

Office of Inspector General

Audit of FCA's Financial Statements
Fiscal Year 2003



November 2003

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For the financial statements and related notes to each fiscal year's financial audit report, refer to FCA's Performance and Accountability Report (PAR) for that year. The PARs can be found at www.fca.gov/reports/performance_reports.html.

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
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January 6, 2004

The Honorable Michael M. Reyna
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Chairman:

This letter transmits the Harper, Rains, Knight, and Company, P.A. (HRK) reports on the audit of the Farm Credit Administration's (FCA) financial statements for the fiscal year ended September 30, 2003. This letter also incorporates a summary of what I believe are the most significant management and performance challenges facing the agency as described in the Office of Inspector General (OIG) Semiannual Report to Congress dated September 30, 2003.

HRK issued an unqualified opinion. HRK opined FCA's principal financial statements present fairly, in all material respects, the financial position of FCA as of September 30, 2003 and 2002, in conformity with generally accepted accounting principles. HRK issued two other reports and a management letter. The report on the internal control noted no matters involving the internal control and its operation that HRK considered to be material weaknesses. The HRK report on compliance with laws and regulations does not note any instances of noncompliance. HRK reported to management other matters involving internal control and its operations in a separate letter.

The OIG tasked HRK, an independent accounting firm, to perform the audit. The task order required HRK to perform the audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. To ensure the quality of the work performed, the OIG:

- reviewed HRK's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored progress of the audit;
- examined working papers; and
- reviewed the audit report.

In our opinion, HRK's work provides a reasonable basis on which to render its November 21, 2003 opinion and we concur with the report.

As part of the agency Performance and Accountability Report, the Inspector General is required to provide an opinion on the most serious management and performance challenges facing the agency. In the most recent Semiannual Report to Congress, I outlined major challenges confronting the Farm Credit Administration 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.

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. 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. 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.

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.

Respectfully,

/s/ Stephen G. Smith

Stephen G. Smith
Inspector General



HARPER, RAINS, KNIGHT
& COMPANY
Certified Public Accountants
A Professional Association

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

FARM CREDIT ADMINISTRATION

The Board and Office of Inspector General

We have audited the balance sheets of the Farm Credit Administration (FCA) as of September 30, 2003 and 2002, and the statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the FCA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial statements contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, "Audit Requirements for Federal Financial Statements". These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position of the Farm Credit Administration as of September 30, 2003 and 2002, and the net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the FY 2003 and 2002 principal financial statements of the FCA. The accompanying financial information, discussed below, is not a required part of the principal financial statements.

The Management Discussion and Analysis on pages 2-23; and the Required Supplemental Information on pages 40-41 is supplementary information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and express no opinion on it.

Harper, Rains, Knight & Company, P.A.

November 21, 2003



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**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL**

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Farm Credit Administration (FCA) as of and for the year ended September 30, 2003 and 2002, and have issued our report thereon dated November 21, 2003. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audits, we considered FCA's internal control over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audits was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

With respect to internal control related to performance measures reported in the Performance report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted other matters involving the internal control and its operations that will be reported to the management of FCA in a separate letter.

This report is intended solely for the information and use of the management of FCA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Knight & Company, P.A.

November 21, 2003



INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) as of and for the year ended September 30, 2003 and 2002, and have issued our report thereon dated November 21, 2003. We conducted our audits in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of FCA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FCA.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the Federal financial management systems requirements, United States Government Standard General Ledger at the transaction level and applicable Federal accounting standards.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audits and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of FCA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Knight & Company, P.A.

November 21, 2003

R E P O R T

Fraud | Waste | Abuse | Mismanagement



FARM CREDIT ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

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