Office of Inspector General

Performance Management and
Internal Control Program
05-02

Veronica M. McCain
Auditor-in-Charge

July 1, 2005

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
McLean, Virginia 22102-5090

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The Honorable Nancy C. Pellett
Chairman of the Board and
Chief Executive Officer
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Ms. Pellett:

The Office of the Inspector General completed an audit of the Farm Credit Administration performance measure and internal management control programs. There were two audit objectives. The first objective was to find out whether the Agency is adequately verifying and validating performance measure accomplishments presented in the Performance and Accountability Report. The second objective was to evaluate the adequacy of the supporting documentation for the Agency's internal management control program review assessments.

We found the Agency is committed to developing a comprehensive system for reporting performance results and assessing internal control. Processes are in place and are followed. However, some improvements are needed to ensure performance results accurately reflect accomplishments. In addition, the Agency's internal management control program could be strengthened to be a more systematic integration of internal control review efforts, approached and written in a more standardized format. On page 6 though 9, we discuss a significant opportunity to reshape FCA's internal control program. Information on a reputable framework and model is included.

We conducted the audit in accordance with *Government Auditing Standards* issued by the Comptroller General for audits of Federal organizations, programs, activities, and functions. We conducted fieldwork from February through May 2005. We provided a draft report to management on June 6, 2005. We conducted an exit conference and discussed the draft report with the Office of Chief Information Officer and the Office of Policy and Analysis, now known as Office of Regulatory Policy, on June 8, 2005.

We would like to highlight the cooperative and collaborative efforts of two offices. Before issuance of the final report, the Office of Chief Information Officer took action on a finding discussed in this report. This prompt recognition and attention to the finding alleviated the need to publish the recommendation for improvement and eliminated the need to initiate and track the recommendation in the audit follow-up system.

The Office of Policy and Analysis agreed to take action concerning an OIG finding and has proposed an action plan to address the audit finding explained within this report. We commend these offices for being so responsive to OIG findings and recommendations. This immediate willingness to focus on the accuracy of the Performance and Accountability Report is demonstrative of our ongoing partnership to improve the FCA.

If you have any questions about this audit, I would be pleased to meet with you as soon as possible.

Respectfully,

Elizabeth M. Dean
Acting Inspector General

EXECUTIVE SUMMARY

Why Did the Office of Inspector General do the Audit?

Decision makers need evaluative information about how programs are working, both to manage programs effectively and to help decide how to allocate resources.

This report discusses the importance of accurate performance measure results and the need for an effective internal control program.

The report specifically identifies areas that may need improving to ensure performance results are clearly reflected in the Agency's Performance and Accountability Report.

In addition, the report addresses an innovative approach the Agency can use to reshape its internal control program in a more integrated effort.

The Inspector General Office strives to be an advocate in providing the Agency with tools that are helpful in managing programs more effectively and efficiently.

Objective. The objective of our review was to determine whether the Agency is adequately verifying and validating performance measure accomplishments presented in the Farm Credit Administration Performance and Accountability Report. We also evaluated the adequacy of the supporting documentation for the Agency's internal control program review assessments.

Audit Results. Our review found that the Farm Credit Administration is committed to developing a comprehensive system for reporting performance results and assessing internal control. However, some improvements are needed to ensure performance results accurately reflect accomplishments. In addition, the Agency's internal management control program could be enhanced to be a more systematic integration of internal control review efforts, approached and written in a more standardized format.

Performance and Accountability Report. For the FY 2004 Performance and Accountability Report we verified the accuracy of information reported for 14 performance measures. Documentation supported the reported performance results in 12 of the 14 performance measures. For 2 performance measures, we question whether results, as reported, accurately reflect program outcomes.

We found the process used by the Office of Policy and Analysis for calculating the amount of regulatory initiatives using supplemental approaches is at times driven by Board actions that are more ministerial or administrative and should, therefore, not be included in the count. In addition, the interpretation of what constitutes a supplemental approach may be misguided. As a result, the number of supplemental approaches in the Performance and Accountability Report may be overstated.

For the Office of Chief Information Officer, we found when determining the number of available network minutes in each quarter, schedule maintenance downtime is subtracted out, making the network availability time less and the percentage for network service availability possibly higher. Our interpretation is that "network service availability" should state the percentage of time the network is available at all times and not exclude routine maintenance down time. If routine maintenance downtime is excluded then it should be footnoted in the Performance and Accountability Report for a clear understanding on how the availability of information technology is calculated.

Prior to issuance of the final report, the Office of Chief Information Officer took action to carry out draft report recommendations to improve performance result measurements on network service availability. We commend the Office of Chief Information Officer for

taking prompt action to ensure the accuracy of the data reported in the Performance and Accountability Report.

Internal Controls. We reviewed the internal control assessments performed in FY 2004 for the four offices: 1) Office of Examination, 2) Office of Policy and Analysis, 3) Office of General Counsel, and 4) Office of the Chief Information Officer. Overall, we found the Agency has established a sound process to assess and report on internal controls. However, the process could be improved through a more systematic integration of internal control review efforts. The Committee of Sponsoring Organizations of the Treadway Commission provides an excellent framework that can help the Agency integrate its internal control program. The Internal Control-Integrated Framework has been used by thousands of businesses to better control their activities in moving toward achieving established objectives. The framework shows a direct relationship between the objectives, which are what the Agency strives to achieve and the Agency risk management components, which represent what is needed to achieve them.

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List of Acronyms

CIO	Chief Information Officer
Farmer Mac	Federal Agricultural Mortgage Corporation
FCA	Farm Credit Administration
FCS	Farm Credit System
FIRS	Financial Institution Ratings System
FMFIA	Federal Manager's Financial Integrity Act
FY	Fiscal Year
GPRA	Government Performance Results Act
OCIO	Office of Chief Information Officer
OE	Office of Examination
OGC	Office of General Counsel
OMB	Office of Management and Budget
OPA	Office of Policy and Analysis

BACKGROUND

The Farm Credit Administration (FCA) is an independent Federal agency responsible for regulating and examining the agriculture government-sponsored enterprises serving rural America, which are the Farm Credit System (FCS) and the Federal Agricultural Mortgage Corporation (Farmer Mac).

The proper stewardship of resources is a fundamental responsibility of FCA office directors and staff. Employees must ensure FCA's resources are used efficiently and effectively to achieve intended program results. In addition, resources must be consistent with the Agency's mission, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement. Effective performance measures and a valid internal management control program helps the Agency achieve desired program results and safeguards the integrity of various FCA programs.

Performance Measures

The Government Performance Results Act (GPRA) is the primary framework which Federal agencies use to set strategic goals, measure performance, and report on the degree to which goals are met. In December 2003, the FCA Board adopted three strategic goals for fiscal years 2004-2009:

1. Ensure the FCS and Farmer Mac fulfill their public missions for agriculture and rural areas.
2. Evaluate risk and provide timely and proactive oversight to ensure the safety and soundness of Farm Credit System and Farmer Mac.
3. Implement the President's Management Agenda.

These goals have 29 associated performance measures and "targets" aimed at determining the degree of success in accomplishing the Agency's performance measures. The accomplishment is published annually in the Performance and Accountability Report. Performance results are compiled by each office submitting performance information to the Executive Director for Planning and Projects. The Director reviews the information for reasonableness and combines the performance report submissions from each office into a single performance report for the Chairman. FCA's Chairman submits the annual Performance and Accountability Report to the President and Congress.

Internal Control

Internal controls are an organization's policies and procedures used to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making. The importance of management controls is addressed in many executive documents:

- The Federal Manager's Financial Integrity Act (FMFIA) establishes specific requirements with regard to management controls. FMFIA requires an agency to conduct an annual evaluation of its internal accounting and administrative control system in accordance with guidance established by the Director of the Office of Management and Budget (OMB). Further, the

agency is required to submit an annual statement to the President and to the Congress on the status of the agency's internal control system.

- OMB Circular No. A-123 "Management Accountability and Control" provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control.
- FCA Policy and Procedures Manual 1007 "Evaluation of Internal Control Systems," further outlines the FCA policies and procedures to be followed by Agency managers in evaluating, improving, and reporting on internal controls in their programs and administrative activities.

FCA's office directors are responsible for establishing and maintaining systems of internal control in their respective offices that conform to the Internal Control Standards. By October 31 of each year, office directors provide assurance letters to the Chairman stating they have performed an evaluation of internal control in their office in accordance with OMB and Agency's guidance.

OBJECTIVE AND SCOPE

The objective of our review was to determine whether the Agency is adequately verifying and validating performance measure accomplishments presented in the FCA Performance and Accountability Report. We also evaluated the supporting documentation for the Agency's internal control program review assessments.

For the FY 2004 Performance and Accountability Report, we validated the accuracy of results reported for 14 performance measures. (See Appendix for performance measures selected). We reviewed supporting documentation and interviewed responsible staff on performance measure results.

We reviewed the FY 2004 internal control risk assessments and supporting documentation for: 1) the Office of Examination (OE), 2) the Office of Policy and Analysis (OPA), 3) the Office of General Counsel (OGC), and 4) the Office of the Chief Information Officer (OCIO). These offices were selected because of their high vulnerability risk to the Agency.

We conducted the audit in accordance with *Government Auditing Standards* issued by the Comptroller General for audits of Federal organizations, programs, activities, and functions.

FINDINGS AND RECOMMENDATIONS

Our review found that FCA is committed to developing a comprehensive system for reporting performance results and assessing internal controls. However, some improvements are needed to ensure performance reporting accurately reflects accomplishments. In addition, the Agency's internal management control program could be a more systematic integration of internal control review efforts and the review process documentation could be more standardized. We suggest a reputable approach.

Performance Measure Reporting

As the GPRA process has evolved, more attention has been given to performance results. Specifically, attention is being focused on the processes used by agencies to verify and validate performance measure results data. For the FY 2004 Performance and Accountability Report, we verified the accuracy of information reported for 14 performance measures. (The Appendix lists performance measures reviewed). We found that for 12 of the 14 performance measures, documentation supported performance results. However, FCA needs to clarify or explain the reporting process for the following two performance measures:

- Percentage of instances in which the Agency solicits public comment and input on applicable regulatory initiatives using supplemental approaches to the notice and comment rulemaking process.
- Availability of information technology resources and information to appropriate users to provide communication and information collection and delivery in a timely manner, as measured quarterly by reports on FCA network and Web components.

We questioned if the reported results give the reader an accurate picture.

Regulatory Initiatives Using Supplemental Approach

OPA's process for calculating applicable regulatory initiatives using supplemental approaches in some instances is, driven by Board actions that are more ministerial or administrative and, therefore, should not be included in the count. In addition, the interpretation of what constitutes a supplemental approach may be misguided. As a result, the number of supplemental approaches stated in the Performance and Accountability Report may be overstated.

Our review of supporting documentation shows the OPA's process for determining regulatory initiatives using supplemental approaches could be improved by adopting the following analysis:

- When determining the number of regulatory initiatives the count should be based on significant Board actions such as adoption of a proposed rule or regulation amendments. Administrative actions, such as extending the comment period on a proposed rule, should not be included in the count.

When determining the number of supplemental approaches, counts should be based on the number of regulatory initiatives using supplemental approaches not simply the number of Board actions. For example:

- August 2003 the Agency published a proposed rule seeking public comments to a regulation on investments in Farmers' Notes.
- October 2003 the Board extended the comment period on Farmers' Notes *(supplemental approach).*
- April 2004 the Board finalized the regulation.

According to OPA this regulatory initiative was counted as using two supplemental approaches based on the number of Board actions. We believe a more accurate count would be one, based on the single regulatory initiative (investments in Farmers' Notes) using a supplemental approach.

We also question whether OPA's interpretation of what constitutes a supplemental approach is consistent with the meaning. In May 2004, the FCA Board took action to amend the list of related services by adding Farm Credit Bank to the list of

institutions authorized to offer the services listed as "Financial Risk Management for Customer". According to the OPA, this was highlighted on FCA's Web site and included as an initiative using a supplemental approach. OPA feels this falls under the category of other unique approaches to gather a broad range of public input because other institutions would become aware of the services and might want to offer them. We question whether this constitutes a supplemental approach because methods should focus on gathering a broad range of public input and it is unclear how this initiative would gather input on the subject matter.

OPA is currently revising its process for the FY 2005 Performance and Accountability Report submission. According to OPA, revisions will include defining applicable regulatory initiatives based on significant Board actions. In addition, OPA will ensure the supplemental approach count is based on the number of regulatory initiatives that actually use supplemental approaches versus just the number of Board actions. We commend OPA for taking prompt action to ensure data reported in the Performance and Accountability Report accurately reflect results.

Availability of Information Technology Resources

Our review shows the OCIO needs to clarify in the Performance and Accountability Report "the availability of information technology resources" calculation. According to the Chief Information Officer (CIO), the information technology resources availability time is computed using the following calculations:

- Number of available minutes in each quarter=Total number of minutes in each quarter minus schedule down time for routine network maintenance.
- Network service availability=Number of available minutes in each quarter minus unscheduled minutes network is down.
- Percentage of service availability=Net service availability/ Number of available minutes in each quarter.

When determining the number of available minutes in each quarter, the OCIO is subtracting out schedule maintenance downtime, thus making the network availability time less and the percentage for network service availability possibly higher. The common reader of the Performance and Accountability Report would interpret "network service availability" as the percentage of time the network is available at all times and not exclude routine maintenance down time. If routine maintenance downtime is excluded then it should be footnoted in the Performance and Accountability Report so there is a clear understanding of how the information technology availability is calculated.

The CIO has taken action to include a footnote explaining how network availability time is calculated in the FY 2005 Performance and Accountability Report. We commend the OCIO for taking prompt action to ensure data reported in the Performance and Accountability Report accurately reflect results.

Agreed Upon Action

1. ***The Office of Policy and Analysis Director will revise the process on reporting performance results for supplemental approach to provide a better match between the numbers of supplemental approach that are used during the rulemaking process for a single regulatory initiative. Also, the Director will review supplemental approaches counted in the Performance and Accountability Report to ensure methods used are consistent with the supplemental approach definition.***

Internal Controls

Internal controls are a major part of managing an organization. It comprises the plans, method and procedures used to meet mission, goals and objectives to support performance based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Internal control is not a one-time event, but a series of actions and activities that occur throughout the Agency's operation on an ongoing basis. Therefore, internal controls should be recognized as an integral part of the system managers use to regulate and guide the organization's operation.

Internal Control Reviews

We reviewed the internal control assessments performed in FY 2004 for the following four offices: 1) the Office of Examination, 2) the Office of Policy and Analysis, 3) the Office of General Office, and 4) the Office of Chief Information Officer. These offices were selected because of their high vulnerability risk to the Agency. The Agency has established a process to assess and report on internal control. However, the process could be improved through a more systematic integration of internal control review efforts, approached and written in a more standardize format.

Internal Control Integration. According to Agency guidance, each of the office directors is responsible for establishing and maintaining systems of internal control in their respective offices. This includes identifying potential risks, making internal control evaluations, reporting results and implementing corrective actions for weaknesses identified. Generally, we found the offices were conscientious in implementing an internal control program. However, internal control review approaches were often focused on specific processes within each of the offices and lacked overall Agency function reviews. For example, the OGC and the OPA are both involved in the regulation development process. However, there is no linkage between the two offices during the internal control review process. Each office performs reviews that are specific to their own office function. As a result, management may not have an overall picture of possible control risks in this area.

Effective internal control involves a unified approach for assessing the vulnerability of various Agency functions. Agency functions that are conducted across the organization should be managed through an integrated effort that provides reasonable assurance the process is working efficiently and effectively.

Review Process and Documentation. According to Agency guidance, when performing annual internal control reviews, each office should review the management control program through the completion of an assessment form that is tailored to identify risks in each given activity. Agency guidance provides an example of an assessment checklist form that can be used for this review. We found the process for completing assessments varied between offices. For example, the OE and the OPA used the assessment checklist to complete reviews. The checklists were comprehensively cross-referenced to supporting work papers with rationale thoroughly documented. The OGC and the OCIO did not use the assessment checklist but provided various types of documentation for overall conclusions reached. Documentation provided did assess some very important control factors however; it did not address all the areas covered in the Agency's vulnerability assessment checklist such as staff training and delegation of management responsibility. Inconsistency in control review process and documentation can result

in the assessments not properly measuring all the levels of risks for a given activity. By developing a systematic, organized, and structured approach to assess internal controls, the Agency can improve and maintain effective operations.

Internal Control Changes

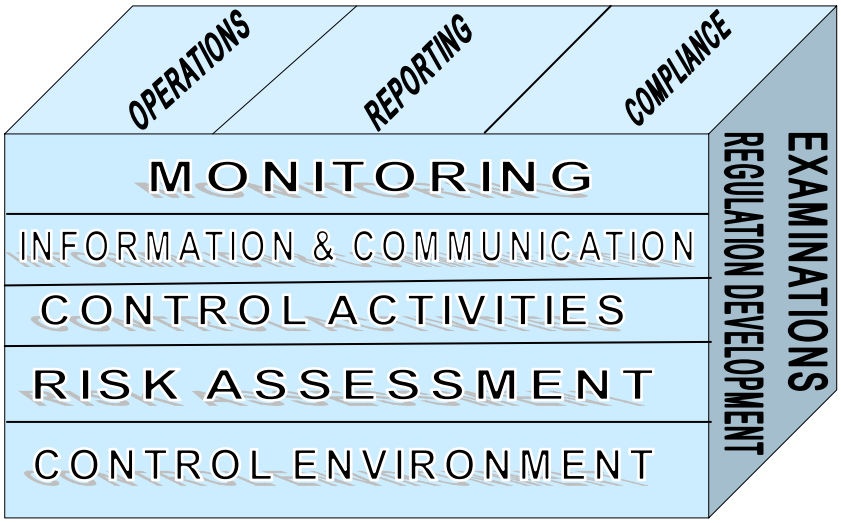
In recent years internal control has received substantial notice largely in response to a wave of corporate financial scandals involving some very prominent companies in the United States. This has resulted in revisions to OMB Circular No. A-123, "Management Responsibility for Internal Control," December 2004. The revisions emphasize the need for agencies to integrate and coordinate internal control assessments that synchronize all internal control-related activities. The circular recognizes that internal control should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and integrity every step of the process and provide continual feedback to management. In addition, personal accountability for results is essential, starting with top agency management and cascading down through the organization. The revised circular encourages the involvement of senior management councils in internal control assessments and monitoring. This can be an excellent means of establishing accountability and ownership. With the advent of a new circular, combined with the strategic studies FCA is currently conducting, Agency management has a significant opportunity to reshape the internal control program so it is an integral tool in improving effectiveness and accountability. A significant benefit of revising the internal control program would be standardized documentation throughout the Agency.

Internal Control-Integrated Framework

The Committee of Sponsoring Organizations of the Treadway Commission provides an excellent framework that can help the Agency integrate its internal control program. The Internal Control—Integrated Framework mirrors concepts within the revised circular and is used by thousands of businesses to better control their activities in moving toward achievement of their established objectives. The framework shows a direct relationship between the objectives, which are what the Agency strives to achieve and the risk management components, which represent what is needed to achieve them.

The relationship is depicted in a three-dimensional cube matrix. The first dimension represented by the vertical columns is the Agency's objectives. The second dimension represented by the horizontal rows is the five interrelated standards that drive the way management runs the Agency. The third dimension represents the Agency's functionalities.

Internal Control-Integrated Framework



Further analysis of the framework shows the first dimension: operations, reporting and compliance are the objectives the Agency is trying to achieve with its internal control program. Operations represent effective and efficient use of resources. Reporting relates to reliable financial statements. Compliance is the Agency's compliance with applicable law and regulations.

The second dimension is the five interrelated standards that drive the way management runs the Agency. Each standard row cuts across and applies to all objective categories.

- Control Environment—Individual attributes, including integrity, ethical value and competence and the environment in which they operate. They are the engine that drives the Agency and the foundation on which everything rests.
- Risk Assessment—The identification and analysis of relevant risk associated with achieving the objectives, such as strategic and annual performance plans developed under the GPRA, and forming a basis for determining how risk should be managed.
- Control Activities—The policies, procedures, techniques and mechanisms that enforce management directives.
- Information and Communication—For the Agency to run and control its operations, it must have relevant, reliable and timely communications relating to internal control as well as external events. Information is needed throughout the Agency to achieve all of its objectives.
- Monitoring—Internal controls should be designed to assure that ongoing monitoring occurs in the course of normal operations.

The third dimension represents the Agency's functionalities to which internal control applies. The FCA's functionalities include examination, regulation development and financial statements.

Given the inconsistent approach by various offices when assessing the current internal control program, we believe this framework offers numerous benefits to help the Agency achieve an integrated internal control approach. With the foundation of a

mutual understanding, all parties will be able to speak a common language and communicate more effectively. In addition, management will be able to assess control systems against a standard and strengthen weaknesses.

Recommendations

1. ***The Chief of Staff should establish a senior assessment team as suggested by OMB Circular No. A-123, "Management Responsibility for Internal Control," December 2004, to ensure a consistent level perspective is applied to the internal control program.***

2. ***Prototype the Committee of Sponsoring Organization framework on several agencies' processes and obtain staff recommendations on how it can be adopted for Farm Credit Administration environment.***

APPENDIX

Below is a listing of the performance measures reviewed from the FY 2004 Performance and Accountability Report.

Goal 1:

Percentage of institutions with effective strategic business plans for providing constructive credit and related services to all potential customers.

Percentage of direct-lender institutions with satisfactory consumer compliance with borrower rights examination ratings.

Percentage of instances which Agency solicit public comment and input on applicable regulatory initiative using supplemental approaches to the notice and comment rulemaking process.

Percentage of direct-lender institutions that have effective programs to furnish sound and constructive credit and related services to young, beginning, and small farmers, ranchers, and producers and harvesters of aquatic products or that have acceptable corrective action plans in place.

Goal 2:

Number of institutions placed in receivership due to financial failure during the previous 12 months.

The total assets of FCS institutions with composite Financial Institution Ratings Systems (FIRS) of "1" or "2" divided by the total assets of FCS institutions.

Percentage of FCS institutions with composite FIRS ratings of "3" or "4", or "5" with corrective action plans in place to address the underlying problems.

Percentage of direct-lender institutions with adverse assets to risk funds less than 100 percent.

Percentage of institutions complying with all regulatory capital ratio requirements.

Percentage of instances of noncompliance with or regulations resolved to FCA satisfaction.

Percentage of institutions that have effective audit and review programs.

Goal 3:

Percentage of Agency staff with broadband connectivity remotely.

Percentage of Agency Web pages and electronic devices that are section 508 accessibility compliant.

Availability of information technology resources and information to appropriate users to provide communication and information collection and delivery in a timely manner, as measured quarterly by reports on FCA network and Web components.

REPORT

Fraud ❖ Waste ❖ Abuse ❖ Mismanagement

FARM CREDIT ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

☎ Phone: Toll Free (800) 437-7322
(703) 883-4316

Fax: (703) 883-4059

e-mail: fca-ig-hotline@starpower.net

mail: Farm Credit Administration
Office of Inspector General Hotline
1501 Farm Credit Drive
McLean, VA 22102-5090