

OFFICE OF  
INSPECTOR GENERAL

## Survey Report

Survey of  
Farm Credit System Institutions  
Regarding the Agency's  
Examination Function

First Quarter  
Fiscal Year 2017  
(Oct. 1 - Dec. 31, 2016)

Issued March 22, 2017



FARM CREDIT ADMINISTRATION

**Office of Inspector General’s Survey of Farm Credit System Institutions  
Regarding the Agency’s Examination Function  
First Quarter Fiscal Year 2017 Summary Report  
(October 1 - December 31, 2016)**

**Introduction**

During the period October 1 – December 31, 2016, the Office of Examination identified eighteen Farm Credit System (FCS) institutions that were in a position to provide meaningful survey responses.

The Office of Inspector General (OIG) sent surveys to those institutions on February 13, 2017. Seventeen of the eighteen institutions surveyed submitted completed surveys (94% response rate). When outstanding responses from prior quarters are received, they are included in the next quarterly report. The OIG did not receive any responses to prior surveys; therefore, no additional responses are included in this report.

The OIG will continue to provide a report to you based on each Fiscal Year (FY) quarter-end, i.e., December 31, March 31, June 30, and September 30, so that you may timely take whatever action you deem necessary to address the responses. The fourth quarter report will include FY 2017 summary data.

The survey asks respondents to rate the eight survey statements from "1" (Completely Agree) to "5" (Completely Disagree). The rating options are as follows:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5
Does Not Apply (not included in averages)	6

Narrative responses are provided verbatim, except identifying information has been removed and any grammatical, punctuation and spelling errors may have been corrected. Any narrative in “brackets” is explanatory information provided by the OIG based on conversations with institution management.

**Survey Results – First Quarter FY 2017**

Average numerical responses to survey statements 1–8 ranged from 1.6 to 2.0 for the first quarter.

Average Numerical Response Range to Survey Statements 1–8			
1 <sup>st</sup> Quarter FY17	4 <sup>th</sup> Quarter FY16	3 <sup>rd</sup> Quarter FY15	2 <sup>nd</sup> Quarter FY16
1.6 – 2.0	1.3 – 2.0	1.6 – 2.2	1.5 – 2.2

The average numerical response for all survey statements was 1.8 for the first quarter.

Average Numerical Response for all Survey Statements			
1 <sup>st</sup> Quarter FY17	4 <sup>th</sup> Quarter FY16	3 <sup>rd</sup> Quarter FY15	2 <sup>nd</sup> Quarter FY16
1.8	1.7	1.9	1.9

In this quarter, there were more positive than negative narrative comments to survey statements 1–8. (Perceived negative comments of any degree are color coded in maroon.)

Survey item 9 asks for feedback on the most beneficial aspect of the examination process. Consistent with prior quarters’ responses to this survey item, many very positive comments were provided about the examiners and the examination process.

Survey item 10 asks for feedback on the least beneficial aspect of the examination process. While most were negative, as would be expected, several comments provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments from the board as a whole. It elicited a number of thoughtful responses from full boards, which was the objective of the question.

### EXAMINATION PROCESS

**Survey Statement 1:** The scope of examination activities was focused on areas of risk to the institution and appropriate for the size, complexity, and risk profile of the institution.

**Average Response: 1.8**

Statement 1	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.8				1.8
FY 2016	1.6	1.8	1.9	1.7	1.8
FY 2015	2.4	1.8	1.9	1.9	2.0
FY 2014	2.0	2.2	2.4	1.9	2.1

**Comments:**

- Overall, very balanced review. **Compliance with more minor issues at times overshadows core business issues.**
- Because of the running nature of our audit process, **additional focus areas were added in mid review cycle that create challenges.**
- The most recent FCA examination of the institution focused on material safety and soundness issues, internal controls, portfolio management, and regulatory compliance. These are areas we would anticipate for review.
- The primarily focus of the exam activities were on the deterioration in credit quality due to the decline in commodity prices and resulting lack of customer profitability – along with internal controls and standard of conduct controls. The questions related to this area of concern were appropriate and in-line with the risk in the portfolio. There was also recognition that the size of the earnings, capital and organizational capabilities (technology, robust portfolio management practices, etc.) are considerations in determining appropriate actions to manage through economic cycles.
- As a result of the risk assessment, the examination focused primarily on board and management operations, financial reporting and disclosures, funding operations, and information technology. To complete the risk assessment, the examiners considered the institution's Strategic and Operational Business Plan, policies and procedures, previous examination findings and any recent changes.
- We have a good diversified well run institution and as a board we are very involved. Management does a good job of providing the information needed to understand our risks. We like it when FCA

focuses on credit and financial risks, but all the policies seems over kill to us. You have to have a policy for everything - seems burdensome to our operation.

- There was a good mix of administrative and Information Security Controls examined.

**Survey Statement 2:** Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.

**Average Response: 1.8**

Statement 2	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.8				1.8
FY 2016	1.9	1.8	2.1	1.8	1.9
FY 2015	2.0	1.7	1.5	1.8	1.8
FY 2014	1.8	2.1	1.9	1.8	1.9

**Comments:**

- We appreciate that the examination team asks thoughtful questions and encourage discussion especially in the area of allowance and Capital to help establish a baseline of understanding.
- In general, the "required actions" noted in our exam report that were directly tied to regulatory criteria as would be viewed as appropriate by our institution.
- Appropriate laws and regulations were appropriately referenced during the exam. The chattel collateral management regulations were in the early stages of review and subsequent guidance has since been discussed and provided to the System. The FCA team has worked proactively with the System to come to a short-term position with the intent of addressing the regulation as soon as possible - first proactively seeking input from System representatives.
- Throughout the report, FCA's examination conclusions and results were supported by FCA regulations and best practices.
- The examiners were courteous and not outside the rules, regulations or other criteria. In fact we felt the last examination group used more common sense than previous reviews.

**Survey Statement 3:** The recommendations, required actions, and any supervisory agreement with FCA assisted the board and management in addressing the risks of the institution.

**Average Response: 1.8**

Statement 3	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.8				1.8
FY 2016	2.1	2.2	2.1	2.0	2.1
FY 2015	2.1	1.8	2.0	2.3	2.1
FY 2014	1.7	2.0	2.1	2.1	2.0

**Comments:**

- Generally, yes.
- Required and recommended actions noted in the exam report were reviewed by board and management and agreed to be appropriate processes or practices, and of benefit for the institution. In each case (required and recommended) actions are being taken as prescribed by FCA.

- The recommendations and required actions were reasonable and consistent with the examination findings.
- Management agreed to the one recommendation to expand the business continuity plan to reflect updates in key contracts.
- Particularly this last examination was helpful in areas that needed corrections or improvements.
- The Supervisory Letter prompted the board to merger with another institution for stronger management, which was likely necessary in the near future.
- **One recommendation in particular was not clear. Because we service ACAs, the recommendation for DLP was unclear as to the recommended action, or deliverable.**

**Survey Statement 4:** The examiners were professional and efficiently conducted examination activities.

**Average Response: 1.8**

Statement 4	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.8				1.8
FY 2016	1.5	1.5	1.8	1.3	1.5
FY 2015	1.5	1.6	1.9	1.5	1.6
FY 2014	1.4	2.2	1.8	1.6	1.8

**Comments:**

- The examination team acted in a very professional manner.
- FCA examiners were professional and courteous. **A point to note was that the off-site review process included unscheduled calls which would get into detailed/specific questions with little opportunity for our staff to prepare or research responses.** Having a question list provided in advance of a call would be beneficial to the discussion process.
- The exam team was professional and cooperative, yet maintained appropriate independence in the process.
- The examiners were very professional demonstrating good judgement and discretion.
- **The examination was somewhat unorganized.** Part of the reason for this could be the turnover of the EIC near the start of the examination.
- They have never been discourteous, but the last team displayed a "common sense" approach. What needed discussing was discussed and what was minor was left alone. We like the last examiner in charge.
- The examiners conducted themselves professionally whenever I met with them.
- Very professional.

## COMMUNICATIONS

**Survey Statement 5:** Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

**Average Response: 1.6**

Statement 5	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.6				1.6
FY 2016	1.8	1.7	1.8	1.6	1.7
FY 2015	1.5	2.0	1.7	1.8	1.8
FY 2014	1.6	2.2	2.0	1.7	1.9

**Comments:**

- Generally yes – **although at times questions were not specific enough for us to determine if we had appropriately addressed the question/concern.**
- EIC \_\_\_\_\_, Supervisor \_\_\_\_\_, and staff were good at raising questions to ensure clarity and understanding of situations before making conclusions. We appreciate the opportunity to discuss the situations where Examiners had questions.
- The institution was provided with adequate advance notice of the exam activity. The exam team was open and transparent with challenges and findings, and the final recommendations/findings were consistent with what was discussed during the exam process.
- Communication between the FCA auditors and staff was effective. Management received an advance request list and the entrance meeting introductions and planning provided a good framework for the examination period.
- Communication from the examiner in charge and his assistant is very good.
- There was good and continuous feedback through the exam process.

**Survey Statement 6:** Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.

**Average Response: 1.8**

Statement 6	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.8				1.8
FY 2016	1.7	1.7	1.6	1.6	1.7
FY 2015	2.0	1.8	1.7	1.9	1.9
FY 2014	2.1	2.2	1.8	1.9	2.0

**Comments:**

- **There have been instances where the institution has identified an issue and is implementing a solution and the examiners will take the issue and treat it as if it were a finding of theirs.**
- Exam communications, both verbal and written, during the exam process that management was able to communicate to the Board and Audit Committee, and the exam report findings that were

communicated by FCA directly to the Board and Audit Committee were all viewed as adequate and appropriate.

- In addition to the exam document, a formal on-site close out meeting with the Board of Directors provided an adequate opportunity for dialogue and clarifying questions regarding the results of the exam.
- The FCA presentation to the board of directors was productive and provided a clear understanding of the audit process and examination conclusions.
- We think so.

**Survey Statement 7:** Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

**Average Response:** 1.6

Statement 7	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	1.6				1.6
FY 2016	1.9	1.8	1.9	1.8	1.9
FY 2015	1.8	1.6	1.9	2.1	1.9
FY 2014	1.8	2.2	1.9	2.1	2.0

**Comments:**

- We use the term "balance and perspective" a lot internally, and would complement FCA field staff with practicing this approach as well.
- The FCA examination team was good at encouraging discussion and listening to detail and explanation.
- In each case of finding, FCA examiners brought to our attention questions or observations that allowed for management response before FCA conclusions were made. We appreciated that opportunity.
- The exam team consistently provided opportunities for dialogue to ensure a solid understanding of the institution's processes and viewpoints prior to determining their final position on various findings.
- The exit meeting gave management and auditors the opportunity to review the draft report together and provide clarification when necessary.
- The examiners did on the last review, **not the previous**.
- Other than the DLP recommendation mentioned above, all other recommendations considered the feedback from mgt and BOD.

**Survey Statement 8:** FCS-wide guidance from the Office of Examination was proactive and helpful.

**Average Response:** 2.0

Statement 8	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 2017	2.0				2.0
FY 2016	1.7	2.2	2.2	1.8	2.0
FY 2015	1.9	1.9	2.0	2.2	2.0
FY 2014	2.0	2.2	2.0	2.1	2.1

**Comments:**

- Agree based on change to new EIC.
- I agree and appreciate the disclosure of focus areas for the coming year. **The timing of the announcement can be burdensome if the institution is in the middle of the review when the new focus areas are released, especially when the new focus areas are a result of some issue or situation that has arisen somewhere else in the system. In these instances, the institution has little time to respond or prepare for the new focus area.**
- Yes, there was good dialogue during the course of the exam between the institution and FCA staff on the varied topics and issues that arose during the course of the exam.
- Consistency across exam teams is always important and understandably an ongoing challenge. The current agricultural commodity cycle creates an even stronger need for consistency in philosophy to assure the impact to customers is appropriate and consistent with balancing credit risk and the reputation of the System. System representatives worked proactively with FCA over the past couple of years to develop a consistent approach to managing through the cycle - and we found the exam team not only be fully attuned of the approach, but also consistent and proactive with the desire to execute this approach. An area that was still under discussion and development was FCA's approach to chattel collateral valuation - which since has been further defined.
- **The memorandum issued on August 29, 2016 regarding the guidance on addressing personal and intangible property valuations may have the consequence of reducing the amount of collateral taken to secure a loan. There are times we take secondary collateral to supplement the primary source of loan repayment created by the growing crop or livestock that are liquidated through the course of normal operations. The additional collateral can maintain the soundness of the loan should the value of the primary source of repayment be insufficient as a result of adverse weather, lack of water, or low commodity prices. It wasn't clear to us how the guidance in the IM would be enforced. The uncertainty creates the awkward choice between accepting regulatory risk (increased risk of a regulatory finding relating to how we've substantiated the value of the abundance of caution collateral), or maintaining the soundness of our loans by continuing to take the additional collateral.**
- The Office of Examination is always available to discuss laws, regulations, and other regulatory criteria used in their examinations.
- Yes, we think so.
- We believe we understand the expectations from FCA.

### GENERAL QUESTIONS

**Survey Item 9:** What aspect of the examination process did you find **most** beneficial?

**Comments:**

- Examiners willingness to listen to any follow up information from the institution.
- Honest/Factual/Constructive Feedback.
- Exit conference with the full Board and CEO along with the Exit Conference Memo.
- Good input from EIC on portfolio management and internal controls prior to onsite examination.
- Discussions on specific issues and long-range institution performance.
- The open dialogue on important or emerging issues.

- Hearing from FCA on broader perspectives of system-wide business activity and practices is always beneficial.
- The level of questions and extent of effort the exam team put into understanding our institution's approach to managing through the current industry cycle and then reconciling that with the philosophy developed in coordination with FCA.
- The best practice and collaborative discussion in the boardroom by the exam team was helpful. We also appreciated the collaborative nature of the individuals involved with our exam.
- The advance request list provided the scope of the examination and allowed us to use our resources (i.e., time and staff) in an efficient manner.
- FCA's renewed focus on credit related topics was a positive change.
- Discussing what the staff is doing right. We pay for 5 examinations a year which we believe is a lot but in today's environment necessary as we are told. We see all the spots that need fixing which most of which seem minor in nature and posing minimal risk. Our institution has good growth, earnings, and a 99.5% credit quality that is diverse.
- Providing guidance re: Whistleblower procedures and bringing to light standards of conduct issues/rules.
- Introduction with Examiners.

**Survey Item 10:** What aspect of the examination process did you find **least** beneficial?

**Comments:**

- **It seemed we had repetitive meetings/calls with examiners on the findings.** Though we appreciate the communication and clarity **we felt like the same findings were brought up numerous times through various meetings, emails, phone calls, and with our board at least twice through conference calls, actual attendance at the board meeting and through the well documented final report.**
- **In the past we had some incorrect/partially factual feedback.**
- Exam Team very engaging and respectful to Board's opinion.
- **The need to react to questions that are promulgated by emerging issues in other institutions.**
- **As noted in response 4, the process of receiving a phone call from an FCA Examiner to address questions without review of the issue or preparation time for a response can be challenging.** Providing questions in advance of a phone call would be beneficial.
- **Separate exam teams and process for \_\_\_\_\_ and \_\_\_\_\_.** The strategic alliance between these two entities provides for consistent origination, monitoring and underwriting practices. This will change in 2017 as the FCA oversight of both institutions has been merged under one exam team.
- **The final IT examination letter (separately issued) indicated scores that were materially different than those communicated in our closing conference call. There was no explanation provided for the changed ratings.**
- We provide all requested documents through the secure portal in advance. **However, FCA staff would frequently ask for additional copies once they were onsite.**
- The examiners were good and courteous. **It just seems we are being reviewed to death.** However as a board we know it is vital to have checks and balances and FCA is a good provider of that. **When the final report has nothing major then an exit conference to the entire board is all that is needed.**
- **A few of the suggestions seemed unnecessary.**

**Survey Item 11:** Please provide any comments from the **Board as a whole** regarding the examination process not provided in the preceding responses.

**Comments:**

- It seemed we had repetitive meetings/calls with examiners on the findings. Though we appreciate the communication and clarity we felt like the same findings were brought up numerous times through various meetings, emails, phone calls, and with our board at least twice through conference calls, actual attendance at the board meeting and through the well documented final report. [same response to survey item 10]
- The board felt the examination was very accurate.
- In the past couple examinations, we have noted an increase in required actions and recommendations that go beyond the cited regulation and where the examination team provided specific direction on how to resolve the issue(s). Our institution has always been responsive to addressing regulatory issues identified by the examination process. We believe findings should be based on consistent regulatory guidance and that it is the Board and management's responsibility to use sound business judgment to determine how to best address issues identified in the examination.
- No further comments beyond previously mentioned.
- The examination result format has evolved in a positive way. We have seen other industries follow a process that allows for a process whereby Management has the opportunity to provide comments to the draft report of examination. The result is a final product that reflects management input, which can be more helpful to the directors, and results in a report that may stand on its own.
- The Board was satisfied with the process and results of the examination.
- I believe the merger will be beneficial to both \_\_\_\_\_ and \_\_\_\_\_, due to stronger management and the state of the agriculture economy.
- The frank and open discussion/conversation with \_\_\_\_\_ was very helpful.