

OFFICE OF
INSPECTOR GENERAL

Survey Report

Survey of
Farm Credit System Institutions
Regarding the Agency's
Examination Function

Second Quarter
Fiscal Year 2016
(Jan. 1 - March 31, 2016)

Issued June 3, 2016



FARM CREDIT ADMINISTRATION

**Office of Inspector General’s Survey of Farm Credit System Institutions
Regarding the Agency’s Examination Function
Second Quarter of Fiscal Year 2016 Summary Report
(January 1 – March 31, 2016)**

Introduction

During the period January 1 – March 31, 2016, the Office of Examination identified thirteen Farm Credit System (FCS) institutions that were in a position to provide meaningful survey responses.

The Office of Inspector General (OIG) sent surveys to those institutions on April 26, 2016. Eleven of the thirteen institutions surveyed submitted completed surveys (85% response rate). When outstanding responses from prior quarters are received, they are included in the next quarterly report. The OIG did not receive any responses to prior surveys; therefore, no additional responses are included in this report.

The OIG will continue to provide an email report to you based on each Fiscal Year (FY) quarter-end, i.e., December 31, March 31, June 30, and September 30, so that you may timely take whatever action you deem necessary to address the responses. The fourth quarter report will include FY 2016 summary data.

The survey asks respondents to rate the eight survey statements from "1" (Completely Agree) to "5" (Completely Disagree). The rating options are as follows:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5
Does Not Apply (not included in averages)	6

Narrative responses are provided verbatim, except identifying information has been removed and any grammatical, punctuation and spelling errors may have been corrected. Any narrative in “brackets” is explanatory information provided by the OIG based on conversations with institution management.

Survey Results – Second Quarter FY 2016

Average numerical responses to survey statements 1–8 ranged from 1.5 to 2.2 for the second quarter.

Average Numerical Response Range to Survey Statements 1–8			
2 nd Quarter FY16	1 st Quarter FY16	4 th Quarter FY15	3 rd Quarter FY15
1.5 – 2.2	1.5 – 2.1	1.5 – 2.3	1.5 – 2.0

The average numerical response for all survey statements was 1.9 for the second quarter.

Average Numerical Response for all Survey Statements			
2 nd Quarter FY16	1 st Quarter FY16	4 th Quarter FY15	3 rd Quarter FY15
1.9	1.8	1.9	1.8

In this quarter, there were slightly more positive than negative narrative comments to survey statements 1–8. (Perceived negative comments of any degree are color coded in maroon.)

Survey item 9 asks for feedback on the most beneficial aspect of the examination process. Consistent with prior quarters' responses to this survey item, many very positive comments were provided about the examiners and the examination process.

Survey item 10 asks for feedback on the least beneficial aspect of the examination process. While most were negative, as would be expected, several comments provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments from the board as a whole. It elicited a number of thoughtful responses from full boards, which was the objective of the question.

Responses to Survey Statements 1–8

EXAMINATION PROCESS

Survey Statement 1: The scope of examination activities was focused on areas of risk to the institution and appropriate for the size, complexity, and risk profile of the institution.

Average Response: 1.8

Statement 1	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.6	1.8			1.7
FY 15	2.4	1.8	1.9	1.9	2.0
FY 14	2.0	2.2	2.4	1.9	2.1
FY 13	2.0	1.7	1.9	2.0	1.9

Comments:

- The scope of the examination was appropriate with regard to safety and soundness. **With other areas of focus, historically the agency has provided written communications of requirements or expectations; this was not the case with the Audit Universe focus.**
- Ensure the exam aligns with Enterprise Risk Management priorities.
- Whether due to our proximity to the field office or FCA's standard operations, the examiners are conducting portions of the examination throughout the 18-month cycle. As a result we have numerous opportunities to interact, share perspectives and provide updates. This helps the statutory cycle go more smoothly and create less disruption.
- The review seemed detailed and well planned. **The regulatory exam activities might not mirror the same risks that were identified by management and the audit planning process. The number of auditors seemed unwarranted and unnecessary given the current operating environment.**

Survey Statement 2: Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.

Average Response: 1.8

Statement 2	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.9	1.8			1.9
FY 15	2.0	1.7	1.5	1.8	1.8
FY 14	1.8	2.1	1.9	1.8	1.9
FY 13	1.9	1.6	1.8	2.3	1.9

Comments:

- Examination findings specific to a required Audit Universe are not specified in any laws, regulations or other regulatory criteria. The sample provided was greatly appreciated.
- The EIC and Senior Portfolio Manager along with the rest of the exam team were reasonable and pragmatic in their interpretation and application of regulations. They were very willing to listen to other points of view before reaching final conclusions.
- **Review stated 2015 Business Plan had no identified material weaknesses and determined that the business plan met the minimum FCA regulations requirements, then the written report had a required action to ensure all regulatory requirements are met in the business plan.**
- **While many findings were appropriately supported, certain findings and conclusions, particularly related to earnings were not solidly based on specific statutory or regulatory criteria that the examiners were able to cite as authority for their position.**
- We are in agreement with the overall findings.
- Overall, the examiners did apply laws, regulation, etc. to findings and conclusions appropriately, **but there continues to be issues within the Agency of individual field examiners who apply their own interpretations to the regulations. This inconsistent and, sometimes, incorrect interpretation leads to unnecessary and time consuming debate between the parties.**
- Regulators are knowledgeable with current laws and regulations. During the exam process, the examiners showed competence.

Survey Statement 3: The recommendations, required actions, and any supervisory agreement with FCA assisted the board and management in addressing the risks of the institution.

Average Response: 2.2

Statement 3	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	2.1	2.2			2.2
FY 15	2.1	1.8	2.0	2.3	2.1
FY 14	1.7	2.0	2.1	2.1	2.0
FY 13	2.0	2.0	1.8	2.2	2.0

Comments:

- With an increased focus on internal controls, the institution understands the need for further emphasis on Enterprise Risk Management.
- Some of the recommendations made will assist the organization in improving areas of credit and risk mitigation.
- Risks were identified and communicated to the Board of Directors.
- **Recommended actions related to audit department operations were not proportionate to the business risks faced by our institution. In addition, the required action for a communications plan with affiliated institutions was managerial in nature and not reasonably related to safety and soundness. Focus on earnings is inconsistent with Banking and current environmental stress. Making a broad statement to improve earnings without specifics is not a quality recommendation.**
- An area of our discussion at closeout was an observation FCA has become highly prescriptive in more of its findings and recommendations. We are in agreement with the findings themselves, however, **as the recommendations become more and more prescriptive it begins to intrude on the management of the organization.** We respect the role of FCA as an arm’s length regulator, to identify potential weaknesses and to validate compliance with regulatory requirements. We may not always agree but we can appreciate and value another perspective. It is management’s role to

determine how to best address those weaknesses. The arm's length concept extends both directions.

- We spent time discussing this concept at our closeout, with focus on where the analysis we perform on out of territory lending should be located. However, the concept applies to other areas as well. FCA agrees with the depth and thoroughness of the out of territory lending analysis we are completing and providing to the Board, however, wanted it located within the business plan. The key is a thorough analysis is being completed and provided to the board. **We encourage FCA to focus on the findings and allow the institutions to best determine the resolution. There needs to be a distinction between identifying potential risk and directing the management of the institution.**

Survey Statement 4: The examiners were professional and efficiently conducted examination activities.

Average Response: 1.5

Statement 4	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.5	1.5			1.5
FY 15	1.5	1.6	1.9	1.5	1.6
FY 14	1.4	2.2	1.8	1.6	1.8
FY 13	1.5	1.3	1.4	2.0	1.6

Comments:

- **The efficiency of exam process needs improvement as it was very lengthy, both prior to and following the on-site visit (often re-visiting topics previously covered).**
- _____, EIC, _____, Senior Portfolio Manager, and their entire team conducted themselves in a very professional and efficient manner. One of the best teams we have ever worked with at FCA.
- Very professional and good to work with. Open to discussing institution questions and provide direction input for clarification of regulations.
- While the examination staff was professional, **the audit department segment of the examination required more extensive staff resources to respond to issues and questions, which could have been reduced with better planning on the part of the examiner. The IT examination was too detailed and staff did not meet their deadlines for providing feedback. It is frustrating and not a good use of time to post information requests to the FCA portal and then be asked to provide the information again when the examiners are on site.**
- We believe we have a good working relationship with the examination team. The use of electronic loan files has allowed FCA to complete some work remotely reducing disruption.
- The examiner in charge did an excellent job of working with the exam team. **The size of the team and the onsite training proved to be problematic at times but the EIC managed the exam team size very well. It is challenging with that many examiners and trainees in an office for a week.**

COMMUNICATIONS

Survey Statement 5: Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

Average Response: 1.7

Statement 5	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.8	1.7			1.8
FY 15	1.5	2.0	1.7	1.8	1.8
FY 14	1.6	2.2	2.0	1.7	1.9
FY 13	1.9	1.5	1.4	2.1	1.7

Comments:

- Communications were effective.
- _____ has been very good to work with when there have been borrower complaints, facilitating the information gathering process for exams, and handling follow-up questions. Very balanced and reasoned.
- During the examination process the interaction was clear, accurate, timely and professional. **The process of issuing the final report was not. The fact that the FCA exam staff met with our board without having issued a final report for their review was inefficient for all and the process of providing a draft report that was then substantially modified after being shared with management created confusion and undermined our confidence in the judgement and authority of the local examination professionals. The expected turnaround time for the draft report was unreasonable.**
- Expectations and information needs were clearly communicated upfront. The examination itself went smoothly with limited disruption.
- We are pleased with the overall content of communications by the Agency, its examiners and particularly the EIC. Issues, if any, were adequately discussed and resolved to the satisfaction of both parties.
- The communication from the EIC during the review process was excellent. **There was a significant delay in communication of the final report but delays are understandable. That said, the institution will have FCA back in the office in 12 months so the value of an 18-month audit cycle is lost.**

Survey Statement 6: Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.

Average Response: 1.7

Statement 6	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.7	1.7			1.7
FY 15	2.0	1.8	1.7	1.9	1.9
FY 14	2.1	2.2	1.8	1.9	2.0
FY 13	1.7	1.6	1.6	1.9	1.7

Comments:

- Communication was clear and information was appropriate and helpful to the Board.
- The audit operations section of the exam required actions and recommendations that do not aid the audit committee in fulfilling their oversight responsibilities, but instead require actions that will clutter important risk-based oversight with technically-focused reports and information that brings less value to the audit committee's guidance and decisions. Adding administrative detail to audit committee responsibility puts the audit committee in the position of managerial responsibility rather than governance. The exam point on earnings puts pressure on the board but is not a meaningful recommendation.
- The board chair and assigned EIC connect monthly by phone for a brief update. In addition to the ongoing communication with the CEO and staff this regular communication has helped to prevent any surprises and to keep FCA apprised on changes we are making.
- FCA took time to meet with senior management and the AC Chairman. That time spent and communication was valuable for management and board members. The final communication was clear and easy to read. The exit process did touch on topics not in the report so separate guidance on global FC issues would be helpful.

Survey Statement 7: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 1.8

Statement 7	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 16	1.9	1.8			1.9
FY 15	1.8	1.6	1.9	2.1	1.9
FY 14	1.8	2.2	1.9	2.1	2.0
FY 13	1.8	1.6	1.6	2.0	1.8

Comments:

- As mentioned before, very reasoned and willing to listen in order to understand other views and interpretations before rendering conclusions in their findings.
- Recommendations were discussed with the full Board during exit interview.
- The exam team provided adequate opportunity for institution staff and board to present their views. We feel the input while considered did not receive the appropriate weight in the final findings. In the audit operations area this led to findings which are not factually accurate. Recommendations as related to audit hiring an outside party are not quality recommendations. There is still a lack of clarity from the board and management in terms of why FCA believes institution earnings need to be higher given the overall risk profile of the organization and after considering that we have greater capital position as a District and higher earnings from a District ROA perspective than 2 of the other 3 Districts.
- The most recent work focused on credit. With the changing economics in the grain industry we know credit quality will trend downward. Both FCA and the institution team agree there are credits that are close calls as to PD rating. There were no material differences in our points of view.
- FCA was attentive to the voices and concerns from the institution. The discussions seemed well received but not all of those discussions made it into the final report or the exit conference. Regardless, FCA's team communicates well with the institution.

Survey Statement 8: FCS-wide guidance from the Office of Examination was proactive and helpful.

Average Response: 2.2

FY 15	1.9	1.9	2.0	2.2	2.0
FY 14	2.0	2.2	2.0	2.1	2.1
FY 13	2.6	2.4	1.9	2.1	2.3

Comments:

- Generally agree. Most guidance we receive relative to the credit area has been proactive and helpful. Most recent example was the face-to-face meeting in _____ on classifying credits in the current environment. **An exception to this has been the guidance on the Similar Entity area specific to same loan definition.**
- It is helpful to be provided upfront guidance. The guidance overall is quite general.
- The verbal guidance from FCA is much more useful and helpful than FCA's written guidance. Open discussion was had concerning IT matters. **Unfortunately, the written guidance concerning IT is nearly a decade old and none of the reference links or supplemental information links are valid.**

Responses to Survey Items 9–11

Survey Item 9: What aspect of the examination process did you find **most** beneficial?

Comments:

- We greatly appreciated the good communications regarding the items that would be included in the report.
- The professionalism and experience of the exam team's leadership.
- Communication with FCA staff.
- The interaction with examiners and the opportunity to consider alternate views in the operation of our business. Reviewed charter and fine-tuned.
- Continuing discussion and alignment on the changes in the grain economics.
- Our experience with both the prior and current EIC has been positive and we appreciate the "common sense" approach and application exhibited by both individuals.
- Confirmation that our internal processes comply with FCA expectations.
- The open communication process with the EIC. We believe the EIC is a value added asset and helps the institution become better rather than simply being reactionary. We value that counsel.
- The exam team was very good to work with.
- The opening and closing discussions with the executive team is very helpful. Overall our examiners are easy to work with. The information shared with the Board of Directors is extremely insightful.

Survey Item 10: What aspect of the examination process did you find **least** beneficial?

Comments:

- Perhaps a better coordination between reviewers/trainees with regard to asking for information that had been previously provided would enhance efficiencies.
- Examination staff working through the revised FCA exam requirements and processes causing requests for information due in a very short time frame.
- Recommendations are broad and general, not clear what actions the board should take in audit practices and earnings. Required/recommended actions that appear to be inconsistent with current best practices.
- Suggestions for the agency would be to provide training and direction on the current regulations with focus on differentiating between regulation, individual preference and best practice insuring proper application within the exam process and report. On a separate issue, the Agency, in its effort to improve communications during the exam and post exam process, has incorporated a number of repetitious exits or follow-up communications. While the improved communication is applauded, the number of exits should be tempered and better coordinated.
- The number of FCA employees, especially the number of trainees, that visited the institution is simply overwhelming. The number of employees seemed to really slow down the process. The time gap between the wrap up and the presentation caused communication issues as well.
- Nothing of significance.
- It appears that throughout the recent years the Information Technology (IT) exams have not been very in depth given the recent IT trends. It would be more helpful if a strong IT centric staff were to conduct the IT portion of the exams systemwide.

Survey Item 11: Please provide any comments from the **Board as a whole** regarding the examination process not provided in the preceding responses.

Comments:

- The board appreciated the professionalism of the exam team as well as guidance in areas needing improvements and acknowledgment of areas in which improvements have been made.
- The Board was not in full agreement with the FCA opinion of revising commodity concentration to reduce "risk exposure". Overall commodity concentration is considered appropriate for the customer base and territory served.
- Not adequate time for draft to be reviewed with the board.
- As mentioned the ongoing communication with the board chair and the EIC continues to be beneficial.
- As in prior years, the Board of Directors has appreciated the level of professionalism and insight provided by the Agency and Examination Leadership. The opportunity of the Board to have frank discussions relative to oversight, safety and soundness through onsite visits have been both productive and useful in addressing potential risk and trends impacting our institution.
- Our Board is satisfied with the audit process utilized by FCA.
- We value our relationship with FCA. The guidance that is given in person is valuable in ensuring that the correct thought process takes place for strategic oversight of the institution.
- I think everyone was generally pleased.
- The information shared with the Board of Directors is extremely insightful.