

Office of Inspector General

Semiannual Report
to the Congress

April 1, 2003
to
September 30, 2003



October 2003

Farm Credit Administration

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



October 27, 2003

The Honorable Michael M. Reyna
Chairman of the Board and
Chief Executive Officer
Farm Credit Administration
McLean, Virginia 22102

Dear Mr. Reyna:

Enclosed is the semiannual report on the activities of the Farm Credit Administration's Office of Inspector General for the period from April 1, 2003 through September 30, 2003. We are filing this report in accordance with the Inspector General Act of 1978, as amended (Act). This is the twenty-ninth report since creation of the office on January 22, 1989. Section 5(b) of the Act requires that you send this report to the appropriate Congressional committees and subcommittees within 30 days after the date of this transmittal, with management's report on the status of audit recommendations.

With a full complement of Board members, we look forward to advancement in governance of the Farm Credit Administration and its leadership to the Farm Credit System, continually aiming to improve quality of life in rural America.

Respectfully,

A handwritten signature in black ink that reads 'Stephen G. Smith'. The signature is written in a cursive style with a large, stylized 'S' and 'G'.

Stephen G. Smith
Inspector General

Enclosure

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EXECUTIVE SUMMARY

This semiannual report to the Congress summarizes the activities and accomplishments of the Farm Credit Administration (FCA or Agency), Office of Inspector General (OIG) and covers the period April 1, 2003 through September 30, 2003. Our efforts were directed toward performing audits, inspections, and evaluations of the FCA programs and operations, conducting investigations, and providing technical assistance and advice on FCA programs.

The FCA Board is at full strength. Moreover, the Board members are engaged in healthy discussions about regulatory and enforcement issues facing the FCA. The Board members are embracing a collegial relationship that is vital to the organization. We believe that the work we performed on governance will help serve as a building block for a strong Board.

The Board is reaching out to the public to gain their views on FCA's regulatory approach, in part, due to the comments from the survey on Regulatory Development that was conducted by OIG during a prior reporting period. The Board is making an effort to reach out to the public and Congress to gain broad input into carrying out the Agency's mission.

The OIG advised managers on multiple issues that came to our attention. This advice encourages managers to take proactive actions. For example, we encouraged Agency managers to evaluate prepayment penalty practices when we noted an increase in complaints to FCA. We also identified improvements needed in several Agency policies. OIG input contributed to improved efficiency and controls in areas such as emergency planning and large procurements.

BACKGROUND

The FCA is an independent Federal agency of the United States government responsible for the regulation, examination and supervision of institutions chartered under the Farm Credit Act of 1971, as amended (Farm Credit Act). FCA is a nonappropriated agency with a fiscal year (FY) 2003 budget of \$38,033,000 for administrative costs. The FY 2003 budget for the OIG was \$829,601 and total obligations were \$796,659. FCA is a “designated Federal entity” within the meaning of the Inspector General Act of 1978, as amended.

FCA currently has 284 employees, about half of which are examiners located at five field offices. The OIG maintains five positions. Appendix B displays the current organizational structure of FCA and Appendix C displays the OIG within that structure.

MANAGEMENT CHALLENGES

Two years ago, the OIG added this part of the semiannual report to highlight major challenges confronting the Agency as it works to fulfill its mission. These challenges fall into two general categories. First are the challenges related to the FCA’s core mission of ensuring a dependable supply of credit to agriculture through the institutions it has chartered. These challenges are often shaped and influenced by events that are outside the control of the Agency. Second, but no less important, are those challenges related to the Agency’s operations. These management challenges were incorporated in the previous semiannual report but have been updated to reflect changes and progress in meeting the challenges.

Farm Credit System Risk

The Farm Credit System (FCS) is a single industry lender and therefore is vulnerable to economic swings. The FCA is challenged to balance the often-competing demands of ensuring the FCS fulfills its public purpose, proactively examining risk in the regulated institutions both individually and systemically, and controlling the cost of the regulator. For example, the FCA requested comments from the public on its interpretation of loan syndications. This is a significant issue to the FCS because loan syndications represent a material portion of the loan growth over the past several years. The FCA Board extended the comment period 3 times for a total of 9 months.

Organizational Leadership

The Farm Credit Act provides for a full time three-member Board. The Board members are appointed by the President and confirmed by the Senate. The rapidly changing, complex financial and banking environment makes the Board’s task both challenging and important. The Board must be able to engage in professional policy debate and set a sound course for the Agency.

The Board is in an important period of transition. Last year the Board returned to full strength ending a 19-month period with only two Board members. The return to a full strength Board is an important element in setting clear priorities and deliberating fully on

the issues. The Board must plan for and anticipate more changes especially in the succession of leadership. Chairman Reyna's term expires in May 2004. The President will appoint the Chairman's successor. However, a primary responsibility of an organization's board is to ensure that there is a smooth transition in leadership. In addition to anticipating a new Chairman, the Board should prepare for other changes. For example, the Board needs to anticipate and be prepared to replace almost half of the top executives in the Agency over the next few years.

A relatively small full-time Board also presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the Agency. As the membership on the Board changes, it needs to update its rules of operation to ensure it fulfills its statutory role in the governance of FCA. Each Board member must accept the rules of operation and be comfortable with the degree of oversight and accountability within the FCA. During this reporting period an OIG report pointed out the need to update and revise the Board Policy Statements.

Strategic Planning

The FCA Strategic Plan was updated and revised for FY 2000 to reflect the FCA Board's priorities at that time. The current FCA Strategic Plan reflects an environment that has changed significantly since it was adopted—the composition of the Board, the economy, the structure of the FCS, and the President's Management Agenda. The FCA Board has worked for more than 6 months getting input from a cross section of stakeholders and taking a fresh look at the substance of FCA's mission, goals and objectives. The Board has the opportunity to set a course for FCA that focuses on the results that it wants to achieve through clear and balanced performance measures. The change in the Board's composition has and will allow the new Board to develop a new perspective that is not unduly constrained by past practices but builds on the experience of prior FCA Boards.

Human Capital

The President identified human capital as a critically needed management reform in the Federal government. The OIG recommended FCA develop a 5-year human capital plan in March 2001. FCA still does not have a plan 2½ years later. FCA needs to develop a comprehensive, integrated approach to human capital issues. In light of the changes in the competitive environment, advances in technology, and the tenure of its workforce; the Agency will be challenged to closely evaluate business processes, their associated costs, and alternatives available through competitive sourcing. The General Accounting Office's (GAO) *High-Risk*¹ report outlined four pervasive human capital challenges that the government faces:

- Planning strategic human capital and organizational alignment;
- Planning for succession and leadership continuity;
- Acquiring and developing staffs whose size, skills, and deployment meet agency needs; and
- Creating results-oriented performance cultures.

¹ GAO-01-263

Financial Management

During FY 2001, FCA successfully implemented a financial management system using the services of the Department of Interior's National Business Center. FCA has received an unqualified audit opinion on its financial statements. However, financial management success goes beyond an unqualified financial statement audit opinion. Management's challenge is to leverage the system to deliver timely financial information that is critical for making well-informed management decisions. This challenge will be compounded by the recent decision to move to a new financial management system. Meeting this challenge requires new measures of success. Measures such as delivering financial information that managers can use for day-to-day operations; and developing reports that capture the full cost of programs and projects can help bring about a transition.

Security and Disaster Preparedness

In the recent report on information security, the OIG found a strong foundation for security practices. However, the speed of change in the security environment will be a challenge for all government organizations. This is especially true for smaller organizations like FCA where an increased emphasis on physical and information security will compete with program areas for tight budget funding. Therefore, security remains a major challenge for the Agency. The Continuity of Operations Plan needs to be updated and practiced. OIG previously provided suggestions to management to facilitate an expedited effort in this regard. Some actions have taken place, although continued planning, finalization and communication of emergency preparedness policies needs to be accomplished.

Leveraging Technology

The Agency has recognized that in order to meet the constraints of its budget, it must be able to maximize its return on investment in technology. FCA will need effective mechanisms to ensure that current and future staff has the technical skills to use technology to operate in an efficient manner.

AUDIT AND INSPECTION REPORTS ISSUED

We issued an audit report on the Loan Account Reporting System and an inspection report on FCA Board Policies. We also performed a review of the Federal Information Security Management Act (FISMA). We conduct all audits in accordance with the standards established by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are in accordance with the President's Council on Integrity and Efficiency's Quality Standards for Inspections. For the FISMA review, we followed guidance published by the Office of Management and Budget. Copies of most OIG reports are available on FCA's Web site (www.fca.gov/oig), by contacting the OIG on 703/883-4030, or by e-mail at IG_information@fca.gov.

Loan Account Reporting System

The OIG completed an audit of the Loan Account Reporting System (LARS) at FCA. The overall objective of this audit was to determine whether LARS is effectively utilized. Specific audit objectives included: (1) determining the adequacy of LARS data; (2) determining whether information provided is duplicative; and (3) assessing LARS future

data use. We found that LARS is not providing sufficient and efficient loan data to support the Agency's mission. Specifically LARS data is deficient, the system is outmoded, and system improvements are challenging. As a result, LARS is underutilized and without significant reengineering, we question whether the system is effective in realizing Agency mission and goals.

Federal Information Security Management Act Review

OIG engaged an independent audit firm, Harper, Rains, Knight & Company to conduct a review of the information security in accordance with procedures essential for establishing compliance with the Federal Information Security Management Act. The Federal Financial System, Consolidated Reporting System, Lotus Domino, Personnel Payroll Systems, and Windows 2000 were reviewed. The auditors found no security issues concerning the Agency-wide security program.

FCA Board Policy Statements

OIG conducted an inspection of FCA Board Policy Statements. The objective of this inspection was to determine if policies are consistent with sound business practices and provide appropriate governance for FCA. We found many policy statements need updating and refinement. It appears the Board's role in overseeing the operations of FCA could be enhanced if it establishes a methodical approach to develop, review and update its policies. These practices would be more consistent with sound business practices and the standards established in the FCA Examination Manual.

STATUS OF UNIMPLEMENTED AGREED UPON ACTIONS

At the beginning of the period there were five unimplemented agreed upon actions. During the reporting period, management took final action on one of the agreed upon actions. During this period, nine more agreed upon actions were issued. At the end of this reporting period, 13 agreed upon actions remain unimplemented.

Audits

The following table summarizes the final actions management took on open audit items.

AUDIT AGREED UPON ACTIONS			
Audit Report	Open during this 6-month period	Final Management Actions during this period	Open on 10/01/2003
Performance BudgetingIssued March 23, 2001	3	1	2
Office of Chief Financial OfficerIssued January 24, 2002	2	0	2
Loan Account Reporting System Issued August 28, 2003	9	0	9
Totals	14	1	13

The audit report of Performance Budgeting was issued more than 2 ½ years ago. Two of the original 14 agreed upon actions remain open. Remaining open are agreed upon actions to establish 5-year financial management and human capital plans. When implemented, these actions will further the Agency's financial accountability and improve strategic planning by providing a roadmap for future human capital and financial management needs.

The OIG issued the audit report on the Office of Chief Financial Officer more than 20 months ago. The two remaining agreed upon actions address the role of the Chief Financial Officer and the staffing of the organization.

Inspections

The following table summarizes the final action management took on recommendations contained in an inspection report.

INSPECTION RECOMMENDATIONS			
Inspection Report	Open during this 6-month Period	Final Management Actions during this period	Open on 10/1/2003
FCA Board PoliciesIssued September 15, 2003	3	0	3
Totals	3	0	3

Investigations

Most OIG Hotline calls and e-mails dealt with borrower complaints concerning FCS institutions and were referred to the FCA office responsible for reviewing such matters. All other Hotline calls were addressed or were referred to the appropriate FCA office or other Federal agency.

One investigation was open at the beginning of this reporting period. This investigation substantiated allegations related to leave practices at FCA. The OIG advised management to take certain administrative actions and change practices to prevent future problems. Two new investigations were opened this period, with one being closed unsubstantiated.

Legislation And Regulations

OIG staff reviewed several FCA regulations in both proposed and final form. Statutory and regulatory compliance issues were reviewed as they arose in the evaluative process. Also, we reviewed and commented on proposed legislation affecting the Inspectors General community through the legislation committee of the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency (PCIE/ECIE).

The FCA requested comments from the public concerning regulations and policies that may duplicate other requirements, are ineffective, or impose burdens that are greater than benefits received. A former solicitation for comments on regulatory burden went out to the public in 1993. OIG is also in the process of reviewing the public comments requested by the Agency on syndication loans and scope and eligibility regulations. We continue to gather information on the Basel Accord and information relating to preferred stock and permanent capital.

This office is involved in workgroups that create guidance for use in the investigation review process. We are working with the ECIE/PCIE to prepare for participating in the quality assurance review of investigations.

Other Activities

Management Advisories

During this reporting period, the OIG has continued the use of management advisories. These advisories provide management with feedback on issues that came to our attention during the process of performing other OIG work. In this 6-month period, we advised Agency managers on issues including processing in of new employees, selecting a new financial management system, billings for reimbursable activities, credit card issuance and monitoring processes, securing Agency credit cards, travel policies, security practices, continuity of operations planning, and Agency outreach activities.

E-Government Study

The OIG conducted a study on the best practices of E-Government. The study identified several efforts underway in other Federal agencies that may be appropriate for FCA to consider. Some of these areas involve electronic corporate applications and making the FCA Web site more user friendly. The study is available on the FCA OIG Web site, www.fca.gov/oig.

Survey of Farm Credit System Institutions

OIG administers an ongoing Agency survey of the regulated institutions of the FCS. This survey is designed to provide the FCA Board and senior management with independent feedback about how well FCA performs its examination and enforcement activities. The feedback is based on confidential responses received from FCS institutions. We surveyed the Chairman of the Board and the Chief Executive Officer of each FCS institution, following their receipt of FCA's report of examination, for their voluntary feedback on the quality and consistency of the examination and enforcement processes. OIG reports the results of the survey annually. During this 6-month period we mailed 45 surveys and received 29 responses, equating to a 64 percent response rate. Overall, the average rating for the questions answered during this reporting period was slightly more favorable (1.5) [1=completely agree; 5=completely disagree] than the prior semiannual reporting period (1.7).

OIG Performance Measures

OIG's performance measures were developed in 1995. Each year we review these measures and issue a report on our performance. It is available on the FCA OIG Web page at www.fca.gov/oig.

Staff Participation in Activities of the Professional Community

OIG staff members are encouraged to take part in organizations that contribute to the mission of the Inspector General community, as well as their individual professional development. Most staff is actively involved in one or more professional organizations as well as ad hoc activities of the PCIE/ECIE.

Staff Participation in Agency Organizations

Staff is active on several Agency workgroups and task forces. During this reporting period the OIG was represented in Blacks in Government, FCA Employees' Council, Administrative Burden Reduction Workgroup, the Federal Women's Program, the Budget and Planning task force, Budget Workgroup, the Laptop Replacement Workgroup and the Farm Credit Club.

The IG sponsored a drive in the Farm Credit Building to collect school supplies for a local public school with a large population of at-risk children.

AUDIT / INSPECTION REPORTS ISSUED BY FCA OIG

TITLE OF REPORT	NUMBER OF RECOMMENDATIONS/ AGREED UPON ACTIONS	QUESTIONED COSTS	RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE
Loan Account Reporting System	9	0	0
FCA Board Policy Statements	3	0	0
Total	12	\$ 0	\$ 0

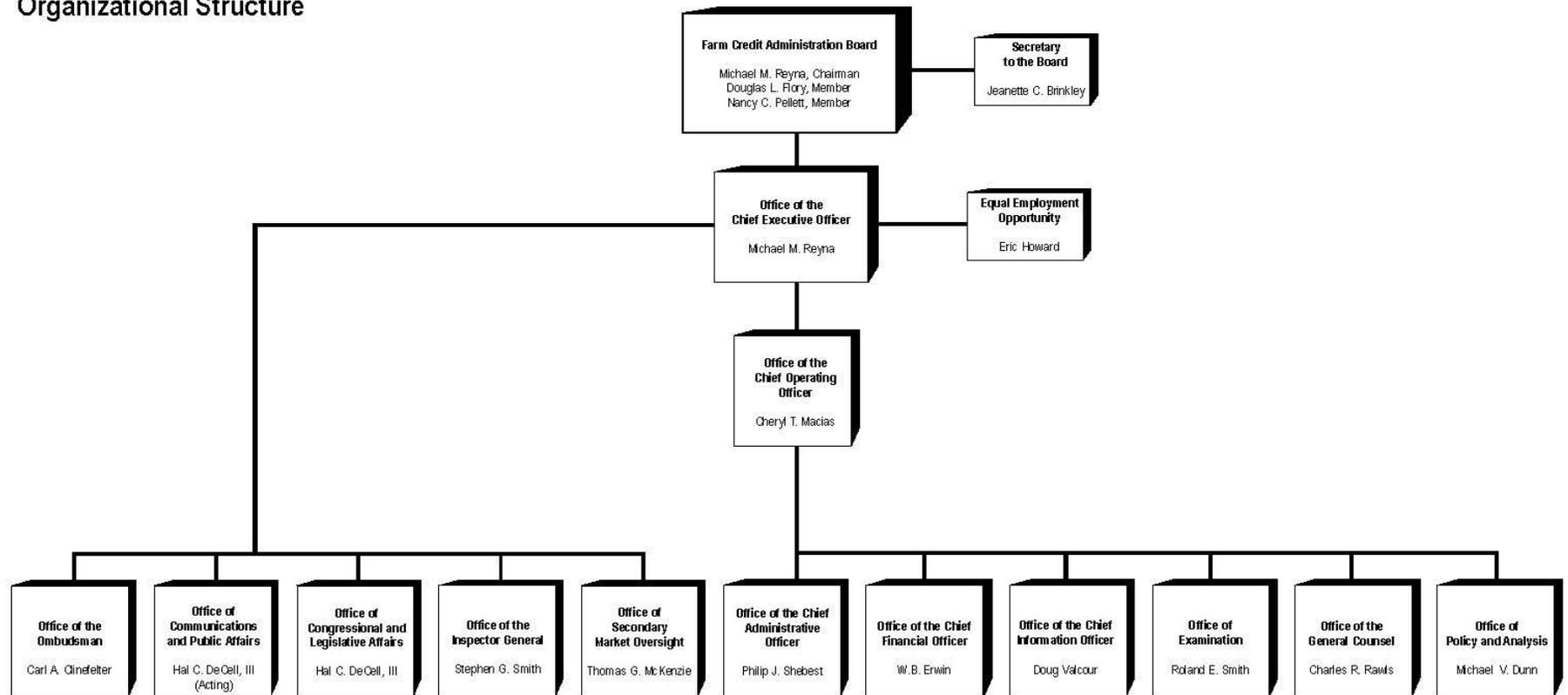
INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS

	Number		Dollar Value	
	Reports	Recs.	Questioned Costs	Unsupported Costs
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0	\$ 0
Subtotals (A+B)	0	0	\$ 0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0	\$ 0
(i) dollar value of disallowed costs	0	0	\$ 0	\$ 0
(ii) dollar value of costs not disallowed	0	0	\$ 0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0	\$ 0

**INSPECTOR GENERAL ISSUED REPORTS WITH
 RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE**

	Number		Dollar Value
	Reports	Recs.	
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0
Subtotals (A + B)	0	0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0
(i) dollar value of recommendations that were agreed to by management	0	0	\$ 0
--based on proposed management action	0	0	\$ 0
-- based on proposed legislative action	0	0	\$ 0
(ii) dollar value of recommendations that were not agreed to by management	0	0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0

Farm Credit Administration Organizational Structure



Farm Credit Administration Office of Inspector General

