

**Fourth Quarter (July 1- September 30, 2009)
and Fiscal Year (FY) 2009 Summary Report**

**Office of Inspector General's (OIG) Survey of Farm Credit System (FCS) Institutions
Regarding the Agency's Examination Function**

Introduction

Based on the interface FCS institutions had with the Agency's examination function during the period July 1 – September 30, 2009, the Office of Examination (OE) identified 21 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 21 institutions on November 2, 2009. A follow-up e-mail was sent to nonresponding institutions on December 2. Of the 21 institutions surveyed, 17 submitted completed surveys. If the nonresponding institutions subsequently send a completed survey, it will be included in the next quarterly report.

The OIG will continue to provide an e-mail report to you based on each fiscal year 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 as of September 30 will continue to include fiscal year summary data.

The survey asks respondents to rate the 9 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 |

There is also an available response of "6" (Does Not Apply) for each survey statement.

Narrative responses are provided verbatim, except that any identifying information has been removed and any grammatical or punctuation errors may have been corrected. Any narrative in "brackets" is explanatory information provided by the OIG based on communication with the institution.

Survey Results – 4th Quarter FY 2009

The average numerical responses to survey statements 1 - 9 ranged from 1.5 to 1.9.

| Average Numerical Responses to Survey Statements 1 – 9 | | | |
|--|---------------------|---------------------|---------------------|
| 4 th Qtr | 3 rd Qtr | 2 nd Qtr | 1 st Qtr |
| 1.5 – 1.9 | 1.8 – 2.1 | 1.7 – 2.1 | 1.6 – 2.2 |

The average response for all survey statements was 1.7.

| Average Response for all Survey Statements | | | |
|--|---------------------|---------------------|---------------------|
| 4 th Qtr | 3 rd Qtr | 2 nd Qtr | 1 st Qtr |
| 1.7 | 1.9 | 1.9 | 2.0 |

The majority of narrative comments to survey statements 1 - 9 were positive. However, there were a number of negative comments (color coded in red) that should provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 10a asks for feedback on the most beneficial aspects 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 10b asks for feedback on the least beneficial aspects of the examination process. These comments should also provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 11 asks for any other comments. There were several positive comments, but also one negative comment.

Survey Results – FY 2009 Summary

For FY 2009, the OIG issued 64 surveys and received 58 completed surveys. This is a 90.6 percent response rate, which is very favorable. This favorable response rate is due to the revised format of the survey; the survey’s ease of completion and submission, i.e., all electronic; and our follow-up process on surveys distributed.

See the FY 2009 Summary Report on page 8 for numerical responses to all nine survey statements for all 58 respondents.

Responses to Survey Statements 1–9

Examination Process

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

Average Response: 1.8 (3rd quarter was 1.8, 2nd quarter was 1.8, 1st quarter was 2.0)

Comments:

- The institution perceives that the scope of the review was significantly larger in terms of percent of volume reviewed than would be experienced by a larger institution.
- The examination was very thorough. Most all aspects of the organization were examined. Given the current environment, we thought more attention to underwriting versus regulatory compliance would have been appropriate. However, underwriting was a part of the exam.

Survey Statement 2: The examination process helped the institution understand its authorities and comply with laws and regulations.

Average Response: 1.9 (3rd quarter was 1.9, 2nd quarter was 2.0, 1st quarter was 2.2)

Comments:

- The exam team was very well versed in their understanding of regulations. The exam staff's interpretation of regulations has evolved over time.
- While we believe we are keeping abreast of the regulations and revisions, examinations are helpful to ensure that we are.

Survey Statement 3: The results and recommendations of the examination process covered matters of safety and soundness, and compliance with laws and regulations.

Average Response: 1.7 (3rd quarter was 1.8, 2nd quarter was 1.8, 1st quarter was 2.0)

Comments:

- Matters of safety and soundness were covered by the exam team. There was more of a focus on less significant details that may not be significant in terms of overall safety and soundness.

Survey Statement 4: Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.

Average Response: 1.8 (3rd quarter was 2.1, 2nd quarter was 2.1, 1st quarter was 1.9)

Comments:

- While there were some new examiners on site, the training aspect of their participation was explained prior to the on-site work. We are very impressed with the more experienced exam staff. The agency has done an admirable job of selecting bright, well-educated, knowledgeable and professional staff in the past five years or so. The examiners are a very positive reflection of the agency and the Office of Examination.
- Appreciated the “mix” of tenured and new Team Members.
- A lot of discussion around time to restructure application. Was resolved later.

Communications and Professionalism

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

Average Response: 1.8 (3rd quarter was 1.9, 2nd quarter was 1.8, 1st quarter was 1.6)

Comments:

- **Communications from FCA were not very timely.**
- Verbal interactions are always good and the written were very informative. Timing of notices of exam could certainly be earlier—although we generally knew when they were coming—this area is better than last year—improvement noted.
- **Better communication could have been sent to inform us that the examination process would be split into two sessions (one for compliance and the other for credit). We were not notified until the first visit occurred.**
- Communication between exam staff and institution staff was definitely clear, accurate and timely. When discussing issues that are not specifically addressed by regulation, there was some hesitation on the part of examiners to provide their perspective on what they considered best practices. An example would be committee structure for the board of directors. Policy hold limits for concentration risk in the portfolio is another example. The discussion around those issues was very insightful, candid and helpful. In the end, the exam report did include recommendations for best practices which were very helpful.
- As Audit Committee Chair, I appreciate the advance correspondence from the examiners. It gives the committee the opportunity to contact the examiners if we feel it may be necessary.
- Would say that communications were excellent with Ira Marshall and the Team, prior to, during, and subsequent to the review.

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 (3rd quarter was 2.1, 2nd quarter was 1.7, 1st quarter was 1.9)

Comments:

- Audit Chair appreciates the communications from FCA before the exam begins and after exam is completed. This provides an opportunity for Audit Committee to communicate with the examiners if there is an internal issue that needs attention.
- **The post-examination phone call and subsequent meeting with the Board were not helpful and added additional confusion.**
- The examiners were very interactive with the board chairman through the exit conference and with the audit committee during the formal meeting with the audit committee. Examination scope and findings were explained to the satisfaction of the audit committee and the examiners allowed sufficient time for open dialog with the committee.

Survey Statement 7: The examiners were organized and efficiently conducted examination activities.

Average Response: 1.9 (3rd quarter was 1.9, 2nd quarter was 2.0, 1st quarter was 2.1)

Comments:

- **To be more efficient, if documented information is needed it would be nice in the future if we were notified the week before and we would have it all available upon arrival for the examination.**
- The examiners are very efficient and know exactly what to ask for during the exam. They were very considerate of staff time and coordinated their activities with little if any disruption to ongoing operations. Thank you!

Survey Statement 8: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 1.5 (3rd quarter was 1.9, 2nd quarter was 1.9, 1st quarter was 1.9)

Comments:

- Examiners did listen to management as well as the board prior to formulating their written conclusions and recommendations.
- The board appreciates the presentation of the report to the full board. Again, it is a perfect opportunity to discuss the exam and any additional matters with FCA examiners.

- The exam team was very well informed and knowledgeable. The issues discussed were specific and to the point. The exam team was articulate and questions were addressed appropriately. On several occasions, the examiners asked for additional insight or direction from other examiners in the home office in McLean. They put our staff in direct contact with resident experts who helped with modifications to some of our policies. "Other Credit Needs," distressed borrower notifications are good examples. This consistent approach is very effective.

Survey Statement 9: FCS-wide examination guidance from the Office of Examination (e.g., examination bulletins, informational memoranda, etc.) was timely, proactive and helpful.

Average Response: 1.6 (3rd quarter was 2.0, 2nd quarter was 2.0, 1st quarter was 2.2)

Comments:

- I can't recall a time when we have received more guidance from the agency through bulletins and informational memorandums. These are helpful in keeping communications open and understanding what the agency considers important. Very good!

Responses to Additional Survey Items 10a, 10b, and 11

Survey Item 10a: What aspects of the examination process did you find **most** beneficial?

- They found credit weakness that needed to be addressed.
- Examiners are professional and complete their duties in an efficient and timely manner. We perceive that they welcome the opportunity to answer questions.
- Completing as much of the exam off site is very beneficial as to provide as little disruption to the on-going business activities as possible. Provides validation to existing audit, review and governance processes that the Institution has in place.
- Communication between internal auditor, audit committee chair and CEO. Followup with the board after examination is complete. Provides board with opportunity to ask questions about the system in general.
- Interaction with examiners and talking about the bigger picture of various areas.
- Examination of pricing and asset quality review.
- The discussion of credit philosophy and FCA's thoughts on the various commodity issues.
- Understanding of Linda Jew.
- We consider examinations to be an integral part of our overall risk management. The examiners are engaging and open in conversations rather than being short and abrupt. The examiners' perspective on risk factors and trends around the system was helpful and enlightening.
- The exam confirmed institution assessment of our risk and controls!
- Receiving a relatively "clean" report is always beneficial. The criticisms received were valid.

- They provided us some clarification on our regulations with regards to compliance. They also had a healthy perspective on the current economic stress some of our industries are facing and generally agreed with our approach to managing through the issues we are facing.
- Exit Conference.

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

- Better communication could have been sent to inform us that the examination process would be split into two sessions (one for compliance and the other for credit). We were not notified until the first visit occurred. To be more efficient, if documented information is needed it would be nice in the future if we were notified the week before and we would have it all available upon arrival for the examination.
- Lack of general staff experience.
- We have some concern, although it may be appropriate in some cases, that exam teams may be overly conservative in their estimate of risk assessment. This is not new to the system. Being proactive in portfolio risk management is always appropriate, but if we are overly conservative, that easily leads to quality and performance downgrades as well as allowances being set on accounts prematurely.

Survey Item 11: Please provide any additional comments about the examination process and related communications.

- Appreciated discussion of potential for industry specific allowances.
- The institution maintains a sound Regulator – Institution relationship. The reporting process was handled effectively between the examiners to the Audit Committee and Board of Directors.
- We appreciate the experience and knowledge of the examiners. We feel that their seasoned approach is needed in these troubled financial times.
- The review team was fair and professional in conducting the examination and exhibited superior communication before and after the examination.
- Again this year, comments and information were presented in the Executive Session that were not mentioned in the Report of Examination and had not been addressed at any time during the Examination process including broad statements about “credit administration weaknesses,” references to [a large loan] being handled like a \$50,000 loan,” and references to “numerous scope problems.”
- FCA is to be commended on recruiting, selecting, training, and retention of quality exam teams.
- Just thought the examination was appropriate, focused on true risk areas, and professional.
- Erica King was very professional. She displayed a no nonsense approach to her duties and responsibilities while at the same time being very respectful of our daily time constraints. Tom Gist, as always, provided a mature and knowledgeable perspective. His interaction with our board was professional and to the point. It is very refreshing to have a regulator who understands the Ag industry and the risks associated with them. Tom has the ability to point out Institution weaknesses in a professional manner, but also is willing to point out areas where management and the board seem to be doing well. This approach is very effective especially in gaining credibility with the board and management.

FY 2009 Summary Report

Numeric Responses to Survey Statements 1-9

| Question | Percentage of Total Responses | | | | | | | | | | | | Total No. Responses | Average Response |
|------------------------|-------------------------------|-------|------------|-------|--------------------------------|-------|--------------|------|-------------------------|------|--------------------|------|---------------------|------------------|
| | Completely Agree (1) | | Agree (2) | | Neither Agree nor Disagree (3) | | Disagree (4) | | Completely Disagree (5) | | Does Not Apply (6) | | | |
| 1 | 17 | 29.3% | 35 | 60.4% | 5 | 8.6% | 1 | 1.7% | 0 | 0.0% | 0 | 0.0% | 58 | 1.9 |
| 2 | 11 | 19.0% | 36 | 62.1% | 10 | 17.2% | 0 | 0.0% | 0 | 0.0% | 1 | 1.7% | 58 | 2.0 |
| 3 | 15 | 25.9% | 39 | 67.2% | 4 | 6.9% | 0 | 0.0% | 0 | 0.0% | 0 | 0.0% | 58 | 1.8 |
| 4 | 12 | 20.7% | 37 | 63.8% | 7 | 12.1% | 2 | 3.4% | 0 | 0.0% | 0 | 0.0% | 58 | 2.0 |
| 5 | 24 | 41.4% | 24 | 41.4% | 8 | 13.8% | 2 | 3.4% | 0 | 0.0% | 0 | 0.0% | 58 | 1.8 |
| 6 | 17 | 29.3% | 34 | 58.6% | 7 | 12.1% | 0 | 0.0% | 0 | 0.0% | 0 | 0.0% | 58 | 1.9 |
| 7 | 14 | 24.1% | 35 | 60.4% | 6 | 10.3% | 3 | 5.2% | 0 | 0.0% | 0 | 0.0% | 58 | 2.0 |
| 8 | 22 | 37.9% | 29 | 50.0% | 3 | 5.2% | 4 | 6.9% | 0 | 0.0% | 0 | 0.0% | 58 | 1.8 |
| 9 | 14 | 24.2% | 34 | 58.6% | 10 | 17.2% | 0 | 0.0% | 0 | 0.0% | 0 | 0.0% | 58 | 2.0 |
| Total Responses | 146 | | 303 | | 60 | | 12 | | 0 | | 1 | | | 1.9 |

Total Number of Surveys Sent to Institutions: 64

Total Number of Surveys Received: 58