

**Fourth Quarter (July 1 – September 30, 2011)
and Fiscal Year (FY) 2011 Summary Report**

**Office of Inspector General's (OIG) Survey of Farm Credit System (FCS) Institutions
Regarding the Agency's Examination Function**

Introduction

Based on the interface FCS institutions had with the Agency's examination function during the period July 1 – September 30, 2011, the Office of Examination (OE) identified 16 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 16 institutions on October 28. Of the 16 institutions surveyed, 10 submitted completed surveys. If the nonresponding institutions subsequently send a completed survey, they will be included in the next quarterly report.

One response to the survey issued for the third quarter of FY 2011 was received subsequent to the third quarter report and is included in this report. As a result, this report covers 11 responding institutions.

The OIG will continue to provide an email report to you based on each 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 as of September 30 will continue to include FY summary data.

The survey asks respondents to rate the nine 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

There is also an available response of "6" (Does Not Apply) for each survey statement.

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

Survey Results – Fourth Quarter FY 2011

Average numerical responses to survey statements 1-9 ranged from 1.5 to 2.4.

Average Numerical Responses to Survey Statements 1 – 9			
4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
1.5 – 2.4	1.5 – 2.4	2.0 – 2.2	1.4 – 2.1

The average response for all survey statements was 1.9.

Average Response for all Survey Statements			
4 th Qtr	3 rd Qtr	2 nd Qtr	1 st Qtr
1.9	1.9	2.1	1.7

The above represents no change from the prior quarter's results. One institution rated survey statements 2 and 7 as "4" (Somewhat Disagree). No other ratings less than "3" (Neither Agree nor Disagree) were recorded.

In this quarter, there were more positive than negative narrative comments to survey statements 1-9. (Negative comments of any degree are color coded in maroon.)

Survey item 10a asks for feedback on the most beneficial aspects 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 10b asks for feedback on the least beneficial aspects of the examination process. As would be expected, most were negative. However, several comments do provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments. Of particular note is the second bullet that speaks to the institution's concern with the potential loss of experience in the examination staff due to retirements.

Survey Results – FY 2011 Summary

For FY 2011, the OIG issued 67 surveys and received 57 completed surveys. This is an 85 percent response rate. An FY 2011 Summary Report is on page 8.

Responses to Survey Statements 1–9

Examination Process

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

Average Response: 1.8 (3rd Quarter was 1.8, 2nd Quarter was 2.0, 1st Quarter was 1.8)

Comments:

- The institution has had a complete management change as well as a new culture initiative. The regulator has been very supportive and involved with the board and management in the genesis of the new structural, human capital, and processes being implemented.
- The timing and scope seems appropriate for our institution's risk level and size.

- Being a small, well capitalized and good earnings institution, with good credit quality, we pose limited risk to the FCS. Appears a longer frequency would benefit FCA by allowing professional resources to be more effectively used.

Survey Statement 2: The examination process helped the institution understand its authorities and comply with laws and regulations.

Average Response: 2.4 (3rd Quarter was 1.7, 2nd Quarter was 2.1, 1st Quarter was 1.9)

Comments:

- The exam process raised issues for discussion regarding interpretation of regulations. The discussion and ultimate resolution was a result of a more common understanding.
- The regulator has opined on DLR and certain consumer compliance matters needing more management training and oversight.
- The examination does little in helping our institution understand its authorities or ability to comply with laws and regulations. The exam process is a regulatory oversight, compliance, and enforcement tool, not an educational nor enhancement experience.
- Institution is abreast of these areas.

Survey Statement 3: The results and recommendations of the examination process covered matters of safety and soundness, and compliance with laws and regulations.

Average Response: 1.9 (3rd Quarter was 1.7, 2nd Quarter was 2.0, 1st Quarter was 1.5)

Comments:

- We agree that the report and processes fairly and accurately addressed safety, soundness and compliance.
- In our opinion, some of the results and recommendations from this exam covered matters of safety or soundness, but others focused on a number of recommendations that were much more focused on agency preferences, interpretations, and philosophies other than critical safety and soundness issues.
- The exams always center on the safety, soundness and compliance, as they should. On occasion minor institution policy questions seem to take too large a role with less experienced examiners, but typically lead examiners help interpret the situation more judiciously.

Survey Statement 4: Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.

Average Response: 1.9 (3rd Quarter was 1.8, 2nd Quarter was 2.2, 1st Quarter was 1.9)

Comments:

- I generally agree. The rapid evolution of financial products, business practices, and regulations, specifically with treasury and funding, is testing the exam group's ability to stay current.

- We have had at times upwards of thirteen examiners of various tenures and experience levels. Whenever there is a mix of experience levels there is also perception of learning curve levels. For the most part we found the examiners to be knowledgeable and fair.
- Very professional.
- **The examiner in charge and senior examiners are knowledgeable. The composition of Agency exam teams in our institution over the past several years has been dominated by trainees and examiners with little tenure. This causes unnecessary confusion between our staff and the exam team let along the inefficiency created by the need for added discussion and clarification of issues.**
- Exam did have several trainee type employees which are working to build their knowledge and experience.

Communications and Professionalism

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

Average Response: 1.8 (3rd Quarter was 1.9, 2nd Quarter was 2.0, 1st Quarter was 1.4)

Comments:

- We have complete and frequent communications with exam staff. Discussions are open, professional, and constructive.
- We believe we have a very strong and clear communication channel open with the OE staff. We believe the communications are clear and we also believe that it is a reciprocal process.
- Examination staff and our own are still adjusting to personnel changes. (Name) used to handle most formal correspondence and now (Name) is in a new compliance role as well.

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: 1.7 (3rd Quarter was 1.5, 2nd Quarter was 2.0, 1st Quarter was 1.7)

Comments:

- The regulator has, in our estimation, never been less than earnest and forthright in the manner and quality of communications.
- The examiners were very open to discussion and able to speak on a variety of topics related to business risk and system soundness. The lead examiner took time to visit with Audit Committee Chair as well as the Audit Committee as a whole during the examination. These discussions are educational for the Audit Committee. It was difficult for examiners to adequately explain how they evaluate third-party risk in the institution and how the institution might go about accessing its third-party risk. The institution does endeavor

to identify and consider third-party risk in its loans and other business dealings; however any insight from experienced examiners would be useful.

Survey Statement 7: The examiners were organized and efficiently conducted examination activities.

Average Response: 2.1 (3rd Quarter was 2.1, 2nd Quarter was 2.0, 1st Quarter was 1.5)

Comments:

- The number of examiners and length of time taken to complete the examination was burdensome. The pre-audit request was neither as well organized nor timely as it has been in the past. A lot of last minute items were requested by the agency.
- With increased use of digitally filed documents, efficiency would be improved with increased off-site review process.

Survey Statement 8: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 1.5 (3rd Quarter was 1.7, 2nd Quarter was 2.0, 1st Quarter was 1.8)

Comments:

- While there will sometimes be some difference of opinion or approach to a specific circumstance, we believe the regulator has been fair in respective observations and recommendations.
- In general, the experienced/tenured examiners were even handed and practical in their findings and conclusions. They were willing to listen to management and consider its position in all matters where differences in interpretation or opinion occurred.

Survey Statement 9: FCS-wide examination guidance from the Office of Examination (e.g., examination bulletins, informational memoranda, etc.) was timely, proactive and helpful.

Average Response: 2.2 (3rd Quarter was 2.4, 2nd and 1st Quarters were 2.1)

Comments:

- The volume of Informational Memoranda (IMs) released recently has created an environment of uncertainty without improving communication or understanding. The number of IMs contribute to confusion regarding Board versus Management roles. Examiners appear to be auditing based on IMs, not formally approved regulations.
- The volume of IM's issued during recent months is significant. The IM's don't differentiate between those that already comply and those that don't. A more targeted approach would be beneficial. Significant time is spent

validating our processes and procedures relative to all IM's issued by the Agency.

Responses to Additional Survey Items 10a, 10b, and 11

Survey Item 10a: What aspects of the examination process did you find **most** beneficial?

- The give and take discussions were very positive.
- The examiners are very professional throughout the exam segments. Examiners and managers frequently update our staff on progress or issues. The exam group has frequent discussions at the senior level where we are actively engaged in discussions on all aspects of the business. Exam results are largely based on a balanced view of our business risks and performance.
- The most beneficial aspect of the examination process is the free, frank and candid discussions of best practices and understanding of the time frame that is practical to implement change.
- (Name) and (Name) have common sense and are good to work with. From a board perspective, we found our recent meeting with the examiners extremely helpful; they are professional, candid and direct. Examiners were constructive; are believed to be sincere in their offer to answer questions or have additional contact when issues arise. While we realize they are there to "audit" they do it constructively rather than searching for items as "gotcha's".
- Making sure we are in compliance with all laws and regulations.
- The discussion that our board and management had with the FCA examiners in charge and their supervisors to convey our thoughts about their findings and our risk management philosophy.
- Communications with individual reviewers with regard to specifics of loan analysis and insight as to their findings.
- Working with EIC was helpful in interpreting FCA bulletins and informational memoranda.
- Compliance part of the exams. We have had so many changes in consumer and regulatory disclosures and compliance that we cannot have too many eyes making sure we are in compliance with all areas of consumer compliance as well as compliance with FCA regulations.

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

- Time taken.
- While we have general concurrence with exam results, some metrics, outside of regulations, are arbitrary and inconsistent with our results and performance.
- We do not have any negative data to report on this question. The examination process if both required and necessary for our institution to "right the ship" and return to profitability.
- We were already aware of many of the concerns or findings.
- The institution was found to be in compliance with all but one regulation, to be in a safe and sound financial condition with capable board and management oversight, yet, many of the recommendations made added no value and simply appeared to micromanage institution operations.

- Spending time with the entry level FCA staff.
- Stress testing/allowance reviews. I did not get clear indications on what the agency thought was best practices in these areas.

Survey Item 11: Please provide any additional comments about the examination process and related communications.

- Very well done with positive results for all.
- We are concerned about the loss of knowledge and expertise that will occur with the older FCA staff as they retire. Do the entry level staff truly understand agriculture? Why not hire more farm background employees similar to what the System does? Would this not make FCA more efficient and would this not be practical as well, since you are dealing in examining Ag Lending institutions.

FY 2011 Summary Report

Numeric Responses to Survey Statements 1-9

Question	Percentage of Total Responses												Total No. Responses	Average Response
	Completely Agree (1)		Agree (2)		Neither Agree nor Disagree (3)		Disagree (4)		Completely Disagree (5)		Does Not Apply *(6)			
1	14	24.6%	38	66.7%	4	7.0%	0	0.0%	1	1.75%	0	0.0%	57	1.9
2	14	24.6%	31	54.4%	8	14.0%	3	5.3%	1	1.75%	0	0.0%	57	2.1
3	16	28.1%	36	63.2%	4	7.0%	1	1.8%	0	0.00%	0	0.0%	57	1.8
4	9	15.8%	43	75.4%	3	5.3%	0	0.0%	2	3.51%	0	0.0%	57	2.0
5	21	36.8%	29	50.9%	5	8.8%	0	0.0%	2	3.51%	0	0.0%	57	1.8
6	19	33.3%	32	56.1%	4	7.0%	2	3.5%	0	0.00%	0	0.0%	57	1.8
7	16	28.1%	32	56.1%	6	10.5%	1	1.8%	1	1.75%	1	1.8%	57	1.9
8	19	33.3%	32	56.1%	4	7.0%	1	1.8%	1	1.75%	0	0.0%	57	1.8
9	6	10.5%	38	66.7%	9	15.8%	4	7.0%	0	0.00%	0	0.0%	57	2.2
Total Responses	134		311		47		12		8		1			1.9

The total number of completed surveys represented in this table is 57.

* "Does Not Apply" not calculated in percentages.