

# Office of Inspector General

Semiannual Report  
to the Congress

October 1, 2004  
to  
March 31, 2005



Number 32  
March 2005



April 29, 2005

The Honorable Nancy C. Pellett  
Chairman of the Board and  
Chief Executive Officer  
Farm Credit Administration  
McLean, Virginia 22102

Dear Ms. Pellett:

Enclosed is the semiannual report on the activities of the Farm Credit Administration's Office of Inspector General for the period October 1, 2004 through March 31, 2005. We are filing this report in accordance with the Inspector General Act of 1978, as amended (Act). This is the thirty-second report since creation of the office on January 22, 1989. Section 5(b) of the Act requires that you send this report to the appropriate Congressional committees and subcommittees within 30 days after the date of this transmittal, with management's report on the status of audit recommendations.

In this second semiannual report addressed to you as Chairman, I am optimistic that the Agency has demonstrated a renewed commitment to address some long-standing management challenges. I am hopeful that the commitment results in the implementation of a number of agreed upon actions and continued recognition of the partnership to improve the Agency. There was a slight decline in the number of open recommendations during this reporting period which marked a reversal of the trend over the past several years. Moreover, management decisions were reached on all open recommendations. I look forward to working with you and FCA managers to continue these positive trends.

Respectfully,

Stephen G. Smith  
Inspector General

Enclosure

# TABLE OF CONTENTS

<b>EXECUTIVE SUMMARY</b>	<b>1</b>
<b>BACKGROUND</b>	<b>2</b>
<b>MANAGEMENT CHALLENGES</b>	<b>2</b>
<b>FARM CREDIT SYSTEM RISK</b>	<b>2</b>
<b>HUMAN CAPITAL</b>	<b>3</b>
<b>AGENCY GOVERNANCE</b>	<b>4</b>
<b>STRATEGIC PLANNING</b>	<b>4</b>
<b>FINANCIAL MANAGEMENT</b>	<b>4</b>
<b>LEVERAGING TECHNOLOGY</b>	<b>5</b>
<b>AUDIT AND INSPECTION REPORTS ISSUED</b>	<b>6</b>
<b>CALL REPORT DATA VERIFICATION</b>	<b>6</b>
<b>INDEPENDENT FINANCIAL AUDIT</b>	<b>6</b>
<b>STATUS OF UNIMPLEMENTED RECOMMENDATIONS</b>	<b>6</b>
<b>AUDITS</b>	<b>7</b>
<b>INSPECTIONS</b>	<b>8</b>
<b>INVESTIGATIONS</b>	<b>8</b>
<b>LEGISLATION AND REGULATIONS</b>	<b>8</b>
<b>OTHER ACTIVITIES</b>	<b>9</b>
<b>APPENDIX A</b>	<b>11</b>
<b>TABLE 3. AUDIT / INSPECTION REPORTS ISSUED</b>	<b>11</b>
<b>TABLE 4. REPORTS WITH QUESTIONED COSTS</b>	<b>11</b>
<b>TABLE 5. REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE</b>	<b>12</b>
<b>APPENDIX B</b>	<b>13</b>
<b>FARM CREDIT ADMINISTRATION ORGANIZATION CHART</b>	<b>13</b>
<b>FCA OFFICE OF INSPECTOR GENERAL ORGANIZATION CHART</b>	<b>14</b>
<b>APPENDIX C</b>	<b>15</b>
<b>INDEX OF REPORTING REQUIREMENTS</b>	<b>16</b>

## EXECUTIVE SUMMARY

This Semiannual Report to the Congress summarizes the activities and accomplishments of the Farm Credit Administration (FCA or Agency), Office of Inspector General (OIG) and covers the period October 1, 2004 through March 31, 2005. Our efforts were directed toward performing audits, inspections, and evaluations of FCA programs and operations, conducting investigations, and providing technical assistance and advice on FCA programs.

Dallas P. Tonsager was appointed as an FCA Board member on December 1, 2004 for a term that expires May 21, 2010, replacing Michael M. Reyna as a Board member.

The Chairman, Nancy C. Pellett, has made some changes in top management of the Agency. With such changes, there are opportunities to implement new ideas that can bring about improvements in the Agency. There are also risks that important controls may be lost in the changes.

During this period of transition, management initiated several actions that show promise of resolving some of the long-standing recommendations. The number of unresolved recommendations has decreased and the Chairman has demonstrated a commitment to resolve long-standing recommendations and address the management challenges by committing resources to correct issues. Specifically, FCA strategic studies initiated by the Chairman are promising because they aim to refine Agency processes and prepare the organization for environmental changes over the next 5 to 7 years.

## BACKGROUND

The FCA is an independent Federal agency of the United States government responsible for the regulation, examination, and supervision of institutions chartered under the Farm Credit Act of 1971, as amended (Farm Credit Act). FCA is a non-appropriated agency with a fiscal year (FY) 2005 budget of \$39.4 million for administrative costs. The FY 2005 budget for the OIG was \$908,375. FCA is a “designated Federal entity” within the meaning of the Inspector General Act of 1978, as amended.

FCA currently has 278 employees, about half of which are examiners located at five field offices. This is a three percent decrease in staffing during this reporting period and five percent decrease from the same reporting period last year. The OIG maintains five positions. Appendix B displays the organizational structure of FCA and Appendix C displays the OIG within that structure.

## MANAGEMENT CHALLENGES

This part of the semiannual report highlights major challenges confronting the Agency as it works to fulfill its mission. These challenges have remained for several years. While some are outside of the Agency’s control, most should be addressed through concerted action by management. Over the past 6 months, the OIG has observed a continued commitment by FCA management in addressing the challenges.

### Farm Credit System Risk

The Farm Credit System (FCS or System) is a single industry lender and is vulnerable to economic swings. FCS remains sound in all material respects. Earnings and capital levels have continued to strengthen and asset quality remains high. However, there are many challenges facing agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act in order to enhance agricultural and rural economies of the future.

In the early 1990s, the Government Accountability Office (GAO) conducted a comprehensive study of the cost and availability of credit in rural America,<sup>1</sup> The GAO concluded that the System did not need new statutory authorities in the near term, but that ongoing structural changes in agriculture and rural America could justify such changes in the longer term. GAO noted that over time, as agriculture and rural America continued to change, the System’s charter may need to be updated to ensure that the System is not hampered by outdated restrictions.

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<sup>1</sup> GAO/GGD-94-39 Farm Credit System Repayment of Federal Assistance and Competitive Position, March 1994

The FCA must 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. FCA's challenge is complex because it has become increasingly difficult to reconcile significant provisions of the Farm Credit Act with the realities of the agricultural industry, the business environment, and financial markets in the 21<sup>st</sup> Century. FCA management recognizes this challenge as evidenced by the Chairman's testimony before the House Agriculture Subcommittee on Conservation, Credit, Rural Development, and Research in September 2004.

As a financial regulator, FCA must maintain a flexible and responsive regulatory environment. The Agency can anticipate that the System will press for broader powers through regulatory interpretations of the Act. At the same time, FCA must anticipate that the System's competitors will press for more regulatory constraints on the System. In balancing these forces, the FCA Board must remain vigilant that its actions are transparent and congruent with its regulatory philosophy. Without these ingredients, the Agency risks being labeled as inflexible by the System or a captive by the System's competitors.

## **Human Capital**

In March 2001, the OIG recommended FCA develop a human capital plan and FCA management agreed to this recommendation. Under Chairman Pellett's leadership, senior managers have focused on the challenge of marshalling, managing, and maintaining human capital to maximize FCA performance and assure its accountability. While FCA still does not have a human capital plan, the Agency has made a significant investment in these strategic studies that can serve as the plan's foundation. The objective of the strategic studies is to create a picture of the System in 5 to 7 years and identify changes that can help FCA adapt to the environmental changes. The approach is a marked contrast to our prior semiannual reports where we noted the problem was the lack of a consistent strategic approach in establishing a human capital plan.

FCA's challenge will be to transform the strategic studies into management actions (organizational changes and process improvements) that achieve better results and clarify accountability. Realignment of resources and/or processes may help FCA pursue organizational approaches that recognize the reality of evolving technology, a changing workforce, and other environmental forces. For example, as competitive sourcing, electronic government (E-Government), financial management, and other initiatives lead to changes—how FCA meets its mission may need to change, including the skill sets it needs and how it organizes those skills to meet its mission.

Transparency, staff commitment, and accountability are key ingredients to sustained improvements in human capital.

## **Agency Governance**

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. A small full-time Board presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the Agency. The Board must be able to engage in professional policy debate and set a sound course for the Agency. The Board and the Agency are most effective when they can focus on the business of the Agency instead of lower level operational issues. The Board's rules of operation are a foundation for trust and shared expectations among Board members. A collegial Board founded on mutual trust and respect is essential to FCA's ultimate effectiveness.

The Chairman has taken action to address this challenge by sharing authority and tasking a Board member with the responsibility to lead the Board in its efforts on governance issues. During the past 6 months, the OIG has noted management efforts to review, deliberate, and revise Board policies including the Board's rules of operation. This has resulted in significant progress towards addressing this long-standing management challenge.

## **Strategic Planning**

The FCA Board adopted a Strategic Plan a year ago. Since adoption, the Agency has a new Chairman and a new Board member. The changes in top leadership provides an opportunity to refine strategies and alignment to ensure the Board's vision is accomplished.

The Board and Agency staff have refined the performance measures. Further refining performance measures may enhance a results-oriented culture at FCA. The Agency will need to achieve a balance among results, public expectations, and employee issues. FCA should evaluate its performance measures to ensure that they challenge and stretch the organization. Performance measures can be a powerful tool to continue the push into a results-oriented organization. An effective performance management system fosters performance and accountability at the individual, organizational, and ultimately overall Agency levels.

## **Financial Management**

Timely, accurate, and useful financial information is essential for:

- making day-to-day decisions;
- managing the Agency's operations more efficiently, effectively, and economically;
- supporting results-oriented management approaches; and
- ensuring accountability on an ongoing basis.

During FY 2001, FCA successfully implemented a financial management system using the services of the Department of Interior's National Business Center (NBC).

During September 2003, the Agency decided to reprogram funds and purchase a new financial system. Management originally scheduled implementation of the new system during FY 2004. However, implementation has been delayed until July 1, 2005. During the prior reporting period, the OIG performed an inspection that showed significant improvements are needed in project management to successfully complete implementation.

Management's challenge is to bring yet another system on line at a reasonable cost to the FCA and concurrently leverage the system to deliver timely financial information critical for making well-informed management decisions. The challenge suggests the Agency should develop measures of financial management success beyond an unqualified financial statement audit opinion. 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 improvements.

During this reporting period, new financial reports were made available that can serve as an important tool to enhance FCA's business operations and management culture. FCA took an important step to get information into the hands of managers. FCA will also need to improve managers' ability to use the information to measure, control, and manage costs, to manage for results, and to make timely and fully informed decisions about allocating limited resources. Meeting this challenge will help FCA ensure that underlying financial management processes, procedures, and information are in place for effective program management.

## **Leveraging Technology**

Information technology (IT) is a key element of management reform efforts that can help dramatically reshape government to improve performance and reduce costs. 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's challenge is to establish effective mechanisms to ensure that current and future staff has the skills to use technology to operate in an efficient and effective manner.

Internally, there is an opportunity for IT to complement human capital initiatives to reformulate the work processes of FCA. There is also an opportunity to capture knowledge of employees who are approaching retirement. In order to take advantage of these opportunities, FCA will need to invest in training and reward employees who are able to develop innovative approaches to accomplish Agency goals using technology.

Externally, E-Government offers many opportunities to better serve the public, make FCA more efficient and effective, and reduce costs. FCA has begun to implement some E-Government applications, including the use of the Internet to collect and disseminate information and forms. Here, FCA's challenge is to identify opportunities to develop partnerships with other agencies to develop joint E-Government strategies.



## AUDIT AND INSPECTION REPORTS ISSUED

We conduct all audits in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are in accordance with the *President's Council on Integrity and Efficiency's Quality Standards for Inspections*. Copies of most OIG reports are available on FCA OIG Web site ([www.fca.gov/oig](http://www.fca.gov/oig)), or by contacting the OIG on (703) 883-4030, (703) 883-4359 for TTY, or by e-mail at [ig\\_information@fca.gov](mailto:ig_information@fca.gov).

### Call Report Data Verification

The OIG completed an audit of the Agency's validation process for call report data. The call report is comprised of financial information including a report of condition, report of income, and supporting schedules on the financial condition of the Farm Credit System institutions. The audit objective was to assess the process used by FCA to ensure call report data is accurately reported. We found that overall the call report validation process is adequate to ensure data is accurately reported and examiners are routinely validating significant call report data. However, some improvements are needed in the risk-based examination process for conducting call report validation checks.

### Independent Financial Audit

The Accountability of Tax Dollars Act of 2002 was created as a government-wide initiative. The President's Management Agenda states agencies must continue to improve their financial performance by improving timeliness, enhancing usefulness, and ensuring reliability by obtaining and sustaining a clean audit opinion. In November 2004, the OIG transmitted the Harper, Rains & Knight, PA (HRK) report on the audit of FCA's financial statements for the fiscal year ended September 30, 2004. HRK issued an unqualified opinion. HRK opined the financial statements present fairly, in all material respects, the financial position of FCA as of September 30, 2004 and 2003, in conformity with generally accepted accounting principles. HRK issued two other reports. The report on internal controls noted no matters that HRK considered to be material weaknesses. The HRK report on compliance with laws and regulations found no instances of noncompliance.

## STATUS OF UNIMPLEMENTED RECOMMENDATIONS

At the beginning of the period, there were 18 unimplemented agreed upon actions for audits and 8 unimplemented recommendations for inspections. During this period, two more agreed upon actions were issued. Management took final action on 5 of the agreed upon actions. At the end of this reporting period, 15 agreed upon actions and 8 recommendations remain unimplemented.

## Audits

The following table summarizes the final actions management took on open audit items.

<b>Table 1. Audit Agreed-Upon Actions</b>				
<b>Audit Report</b>	<b>Issued</b>	<b>Open during this 6-month period</b>	<b>Final Management Actions during this period</b>	<b>Open on 04/01/2005</b>
Performance Budgeting	03/23/01	2	0	2
Office of Chief Financial Officer	01/24/02	2	0	2
Loan Account Reporting System	08/28/03	4	0	4
FCSBA Business Practices	03/09/04	5	4	1
Human Capital: Job Classification	06/29/04	5	1	4
Call Report Data Verification	02/03/05	2	0	2
<b>Total</b>		<b>20</b>	<b>5</b>	<b>15</b>

The OIG issued audit reports on Performance Budgeting over 4 years ago and the Office of Chief Financial Officer more than 2 years ago. Two of the original agreed upon actions from each of these reports remain open. However, as noted in the management challenges, the Agency has made progress on the agreed upon action concerning a human capital plan.

The OIG issued an audit report on the quarterly collection of detailed borrower data (Loan Account Reporting Data) 18 months ago that included nine action items. Since the report's issuance, four action items remain open.

The OIG issued an audit report during the last reporting period on the business practices of the FCS Building Association. The FCS Building Association, in coordination with FCA, implemented changes and improvements in operations that resulted in closing four of the five agreed upon actions and has made significant progress on the remaining agreed upon action.

## Inspections

The following table summarizes the final action that management took on recommendations contained in two inspection reports.

<b>Table 2. Inspection Recommendations</b>				
<b>Inspection Report</b>	<b>Issued</b>	<b>Open during this 6-month period</b>	<b>Final Management Actions during this period</b>	<b>Open on 04/01/2005</b>
FCA Board Policies	09/15/03	3	0	3
Project Management	09/09/04	5	0	5
<b>Total</b>		<b>8</b>	<b>0</b>	<b>8</b>

The OIG issued an inspection report on FCA Board Policy Statements a year and a half ago. Management made decisions on the recommendations and has committed resources to address the issues noted in the report.

In the inspection report on FCA's project management, the OIG made five recommendations for improved project management that can be applied to FCA's future large-scale projects. Management made decisions on these recommendations and is working towards resolution.

## Investigations

Most OIG Hotline calls and e-mails dealt with borrower complaints concerning FCS institutions and other FCS issues. These were referred to the FCA office responsible for reviewing such matters. All other Hotline calls were addressed or were referred to the appropriate FCA office or other Federal agency.

One investigation was open at the beginning of this reporting period and it was closed during this reporting period. The investigation involved the performance rating program within the Agency. The OIG substantiated problems and referred the matter to the Chairman for administrative action. No new investigations were opened for this 6-month period.

## Legislation and Regulations

OIG staff reviewed several FCA regulations in both proposed and final form. Statutory and regulatory compliance issues were reviewed as they arose in the evaluative process. Also, we reviewed and commented on proposed legislation affecting the Inspector General community through the legislation committee of the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency (PCIE/ECIE).

OIG provided comment on the FCA proposed rule on Loan Syndication Waiver of Borrower Rights. The OIG also reviewed regulations on liquidity and investments, governance of the System and receivership.

## **Other Activities**

### ***Observations***

During this reporting period, the OIG has continued the use of Observations to provide management feedback on issues that came to our attention during the process of performing other OIG work. In this 6-month period, we commented on the internal procedures involving job evaluation reconsideration and on new legislation involving the appointment of a Chief Privacy Officer.

### ***Survey of Farm Credit System Institutions***

OIG administers an ongoing Agency survey of the regulated institutions of the FCS. The survey objectively measures the quality and consistency of the Agency's examination and enforcement functions. During the reporting period, OIG issued a report on the survey results for fiscal year 2004. During fiscal year 2004 OIG sent 71 surveys and received 53 responses. During this reporting period, there were no enforcement actions. Overall, Farm Credit institutions continued to provide favorable ratings. Further, the 75 percent response rate on the survey was a significant increase over the prior year's rate of 54 percent.

### ***Investigation Peer Review***

Our office completed the fieldwork for the PCIE/ECIE quality assessment review of the U.S. Government Printing Office investigative operations.

### ***Internal Processes***

This reporting period we initiated a review of OIG operating procedures. In addition, OIG provided input into several Agency policies and procedures concerning governance and non-Federal audits.

### ***OIG Performance Measures and Strategic Plan***

This is the tenth year this office has been using performance measures. Each year we assess the validity of the measures, update our benchmarks, as appropriate, and use the performance results to review and/or improve our effectiveness. We issue a report on our performance each year. It is available on the FCA OIG Web page at [www.fca.gov/oig](http://www.fca.gov/oig).

During this reporting period, OIG issued a strategic plan for FY 2005-2010. See Appendix C.

### ***Staff Participation in Activities of the Professional Community***

OIG staff members are encouraged to take part in organizations that contribute to the mission of the Inspector General community, as well as their individual

professional development. Most staff is actively involved in one or more professional organizations as well as ad hoc activities of the PCIE/ECIE.

During this reporting period, a staff member participated in a panel to recommend candidates for the Inspector General of Montgomery County, Maryland, to the County Council. The Inspector General participated as a panel member at the Government Printing Office for rating and ranking of the Assistant Inspector General for Auditing candidates.

***Staff Participation in Agency Organizations***

Staff is active on several Agency workgroups and task forces. During this reporting period, the OIG was represented in Blacks in Government, Administrative Burden Reduction Workgroup, the Federal Women's Program, the Combined Federal Campaign, and the E-Travel Workgroup.

***Staff Development***

The OIG employees continually seek ways to improve skills and become knowledgeable in IG community efforts. The Inspector General participated in Association of Government Accountants' 15th Annual Leadership conference and the Government Auditing Conference sponsored by the Institute of Internal Auditors.

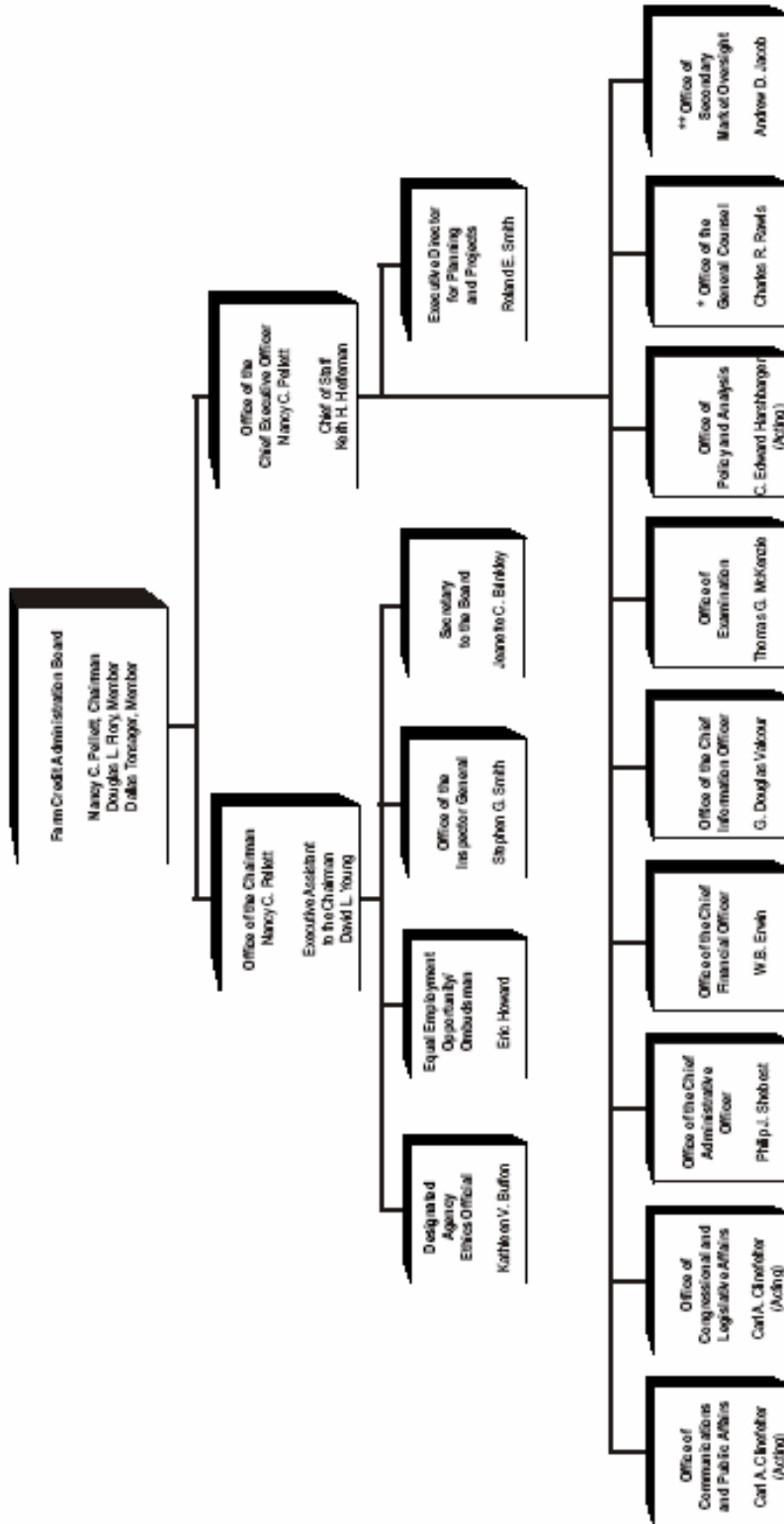
APPENDIX A

<b>Table 3. Audit / Inspection Reports Issued</b>			
<b>Title of Report</b>	<b>Number of Agreed Upon Actions/ Recommendations</b>	<b>Questioned Costs</b>	<b>Recommendations That Funds Be Put to Better Use</b>
Call Report Data Verification	2	\$ 0	\$ 0
FCA FY 2004 Financial Statement	0	\$ 0	\$ 0
<b>Total</b>	<b>2</b>	<b>\$ 0</b>	<b>\$ 0</b>

<b>Table 4. Reports with Questioned Costs</b>				
	<b>Number</b>		<b>Dollar Value</b>	
	<b>Reports</b>	<b>Recs.</b>	<b>Questioned Costs</b>	<b>Unsupported Costs</b>
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0	\$ 0
<i>Subtotals (A+B)</i>	0	0	\$ 0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0	\$ 0
(i) dollar value of disallowed costs	0	0	\$ 0	\$ 0
(ii) dollar value of costs not disallowed	0	0	\$ 0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0	\$ 0

<b>Table 5. Reports with Recommendations that Funds be Put to Better Use</b>			
	<b>Number of Reports</b>	<b>Number of Recs.</b>	<b>Dollar Value</b>
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0
<i>Subtotals (A + B)</i>	0	0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0
(i) dollar value of recommendations that were agreed to by management	0	0	\$ 0
--based on proposed management action	0	0	\$ 0
-- based on proposed legislative action	0	0	\$ 0
(ii) dollar value of recommendations that were not agreed to by management	0	0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0

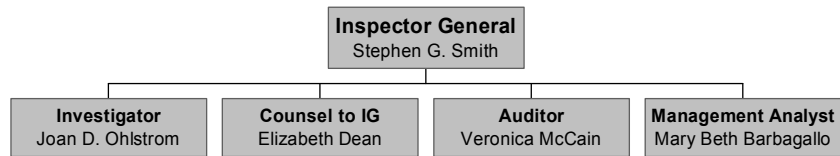
APPENDIX B



\* Maintains a confidential advisory relationship with each of the Board members.  
 \*\* Reports to the Board for policy and to the CEO for administration.



## Farm Credit Administration Office of Inspector General



APPENDIX C

KEY EFFORTS, EXPECTED OUTCOMES AND INITIATIVES	
<b>Key Effort 1: Provide value-added customer service to the FCA.</b>	
Expected Outcomes	Initiatives
OIG will continue to ensure: <ul style="list-style-type: none"> <li>◆ FCA is effective and independent arms-length regulator</li> <li>◆ FCA efficiently manages its resources</li> <li>◆ FCA's stakeholders have confidence in the integrity of the Agency and its employees</li> </ul>	Provide insight to the board where possible risks/challenges are foreseen in regulations and/or System initiatives.  Recommend improvement to make operations more efficient/effective.  Prevent/detect fraud, abuse, and mismanagement to ensure integrity of FCA employees and programs.
<b>Key Effort 2: Enhance communication and coordination with Board, agency management and other stakeholders.</b>	
Expected Outcomes	Initiatives
OIG will build: <ul style="list-style-type: none"> <li>◆ A relationship of mutual trust with FCA</li> <li>◆ Effective communication with Congress</li> <li>◆ A network of mutual support among other OIGs</li> <li>◆ Innovative approaches to reporting on work performed.</li> </ul>	Ensure open communication between OIG and FCA Board, management and staff.  Timely inform Congress and other stakeholders of FCA operation and progress in meeting current challenges.  Create innovative and user-friendly reporting mechanisms to educate and assist.
<b>Key Effort 3: Continually assess OIG operations to identify methods to increase productivity and enhance resource use.</b>	
Expected Outcomes	Initiatives
We will foster continuous improvements by: <ul style="list-style-type: none"> <li>◆ Refining our measures of performance</li> <li>◆ Evaluating and improving our work processes</li> <li>◆ Adhering to PCIE/ECIE quality standards</li> <li>◆ Investing in training and development opportunities for OIG staff</li> </ul>	Utilize technology to increase productivity and reduce processing time.  Increase success in our accomplishments through appropriate and rigorous performance measures.  Meet established standards ensuring the quality, validity and integrity of products.  Expand knowledge through employee development using external and internal opportunities and expertise.

## INDEX OF REPORTING REQUIREMENTS

<b>INSPECTOR GENERAL ACT CITATION AND REQUIREMENT</b>	<b>PAGE</b>
Section 4(a)(2) Review of Legislation and Regulations.....	8
Section 5(a)(1) Significant Problems, Abuses and Deficiencies .....	none
Section 5(a)(2) Recommendations for Corrective Action .....	none
Section 5(a)(3) Prior Recommendations Not Yet Implemented.....	6-7
Section 5(a)(4) Matters Referred to Prosecutive Authorities .....	none
Section 5(a)(5) Summary of Instances Where Information .....	none
Was Unreasonably Refused or Not Provided	
Section 5(a)(6) List of OIG Audit/Inspection Reports.....	8
Section 5(a)(7) Summary of Significant Reports .....	6
Section 5(a)(8) Statistical Table on Management Decisions.....	11
with Questioned Costs	
Section 5(a)(9) Statistical Table on Management Decisions on .....	12
Recommendations that Funds be Put to Better Use	
Section 5(a)(10) Summary of Each Audit Over Six Months Old for .....	7
Which No Management Decision Has Been Made	
Section 5(a)(11) Significant Revised Management Decisions .....	none
Section 5(a)(12) Significant Management Decisions with Which .....	none
the Inspector General Disagreed	
Section 5(a)(13) Compliance of Agency Financial Management System .....	6

# R E P O R T


Fraud ❖ Waste ❖ Abuse ❖ Mismanagement




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