

**OFFICE OF
INSPECTOR GENERAL**

Audit Report

**Farm Credit Administration's
Special Supervision and
Enforcement Processes
A-15-01**

Auditor-in-Charge
Sonya Cerne

Issued March 31, 2015



FARM CREDIT ADMINISTRATION



March 31, 2015

The Honorable Kenneth A. Spearman, Board Chairman
The Honorable Dallas P. Tonsager, Board Member
The Honorable Jeffrey S. Hall, Board Member
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Board Chairman Spearman and FCA Board Members Tonsager and Hall:

The Office of Inspector General (OIG) completed an audit of the FCA's Special Supervision and Enforcement Processes. The objective of this audit was to determine whether FCA is following the special supervision and enforcement processes and monitoring institution compliance effectively.

During our audit, we found that FCA is generally following the processes and monitoring compliance. Preliminary decisions, formal decisions made through the Regulatory Enforcement Committee, and recommendations to the Board are clearly documented. Justifications to initiate actions are in supporting documentation, and FCA documents the special supervision and enforcement processes. We also found that the Watch List is effective, identification and escalation of concerns were appropriate, complexity and length of actions are correlated, and persistent involvement and communication leads to corrective action.

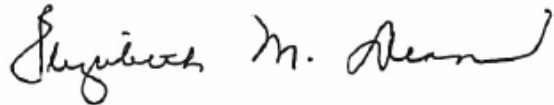
We would like to highlight the responsive actions the Office of Examination (OE) plans to take to address opportunities to improve or modify the processes identified during the audit. OE agreed to the following actions:

1. Develop a training program for special supervision and enforcement actions to ensure the organization has the knowledge to react to the changing FCS environment.
2. Emphasize the requirement of FCA Regulation 612, Subpart B, and provide training and/or education to examiners on the role and responsibility FCA has regarding the criminal referral form and to ensure institutions are filing the form as required.

3. Address the use of informal ratings and other supervisory letters by either expanding or changing current directives and/or processes to include when they are appropriate and how they will be used.

We appreciate the courtesies and professionalism extended to OIG staff by FCA personnel. If you have any questions about this audit, I would be pleased to meet with you at your convenience.

Respectfully,

A handwritten signature in black ink that reads "Elizabeth M. Dean". The signature is written in a cursive style with a large initial "E" and a long, sweeping underline.

Elizabeth M. Dean
Inspector General

Enclosure



EXECUTIVE SUMMARY

A-15-01

OBJECTIVE:

To determine whether FCA is following the special supervision and enforcement processes and monitoring institution compliance effectively.

BACKGROUND:

The mission of the FCA is to promote a safe, sound and dependable source of credit for agriculture and rural America. FCA is responsible for regulating and examining the FCS and the Federal Agricultural Mortgage Corporation, the nation's two agricultural Government sponsored enterprises. FCA's Office of Examination (OE) conducts examinations of FCS banks and associations. If examiners identify concerns with institutions through examination activities, they may refer the institution to OE's Risk Supervision Division (RSD) for possible supervision or enforcement actions. The Farm Credit Act of 1971, as amended, provides the FCA with statutory enforcement authorities. In general, there are three levels of supervision used by FCA for FCS institutions: normal supervision, special supervision, and enforcement. Each level provides increased monitoring and involvement with the institution.

AUDIT OF THE FARM CREDIT ADMINISTRATION'S SPECIAL SUPERVISION AND ENFORCEMENT PROCESSES

The Farm Credit Administration (FCA) regulates and supervises Farm Credit System (FCS or System) institutions. When weaknesses or problems arise or correction is necessary, FCA has a proactive supervisory process to address issues of concern. These processes have developed through time and experience and have most often returned problem institutions to healthy conditions.

We found preliminary decisions, formal decisions made through the Regulatory Enforcement Committee, and recommendations to the FCA Board are clearly documented. Justification to initiate the special supervision and enforcement actions are in Reports of Examination, memoranda, and communications with the institutions. FCA also documents the special supervision and enforcement processes through: FCA Board policies, policies and directives, sections of the Examination Manual, and RSD procedures.

During the audit, we found:

- the Watch List is effective;
- identification and escalation of concerns were appropriate;
- complexity and length of actions are correlated; and,
- persistent involvement and communication leads to corrective action.

We also identified a few opportunities to improve or modify the processes through:

- increasing staff readiness;
- ensuring institutions adhere to the criminal referral process requirements; and,
- expanding or changing current directives and/or processes.

There are three agreed-upon actions to improve the oversight of special supervision and enforcement actions.

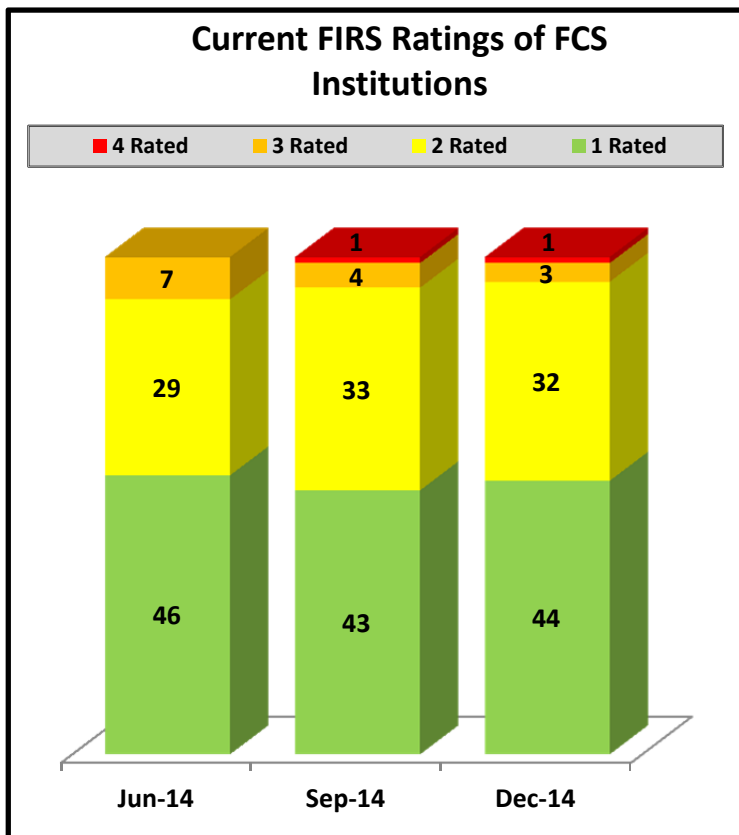
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BACKGROUND

The Farm Credit Administration (FCA or Agency) is an independent agency in the Executive Branch of the U.S. Government. The mission of the FCA is to promote a safe, sound and dependable source of credit for agriculture and rural America. FCA is responsible for regulating and examining the Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (commonly referred to as Farmer Mac), the nation's two agricultural Government-sponsored enterprises. FCA's Office of Examination (OE) conducts examinations of FCS banks and associations to ensure their safety, soundness, and compliance with laws and regulations. Sections 5.25 through 5.38 (12 U.S.C. § 2261-2274) of the Farm Credit Act of 1971, as amended, provides the FCA with statutory enforcement authorities to take action for unsafe, unsound practices or for violations of law, rule or regulation.

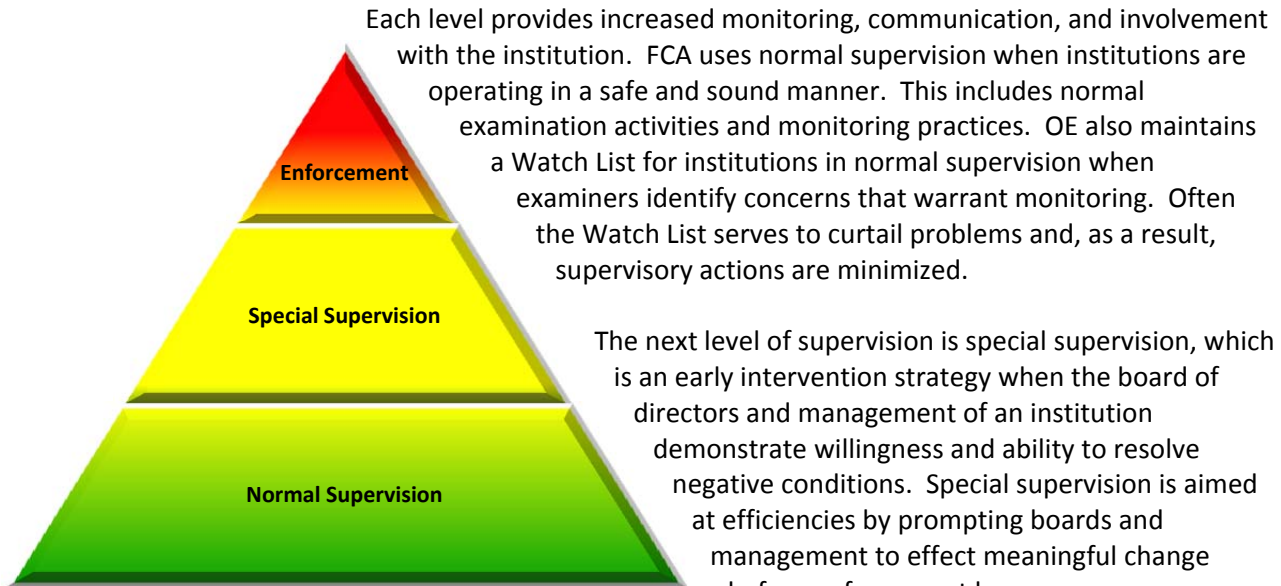
FCA examiners utilize the Financial Institution Rating System (FIRS) to rate, evaluate, and categorize FCS institutions. Under FIRS, each institution receives a composite rating and six component ratings based on Capital, Assets, Management, Earnings, Liquidity, and Sensitivity, collectively known as CAMELS. The ratings range from 1 to 5 for each component and the composite, with a 1 indicating strong performance and a 5 indicating poor performance. Examiners rate institutions each quarter or any time there is a material change. FCA discloses the ratings to the institution through a letter to the board chairman and chief executive officer annually and whenever a composite or component rating is changed. Currently, about 95 percent of institutions have a composite rating of 1 or 2. The chart to the right shows the number of institutions rated 1-4 for the June 2014, September 2014, and December 2014 periods, according to OE. There are currently no 5 rated institutions and one 4 rated institution.



If examiners identify concerns with institutions through examination activities, they may refer the institution to OE's Risk Supervision Division (RSD) for possible special supervision or enforcement actions. RSD is responsible for managing and administering special supervision and enforcement processes. RSD assigns an enforcement examiner to each institution under special supervision and/or enforcement action. RSD coordinates with the OE examination division to determine if recommended actions are needed, and they work in tandem throughout the process. When an enforcement action is contemplated, an attorney from the Office of General Counsel is also assigned to the action.

Supervision Levels

When there are indicators of potential problems or weaknesses within an institution, OE uses proactive measures as an alert and to increase monitoring in a tiered approach. In general, there are three levels of supervision of FCS institutions by FCA: normal supervision, special supervision, and enforcement.



Each level provides increased monitoring, communication, and involvement with the institution. FCA uses normal supervision when institutions are operating in a safe and sound manner. This includes normal examination activities and monitoring practices. OE also maintains a Watch List for institutions in normal supervision when examiners identify concerns that warrant monitoring. Often the Watch List serves to curtail problems and, as a result, supervisory actions are minimized.

The next level of supervision is special supervision, which is an early intervention strategy when the board of directors and management of an institution demonstrate willingness and ability to resolve negative conditions. Special supervision is aimed at efficiencies by prompting boards and management to effect meaningful change before enforcement becomes necessary.

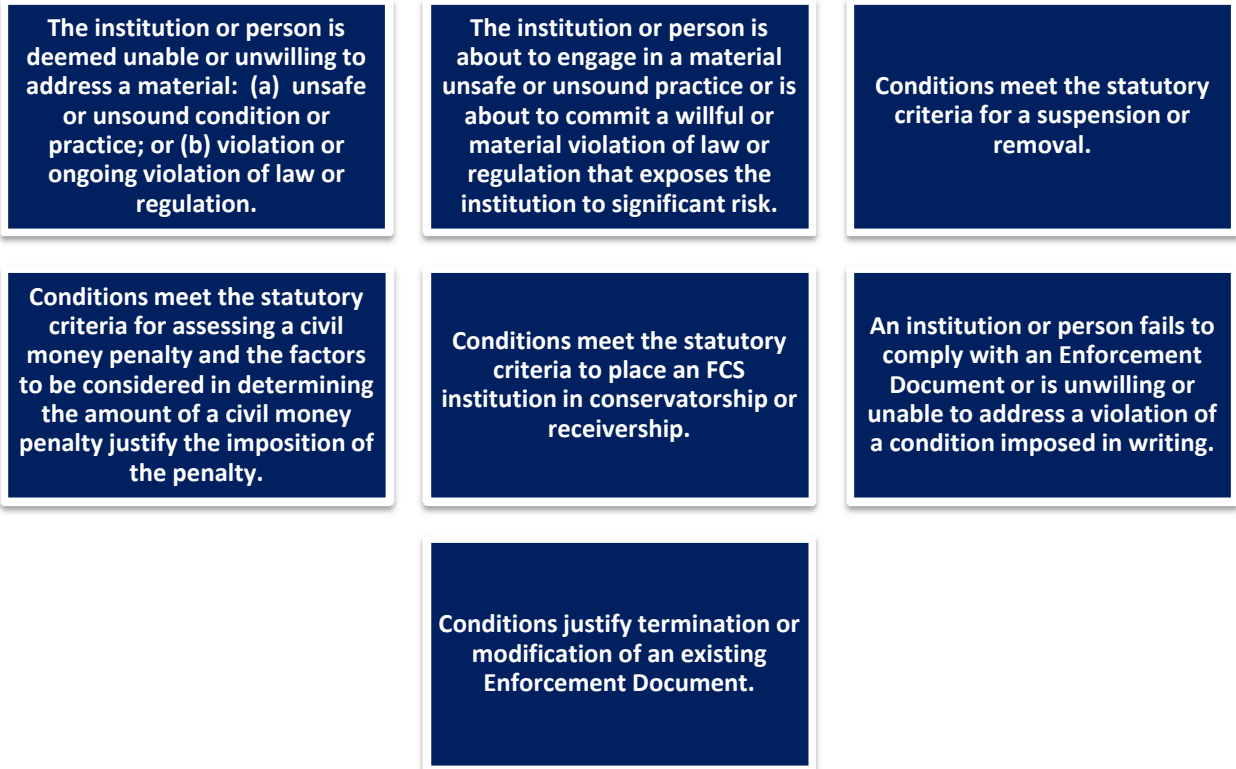
With special supervision, FCA increases monitoring through the development of institution-specific supervisory strategies documented in a supervisory letter. Although FCA can use statutory enforcement actions, OE utilizes special supervision as an additional approach to get the desired improvement without formal enforcement.

If an institution has severe financial, asset quality, management, or governance weaknesses, FCA may utilize the highest level of supervision, enforcement. This level of supervision can include a variety of formal actions. Specifically, the Farm Credit Act of 1971, as amended, promulgated the enforcement powers including: cease and desist orders, suspension and/or removal of directors and officers, and civil money penalties. When faced with the potential of a formal enforcement action, most often, an institution agrees to enter into a written agreement with the FCA to address and correct weaknesses to avoid the formal cease and desist process or other actions. The written agreement identifies specific articles detailing actions to induce corrective measures by the institution's board and management. There are also instances when an institution may begin in special supervision and FCA elevates the supervision level to a formal enforcement action. FCA may also elect to have both supervisory letter(s) and enforcement actions working simultaneously.

Conditions Warranting Actions

OE Directives state that, as a general practice, special supervision is appropriate for any institution with a 3 or above in composite or component ratings. Special supervision may also be warranted in cases where the institution receives a 2 rating if conditions are deteriorating or if a specific issue needs attention. If an institution receives a composite rating of 4 or 5, a referral must be made to the Regulatory Enforcement Committee (REC) for consideration of action. The REC is a group of designated individuals that considers, votes, and recommends the use of enforcement actions to the FCA Board and consults on other actions, as needed.

The FCA Board designated the Chief Operating Officer as the REC Chair. Other REC members include Office Directors of OE, Office of General Counsel, and Office of Regulatory Policy. A representative from the Farm Credit System Insurance Corporation is also invited to participate in REC activities as a non-voting member. The REC recommends actions to the FCA Board, which in turn, votes on whether to initiate actions. The following shows instances in which a referral to the REC must be made according to FCA's Board Policy Statement 79:



Prior OIG Reviews

The OIG conducted an inspection, *Farm Credit Administration's Enforcement Program (I-06-01)*, to assess the readiness of the FCA to take enforcement actions. The inspection results were:

- readiness and training needed improvement
- the FCA Board's involvement in the enforcement process needed to be established in policy guidance and thresholds

The OIG made six recommendations to improve enforcement action readiness. The actions were taken.

The OIG also conducted an audit, *FCA's Use of Enforcement Actions (A-97-03)*, to evaluate FCA's use of enforcement actions in obtaining corrective actions in FCS institutions and to document and evaluate FCA's organizational structure and process as it pertained to achieving enforcement objectives. The findings were the enforcement actions had generally been effective, but opportunities existed to enhance timeliness and efficiency of enforcement actions. The OIG made three recommendations to improve the enforcement process, and the actions were taken.

AUDIT RESULTS

The objective of this audit was to determine whether the FCA is following the special supervision and enforcement processes and monitoring institution compliance effectively. Overall, the FCA is generally following the processes and monitoring compliance. We found preliminary decisions, formal decisions made through the Regulatory Enforcement Committee, and recommendations to the FCA Board are clearly documented. Justification to initiate the enforcement and special supervision actions are in Reports of Examination, memoranda, and communications with the institutions. FCA documents the special supervision and enforcement processes through FCA Board policies, policies and directives, sections of the Examination Manual, and RSD procedures as noted below:

FCA Board Policies

- Policy Statement 34-Disclosure of the Issuance and Termination of Enforcement Documents
- Policy Statement 53-Examination Philosophy
- Policy Statement 79-Consideration and Referral of Supervisory Strategies and Enforcement Actions

Policies and Directives

- Policies and Procedures Manual 504-Enforcement Actions
- OE Directive 35-Special Supervision
- OE Directive 36-Enforcement Action

Examination Manual

- Section 1.4 Supervision and Enforcement
- Section 1.5 FCA Criminal Referral Form and Instructions

RSD Procedures

- Enforcement Actions
- Civil Money Penalties
- Supervisory Filing System
- Supervision-Related Reporting
- Supervisory Document Processing

During the audit, we found:

- the Watch List is effective;
- identification and escalation of concerns were appropriate;
- complexity and length of actions are correlated; and,
- persistent involvement and communication leads to corrective action.

We also identified a few opportunities to improve or modify the processes through:

- increasing staff readiness;
- ensuring institutions adhere to the criminal referral process requirements; and,
- expanding or changing directives and/or processes.

Watch List Effectiveness

The Watch List is effective. Within the three levels of supervision, OE uses various forms of review to monitor the FCS. One of those mechanisms is the OE Watch List, which tracks emerging issues within the System. If a concern arises with an institution, the examination division coordinates with RSD to place the institution on the Watch List. We reviewed OE's monthly Watch List to determine effectiveness. We analyzed the reasons why institutions were placed on the list, how long they remained, and whether the institutions were subsequently moved to special supervision or enforcement.

While there are other factors to consider, utilizing the Watch List allows OE to heighten awareness while reviewing and gathering information on potential concerns and emerging threats. It also increases efficiency by curtailing the need for supervisory or enforcement actions and providing ongoing coordination and communication between examination divisions and RSD.

In one case, an institution notified OE of potentially fraudulent transactions at the institution. The institution uncovered suspicious activity, but officials were unsure about the depth and impact of the activities. OE immediately placed the institution on the Watch List while the institution and the Agency gathered important information. This allowed FCA to discover the extent of the issues and determine a productive path for correcting issues identified. The institution was on the Watch List for two months before OE increased the level of supervision.

Another example of how the Watch List creates efficiency involved an allegation received, regarding a potential improper sale of property to an association employee's relative. OE placed the association on the Watch List and conducted onsite work, which included an investigation into the accuracy of the allegation. Subsequently, the examiners concluded there was no violation. However, the Watch List allowed OE to track the emerging issue and potential concern without initiating further action.

Developing supervisory actions takes time, precise directions, and the involvement of many staff. Only one of the eleven institutions reviewed moved from the Watch List, out of normal supervision into special supervision. In addition, institutions tend to be on the Watch List for a short amount of time. Nine of the eleven institutions reviewed were on the Watch List for ten months or less. While these institutions required heightened awareness, most issues were resolved without the need for intensive special supervision and enforcement actions.

The Watch List also increases communication. The examination division and RSD coordinate at least once a month. This communication allows RSD to prepare for future, emerging issues and to be involved from the beginning in instances of potential unsafe and unsound practices or weaknesses.

Identification and Escalation of Concerns

From the 11 institutions under special supervision and enforcement actions we reviewed, concerns were identified early and increased supervisory measures occurred when needed. We also found the majority of the institutions under special supervision and enforcement actions had management and asset quality concerns. We selected institutions that had special supervision or enforcement actions in process or terminated throughout Fiscal Year (FY) 2014. In total, there were eight institutions under enforcement and three under special supervision that met this criteria.

For each institution, we reviewed the agreements and/or letters documenting the actions and the memoranda documenting the reasons for the actions. We also reviewed the historical FIRS ratings and examination reports for the institutions and each action, including both special supervision and enforcement, initiated and terminated on the institution. During this audit, we identified the following:

- Concerns were identified early. In reviewing the FIRS ratings, 9 of the 11 institutions had a composite rating of 3 when the first action was taken and the remaining two institutions were rated a 2. No institution’s rating had lowered to a 4 or 5 before supervisory initiation.
- Increased supervisory measures occurred when needed. Of the eight institutions under enforcement, six had previously been under special supervision status. When conditions deteriorated or concerns were not addressed properly, OE moved the institutions to formal enforcement status.
- The majority of the institutions under special supervision and enforcement actions had management and asset quality concerns¹. Specifically, 10 of the 11 institutions had management issues and 9 of the 11 had asset quality concerns that were specifically identified as factors needing FCA action. Other themes of concern were earnings, standards of conduct, and credit administration, as noted below:

Institutions under Special Supervision and Enforcement Actions					
	Number of Institutions with the Areas of Concern				
Action Categories	Management	Asset Quality	Earnings	Standards of Conduct	Credit Administration
Special Supervision and Enforcement	6	5	2	1	1
Enforcement Only	2	1	0	1	1
Special Supervision Only	2	3	2	0	1

¹ The list identifies major themes of issues affecting the institutions. This list is not all-inclusive of every issue found at the institutions.

Complexity Correlates with the Length of Time Under Special Supervision and Enforcement Actions

In reviewing special supervision and enforcement actions, we found that complexity of the underlying issues played a pivotal role in the amount of time an institution is under enforcement. Many of the institutions under enforcement action, with problems needing correction, received multiple supervisory letters and multiple iterations of written agreements. For example, one institution received five different supervisory letters and had a written agreement with FCA. Another institution received three supervisory letters and two different iterations of written agreements, with the second agreement focusing more on management of the institution.

Complex agreements involve more time and staff allocations. The following chart shows eight institutions (within this audit scope) under written agreements and the length of time these institutions were under action, with three currently ongoing:

Institutions under Written Agreements				
Institution	Length of Time Under Written Agreement*	Number of Supervisory Letters	Number of Written Agreements	Total Actions
1	60 months	3	2	5
2	23 months	1	1	2
3	19 months	2	1	3
4	27 months	3	1	4
5	50 months	1	2	3
6	34 months	1	1	2
7	53 months	1	2	3
8	46 months	5	1	6

* Calculations were as of January 2015.

These institutions ranged from one and a half to five years under enforcement with an average of 39 months. Three of the institutions remained in enforcement status for over four years; however, each of those institutions had at least two written agreements and one supervisory letter. Six of the eight institutions had three or more actions.

This average can be used internally in evaluating future resource needs. FCA can also use this average externally when communicating with institutions on typical lengths of time an institution may take to recover from downturns or operating in an unsafe and unsound manner. The chart also shows the work completed in 2014. FCA terminated agreements with two of the three institutions exceeding the four-year period and three additional agreements during 2014.

Length of time under an agreement is also important because it is a performance measure for the Agency. The measure is tied to the percentage of requirements in supervisory agreements with which FCS institutions have at least substantially complied within 18 months of execution of the agreements:

Performance Measure	FY 2014 Target	FY 2014 Result	FY 2015-2016 Target
Percentage of requirements in supervisory agreements with which FCS institutions have at least substantially complied within 18 months of execution of the agreements.	≥ 80%	91%	≥ 80%

Persistent Involvement and Communication with Institutions

OE worked persistently to address institutions’ issues and design strategies to correct problems and conditions. As an example, FCA identified significant problems at one institution. The Agency and institution entered into a written agreement. About seven months later, FCA issued a supervisory letter due to the institution’s partial noncompliance with the written agreement and continued deterioration. Another written agreement was entered into about nine months later. FCA terminated the agreement, with the institution now operating under normal supervision.



The consistent and firm approach coupled with monitoring guided this institution back to compliance. Although the FIRS ratings show improvement was not immediate, the institution showed a positive trend. Based on our review, this is a consistent result of persistence and communication.

Year	FIRS Ratings
Year 1	3/3/3/4/3/3/2
Year 2	4/4/4/4/4/4/3
Year 3	3/3/3/3/3/3/2
Year 4	3/3/3/3/2/2/2
Year 5	2/2/3/2/2/2/2
Year 6	2/2/3/2/2/2/2

Further, of the 11 institutions reviewed, seven had current composite FIRS Ratings that improved from the composite rating at the time of the first action. One institution began with a 2 rating, declined to a 3, but returned to a 2 with corrective action.

Composite FIRS Ratings for Institutions under Special Supervision and Enforcement		
Composite FIRS Rating at time of Special Supervision	Composite FIRS Rating at time of Enforcement	Current Composite FIRS Rating
3	4	3
N/A	3	2
2	3	3
3	3	2
N/A	3	2
3	3	2
2	3	2
3	3	3
3	N/A	2
3	N/A	2
3	N/A	2

OIG regularly conducts a survey of FCS institutions regarding the quality and consistency of the Agency’s examination function and the examiners performing the main mission functions. This survey collects and publishes the results without attribution. In a recent OIG survey of FCS institutions, one response answered affirmatively that the institution was recently released from a written agreement. The institution comments were, “FCA staff were very considerate and friendly, but firm.” The response further stated that the institution “appreciates their assistance and acknowledges their contribution to our present level of expertise.”

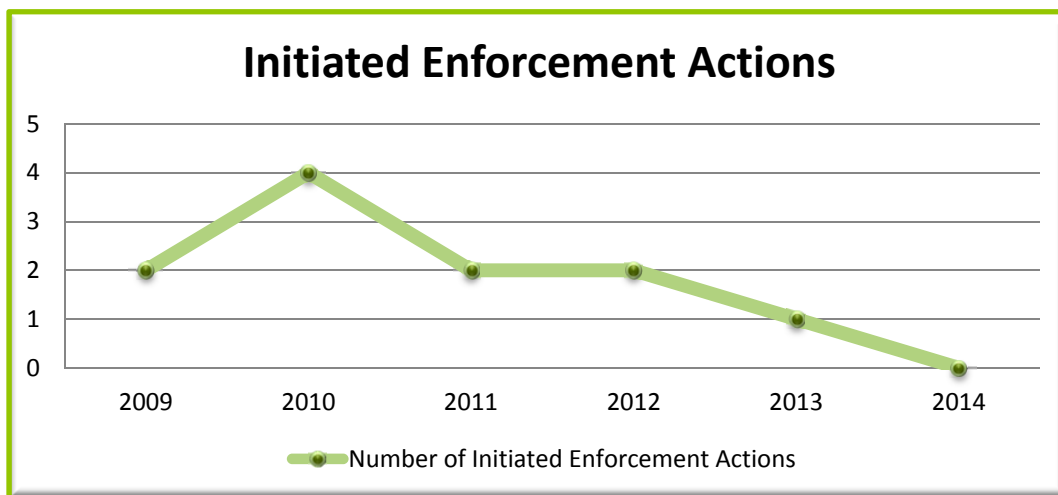
Improvements to the Special Supervision and Enforcement Processes

The audit also revealed improvements or modifications could also be made to the special supervision and enforcement processes. Areas that could be improved include:

- staff readiness,
- the criminal referral process, and
- special supervision and enforcement directives and processes.

Staff Readiness

Given the ever-changing FCS environment, staff readiness for special supervision and enforcement actions could be improved. The special supervision and enforcement environment has changed over the last two years. The number of enforcement and special supervision matters has declined. In 2014, FCA terminated 10 actions². In 2013, FCA terminated four supervisory letters; two of those resulting in increased supervision by undertaking enforcement action. The initiation of formal enforcement actions (written agreements), has also trended downward since 2012, with no new written agreements in 2014, as shown below:



RSD currently has five assigned staff with two staff members also performing additional duties outside of RSD. Three of the five assigned members of RSD are retirement eligible or near retirement eligible. While the enforcement and supervision processes are well documented, OE currently does not have a dedicated training program for enforcement examiners. Based on interviews with RSD staff, additional expertise in RSD work is acquired from experienced enforcement examiners and on-the-job training. Because of this, it is essential that RSD and OE capture the knowledge of those experienced examiners.

There are also ongoing discussions about how to best utilize RSD examiners during times of decreased special supervision and enforcement activity. It is not possible to predict needs or changes in the condition of an institution, which may warrant the need for supervisory attention. By documenting a training program that could be utilized by all examiners, there can be multiple options for RSD. For example, with a proper training program, an examiner could become more familiar with supervisory actions and have the ability to serve in RSD on an as needed basis. OE officials stated that, if needed, there are a number of staff within OE who have knowledge from their past experiences with special

² These actions included: one supervisory conditions of merger, five written agreements, and four supervisory letters.

supervision and enforcement processes who could assist as enforcement examiners with minimal additional training under RSD's oversight.

A recent case within RSD shows the significance and importance of RSD readiness. A large potentially fraudulent scheme was uncovered at an FCS institution. Because of the significance of the issues and concerns, it is and will continue to be a large undertaking for RSD and other parts of OE. Because current staff are knowledgeable and have experience in this area, they were able to react quickly and efficiently. For the future, it is imperative that OE direct attention to developing a training program so that examiners understand special supervision and enforcement processes and actions and are able to react quickly if needed.

Agreed-Upon Action 1

In order to improve the future readiness of RSD, OE agreed to:

1. Develop a training program for special supervision and enforcement actions to ensure the organization has the knowledge to react to the changing FCS environment.

Criminal Referrals

At times, FCA can and does initiate special supervision and/or enforcement actions based on potential violations of laws, regulations, or rules. This may include actions taken by certain individuals that involve suspected fraudulent activities affecting the institutions. As part of the audit, three institutions under special supervision or enforcement where potential criminal activity had taken place were judgmentally selected to ensure the criminal referral process was followed. FCA regulations require institutions to file a criminal referral form for known or suspected criminal violations.

Two of the three institutions reviewed had not filed criminal referrals. Institutions are required to complete the FCA Referral Form within 30 calendar days of determining that a known or suspected criminal violation has occurred. A copy of the referral form must be provided at the same time to FCA's Office of General Counsel. For the first institution reviewed, we found RSD initiated timely actions that included specific instructions to one institution about filing the criminal referral. In fact, RSD responded to the institution with the instruction only six days after the institution notified FCA of an alleged fraudulent activity. Subsequently, the institution filed two separate criminal referral forms, as required.

In the other two cases reviewed, we found that the institutions did not submit a criminal referral. One case involved misconduct and numerous instances of standards of conduct violations by a director. FCA initiated enforcement actions against the director; however, a criminal referral was not filed.

In the last case reviewed, FCA directed an institution to have an independent third-party investigation of a large charge off. FCA directed the institution to identify any known or suspected criminal activities and complete the criminal referral if these activities were identified. The investigative report concluded there was no evidence of funds diversion or collateral conversion. However, the report noted other

**FCA Regulation § 612.2301
Referrals**
Within 30 calendar days of determining that there is a known or suspected criminal violation of the United States Code involving or affecting its assets, operations, or affairs, the institution shall refer such criminal violation to the appropriate regional offices of the United States Attorney, and the Federal Bureau of Investigation or the United States Secret Service or both, using the FCA Referral Form.

items such as a misrepresentation by the borrowers, comingling of assets and liabilities, a lack of audited financial statements, and appraisals with serious deficiencies. Despite these findings, the institution did not file a criminal referral.

The FCA Criminal Referral Regulation 612, Subpart B, is written to require any known or suspected criminal activity to be reported. This regulation is a clear mandate to report to the appropriate law enforcement agency. In both cases where the criminal referrals were not filed, the institutions hired private firms to investigate and report back to the institutions. However, both firms were limited in the reviews. For example, in both investigations, the prime individuals involved in the activities were not interviewed and financial records reviewed were limited. While these investigations are important to the institutions, they are not a substitute for an independent law enforcement inquiry. Criminal referrals are especially important when an institution is under special supervision and/or enforcement actions. Because criminal activities can impact the safety and soundness of the institution, the institutions should be cognizant of, and closely adhere to, all requirements relating to the criminal referral activities. Further, FCA should ensure once the enforcement decisions are made and actions taken, the institutions are still also mindful of the obligation to report “suspected” criminal activity.

FCA has placed the criminal activity referrals and related internal controls on the Spring 2015 Regulatory Projects Plan. Specifically, the purpose is to consider whether the current regulatory guidance regarding internal controls to prevent, identify, and monitor fraud and criminal activity needs revision. The plan also states they will review the processes for referring known or suspected criminal violations.

Agreed-Upon Action 2

In order to improve the criminal referral process, OE agreed to:

2. Emphasize the requirement of FCA Regulation 612, Subpart B, and provide training and/or education to examiners on the role and responsibility FCA has regarding the criminal referral form and to ensure institutions are filing the form as required.

Special Supervision and Enforcement Directives and Processes

As noted in this report, OE has thorough policies, procedures, and directives to document the special supervision and enforcement processes. These documents set forth specific, detailed directions for examiners to follow. We identified two areas where directives did not reflect current practices and could be improved as noted below:

- According to OE Directive 36, *Enforcement Action Procedures*, the examination division is responsible for evaluating compliance with the enforcement action and assigning a preliminary compliance rating. Then, an RSD enforcement examiner reviews the compliance evaluations and assigns a final rating, which is communicated to the institution. We found three instances where an enforcement examiner completed an informal compliance rating analysis, which included some proposed changes to the compliance ratings. This is an action not addressed in the directive. OE officials indicated the documents were not meant to result in a communication to the institution to formally change the ratings. Instead, the process was to document internal analyses to assess the institution’s compliance before considering additional Agency action, such as termination of an enforcement action. Although the examiners annotated the ratings as “informal” or as “part of workpapers,” the existence of these ratings in

OE's records may create confusion as to the intent of the informal ratings or compliance with OE Directive 36.

- OE Directive 35, *Special Supervision Procedures*, sets forth procedures for initiating, monitoring, terminating, and administering special supervision. In three instances, OE issued supervisory letters but each institution remained under "normal supervision." OE also identified the communication as a "supervisory letter" and reported the items to the Board as "other supervisory actions." We understand OE has a variety of tools for communicating with and monitoring institutions. However, using the letters for both normal supervision and special supervision may be confusing.

OE procedures do not address how informal ratings are to be used, when they are appropriate, or how they will be relied upon. The procedures thoroughly discuss the supervisory letter process for special supervision status. However, the procedures do not address initiating a supervisory letter when the supervision level does not change but remains normal.

Agreed-Upon Action 3

In order to improve the processes, OE agreed to:

3. Address the use of informal ratings and other supervisory letters by either expanding or changing current directives and/or processes to include when they are appropriate and how they will be used.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this audit was to determine whether FCA is following the special supervision and enforcement processes and monitoring institution compliance effectively. We conducted fieldwork at FCA's Headquarters in McLean, VA from November 2014 through February 2015. We limited our scope to actions initiated or in process in FY 2014.

The following steps were taken to accomplish the objective:

- Reviewed the Farm Credit Act, as amended, for mandates on special supervision and enforcement actions.
- Reviewed FCA, OE, and RSD policies and procedures related to special supervision and enforcement actions.
- Obtained background information for special supervision and enforcement actions.
- Interviewed OE management and selected examiners on internal policies and procedures.
- Reviewed documentation from the Enterprise Documentation and Guidance system and the Enforcement and Supervision databases.
- Reviewed special supervision and enforcement actions initiated or in process during FY 2014, and determined why FCA placed the institution under special supervision or enforcement.
- Analyzed historical information in the Supervisory History Database maintained by OE for actions taken since 2007.
- Analyzed actions for potentially fraudulent activities and reviewed files for criminal referral forms. We judgmentally sampled three activities based on the reasons behind certain actions and activities conducted by the institution. Because our sample was judgmental and not statistically sampled, we cannot project our findings to the entire population.
- Reviewed compliance ratings for institutions under enforcement actions.
- Reviewed and analyzed the watch list for identification, length of time on the list, and escalation to special supervision or enforcement.

This audit was performed in accordance with the 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 assessed internal controls and compliance with laws and regulations to the extent necessary to satisfy the objective. 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 assessed the computer-processed data relevant to our audit objective and determined that the data was sufficiently reliable. Overall, we believe the evidence obtained provides a reasonable basis for our conclusions based on our audit objective.

ACRONYMS

CAMELS	Capital, Assets, Management, Earnings, Liquidity, and Sensitivity
FCA	Farm Credit Administration
FCS	Farm Credit System
FIRS	Financial Institution Rating System
FY	Fiscal Year
OE	Office of Examination
OIG	Office of Inspector General
REC	Regulatory Enforcement Committee
RSD	Risk Supervision Division

R E P O R T

Fraud | Waste | Abuse | Mismanagement



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