from outside sources.

Cloud infrastructure working as expected with strong speed and performance. Security self-assessment and authority to operate for new system completed prior to go-live, as required.

Mr. Lofthus asked what data was migrated and moved and if historical data was brought in. Mr. Marshall responded that for transactional data such as orders, we brought over open items. For master data, we brought over all after conducting a cleanup. For example, for customers, we have brought in information about customers who have placed an order in the past eight years. The old system is our source for legacy and we are working on how best to archive that.

Mr. Lofthus asked about year-end tax reporting and if it was part of SAP S/4HANA or if FPI relies on another system. Mr. Marshall replied that data was brought over to the new system. He stated that he will double check that any active reporting is brought over to the new system.

Mr. O'Connor stated that SAP and FMB put in a lot of work to get it up and going. Mr. Spears requested that Mr. Marshall and Mr. O'Connor let the team know that the Board appreciates all of the team's hard work.

IV. Financial Audit Summary

Mr. Rasmussen presented the results of the financial statements audit for FY21.

Quality is our first and highest priority when conducting an audit. Key results are that we issued an unmodified opinion, which is the best you can get. Congratulations to FPI for gaining an unmodified opinion. There were no incidents of noncompliance. Mr. Rasmussen emphasized the important ongoing focus on ASC 606. Management was able to identify amounts for this adjustment through Herculean efforts by staff, particularly Ms. Gatz. I recommend for management to automate the process so it can be conducted more efficiently. ASC 605 is the old revenue standard and ASC 606 is the new one. The main difference is the timing of when you recognize the revenue. In FPI's case, it accelerates the time you recognize revenue.

V. Action Items/Legal Updates

The next meeting is scheduled for February 16, 2022. The proposed 2022 schedule was discussed.

The Board unanimously approved the draft meeting minutes for the October, 2021 Board meeting.

The meeting adjourned.

/s/
Patrick T. O'Connor, Chief Executive Officer