

OFFICE OF  
INSPECTOR GENERAL

# Survey Report

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

Fourth Quarter  
(July 1 - Sept. 30, 2015)  
and  
Fiscal Year 2015 Summary

Issued January 4, 2016



FARM CREDIT ADMINISTRATION

**Fourth Quarter (July 1 – September 30, 2015)  
and Fiscal Year (FY) 2015 Summary Report**

**OFFICE OF INSPECTOR GENERAL'S (OIG) SURVEY OF FARM CREDIT SYSTEM (FCS) INSTITUTIONS  
REGARDING THE AGENCY'S EXAMINATION FUNCTION**

**Introduction**

During the period July 1 – September 30, 2015, the Office of Examination identified 18 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 18 institutions on October 27, 2015. Of the 18 institutions surveyed, 12 submitted completed surveys (67% 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 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. This fourth quarter report includes FY 2015 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 – Fourth Quarter FY 2015**

Average numerical responses to survey statements 1–8 ranged from 1.5 to 2.3 for the fourth quarter.

Average Numerical Response Range to Survey Statements 1–8			
4 <sup>th</sup> Quarter FY15	3 <sup>rd</sup> Quarter FY15	2 <sup>nd</sup> Quarter FY15	1 <sup>st</sup> Quarter FY15
1.5 – 2.3	1.5 – 2.0	1.6 – 2.0	1.5 – 2.4

The average numerical response for all survey statements was 1.9 for the fourth quarter.

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

**Responses to Survey Statements 1–8**

**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: 1.9**

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 15	2.4	1.8	1.9	1.9	2.0
FY 14	2.0	2.2	2.4	1.9	2.1
FY 13	2.0	1.7	1.9	2.0	1.9
FY 12	1.9	2.1	2.1	1.8	2.0

**Comments:**

- The scope in the area of Internal Controls did seem to deepen/change during the examination cycle.
- We agree. However, it is a little difficult to take when the examiners in prior years have not flagged or commented on the SAME situations that we were written up for this year!
- In general, the scope of examination in most areas examined was appropriate. In a number of areas, however, examiners rely on a one-size-fits-all approach based on theoretical concepts that fail to take adequately into account the differences among System institutions, as well as between System and non-System institutions, based on their different business models, risks, markets, portfolios, processes and documentation. In addition, examiners often fail to recognize the validity of different management methodologies and approaches, and instead try to use the examination process to force all institutions to look exactly the same and adopt practices that are not related to their particular business risks. As a result of their assumptions, examiners' recommendations are sometimes not appropriate to the actual situation of the particular institution.
- Agree Examination Scope matched potential risk in our size/profile institution.

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

Average Response: 1.8

FY 14	1.8	2.1	1.9	1.8	1.9
FY 13	1.9	1.6	1.8	2.3	1.9
FY 12	1.8	1.8	1.9	2.0	1.9

**Comments:**

- IA quality assessment not necessarily FCA regulations but best practice within IA guidelines.
- Yes, it appears that the rules and regs were followed.
- While in general examiners have appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions, there are notable and troublesome exceptions. One such exception is the tendency of examiners to apply System or industry "best practices" or informal FCA guidance as though they were legally binding requirements when they are in fact not. While such best practices and informal guidance can be pertinent and useful, sometimes, given all of the circumstances, there are very good reasons not to follow them in a particular institution. In addition, in some areas, such as internal audit, examiners have cited "best practices" without providing any supporting information on which those best practices are based.

Another recurrent problem is the issue of "regulation-by-examination," where an examiner formulates a completely novel interpretation of a regulation in order to impose a new substantive requirement on an institution that the institution could not reasonably have been expected to discover prior to the examination. This practice of looking for new ways in which a regulation can be violated can in effect create new regulatory requirements without proper notice and comment to the regulated institutions or a thorough consideration of the reasonableness of the interpretation. This practice can also result in arbitrary and inconsistent enforcement of the regulations across the System. Examiners should therefore exercise more caution before applying a totally new interpretation in the context of an examination.

**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: 2.3

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 15	2.1	1.8	2.0	2.3	2.1
FY 14	1.7	2.0	2.1	2.1	2.0
FY 13	2.0	2.0	1.8	2.2	2.0
FY 12	2.1	2.0	2.4	2.0	2.1

**Comments:**

- Our institution agreed with four of the recommendations, but **disagreed with one recommendation due to our organization's size, capital level, and true risk to our institution.**
- We agree. **However, it is a little difficult to take when the examiners in prior years have not flagged or commented on the SAME situations that we were written up for this year!**
- With respect to the institution, some of the recommendations and required actions in the current examination reports were helpful in identifying general areas where the institution could improve its procedures and documentation, such as in the areas of change management processes, data privacy, vendor management, whistleblower protections, online banking security, the e-commerce plan, and the pension plan. **Less helpful were the recommendations on monitoring market value of equity exposure to interest rate risk, which has little relevance to our institution's business model, audit issue tracking and reporting, which adds volume, but little value to audit committee reports, and dashboard reporting to the board of leading economic indicators, which is unnecessary. At the other end of the spectrum, the requirement to revise the external auditor policy was of no value in addressing the institution's risks.**
- There was great dialogue with the Board and Management Team regarding the "why" behind the recommended actions. Also examiners "listened" to what the Board and Management had to say about the recommendations and in some instances made changes after better understanding how the institution operates.

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

**Average Response:** 1.5

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 15	1.5	1.6	1.9	1.5	1.6
FY 14	1.4	2.2	1.8	1.6	1.8
FY 13	1.5	1.3	1.4	2.0	1.6
FY 12	1.7	1.7	1.6	1.8	1.7

**Comments:**

- Great improvement noted in comparison to the previous examination.
- Fairly efficient but **IA examiner asked the same questions a couple of different times just in a different way.**
- **There were some lapses during the review when we would not hear anything from reviewers and believe they were working on other reviews then a few weeks would go by and we would begin to get questions and calls again and there seemed to be an urgency with the questions and the institution would need to drop what they were doing to get information or answers to the reviewers when time had been lost earlier in the review when the reviewers took a break from the review for several weeks.**
- **We did not appreciate the initial attitude displayed by the examiners when presenting the report and findings to the board. We were nice but did question the examiners concerning some of the comments.**
- **The lead examiner and the lead examiner trainer where very courteous, good listeners, and thorough. They were young and will get better with more experience. We had one examiner on their team that had an attitude and was not a good listener.**

- In our experience, examiners have been consistently professional and generally efficient in conducting examination activities. **In certain respects, however, examination activities have not been as efficient as they could have been. One example is the continued reliance by examiners on manual reports of portfolio information which the institution is required to submit to FCA quarterly even though the same information may be obtained through the FCA data extract and the \_\_\_\_\_ large loan reports. Perhaps, examiners should receive additional training in the use of the FCA data extract and \_\_\_\_\_ processes or internal agency communications should be streamlined so that the manual reports can be phased out. Another example is examinations in the area of internal audit, where on multiple occasions over a period of many months, examiners have sent out duplicative requests for information that prolong the examination process.**
- Really appreciated the professionalism displayed by ALL examiners on the team!

COMMUNICATIONS

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

Average Response: 1.8

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 15	1.5	2.0	1.7	1.8	1.8
FY 14	1.6	2.2	2.0	1.7	1.9
FY 13	1.9	1.5	1.4	2.1	1.7
FY 12	1.7	1.9	1.9	2.0	1.9

Comments:

- I would say things were communicated well and probably over communicated (not a bad thing) but we heard the same thing several times.
- In general, communications between OE staff and the institution staff have been sufficiently clear, accurate, and timely. **Sometimes, however, examination reports and examiner commentary are not clearly written or do not provide a sufficient explanation of the reasons for their conclusions. On occasion, agency communications are not timely. It takes a very long time for the agency to respond to e-mailed questions, especially if multiple levels or divisions within the agency must be consulted.**
- Communications exceeded our expectations and set the bar high for the next examination team. \_\_\_\_\_ and \_\_\_\_\_ provided timely updates during the examination process. Really appreciated the communications about findings before, during and after the exit conference. Board expressed appreciation about the good dialogue during the meeting with \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ during the executive session with the board.

**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: 1.9

FY 14	2.1	2.2	1.8	1.9	2.0
FY 13	1.7	1.6	1.6	1.9	1.7
FY 12	1.7	1.8	2.3	1.9	1.9

**Comments:**

- Agreed with the comments but **feel the delivery could have been better.**
- In general, examination communications have included the appropriate amount and type of information.
- Examiners communicated in such a way that they connected with the Board. Appreciated \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ having dialogue about points raised in the examination report. After the Board meeting with \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_, the Board expressed appreciation about how it felt the meeting was a dialogue plus FCA listened to Board member concerns/statements and NOT a pitch and funnel where FCA was not interested in hearing Board member's questions/remarks.

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

Average Response: 2.1

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 15	1.8	1.6	1.9	2.1	1.9
FY 14	1.8	2.2	1.9	2.1	2.0
FY 13	1.8	1.6	1.6	2.0	1.8
FY 12	1.8	1.9	2.1	1.9	1.9

**Comments:**

- Felt we had an excellent conference between the board, management and FCA.
- While they might not have agreed with our viewpoint, they did take time to evaluate the comments.
- Maturity will help the young staff to listen, not everyone is guilty, and most importantly major in the majors and minor in the minors. In other words differentiate between the important issues and minor ones.**
- With respect to whether examiners have given fair consideration of the institution's views and responses, generally speaking, examination staff have been relatively easy to work with and have been willing to discuss issues with institution staff, but sometimes that has not been the case. One example of FCA's willingness to consider the institution's views is with respect to the institution's pension plan, where it considered the institution's position both in open discussions prior to the issuance of the examination report and by participating in a subsequent presentation on the

institution's pension funding strategy with institution staff and the institution's expert actuarial consultant. **If there is anything that would improve the usefulness of the examination process, it would be more open dialogue and genuine collaboration between the institution and examination staff.**

- Really appreciated how examiners took time to listen to the Board and management team. When the management team explained – here's how we do it and the why – examiners listened and took the remarks into their decision process.

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

Average Response: 2.2

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 15	1.9	1.9	2.0	2.2	2.0
FY 14	2.0	2.2	2.0	2.1	2.1
FY 13	2.6	2.4	1.9	2.1	2.3
FY 12	2.0	1.9	2.3	2.1	2.1

**Comments:**

- Sometimes overly broad which makes it hard to keep in perspective.
- The findings had been overlooked for many years. Now, because of Southwest we are written up over infractions that have been in place for many prior audits.
- This is true for the most part, but FCA seems to overact to a problem in one institution and carry it across the whole nation.
- In general, FCS-wide guidance has not been very helpful. For example, recent FCA guidance emphasizing a need for subjective management of the allowance for loan losses is puzzling, given that this approach appears to be inconsistent with GAAP requirements and to represent a step back to the regulatory capital requirements for the System that prevailed prior to the 1987 Act. Such a subjective approach to management of the allowance invites manipulation of earnings to avoid the recognition of problems by the board and the stockholders, and has generally been recognized as an undesirable practice. Most System institutions in our district already have very high capital levels and earning capacity, so an additional allowance requirement that is not based on documented risk in the portfolio is not warranted. Furthermore, higher allowances that are not based on a quantifiable risk make System institutions less efficient and less competitive, which paradoxically, jeopardizes their safety and soundness.

Another way in which FCS-wide guidance has not been helpful is where FCA has demanded certain information or imposed certain requirements in response to specific problems somewhere else in the System, such as standards of conduct or fraud issues, but for reasons of confidentiality or other considerations, does not identify what the specific regulatory concerns it is trying to address are. While we can understand the need for confidentiality, the lack of specific information makes it very difficult for institutions to respond to FCA in a productive and appropriate way.

- FCA as the regulator has a job to do but appreciate the communications to institutions and its OE's willingness to listen when we have questions.

## Responses to Survey Items 9–11

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

#### Comments:

- The discussion on impending risks and strategic planning.
- It was helpful for FCA to call attention to the processes surrounding the Nominating Committee.
- FCA's thoughts and insight to internal controls did bring about great discussion with management and board. It was greatly appreciated to receive positive reinforcement for our Enterprise Risk Management Program.
- FCA review teams willingness to utilize technology to conduct some review work off-site which reduces impact on institution staff.
- The early notice of details associated with the review.
- We look at the audit process as a way of finding our deficiencies within our system of procedures and internal controls. One of the objectives of an audit is to help the organization become stronger. We feel that the recommendations made will help the institution in the future.
- The Examiners are willing to provide other points for consideration and general views of other institutions on issues. This is very helpful.
- FCA staff is usually very good about sharing practices they have seen in other institutions that might benefit our institution. As a note, they do not divulge where they observed those practices.
- Meeting with the examiners and reviewing their findings first hand.
- We are always looking for ways to improve and get better. I like those aspects that help us do that.
- It is useful to have FCA, as an independent third party that has access to some knowledge about practices in institutions elsewhere in the System, to come in and review the institution's operations and risk management practices and to challenge management on what the institution is doing and why.
- Dialogue with the examiners about what they are seeing plus being able to run "things" past them and not feel it will be used against us should it not be totally in-line with FCA opinion.

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

#### Comments:

- Time spent on issues that stray from safety and soundness.
- Questioning the eligibility of a relationship that has been in place for more than a decade.
- Best practices discussions tended to serve more as an educational opportunity for FCA staff to benefit other institutions rather than a value add for this institution.
- Multiple calls to answer questions and the overall long period it took to complete the review with gaps of time where nothing happened that prolonged the review period. It is more beneficial for us to have a shorter window and apply our time and resources to answering questions in a shorter window.
- Not enough consistency in reviews from one institution to another. This isn't a new issue but remains a problem.
- No differentiating between major and minor issues - both carrying the same weight.
- The examination process is least beneficial when FCA makes recommendations or imposes requirements that are based solely on a notion of "best practices" developed for commercial

banks or other non-System business entities that do not necessarily apply to the institution's business model as a full-service Farm Credit institution in a federated cooperative structure. Sometimes, an examiner, whether from inexperience or disposition, rigidly applies a checklist approach rather than reasoned judgment. That rigidity can lead to a focus on trivial issues rather than on real risks in the institution.

- Continue to feel the Agency's SOP to hire examiners that have never worked in lending or a Farm Credit institution limits their ability to understand what it takes to run a cooperative. This was not a negative factor when dealing with the FCA Team this time because they were experienced, were willing to listen and realized there is more to running a cooperative than what is captured in their check-list.

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

**Comments:**

- The board appreciates the professionalism and open communication it has with its examination team.
- The board appreciated the collaborative tone of the examination team, and the open discussion that accompanied the delivery of the examination results.
- The examination allows the institution to improve and we are always looking to improve.
- These (above) are the criticisms, but **the board would recommend to FCA that the institution be allowed a year to address the newly raised issues before downgrading the 'management' portion of CAMEL.**
- **The comment from the board was they had essentially 3 exit conferences when one is sufficient. They don't see the need to fly 3 people to a board meeting for the final exit when you have already discussed your findings previously. A conference call would have been OK.**

**FY 2015 Summary Report**

**Numeric Responses to Survey Statements 1–8**

Statement	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	10	21%	32	68%	4	9%	0	0%	1	2%	0	0%	47	2.0
2	18	38%	25	53%	4	9%	0	0%	0	0%	0	0%	47	1.8
3	11	23%	23	49%	12	26%	1	2%	0	0%	0	0%	47	2.1
4	24	51%	19	40%	2	4%	1	2%	1	2%	0	0%	47	1.6
5	19	40%	24	51%	2	4%	1	2%	0	0%	1	2%	47	1.8
6	12	26%	30	64%	5	11%	0	0%	0	0%	0	0%	47	1.9
7	16	34%	24	51%	6	13%	1	2%	0	0%	0	0%	47	1.9
8	13	28%	27	57%	3	6%	3	6%	0	0%	1	2%	47	2.0
<b>Total Responses</b>	123	32.7%	204	54.3%	38	10.1%	7	1.9%	2	0.5%	2	0.5%	376	1.9

Note: Responses of “6” (Does Not Apply) were not included in average response numbers.