Office of Inspector General

Audit of FCA’s Financial Statements
Fiscal Year 2012

A-12-FS

November 5, 2012
Inspector General’s Transmittal Letter of Auditor’s Report………………………………………1
Auditor’s Opinion Letter on the Financial Statements………………………………………. 5
Auditor’s Opinion Letter on Internal Control…………………………………………………7
Auditor’s Opinion Letter on Compliance with
   Certain Laws and Regulations……………………………………………………………..8

For the financial statements and related notes to each fiscal year’s financial audit reports, 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.
November 5, 2012

The Honorable Leland A. Strom, Chairman and Chief Executive Officer  
The Honorable Kenneth A. Spearman, Board Member  
The Honorable Jill Long Thompson, Board Member  
Farm Credit Administration  
1501 Farm Credit Drive  
McLean, Virginia 22102-5090

Dear Chairman Strom and Board Members Spearman and Long Thompson:

This letter transmits the reports on the audit of the Farm Credit Administration’s (FCA’s or Agency’s) financial statements, internal control over financial reporting, and compliance with certain laws and regulations for the fiscal year (FY) ended September 30, 2012. The Office of Inspector General (OIG) contracted with the U.S. Department of the 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. It opined that FCA’s principal financial statements present fairly, in all material respects, the financial position of the Agency as of the FYs ended September 30, 2012 and 2011, 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 cited no instances of noncompliance. In the OIG’s opinion, Brown & Co.’s audit provides a reasonable basis on which to render its opinions and we concur with its reports. All three reports from Brown & Co. are dated November 5, 2012.

The 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, the 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.
Management and Performance Challenges

As part of the Agency’s annual Performance and Accountability Report, the Inspector General is required by law to provide a summary statement on management and performance challenges facing the Agency. The challenges identified fall into two general categories. First is the challenge related to FCA’s mandate 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. However, it should be recognized that some factors affecting this challenge may be influenced by events outside the control of the Agency. Second, and of equal importance, is the challenge related to the Agency remaining an independent, objective, and effective regulator of the FCS.

Farm Credit System

Safety and Soundness

The System is a lender to a single industry – agriculture – and is therefore vulnerable to economic volatility and other risks in that industry. While the FCS remains generally safe and sound, several factors, including insufficient board and management oversight in a number of FCS institutions, adverse economic trends in several agricultural sectors, and extremely adverse weather conditions, have caused deterioration in a number of FCS institutions in recent years. A continuation of these factors, exacerbated by current high land values if they prove to be unsustainable, could result in systemic deterioration in the System. The Agency must continue to oversee rehabilitation of institutions exhibiting serious weaknesses and ensure that the FCS is able to withstand such vulnerabilities in the long-term and remain safe and sound.

In providing for System oversight, the challenge for the Agency is twofold: to continue to be an independent, objective, and effective regulator; to continue to assess in a timely manner economic and operational conditions affecting System institutions; and to take prompt preemptive or remedial actions to ensure their ongoing safety and soundness.

Mission

Further, the overall environment facing agriculture, rural America, and the FCS is ever-changing, presenting new vulnerabilities and opportunities. FCA’s challenge in this environment is to continue to ensure the FCS fulfills its public policy purpose of providing constructive credit to farmers, ranchers, rural residents, agricultural and rural utility cooperatives, and other eligible borrowers.

Farm Credit Administration

Agency Governance

The Farm Credit Act of 1971, as amended, provides for a full-time, three-member Board to govern the Agency. Board members are appointed by the President and confirmed by the Senate, and the President designates the Chairman. Since Chairman Strom’s term ended on October 13, 2012, the President will at some point name a new Chairman and the Board will receive a new member.

All three current Board members are well-experienced, with each having been on the Board for a number of years. Nevertheless, a full-time, three-member Board, particularly when a new Chairman is named and a new member(s) joins the Board, presents an ongoing challenge of
coordination and cooperation for the Chairman and Board Members in defining roles and responsibilities. In this regard, the Board’s various rules of operation are a significant asset; they provide a foundation for trust and shared expectations among its members, enable the Board to engage in professional and constructive policy debate, and provide continuity of operations and a sound course for the Board and the Agency.

Agency Organization

Although the Agency’s statutory mission has remained constant, many factors affect the Agency’s operations and organization. A major factor is the periodic turnover in the Board’s composition and Chairmanship. In addition, the banks and associations of the FCS have continued merging, geographic territories of merged institutions have changed, and FCS institutions’ products and the examination thereof have become more complex.

These and other factors bear on FCA’s organizational structure. An ongoing challenge to the Board and senior management is to periodically reassess FCA’s organizational structure to ensure it remains optimal in relation to all relevant factors.

Agency Staffing

The Agency has a comprehensive five-year Human Capital Plan covering FYs 2012 to 2016. Recent recruitment initiatives for all levels within the Agency have broad search criteria, and have focused on obtaining the best skill sets and achieving diversity in FCA’s workforce.

The Board and senior management recognize the area of human capital as critical for the ongoing success of FCA as an effective Federal financial regulator. A few of the factors contributing to the critical nature of human capital, as delineated by the Agency’s Office of Management Services, are as follows:

- Projections indicate that a substantial portion of the Agency’s workforce is eligible to retire during the next several years.
- The loss of employees during this period will challenge the Agency to retain historical knowledge and perspectives on the programs, practices, and mission of the FCS as well as that of FCA.
- The evolution of FCA, agriculture and rural America, the FCS, and the financial services industry means FCA will need to continue to attract and maintain an experienced and qualified professional staff to meet the anticipated growth and complexity of the FCS and its environment.

The Agency’s challenge is to continue to emphasize the implementation of its human capital plan to ensure FCA has the staff it needs to remain an effective regulator of the FCS by, for example, continuing to identify the critical skills needed in the future, appropriately allocating resources between line and staff functions, and ensuring continuity within senior management and other staff positions.

Leveraging Technology

The Agency’s ability to leverage investments in technologies is a key element in management’s efforts to continually improve Agency performance by increasing the efficiency and effectiveness of operations. The Agency has an active information resource management planning process that identifies, reviews, and prioritizes information technology (IT) initiatives to improve Agency operations. Over the past few years, the Agency made significant investments in technologies and began implementing several tools to improve communication, collaboration,
and efficiency of operations. The Agency’s **challenge** is to continue to maximize the use of IT investments that will increase Agency efficiency and effectiveness. The successful implementation of technologies will provide FCA staff with the IT tools and skills that will enable the Agency to continue to

- improve the quality and availability of data without creating an undue burden on the FCS;
- streamline business processes and build business intelligence to provide decision-makers with timely management information;
- develop electronic recordkeeping and knowledge management capability for capturing, maintaining, and sharing institutional knowledge;
- improve communication with stakeholders; and
- protect FCA information systems and data from ever-increasing external and internal threats.

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, 2012 and 2011 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 audits.

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 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, as amended. Those standards and OMB Bulletin No. 07-04, as amended, 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, 2012 and 2011 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, as amended, we have also issued our reports dated November 5, 2012 on our consideration of the FCA internal control over financial reporting and its compliance with certain 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.

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis (MD&A) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by OMB Circular A-136, Financial Reporting Requirements, as revised, that considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.
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 5, 2012
INDEPENDENT AUDITOR’S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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, 2012 and have issued our report thereon dated November 5, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; 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, as amended.

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, as amended. 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 a material weakness or significant deficiency. Under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 07-04, as amended, a material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency in internal control, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be a material weakness as defined above.

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 5, 2012
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, 2012 and have issued our report thereon dated November 5, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; 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, as amended.

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, as amended. 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 with laws and regulations disclosed no material noncompliance with 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, as amended.

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 5, 2012