

**Farm Credit Administration
Office of Inspector General**

Audit Report

**The Office of Secondary Market
Oversight's Examination Policies
and Procedures**

A-21-01

September 24, 2021

FCAOIG

Farm Credit Administration
Office of Inspector General



Farm Credit Administration
Office of Inspector General

September 24, 2021

The Honorable Glen R. Smith, Board Chairman
The Honorable Jeffery S. Hall, Board Member
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Smith and Board Member Hall:

The Office of Inspector General (OIG) completed an audit of the Office of Secondary Market Oversight's (OSMO) examination policies and procedures. The objective of this audit was to determine whether OSMO's examination policies and procedures are documented and implemented.

We found opportunities to improve OSMO's policies and procedures to guide the areas unique to the Federal Agricultural Mortgage Corporation (Farmer Mac) examination and to document departures from the Farm Credit Administration Examination Manual. During our audit, we found that OSMO's directives focused on the approval and planning of the annual Farmer Mac examination, the completion of the conflict of interest questionnaire, and other various items. However, the directives did not contain guidance on conducting the examination of Farmer Mac.

The OIG also found that OSMO generally implemented the processes tested during the audit, despite a lack of formalized policies and procedures that uniquely apply to Farmer Mac examination work. OSMO conducted [REDACTED] of the 2020 Farmer Mac examination and examiners assigned to OSMO generally completed the conflict of interest forms. However, the OIG identified a need for OSMO to strengthen internal controls and expand written guidance in order to improve the conflict of interest certification process.

We made four recommendations to reduce risk and increase consistency in OSMO's annual examination of Farmer Mac and improve the conflict of interest certification process. FCA agreed to the four recommendations and provided responsive corrective actions for each recommendation. Because of the actions initiated by OSMO over the course of the audit, we consider recommendations 3 and 4 closed.

We appreciate the courtesies and professionalism extended by FCA to our staff during the audit. If you have any questions about this audit, feel free to contact Christopher Coccaro or me, and we would be pleased to meet with you at your convenience.

Respectfully,

A handwritten signature in black ink that reads 'Sonya K. Cerne'.

Sonya K. Cerne
Assistant Inspector General for Audits, Inspections, and Evaluations

EXECUTIVE SUMMARY

Audit of the Office of Secondary Market Oversight's Examination Policies and Procedures

Report No. A-21-01

September 24, 2021

Objective

The objective of this audit was to determine whether OSMO's examination policies and procedures are documented and implemented.

Recommendations

Based on our review, we made four recommendations to reduce risk and increase consistency in OSMO's annual examination of Farmer Mac and improve the conflict of interest certification process:

1. The Office of Inspector General recommends the Office of Secondary Market Oversight document those parts of the Farm Credit Administration Examination Manual that do not apply to the examination of the Federal Agricultural Mortgage Corporation.
2. The Office of Inspector General recommends the Office of Secondary Market Oversight document examination policies and procedures unique to the examination of the Federal Agricultural Mortgage Corporation.
3. The Office of Inspector General recommends the Office of Secondary Market Oversight expand the conflict of interest guidance in Directive 3 to require examiners to complete the conflict of interest form before engaging in examination activities.
4. The Office of Inspector General recommends the Office of Secondary Market Oversight develop internal controls to ensure examiners complete the conflict of interest form according to guidance.

The Farm Credit Administration (FCA or Agency) is an independent federal agency responsible for regulating, examining, and supervising the Farm Credit System (System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The Agency ensures that all System institutions are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America. Farmer Mac is a government-sponsored enterprise with the mission of providing a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. FCA's Office of Secondary Market Oversight (OSMO) has the responsibility for the examination and supervision of Farmer Mac to ensure its safety and soundness. OSMO also ensures that Farmer Mac complies with applicable laws and regulations.

The OIG found that OSMO had limited documented policies and procedures for the areas unique to Farmer Mac examination work. To reduce risk and increase consistency in the examination process, the OIG identified a need for OSMO to document policies and procedures to guide the areas unique to the Farmer Mac examination and to document departures from the FCA Examination Manual.

Despite a lack of formalized policies and procedures that uniquely apply to Farmer Mac examination work, the OIG found that OSMO generally implemented the processes tested during the audit. OSMO conducted the [REDACTED] of the 2020 Farmer Mac examination and examiners assigned to OSMO generally completed the conflict of interest forms. However, to improve the conflict of interest certification process, the OIG identified a need for OSMO to strengthen internal controls and expand written guidance.

Over the course of this audit, OSMO began drafting and implementing written guidance for portions of its examination process and in July 2021 OSMO published two new directives and revisions to two existing directives. The recommendations made in this report, in conjunction with the changes made over the course of the audit, will enhance overall OSMO operations.

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ACRONYMS

Agency or FCA	Farm Credit Administration
Farm Credit Act	Farm Credit Act of 1971, as amended
Farmer Mac	Federal Agricultural Mortgage Corporation
FIRS	Financial Institution Rating System
OE	Office of Examination
OIG	Office of Inspector General
OSMO	Office of Secondary Market Oversight
	
System	Farm Credit System

BACKGROUND

Farm Credit Administration

The Farm Credit Administration (FCA or Agency) is an independent federal agency responsible for regulating, examining, and supervising the Farm Credit System (System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The Agency ensures that all System institutions, are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America.

Farmer Mac

Farmer Mac was established by section 8.1 of the Farm Credit Act of 1971, as amended (Farm Credit Act).¹ Farmer Mac is a government-sponsored enterprise with the mission of providing a secondary market² for a variety of loans made to borrowers in rural America. This secondary market was designed to increase the availability of credit at competitive interest rates to America's rural communities and agricultural sectors, as well as to provide borrowers with the benefits of capital markets pricing and product innovation.³ Farmer Mac conducts its secondary market activities through four lines of business:

¹ 12 U.S.C. §2279aa-1.

² Farmer Mac defines a secondary market as an economic arrangement in which the owners of financial assets, such as the originators of loans, may sell all or part of those assets or pay a fee to offset some or all of the inherent risks of holding the assets.

³ Farmer Mac Annual Report for Fiscal Year ending December 31, 2020 (SEC Form 10-k).

Farm and Ranch

- Mortgage loans secured by first liens on agricultural real estate.

U.S. Department of Agriculture Guarantees

- Portions of loans that are guaranteed by the U.S. Department of Agriculture under the Farm Service Agency and Rural Development programs.

Rural Utilities

- Loans made by cooperative lenders to rural electric cooperatives (both generation and transmission loans as well as electric distribution cooperative loans) and telecommunication facilities.

Institutional Credit

- Farmer Mac's purchase or guarantee of general obligation bonds, known as AgVantage securities, which are issued by lenders and other institutions including financial funds.

FCA regulates Farmer Mac through the Office of Secondary Market Oversight (OSMO), which was established pursuant to the Food, Agriculture, Conservation, and Trade Act Amendments of 1991 (Public Law 102-237). OSMO is responsible for the regulation, examination, and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties and the accomplishment of its public policy purpose as authorized by Congress.

OSMO

OSMO is currently staffed with a Director, two Associate Directors, one Senior Financial Risk Analyst, and an Assistant to the Director. OSMO supplements its full-time staff with employees from other FCA offices such as examiners, legal staff, and other specialists. There are two types of supplemental employees. The first type is a rotational assignment where the supplemental employee is realigned to OSMO.⁴ The second type is an employee who joins the examination team for a limited period of time to conduct a portion of the examination before returning to their original offices.

⁴ According to OSMO's new Directive 6, "rotational assignments vary in length and may last up to 3 years."

Section 8.11(b)(1) and (2) of the Farm Credit Act requires FCA, acting through OSMO, to examine the financial transactions of Farmer Mac no less than once each year. In accordance with a risk-based examination approach, OSMO focuses its oversight efforts and resources on those areas that could materially impact Farmer Mac's safety and soundness. To evaluate the safety and soundness of Farmer Mac, OSMO uses the Financial Institution Rating System (FIRS). A composite rating is based on a qualitative and quantitative analysis of factors comprised of each of the following: Capital, Assets, Management, Earnings, Liquidity, and Sensitivity. Each area is rated on a scale of 1-5 with "1" indicating the strongest performance and management practices and "5" indicating an extremely high, immediate, or near-term probability of failure. OSMO issues Examination Activity Letters to Farmer Mac to communicate matters requiring attention for interim examination activities and a Report of Examination at the end of each annual examination cycle.

FCA Examination Manual

FCA's Office of Examination (OE) is responsible for programs of supervision, regulation, and examination of each System institution, except for Farmer Mac,⁵ in accordance with the Farm Credit Act, and applicable regulations. OE Directive 15, "FCA Examination Manual Maintenance" provides that the FCA Examination Manual represents the primary source of guidance for conducting System institution examination activities. OE's Examination Guidance Division oversees the FCA Examination Manual's development and maintenance. While the FCA Examination Manual does not include specific references to Farmer Mac requirements, OSMO officials reported that staff performing the Farmer Mac examination follow the examination process established by OE and use the FCA Examination Manual as guidance for its examinations, where possible.

Prior Reports

In 2018, the Farm Credit Administration Office of Inspector General (OIG) issued an audit report, ***The Farm Credit Administration's Office of Secondary Market Oversight*** (A-17-03). The objective of the audit was to assess the staffing arrangements and reporting process for OSMO. The OIG made three recommendations to OSMO:

1. Revise OSMO Office Directive 3 to include the risks of specific conflicts of interest or bias from using examiners and other staff that also review, or provide services relating to, System associations and banks;
2. Require independence documentation from rotational staff to mitigate the risks of conflicts of interest or impartiality concerns; and
3. Create an office directive on the assessment process roles and responsibilities.

⁵ While Farmer Mac is a System institution, OE is not responsible for the oversight of Farmer Mac. OSMO is responsible for the regulation, examination, and general supervision of Farmer Mac.

The OIG also recommended the Office of the Chief Financial Officer:

4. Document the methodology and process used to calculate the Farmer Mac assessments to include: details on how the Agency arrives at direct, indirect, overhead, and blended rates; communicating quarterly reports showing charges against annual Farmer Mac assessments to the OSMO Director for review and confirmation; and a method to clearly separate the costs of shared OSMO employees also performing FCA work from the assessments to Farmer Mac.

Lastly, the OIG recommended the Office of the Board:

5. Document the reporting relationship between the OSMO Director and the FCA Board including delegations, supervisory relationships, and FCA Board oversight involvement of the OSMO Director.

All recommendations were closed by June 2018.

AUDIT RESULTS

The objective of this audit was to determine whether OSMO's examination policies and procedures are documented and implemented. The OIG found that OSMO had limited documented policies and procedures for the areas unique to Farmer Mac examination work. To reduce risk and increase consistency in the examination process, the OIG identified a need for OSMO to document policies and procedures to guide the areas unique to the Farmer Mac examination and to document departures from the FCA Examination Manual.

Despite a lack of formalized policies and procedures that uniquely apply to Farmer Mac examination work, the OIG found that OSMO generally implemented the processes tested during the audit. OSMO conducted the [REDACTED] of the 2020 Farmer Mac examination and examiners assigned to OSMO generally completed the conflict of interest forms. However, to improve the conflict of interest certification process, the OIG identified a need for OSMO to strengthen internal controls and expand written guidance.

Documentation of Examination Procedures

OSMO has limited documented examination policies and procedures that uniquely apply to Farmer Mac examination work. During the testing phase of this audit, OSMO had four internal directives which are noted in the chart below.⁶

⁶ OSMO updated Directives 1 and 3 in July 2021. Additionally, in July 2021, OSMO published two new directives: Directive 5, "Quality Assurance Program" and Directive 6, "Rotational Opportunities."

OSMO Directive 1, *Approval of Examination Scope and Activity Plans*, sets forth the parameters and responsibilities for approval of the planning that guides the annual examination and oversight of Farmer Mac.

OSMO Directive 2, *OSMO Enforcement Procedures*, sets forth the OSMO procedures on the FCA enforcement authorities for Farmer Mac, or its directors, officers, or employees.

OSMO Directive 3, *Ethics for FCA Staff*, sets forth the examiners' most significant specific authorities, responsibilities, and limitations found in the Farm Credit Act, the regulations, and the body of ethics laws and rules applicable to all executive branch employees.

OSMO Directive 4, *Farmer Mac Assessment Procedures* sets forth the OSMO procedures on the FCA financial assessment authorities for Farmer Mac.

During our audit we found that OSMO's directives focused on the approval and planning of the annual Farmer Mac examination, the completion of the conflict of interest questionnaire, and other various items. However, the directives did not contain guidance on conducting the examination of Farmer Mac. Over the course of this audit, OSMO began drafting and implementing written guidance for portions of its examination process. As an example, OSMO previously did not have a documented process for its quality assurance review. OSMO officials explained that OSMO relied on OE to conduct its quality assurance reviews. The officials explained that the newly hired Assistant to the OSMO Director will perform the quality assurance review beginning with the 2021 examination.⁷ OSMO published a directive outlining this new quality assurance process in July 2021.

According to OSMO officials, staff performing the Farmer Mac examination follow the examination process established by OE and use the FCA Examination Manual as guidance for Farmer Mac examinations, as applicable. The FCA Examination Manual contains procedures and guidance for examining System institutions. The Examination Manual cannot cover all potential examination areas, but aims to provide examiners a base of procedures, criteria, and guidance to promote examination quality and consistency. However, the FCA Examination Manual is maintained by OE and does not specifically address areas unique to Farmer Mac.

We identified the following two areas of concern when using the FCA Examination Manual for Farmer Mac examinations without further written OSMO guidance. First, there are sections in the Examination Manual containing steps or references not applicable to Farmer Mac, and second, the Examination Manual does not include examination procedures specific to OSMO.

⁷ The Assistant to the Director is also performing quality assurance reviews on interim examination activity letters associated with the 2021 Farmer Mac examination.

For example, the FCA Examination Manual references standards of conduct rules for System Institutions⁸ but does not reference the FCA Standards of Conduct regulations for Farmer Mac.⁹ Thus, examiners relying on the FCA Examination Manual to review Farmer Mac's compliance with Standards of Conduct regulations would be led to incorrect regulations.¹⁰ Because OSMO examiners are relying, in part, on the FCA Examination Manual to conduct the examination of Farmer Mac, there needs to be clear guidance on which areas of the manual do not apply to Farmer Mac.

Secondly, there are times when examiners are unable to follow the OE process because Farmer Mac's business model differs from System banks and associations. Specifically, certain aspects of Farmer Mac's [REDACTED] are unique. For such unique areas, OSMO needs to develop uniform, written policies and procedures. The following examples identify review areas unique to the OSMO examination process that are not addressed in the FCA Examination Manual.

- [REDACTED]
- [REDACTED]

These examples illustrate the concerns in relying on the FCA Examination Manual without documenting the differences for the Farmer Mac examination process. However, these examples are not all inclusive of the OSMO examination process. To ensure that the OSMO examination process is accurate and consistent, OSMO needs to document the following: (1) its reliance on the FCA Examination Manual, (2) those areas of the FCA Examination Manual not applicable to Farmer Mac, and (3) the OSMO examination steps not addressed in the FCA Examination Manual.

⁸ Examination Manual at § 31.1-13, "[Standards of Conduct] SOC Policy & Procedure."

⁹ The OIG reviewed the FCA regulations referenced in the FCA Examination Manual Section 31.1-13, "[Standards of Conduct] SOC Policy & Procedure," and determined that they do not apply to Farmer Mac.

¹⁰ The Farmer Mac Standards of Conduct regulations at 12 C.F.R. §§ 651.22-.24 are not referenced in the FCA Examination Manual.

[REDACTED]

Contributing Factors and Significance

There are several contributing factors to the areas for improvement relating to OSMO's examination policies and procedures that uniquely apply to Farmer Mac examination work. OSMO relies on the experience of examiners understanding the examination process. An OSMO official explained that the examiners who rotate to OSMO are high-performing, seasoned examiners. OSMO focuses its rotational examiner training on how the System uses Farmer Mac products, the responsibilities of OSMO, and the similarities between OSMO supervision of Farmer Mac and OE's supervision of other System institutions. The training materials we reviewed did not highlight the differences between the OE examination process and the OSMO examination process. However, an OSMO official stated that by explaining Farmer Mac's unique operations in the training, the examiners understand how the examination process needs to be different for Farmer Mac.

While we are not questioning the performance of the seasoned examiners used by OSMO, documenting the examination process is an important control for an office with such a crucial mission. OSMO risks issues with inaccuracy and inconsistency by not having a fully documented examination process. These risks are made even greater by the fact that OSMO largely relies on a rotational staff of examiners to conduct the Farmer Mac annual examination. Overall, these risks can potentially affect the quality and reliability of the examination process in OSMO from year to year.

Another factor to consider is OSMO's small size. With a permanent staff of only five full-time employees, OSMO may lack the resources to complete and maintain a separate Examination Manual.

Over the course of this audit, OSMO began drafting and implementing written guidance for portions of its examination process. Specifically, in July 2021, OSMO published two new directives and revisions to two existing directives. Directive 5 outlines OSMO's quality assurance program while Directive 6 outlines OSMO's policy on rotational employees. Revisions to Directive 1 expand the previous version by setting forth the operating procedures that guide the annual examination of Farmer Mac. Additionally, revisions to Directive 3 expand on the conflict of interest process. Finally, in an effort to standardize practices amongst examination teams, OSMO recently developed and began using templates for its examination activities.

Recommendations 1-2

To reduce risk and increase consistency in its examination of Farmer Mac, the OIG makes the following recommendations:

1. The Office of Inspector General recommends the Office of Secondary Market Oversight document those parts of the Farm Credit Administration Examination Manual that do not apply to the examination of the Federal Agricultural Mortgage Corporation.

2. The Office of Inspector General recommends the Office of Secondary Market Oversight document examination policies and procedures unique to the examination of the Federal Agricultural Mortgage Corporation.

FCA Response

The Agency agreed with recommendations 1 and 2. The Director of OSMO stated a detailed reference document will be created for examination staff that will include regulations that are applicable to Farmer Mac. Additionally, OSMO created a Farmer Mac Supplemental Examination Guidance and Procedures Development Plan, which establishes expectations and timelines for creating Farmer Mac examination guidance.

OIG Response

The OIG finds the actions responsive to our recommendations. OSMO's response can be found in the Management Comments section of this report.

Implementation of Examination Procedures

While the OIG found that OSMO had limited documented policies and procedures, our review of certain unique examination activities found that OSMO generally implemented its examination processes. Specifically, OSMO conducted the unique [REDACTED] of the 2020 Farmer Mac examination despite a lack of formal policies and procedures for such reviews. Additionally, examiners assigned to the Farmer Mac examination generally completed the conflict of interest forms required by OSMO Directive 3. However, we found opportunities to improve the conflict of interest certification process by strengthening internal controls and expanding written guidance.

Testing of [REDACTED]

Although OSMO did not have formal policies and procedures for the loan review process, the OIG reviewed selected OSMO workpapers and determined that examiners completed the aspects of the [REDACTED] unique to Farmer Mac.

OSMO assigned an asset team lead for the annual examination who was responsible for providing guidance for the loan review. An OSMO official explained that for the 2020 examination, the asset lead had a pre-examination team meeting with the examiners conducting the loan review during which they conducted a walk-through of the loan review workpaper. This walk-through was important because examiners normally conduct a loan review using a standard workpaper, whereas in OSMO, there is no standard workpaper. Additionally, for the 2020 examination, the asset lead developed and provided examiners with detailed, written guidance for conducting the loan review.

The guidance explains that the objective of the loan review is [REDACTED]

[REDACTED] The guidance provides examiners with details on how to access the information and the criteria used during the examination. Additionally, the guidance describes the loan sample

(including how to access the sample) and provides an overview of the [REDACTED]. [REDACTED] However, this guidance came directly from the asset lead and was not part of OSMO formal policies and procedures. Additionally, because asset leads frequently change for the examination, there is no assurance that subsequent asset leads will provide the same guidance.

The OIG reviewed the [REDACTED] of the 2020 examination and the corresponding workpapers in order to test whether OSMO implemented the guidance. [REDACTED]

- [REDACTED] The OIG reviewed OSMO's internal working papers and found the analysis that supported this observation.
- [REDACTED] The OIG reviewed OSMO's internal working papers and found the analysis that supported the observations [REDACTED]

[REDACTED] The OIG reviewed OSMO's internal working papers and found the analysis that supported this observation.

Testing of Conflict of Interest Forms

The OIG also tested OSMO's implementation of its policies and procedures related to the examiner conflict of interest certification process. We found that OSMO implemented a process to maintain documentation supporting the questionnaire's completion by examination staff. However, we identified opportunities to improve the conflict of interest process by strengthening internal controls and expanding written guidance.

As a result of the 2018 OIG audit, OSMO revised Directive 3, *Ethics for FCA Staff*, and developed a conflict of interest questionnaire for examination staff. OSMO Directive 3 requires individuals working on rotational assignments and FCA examiners assigned to the annual Farmer Mac examination to annually sign OSMO's Conflict of Interest Questionnaire.¹³ OSMO established an internal site for the completed forms for the years we reviewed (2019, 2020, and 2021 to date).

To determine whether individuals working on rotational assignments and FCA examiners assigned to the Farmer Mac examination signed OSMO's conflict of interest form, the OIG compared the

[REDACTED]
¹³ Full-time OSMO employees are not required to complete the conflict of interest form because they do not have involvement with System banks or associations.

Farmer Mac examination participation list for the 2019, 2020, and 2021 examinations with the conflict of interest forms retained by OSMO. The OIG found that:

- For 2019, 4 out of 23 individuals did not complete a conflict of interest form.
- For 2020, 4 out of 23 individuals did not complete a conflict of interest form.
- For 2021, 8¹⁴ out of 17 individuals did not complete a conflict of interest form. According to Directive 3, these individuals are required to annually complete the form and thus have until December 31, 2021 to meet the annual requirement. However, completing the form after performing Farmer Mac examination work defeats the purpose of the form, which is to identify (and consequently eliminate or mitigate) any conflicts of interest an examiner may have as a result of their examination work with System banks and associations.¹⁵

Based on our testing, the controls over the process for completing and verifying the forms could be improved. While OSMO established an internal site for storing the forms, there were insufficient controls to ensure that examiners were completing the form as required. In addition, there were inconsistencies in the timing of completing the form, which as noted above, undermines the purpose of the form.

Contributing Factor and Significance

The contributing factor to the noted weaknesses is that OSMO guidance is mostly silent on the process for completing and approving the conflict of interest form. According to Directive 3, the Associate Director for Examination and Supervision will work with the Examiner-in-Charge and Assistant Examiner-in-Charge as needed to obtain the signatures on the form and the form will be filed on an internal drive for verification purposes. However, the directive does not describe the process for completing the conflict of interest form or outline any internal controls to ensure when and if examiners have completed the form.

Examiners should complete the conflict of interest form before engaging in work for OSMO to certify that they can and will remain impartial when engaging in OSMO matters. Additionally, specifying when examiners should complete the form will help OSMO management ensure examiners complete the form as required.

As a result of this audit, OSMO changed Directive 3 to include specific information on how and when examiners must complete the conflict of interest form. The update expands the requirement for completing a conflict of interest form to include non-examiner employees assigned to Farmer Mac examination activities. The update states that each examination participant must complete the form before commencing any examination work and that, at least semi-annually, the Associate

¹⁴ During the audit, OSMO provided additional documentation that showed 3 of the 8 individuals had not yet started performing Farmer Mac examination work even though they were on the 2021 examination participation list.

¹⁵ Section 8.11(f)(2) of the Farm Credit Act provides that the FCA Board shall ensure that "the supervision of the powers, functions, and duties, of the Corporation [Farmer Mac] is performed, to the extent practicable, by personnel who are not responsible for the supervision of the banks and associations of the Farm Credit System."

Director for Examination and Supervision will verify that examiners have completed the conflict of interest form in compliance with the directive.

Recommendations 3-4

To improve the conflict of interest certification process, the OIG makes the following recommendations:

3. The Office of Inspector General recommends the Office of Secondary Market Oversight expand the conflict of interest guidance in Directive 3 to require examiners to complete the conflict of interest form before engaging in examination activities.
4. The Office of Inspector General recommends the Office of Secondary Market Oversight develop internal controls to ensure examiners complete the conflict of interest form according to guidance.

FCA Response

The Agency agreed with recommendations 3 and 4. The Director of OSMO stated that OSMO revised Directive 3 to require each examination participant complete the conflict of interest form before commencing examination work. Additionally, Directive 3 now requires that the Associate Director for Examination and Supervision verify that questionnaire forms are completed.

OIG Response

The OIG finds the actions responsive to our recommendations. Due to the corrective actions implemented over the course of our audit, we consider recommendations 3 and 4 closed.

OSMO's responses to the recommendations can be found in the Management Comments section of this report. The OIG held an exit conference with OSMO personnel on September 10, 2021.

MANAGEMENT COMMENTS

Memorandum

Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
(703) 883-4000



September 20, 2021

To: Sonya Cerne, Assistant Inspector General for Audits, Inspections, and Evaluations

From: Laurie Rea, Director of the Office of Secondary Market Oversight

Subject: Office of Secondary Market Oversight's Response to OIG's draft audit report titled *Audit of the Office of Secondary Market Oversight's Examination Policies and Procedures*

This memorandum responds to the draft audit report from the Office of the Inspector General (OIG), dated August 31, 2021, titled *Audit of the Office of Secondary Market Oversight's (OSMO) Examination Policies and Procedures*. The stated objective of the audit was to determine whether OSMO's examination policies and procedures are documented and implemented.

The draft audit report includes four recommendations to improve OSMO's examination policies and procedures. OSMO agrees with OIG's recommendations, and our plans and actions to address each recommendation are detailed below.

Recommendation #1: The Office of Inspector General recommends the Office of Secondary Market Oversight document those parts of the FCA Examination Manual that do not apply to the Farmer Mac examination.

OSMO Response: OSMO agrees to implement this recommendation. Following the communication of this recommendation, we began to document those parts of the FCA Examination Manual that do not apply to the Farmer Mac examination. We plan to accomplish this by creating a detailed reference document for examination staff to utilize while participating in the Farmer Mac examination; this document will include regulations that are applicable to Farmer Mac for examiner reference.

Recommendation #2: The Office of Inspector General recommends the Office of Secondary Market Oversight document examination policies and procedures unique to the Farmer Mac examination.

OSMO Response: OSMO agrees to implement this recommendation. The FCA Examination Manual directs staff to apply examiner judgment and discretion when performing procedures, regardless of the institution. Accordingly, OSMO utilizes highly trained examiners and other FCA staff with specialized skill sets to complete examination work on

Farmer Mac, and they are familiar with the need to tailor examination procedures to each individual institution. However, there are situations where the Farmer Mac examination is unique and supplemental guidance is warranted. We have created a Farmer Mac Supplemental Examination Guidance and Procedures Development Plan, which establishes expectations and timelines for creating guidance. Subsequent to the development and implementation of guidance for the critical areas we identified, we will continue maintenance and development of supplemental procedures going forward.

Recommendation #3: The Office of Inspector General recommends the Office of Secondary Market Oversight expand the conflict of interest guidance in OS MO Directive 3 to require examiners complete the conflict of interest form before engaging in OS MO examination activities.

OS MO Response: OS MO implemented this recommendation by finalizing updates to OS MO Directive 3: Ethics for Staff on July 21, 2021. The directive was revised to include the following: "The form must be completed by each examination participant prior to commencing any examination work."

Recommendation #4: The Office of the Inspector General recommends the Office of Secondary Market Oversight develop internal controls to ensure examiners complete the conflict of interest form according to OS MO guidance.

OS MO Response: OS MO implemented this recommendation by expanding OS MO Directive 3: Ethics for Staff to establish internal controls to ensure examiners complete the conflict of interest form according to OS MO guidance. The revised directive states that the examiner-in-charge and assistant examiner-in-charge should follow up with all examination participants to ensure they complete the form before beginning their examination assignments. Also, at least semi-annually, the Associate Director for Examination and Supervision will verify that questionnaire forms are completed in compliance with this directive.

Thank you for the opportunity to respond to the OIG's findings and recommendations related to OS MO's examination policies and procedures.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this audit was to determine whether OSMO's examination policies and procedures are documented and implemented. We remotely performed this audit from February 2021 through September 2021. The scope of this audit was limited to OSMO's policies and procedures for conducting examinations.

We performed the following steps to accomplish the audit objective:

- Identified and reviewed related laws, regulations, and Agency policies and procedures related to Farmer Mac;
- Evaluated prior reviews and corrective actions;
- Interviewed OSMO leadership, staff, and selected examiners from the current and previous examination teams;
- Identified significant internal control processes and determined if they are operating effectively and efficiently;
- Reviewed and analyzed materials from the 2021 OSMO training for rotational examiners;
- Retrieved conflict of interest forms from OSMO's internal drive and compared the forms with a list of examination team members for the 2019, 2020, and 2021 examinations;
- Tested a judgmental sample of findings in the 2020 Report of Examination to determine whether OSMO implemented examination steps. The sample was based on criteria unique to Farmer Mac and limited to [REDACTED] of the 2020 examination. We reviewed selected OSMO workpapers to determine if examiners completed the [REDACTED] unique to Farmer Mac. However, we limited our testing to verifying the completion of work in this area and did not verify examination results. Accordingly, we did not make an independent determination on the examination findings or conclusions. Because this sample was judgmental, it cannot be projected to the population;
- Reviewed OSMO draft directives and templates; and
- Assessed fraud risks relevant to the objective.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit

objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We reviewed internal controls identified as significant to the audit objective and did not identify any material control weaknesses. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We also assessed the data relevant to our audit objective and determined that the data was sufficiently reliable.

We considered the risk of fraud and abuse during our audit and nothing came to our attention to indicate fraud or abuse was occurring.



Farm Credit Administration
Office of Inspector General

REPORT FRAUD, WASTE, ABUSE, & MISMANAGEMENT:

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