

Office of Inspector General

Audit of FCA's Financial Statements
Fiscal Year 2008



November 2008

TABLE OF CONTENTS

Inspector General's Transmittal Letter of Auditor's Report	1
Auditor's Opinion Letter on the Financial Statements	4
Auditor's Opinion Letter on Internal Control	5
Auditor's Opinion Letter on Compliance with Certain Laws and Regulations	7

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
McLean, Virginia 22102-5090
(703) 883-4000



November 7, 2008

The Honorable Leland A. Strom
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Strom:

This letter transmits the report on the audit of the Farm Credit Administration's (FCA or Agency) financial statements, internal control over financial reporting, and compliance with certain laws and regulations for the fiscal year ended September 30, 2008. The Office of Inspector General (OIG) contracted with the U.S. Department of Treasury's Bureau of the Public Debt (BPD) for Brown & Company CPAs, PLLC (Brown & Co.), an independent accounting firm, to perform the audit.

Brown & Co. issued an unqualified opinion on the Agency's financial statements. They opined that FCA's principal financial statements present fairly, in all material respects, the financial position of the Agency as of September 30, 2008 and 2007, in conformity with generally accepted accounting principles. Brown & Co. issued two other reports. Its report on internal control noted no matters considered to be material weaknesses. Brown & Co.'s report on compliance with laws and regulations relating to the Agency's determination of financial statement amounts does not note any instances of noncompliance. In OIG's opinion, Brown & Co.'s work provides a reasonable basis on which to render its opinion and we concur with their reports.

OIG's contract with BPD required that Brown & Co. perform the audit in accordance with "Government Auditing Standards" issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements, as amended." To ensure the quality of the work performed, OIG:

- reviewed Brown & Co.'s approach to and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the progress of the audit;
- examined work papers; and
- reviewed the audit reports.

As part of the Agency's annual Performance and Accountability Report, the Inspector General is required by law to provide a summary statement on the most serious management and performance challenges facing the Agency. These challenges fall into two general categories. First are the challenges related to the FCA's mission of ensuring a safe, sound, and dependable Farm Credit System (FCS or System) as a source of credit and related services to agriculture and rural America. Some of these challenges may be influenced by events that are outside the control of the Agency. Second, but no less important, are the challenges related to Agency operations.

Management and Performance Challenges

Farm Credit System

The System is a lender to a single industry, agriculture, and is therefore vulnerable to economic swings in that industry. Nevertheless, the FCS remains sound in all material respects. Earnings and capital levels have continued to strengthen, and asset quality remains high. The Agency's **challenge** is to continue to ensure the System's ability to withstand this vulnerability through effective examination and regulatory activities. The Agency's regulatory attention must also address other vulnerabilities in the System. Among these are scope of lending excesses and risks associated with exposure to new enterprises, such as alternative fuel production and System institutions' "investments in rural America."

Farm Credit Administration

There continue to be many issues facing agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act to enable the System to better serve agricultural and rural economies of the future. Whether or not there are modifications to the Farm Credit Act, the Agency should anticipate that the System will continue to seek broad regulatory interpretations. However, as a financial regulator, FCA's **challenge** is to continue to maintain an independent and objective, yet flexible and responsive, regulatory environment for the System, geared to continually ensuring the FCS fulfills its public policy purpose. Key to this for FCA is effective examination and regulation of System institutions by maintaining a properly staffed and resourced Agency.

The Next Possible Agricultural Economic Downturn

There are many factors in agriculture today that may indicate future serious difficulties for agriculture and the FCS. For example,

- the System has been experiencing rapid growth for several years, which has had the effect of eroding the System's capital to assets ratio;
- land values, which may not be sustainable, are high;
- the livestock sector is experiencing stress;
- there is volatility in commodity prices; and
- input costs, including fuel, are high.

While some sectors of agriculture are prospering and the Agency's Office of Examination (OE) reports that System institutions remain safe and sound, these factors have also led the OE to state that credit deterioration is likely and risks are rising.

Thus, a major **challenge** for the Agency is to ensure its ongoing ability to timely assess economic and operational conditions affecting the welfare of the System's borrowers and thus System institutions, and to take preemptive or remedial actions to ensure the ongoing safety and soundness of the System. The

first line of preparedness for the Agency in accomplishing this is an effective risk assessment and examination program, including the continual assessment of the reliability of risk evaluation and examination findings, and the sufficiency of the Agency's supervision and enforcement processes.

Human Capital

In 2006, a five-year strategic human capital plan was completed. FCA's **challenge** is to continue to implement the human capital plan to ensure that FCA has the staff it needs to effectively regulate a constantly evolving FCS. In meeting this challenge, the Agency should continue to address the attrition of seasoned staff and ensure the viability of the examination staff, a critical component of the Agency's regulatory capability.

As the Agency moves farther into the human capital plan's five-year cycle, the Agency must critically assess the implementation of the current plan and, as the current plan nears completion, establish a new five-year human capital plan based on current human capital experience and future perceived human resource needs.

Strategic Planning

In December 2003, the FCA Board adopted the Strategic Plan for Fiscal Years 2004–2009. The next Agency strategic plan was not adopted by the FCA Board until May 2008. In accordance with the Government Performance and Results Act of 1993 and Office of Management and Budget Circular A-11, an updated and revised strategic plan is required within three years of submitting a prior strategic plan.

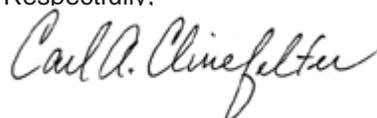
Since the adoption of the 2008-2013 strategic plan, the FCA Board has a new Chairman. This change in leadership and the likelihood of two new FCA Board Members prior to the next major updating of the strategic plan will provide an opportunity and a **challenge** to ensure the then FCA Board's vision is timely incorporated into the next strategic plan.

In 2005, the FCA Board established a Strategic Planning Committee (SPC) composed of Agency staff to facilitate FCA Board input into the plan and the planning process. The SPC should ensure the updating and issuance by the FCA Board of the next strategic plan, presumably dated FY 2011-2016.

Leveraging Technology

Information technology (IT) is a key element in management's efforts to continually improve Agency performance. The Agency is in the process of a major infrastructure transition designed to promote efficient work processes and to provide staff with enhanced communication and collaboration tools. The **challenge** is to stay abreast of emerging technologies and to establish an IT infrastructure that provides FCA staff with IT tools and skills to operate in an efficient, effective, and secure manner. In addition, the Agency must ensure that its technical staff has the skills and knowledge to implement and maintain its infrastructure, and initiatives in this regard are underway.

Respectfully,



Carl A. Clinefelter
Inspector General



INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Farm Credit Administration
The Board and Office of Inspector General

We have audited the accompanying balance sheet of the Farm Credit Administration (FCA) as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, and budgetary resources, for the years then ended (collectively referred to as the financial statements). These financial statements are the responsibility of FCA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirement for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 financial position of the FCA as of September 30, 2008 and 2007 and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with U.S. Government Auditing Standards and OMB Bulletin No. 07-04, we have also issued a report dated November 7, 2008 on our consideration of the FCA internal control over financial reporting and its compliance with provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with U.S. Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The information in "Management's Discussion & Analysis" is presented for the purpose of additional analysis and is required by OMB Circular No. A-136, revised *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.

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

Largo, Maryland
November 7, 2008



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Farm Credit Administration
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration (FCA) as of and for the year ended September 30, 2008 and have issued our report thereon dated November 7, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in U.S Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the FCA's internal control over financial reporting by obtaining an understanding of the FCA'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. 07-04. 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 audit was not to provide an opinion on internal control and therefore, we do not express 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 significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 07-04, a significant deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. 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 a material weakness. A material weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected. 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 significant deficiencies or material weaknesses as defined above.



BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

In addition, with respect to internal control objective related to the performance measures included in the “Management’s Discussion & Analysis,” we obtained an understanding of the design of internal controls relating to the existence and completeness assertions, and determined whether they have been placed in operation as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide opinion on internal control over reported performance measures, and, accordingly, we do not express an opinion on such controls.

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

Largo, Maryland
November 7, 2008



**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

Farm Credit Administration
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration (FCA) as of and for the year ended September 30, 2008, and have issued our report thereon dated November 7, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

The management of the FCA is responsible for complying with laws and regulations applicable to the FCA. As part of obtaining reasonable assurance about whether the FCA'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. 07-04. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the FCA.

The results of our tests of compliance disclosed no reportable instances of noncompliance with other laws and regulations discussed in the preceding paragraph that are required to be reported under U.S. Government Auditing Standards or OMB Bulletin No. 07-04.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

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

Largo, Maryland
November 7, 2008

R E P O R T

Fraud | Waste | Abuse | Mismanagement



FARM CREDIT ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

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