

Office of Inspector General

Farm Credit System Building Association
Business Practices

03-02



March 9, 2004

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4030



March 9, 2004

The Honorable Michael M. Reyna
Chairman of the Board and
Chief Executive Officer
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102

Dear Mr. Reyna:

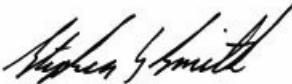
The Office of the Inspector General (OIG) completed an audit of the businesses practices of the Farm Credit System Building Association (FCSBA). The objective of this audit was to determine if the FCSBA is providing the FCA Board enough information about its operations to enable the Board to properly oversee FCSBA operations.

The audit identified actions for the FCA Board to direct improvements in the operations of the FCSBA. Most significantly, the improvements should contribute to helping the Board exercise its duties with respect to the FCSBA. Your response of March 3rd on behalf of the Board is included in the report. The response commends the report and evidences a commitment to the spirit and intent of the recommendations. Furthermore, the Acting President has made some improvements and has others planned. Accordingly, we have revised our recommendations to reflect they are mutually agreed upon actions.

We conducted the audit following *Government Auditing Standards* issued by the Comptroller General for audits of Federal organizations, programs, activities, and functions. We conducted fieldwork from June 14, 2003 through August 20, 2003. We provided a discussion draft report to the FCA Liaison and the FCSBA Acting President on October 17, 2003. We held an exit conference and discussed the draft report with FCA officials, the FCSBA Acting President, and the Audit Follow-up Official on December 10, 2003. A revised draft was issued on January 6, 2004 as a result of the exit conference. We sincerely appreciate the cooperation extended by the FCSBA staff, FCA staff, and the FCA Board.

If you have any questions about this audit, I would be pleased to meet with you at your convenience.

Respectfully,



Stephen G. Smith
Inspector General

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BACKGROUND

Section 5.16 of the Farm Credit Act of 1971, as amended, authorized the Farm Credit System banks (Banks) to “lease or acquire real property” and to “construct, develop, furnish, and equip” quarters for the Farm Credit Administration (FCA). The FCA chartered the Farm Credit System Building Association (FCSBA or Association) in 1981 as a “service organization” under 4.25 of the Farm Credit Act. The FCSBA’s budget for 2003 was \$2,911,100, with assessments to the Banks amounting to \$1,712,900.

The Articles of Association and Bylaws of the FCSBA (1991) designate “the Board,” meaning the FCA Board, to make decisions affecting the FCSBA. According to the FCSBA Articles of Association, the FCA Board governs the affairs of the Association. The Board has exclusive control and authority for the operations and affairs of the FCSBA. Action by the Board on any matter relating to the Association requires a majority vote of the Members of the Board in office.

In 1995, the FCA Board adopted Board Policy Statement, FCA-PS-68. This policy statement supplements the Bylaws and outlines general boundaries for procedures. The policy also outlines the roles of the FCSBA President and the FCA Liaison as well as asset and financial management, standard operating procedures and contract management.

The fieldwork accomplished during this audit was a review of operations that existed under the former President of the FCSBA in his role as President that ended in early March of 2003. Most of the findings are a result of the operations that existed under the former FCSBA President. An Acting President assumed the duties since March 2003. The Acting President has made strides to improve the operations and reporting to the Board. Although there are weaknesses reported in this audit, the Acting President continued to work to remedy weaknesses found both before and during the fieldwork stage of the audit.

EXECUTIVE SUMMARY

The audit revealed that the FCSBA could improve its reporting to the FCA Board of its operations. The Acting President made some improvements and others are planned. Although improvements have been made, the audit found that reporting to the Board should be more thorough and that an assessment should be conducted to determine the appropriate workforce needed to run all operations of the FCSBA. Specifically, it is recommended that: 1) the FCSBA budget be more detailed and delivered to the FCA Board earlier; 2) the FCSBA capital improvement plan needs updating as well as the component reserve fund projections; 3) the FCSBA needs to be more diligent in reporting to the FCA Board; and 4) an assessment should be conducted to determine the workforce and contractual needs of the FCSBA.

SCOPE AND METHODOLOGY

The audit objective is to determine if the FCSBA is providing the FCA Board enough information about its operations to enable the Board to properly oversee FCSBA operations. The OIG reviewed the internal controls for expenses by reviewing the related Standard Operating Procedures (SOP), contract management, and duties of the FCA Liaison to the FCSBA. We also reviewed the information provided to the FCA Board on expenses. Finally, we reviewed the last three years' independent accountant's audits and the last two Office of Examination reports on the FCSBA. We interviewed FCSBA staff, the current and previous FCA Liaison, the property manager assigned to the FCSBA, and the chief engineer for the building.

We conducted the audit following *Government Auditing Standards* issued by the Comptroller General for audits of Federal organizations, program, activities, and functions. We conducted fieldwork from June 14, 2003 through August 20, 2003. We provided a discussion draft report to the FCA Liaison and the FCSBA Acting President on October 17, 2003. We conducted an exit conference and discussed the draft report with FCA officials, the FCSBA Acting President, and the Audit Follow-up Official on December 10, 2003. A revised draft was issued as a result of the exit conference on January 6, 2004. The FCA Board agreed with the recommendations on March 3rd and the OIG changed the recommendations to agreed upon actions.

FINDINGS AND RECOMMENDATIONS

Improve Budget Information to the FCA Board

The FCSBA provides the FCA Board information (budgets, quarterly reports, and financial statement audits) required by the SOPs. However, improved information would assist the Board in providing more effective oversight of the FCSBA.

The FCA Board has the responsibility to ensure the FCSBA is performing efficiently and is safeguarding the Banks' assets. The FCSBA must present the Board with complete, accurate, timely, and clear information. Also, FCSBA must assure the Board that it adheres to the budget, justifies costs, completes planned projects, and addresses reported weaknesses.

The FCSBA's budget is the primary method for reporting to the Board the financial needs and expected performance of the Association. We noted the following actions that would improve the FCSBA's budget proposals to the Board:

Update the Capital Improvement Plan

Policy Statement 68 requires the FCSBA to update and maintain a capital improvement plan. This requirement helps the Board ensure there is enough funding available to cover a 10-year capital repair and replacement program. The FCSBA updated the capital reserve study in 1998 and could not document any more recent updates.

The Association should have the McLean Building inspected and revise the capital improvement plan as soon as possible. It should inform the Board of the results of the

inspection and of capital improvements needed over a 10-year period in its budget proposal. This would help the Board weigh proposals and decide between cosmetic and structural improvements. It would also tell the Board about the effect of delaying or adding building improvements to both the soundness of the building and the amount needed in the component reserve account.

Establish Clearer Performance Goals

The FCSBA budget document generally describes accomplishments for the previous year and plans and goals for the coming year. However, the goals in the FCSBA budget document do not provide enough information to hold the Association accountable for their completion. In recent years, the FCSBA reported some accomplishments as due for completion before year-end. However, this did not always happen. Since the budget establishes accountability and performance goals for the FCSBA, it should provide details to the Board on all projects and operations, including descriptions of work, costs and due dates. This information would improve the Board's ability to hold the Association accountable for performance.

Improve Consistency of Cost Information

The dollar amounts in the narrative sections did not always coincide with the tables in the budget document. The presentation makes it difficult to track total costs in a category because the written justification included some, but not all, of the interrelated costs associated with the specific budget category. This lack of clarity and consistency in the budget document hinders the Board's ability to provide oversight.

Develop Supporting Cost Analyses

The budget document does not provide a cost analysis to support changes in funds needed for each budget area. A cost analysis would provide the Board more information explaining why cost changes occur and how the FCSBA spends funds from year to year.

Provide Budget Proposals Earlier

Board policy (PS 68) states the FCSBA will provide a preliminary budget to the Board each June. The FCSBA has not met this requirement for the past 3 years. The FCSBA has been providing its budget in December of each year, which restricts the Board's opportunity to review the FCSBA budget. During the exit conference, the Board members indicated the June budget requirement is premature because it is 6 months before the new budget year.

Agreed Upon Actions:

1. The FCA Board will ensure its expectations are clear with respect to the FCSBA budget by:
 - a. *Reestablishing the budget due date;*
 - b. *Requiring the FCSBA to include details on projects and services within its budget including:*
 - i. *Cost and completion dates; and*
 - ii. *Comparison to prior year's budget and explanation of significant variances.*

2. *The FCA Board will require that FCSBA update the capital improvement plan and the related 10-year schedule for the component reserve fund. The Board will also direct the FCSBA to incorporate the results in a schedule in the budget.*

FCSBA Quarterly Reporting Improved

After approving the budget, the FCA Board monitors progress and changes in the Association's operations. The quarterly report is the vehicle to provide detailed, current status of the FCSBA's operations and this reporting has improved in past months. Although Policy Statement 68 provides guidelines for the FCSBA's quarterly reports, greater definition of the Board's expectations should be provided. To enhance the current reporting, the Association's quarterly reports should include:

Status of Reviews

The Management Objectives section of the FCSBA quarterly report is designed to report on all recommendations from auditors or examiners. Although required by policy, the FCSBA has not consistently included all recommendations in its quarterly report. For example, the FCSBA failed to report on 1999 examination findings on accessibility compliance. As a result, the Association did not resolve the findings in a timely manner. The Board needs to ensure the FCSBA complies with the reporting requirement and resolves any weaknesses found by auditors or other sources.

Status of Projects and Goals

Previously, the quarterly reports made it appear the Association was working on approved projects when it was not making progress. For example, the FCSBA requested and the FCA Board approved budget funds of \$150,000 in 2002 and \$70,000 in 2003 for upgrades for building compliance with the Americans with Disabilities Act. However, the FCSBA did not complete the planned improvements. Quarterly reports should show the status of all significant FCSBA projects and goals, including the original estimated completion date. If there are circumstances or unplanned projects that prevent performance or justify revisions to due dates or funds needed, the FCSBA should include this information in its quarterly reports to the Board. The FCSBA needs to include detailed information in the quarterly reports on the status of projects and goals.

Status of Expenses

Both the 2002 and 2003 FCSBA proposed budgets included a listing of budget categories it exceeded during the current year. It appears the FCSBA does not report these budget variances until the end of their budget year, after it incurred the costs. The FCSBA should report expenses that would cause it to exceed the approved limit on a budget category since the Board must approve reallocation of funds.

The quarterly reports should also provide the status of approved funding versus what has been expended. In our conversations with the FCSBA, this information will now be easily available monthly as reconciliation and reviews of the accounts are completed.

Although the quarterly reports show the balances of the component and operating reserve accounts, it does not show if or how funds from these accounts have been used or the projected interest rates for future years. Reporting the balance and all activity related to these accounts would provide the Board with more information on the condition of the building and account balances.

Following fieldwork but before issuance of this report, the Acting President presented the FCSBA quarterly report dated June 30, 2003 at the August FCA Board meeting. That report showed that management is addressing many of the reporting issues and has already started to adopt the agreed upon action below.

Agreed Upon Action:

3. *The FCA Board will ensure its expectations for quarterly reporting by the FCSBA are clear by requiring the FCSBA to:*
 - a. *report the status of all projects/building improvements that are planned and actual costs for these projects, and*
 - b. *report budget performance information with specific notations of any expected reallocations of funds that would require Board approval.*

Opportunities to Enhance FCSBA Operations

We found improvement in internal controls but noted opportunity for improvement in practices and cost savings in the following areas:

- Updating and clarifying policy and procedures.
- Evaluating contracting practices and the use of a property manager.

Internal Controls Strengthened

There are various forms of internal controls over the operations of the FCSBA, including: FCA Board oversight; financial audits (clean opinions for the past three years); OE examinations; the FCA Liaison and SOPs. We found recent improvements within these controls.

FCA Board Oversight Responsibilities

The FCA Board has sole discretionary authority under Section 5.16 of the Act to approve the plans and decisions for the building and facilities that the FCSBA operates. To carry out this authority, the Articles of Association and Bylaws of the FCSBA grant the FCA Board the responsibility to oversee the affairs of the FCSBA. In 1995, the FCA Board adopted Policy Statement 68 to outline general parameters and policies for various operational practices of the FCSBA.

Once the FCA Board establishes clear expectations for the FCSBA, Policy Statement 68 should be updated to incorporate the Board's expectations. Greater reporting requirements and improved information and accountability for the FCSBA will allow the FCA Board to maintain an independent oversight role with assurance that it is receiving the necessary and appropriate information to carry out its role.

The policy also needs updating since the organizational position designated for the FCA Liaison no longer exists (the Director of Office of Resources Management (or his/her designee)). The OIG issued a report on "Board Policies" in September that includes recommendations that when implemented will address this issue.

Office of Examination's (OE) Reports

The last two examination reports included findings requiring action by the FCSBA. Some recommendations have not been adequately addressed. However, improvements in the Management Objectives section of the Association's quarterly reports should remedy weaknesses found by OE and other auditors. These improvements should allow the Board to monitor FCSBA management's corrective actions.

Independent Accountant

The FCSBA has contracted with an independent accounting firm. The independent accounting firm is currently assisting the FCSBA in setting up an improved accounting system that will incorporate all accounting on an accrual basis. Additionally, the firm will review the reconciled accounts each month providing a separation of duties and increased accuracy of recording and reporting expenditures for the FCSBA.

FCSBA Standard Operating Procedures

The FCSBA President is charged with issuing appropriate SOPs after FCA Board review. These governing documents require the President to keep all SOPs in a manner that reflects current and up-to-date policies and practices.

The 15 SOPs we reviewed set up proper management controls and procedures. However, many of the SOPs have not been updated since 1994. The FCSBA should update its procedures to reflect organizational and operational changes; including updating the necessary SOPs as a result of Board policy statement changes. For example, it has drafted an SOP on Building Evacuation that should be issued to provide lifesaving procedures for the building occupants.

Agreed Upon Action:

4. *The FCA Board will ensure its expectations for quarterly reporting by the FCSBA is clear by requiring the FCSBA to report specific information on all findings and recommendations from audits, exams, or other studies until corrective action is complete. In addition, all FCSBA SOPs will be updated to reflect the Board's expectations for quarterly reporting.*

Evaluate Contract Administration and Workforce Requirements

Property Manager (PM)

FCSBA has a contract with a PM for processing the engineers' payroll and contract administration. The PM handles payroll for three engineering employees and manages fifteen contracts for the Association. The contract with the PM provides for month-to-month renewal and the option to terminate with 60 days notice. The FCSBA pays \$2,362.50 monthly for these services. The extent of work the PM performs relative to the cost is questionable.

Engineering Services

The PM provides the engineering staff for the building. Engineering staff report to and are under the day-to-day supervision of the President of the FCSBA. The PM maintains slight oversight mainly through repetitive and routine monthly task reports from engineering staff on preventive maintenance work completed.

FCSBA staff regards the engineering staff's extensive experience at this building as valuable and important to the daily operations. The 1998 capital improvement study for the building noted the engineering staff preserved the mechanics of the building well. The engineering staff also contributes to scheduling, training, and supervising contract employees, and helps the FCSBA with any other building issues that need attention.

The FCSBA may gain efficiencies by employing the engineering staff instead of contracting for these individuals through the PM. Engineering staff salaries, benefits, taxes and other payroll expenses are completely supported by FCSBA. However, an assessment should be made to determine the feasibility of hiring the engineering staff directly. This assessment would also require the FCS Banks' agreement to increase FCSBA staff resources. Further, the FCSBA should determine if there are legal ramifications involving hiring the current engineering staff.

PM Contracting Practices

The FCSBA requires the PM to adhere to the FCSBA SOP on contracting in managing its contracts. The PM identifies contractors, receives bids, writes contracts, and provides the FCSBA with monthly status reports on contracts. We found that contracting activities do not require a high level of effort:

- Many contracts are only reconsidered every three to five years.
- With satisfactory performance, the PM extends contracts reviewing the new prices for the contractor to determine if they are competitive, rather than putting the contract out for bid.
- The PM does not specifically attempt to locate minority or disadvantaged contractors.
- The PM uses contractors that already work on its other contracts.

The FCSBA trains, coordinates, supervises, and reviews the work of the contractors at the building. The PM assumes a contractor is satisfactory unless it receives complaints from the FCSBA. The PM's monthly status report on contracts indicates most contractors are performing "satisfactorily."

FCSBA Contract Management

The FCSBA currently manages contracts for telecommunications, the cafeteria, auditors and other reviews, and construction. We could not determine how the previous President of the FCSBA managed the contracting function. The contract files lacked the documentation outlined in the SOP. It is unclear how the former President chose the vendors. However, during the past six months, the Acting President of the FCSBA has sound documentation and demonstrated understanding of the requirements of the SOP.

Although we could not verify that the contracting process was adequately performed by the FCSBA in the past, opportunities exist for the Acting President to manage the contracting function. With direct responsibility, the FCSBA could better assure the FCA Board that the Association was following its SOP. Additionally, PS 68 allows for the FCSBA to use FCA's legal resources for review of larger contracts. However, with any added responsibility, the FCSBA should review and update its SOP to ensure it meets the FCA Board's expectations.

FCSBA Staffing

The Acting President (and Telecommunications Manager) and the Acting Treasurer/Secretary (formerly the Administrative Assistant) have increased their duties since the former President's illness and death. (See the attached appendix of duties of FCSBA positions.) As noted, the Acting President has taken action to address several of the issues raised in this report.

The current FCSBA staff has absorbed all responsibilities of the FCSBA with the help of an outside independent accountant. The Acting President has been in his "acting" position since March 2003. A permanent decision needs to be made for the staffing of the FCSBA. Determining permanent personnel and positions would provide greater stability in the organization. The FCSBA President should complete a detailed workforce analysis to determine the personnel needs of the FCSBA. The current staff possesses most of the required skills needed to perform the responsibilities of the FCSBA. An analysis should consider the current skills of FCSBA staff, training for staff to obtain needed skills, hiring a part-time employee to help with routine tasks, or hiring an additional person that has the skills that are now lacking. Rather than returning to the previous staffing configuration that could unnecessarily duplicate the skill set already present in the current staff, the analysis should look to augment the existing talent. Changing the previous FCSBA staff structure could create a substantial cost savings to the Banks.

Agreed Upon Action:

5. *The FCA Board will require the FCSBA to evaluate:*
 - a) *the need to contract with a property management company,*
 - b) *internal FCSBA resource requirements, and*
 - c) *the feasibility of directly hiring building engineers.*

Appendix 1 -- FCSBA STAFF RESPONSIBILITIES

Responsibility	President	Telecom. Manager, Treasurer/Secretary	Administrative Assistant
Budget Preparation	X		
Quarterly, Annual and Biweekly Reports to the Board	X	X ¹	
Financial Reporting	X	X ¹	
Create inventory schedules for fixed assets	X		
Management objectives schedule	X		
Investment mgmt.	X		
Strategic Planning	X		
Oversight of Purchasing	X	X ¹	
Contracting	X	X ²	
Records management policy	X		
Correspondence	X	X ¹	
Personnel Supervision	X	X ¹	
Leasing	X		
Field Office site selection and negotiations	X		
SOP preparation	X		
Supervise engineering staff	X	X ¹	
ATM Functions	X		X ¹
Telephone System Management (repairs, moves, upgrades)		X	
Coordination/Selection of Service providers		X	
Building communications wiring		X	
Prepare/verify telecom. Billings		X	X ¹
Train users on telecom. Systems		X	
Affix corp. seal and sign authorize docs. authorized by SOP		X	
Monitor and reconcile FCSBA funds and securities		X	
Ensure funds are deposited in approved depository		X	
Process FCSBA employee payroll		X	
Maintain payroll records and file all required tax forms		X	
Working knowledge of FCSBA accounting system		X	
Reconcile FCSBA bank accounts monthly		X	
Process all payables		X	
Prepare/track all services by FCSBA to FCA & tenants		X	
Manage records maintenance and disposition		X	X
Manage asset inventory		X	X
Maintains/distributes to member banks approved Board results, records, minutes & proceedings related to the FCSBA			X ¹
Issue quarterly assessment letters & ensure monies received			X
Handles calls to FCSBA			X
Schedules/oversees training rooms at FCSBA			X
Coordinator for all functions in building			X
Process and maintain all FCSBA correspondence, general and accounts payable files			X ¹
Update/maintain all art and furniture inventories			X
Maintain Kastle logs/parking			X
Orders supplies, monitors coffee monies/program			X
In charge of entire vending program			X
Maintain/orders office and building supplies			X
Oversee security, logs, reports & follow up on any issues			X
Oversees daily operations of cafeteria service			X
In-house decorator for furniture, carpet, wall coverings, remodeling			X
Handles/coordinates FCA and tenant requests			X
Assists Telecom. Manager with billings for monthly phone bill			X ¹
Serves as EIC when President is out			X ¹

¹New duties since March 2003 when Acting President was selected.

²Contracting for Telecommunication services.

Appendix 2 – MANAGEMENT RESPONSE

Memorandum

Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090



March 3, 2004

To: Steve Smith
Inspector General

From: Michael M. Reynolds
Chairman and CEO

Subject: Response to OIG Audit 03-02

Thank you for the opportunity to respond to your latest draft report entitled, "Draft Audit Report on FCSBA Business Practices (Audit No. 03-02)." The report contains five Agreed Upon Actions aimed at improving the operations of the Farm Credit System Building Association. The goal of your report is to be commended.

On behalf of the Farm Credit Administration Board of Directors, I would like to state that we concur with the proposed actions. As such, I have directed the Acting Building Association President, Rick Albrecht, to develop an Action Plan with a detailed timetable for implementation.

The Action Plan will be developed, reviewed and approved by the Board within the next 30 days, after which we will forward it to your office.

Again, thank you for the opportunity to comment on your report.