Second Quarter Fiscal Year (FY) 2012 Summary Report  
(January 1 – March 31, 2012)

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 January 1 – March 31, 2012, the Office of Examination (OE) identified 13 FCS 
institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 13 institutions on April 26. Of the 13 institutions surveyed, 9 
submitted completed surveys. If a nonresponding institution subsequently sends a completed 
survey, it will be included in the next quarterly report.

One response to the survey issued for the first quarter of FY 2012 was received subsequent to the 
first quarter report and is included in this report. As a result, this report covers 10 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 eight survey statements from "1" (Completely Agree) 
to "5" (Completely Disagree). The rating options are as follows:

<table>
<thead>
<tr>
<th>Rating</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completely Agree</td>
<td>1</td>
</tr>
<tr>
<td>Agree</td>
<td>2</td>
</tr>
<tr>
<td>Neither Agree nor Disagree</td>
<td>3</td>
</tr>
<tr>
<td>Disagree</td>
<td>4</td>
</tr>
<tr>
<td>Completely Disagree</td>
<td>5</td>
</tr>
</tbody>
</table>

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 – Second Quarter FY 2012

Average numerical responses to survey statements 1 - 8 were 1.7 to 2.1. (For the first quarter 
FY 2012, the range also averaged 1.7 to 2.1.)

The average response for all survey statements was 1.9. (For the first quarter FY 2012, the 
average response was 2.0.)

June 13, 2012
In this quarter, there were many more negative than positive narrative comments to survey statements 1-8. (Negative comments of any degree are color coded in red.)

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. This is a new survey item beginning with this fiscal year inserted at the request of OE. It elicited a number of thoughtful responses from full Boards, which was the objective of the question. This quarter, however, many of the Boards’ comments were negative.

### Responses to Survey Statements 1–8

#### Examination Process

<table>
<thead>
<tr>
<th>Survey Statement 1:</th>
<th>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.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Response:</strong></td>
<td>2.1 (First quarter average was 1.9)</td>
</tr>
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</table>

**Comments:**
- The level of detail required by the new Loan Portfolio Management modules seemed excessive considering our past performance, asset quality and permanent capital position.
- While we generally agree with this statement, many of the examination components were designed for larger institutions with limited application in an institution under $500MM. Examiners had little flexibility to tailor the examination to the specific circumstance.
- Sometimes focused on minute details.
- Institution size, asset quality, capital strength, liquidity, earnings and proven past performance did not appear to be adequately considered in determining scope of examination.

<table>
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<tr>
<th>Survey Statement 2:</th>
<th>Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Response:</strong></td>
<td>1.8 (First quarter average was 1.8)</td>
</tr>
</tbody>
</table>

**Comments:**
- With new examiners in training there was no stone left unturned and areas were taken to extremes without regard that things were covered just not where the trainee was looking.
Examiners were overly aggressive in applying findings to their “qualitative” conclusions. Conclusions did not track with the demonstrated institution performance.

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: 2.0 (First quarter average was 2.1)

Comments:

- There is little distinction between “required actions” and “recommendations.” Seems all are “required.”
- The board felt that some of the recommendations did not necessarily improve the knowledge of the board or of the staff. It just made FCA’s job easier and eliminated their need to analyze a loan without the institution’s notes or analysis.
- Some of the required actions and recommendations were helpful to board and management; however, some were not because they moved past regulatory compliance and encroached upon business and management practices.

Communications

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

Average Response: 1.7 (First quarter average was 1.7)

Comments:

- The exam team was professional and we appreciate the task they are charged with. However, we had over 10 examiners in for the first week which is a strain on the institution staff in a small institution.
- The examination seemed to go on for an extended period of time and consumed a significant amount of institution management time as compared to past examinations. Coordination of the examination team seemed to be less than what we have experienced in past examinations.
- Noted some duplication of tasks between examiners.
### Survey Statement 5:

Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

**Average Response:** 1.9 (First quarter average was 1.7)

**Comments:**
- FCA examination staff is professional and provided a comprehensive review of their examination.
- Some of the examination staff appeared to be lacking in experience, and it appeared they were working off of and asking questions from a checklist and may not have understood exactly what they were requesting. They also did not seem to always understand the institution’s management responses.

### 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 (First quarter average was 1.7)

**Comments:**
- The board and audit committee appreciate FCA taking the time to visit with and report to the board of directors.
- Exit conference included numerous examiners which affected the clarity of communication.
- The examination provided helpful information to the Board and Audit Committee regarding those areas of risk examined by FCA.
- Some of the examination communications were vague, general and broad sweeping in nature, and specific questions from board or management did not result in specific responses.

### Survey Statement 7:

Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

**Average Response:** 1.9 (First quarter average was 1.8)

**Comments:**
- Lively discussion.
- They were considered.
- Examiners did not appear to adequately consider the views and responses of board and management in their conclusions and recommendations. A technical checklist and qualitative assumptions appeared to be their primary source of conclusions.
Survey Statement 8:  FCS-wide guidance from the Office of Examination was proactive and helpful.

Average Response:  1.9 (First quarter average was 2.0)

Comments:
- It is increasingly challenging to keep track of new rules and regulations taking the form of “FCA Informational Memorandums.” Examiners’ expectations are 100% implementation of all the details in the IM’s which is very burdensome and sometimes not very applicable to our institution. The FCA website refers to IM’s in the following manner: “Informational Memorandums (Info Memos) are FCA communications addressed to all Farm Credit institutions and are not meant to be a formalized category of communication. Info Memos do not require FCA Board review and prior approval prior to distribution and may be effective for a short period of time.” However, in most instances, the examiners treat IM’s no differently than fully vetted FCA regulations.
- Good to the advance notice of issues.
- Overall guidance from the Office of Examination seems fine. However, the examination modules do appear to be creeping from regulatory compliance towards managing and attempting to mandate institution business practices and lending standards.

Responses to Additional Survey Items 9, 10, and 11

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

- The opportunity to have an “entrance meeting” with the examiners.
- General recommendations on best practices obtained through informal communications with exam team members.
- The risk area of examination. The reviewers doing a very good job making sure our institution stays strong.
- Discussion with Board during the closeout. Phone contact during the year discussing both institution and FCA issues.
- Discussions with the examiner-in-charge and building a better relationship with FCA.
- The FCA examination provided the Board and Audit Committee with an important third-party review of our institution’s potential risk exposure. The positive findings provided directors with additional assurance that our institution is careful and deliberate about our risk exposures.
- We found the validation of our Quantitative FIRS Rating factors to be beneficial as they were all a 1 FIRS Rating Quantitatively.
- Exit conference.
- Interaction with the review staff on the process and general areas of concern within the system.
Survey Item 10: What aspect of the examination process did you find least beneficial?

- The depth and detail of the exam seemed excessive relative to the risk profile of our institution.
- The new Portfolio Management Modules. These are very lengthy, redundant, and often not entirely applicable. Completion requirements forced the examiners to be overly focused on the process. They were forced to be “box-checkers.”
- There are too many trainees involved in the exam process. Too much time spent on trivial issues.
- FCA’s dependency on new hires’ opinions on matters regarding the review. If they are considered trainees then their opinions and analysis should be reviewed and discussed on site and definitely not relied on for the summary, recommendations, or required actions without guidance from a seasoned examiner.
- The conclusions based on Qualitative assumptions and FIRS Rating assignments based on those assumptions were of no benefit to board or management. Based on the amount of management time that was consumed during this review, any potential benefits did not justify the expense.
- There was no area that we would consider least beneficial.

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

- Please look for ways to avoid a “one size fits all” exam model. The current examination process appears to be designed for larger institutions. Natural advantages of smaller institutions (such as detailed portfolio knowledge) don’t fit the mold and therefore don’t get proper recognition in the examination.
- The board is very appreciative of the efforts conducted by FCA to keep our business financially strong.
- Exam and examiners are professional. Too many people at closeout, costly, not needed. Search for minor infractions if they couldn’t find anything wrong. Board thought it was valuable to have open discussion including disagreements and come to a reasonable conclusion.
- The board considers FCA exam’s to be inconsistent from institution to institution. In the board’s opinion this is evidenced by the problems experienced by some institutions in our District versus the institutions that have no or limited problems. Our institution is the second strongest institution in the District yet management was scored a 2 and there were several recommendations and required actions per the review. The board believed that the recommendations and required actions were unnecessary and did nothing to strengthen the institution’s position. The board believes the strength of an institution lies with good board direction and management carrying out that direction.
- The Board is concerned with the direction of the FCA Supervision process as it appears to be creeping past regulatory compliance and into driving board and management decisions and business practices.
- The Board was pleased with the report and the examination process and appreciated the open dialogue during the Board meeting and executive session.