

**Second Quarter Fiscal Year (FY) 2014 Summary Report  
(January 1 – March 31, 2014)**

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

**Introduction**

During the period January 1 – March 31, 2014, the Office of Examination identified 21 Farm Credit System institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 21 institutions on April 24, 2014. Of the 21 institutions surveyed, 16 submitted completed surveys. When outstanding responses from prior quarters are received, they are included in the next quarterly report. Two responses to the survey issued for the first quarter of FY 2014 was received and are included in this second quarter FY 2014 report. Therefore, this report includes a total of 18 responses.

The OIG will continue to provide an email report to you based on each fiscal year 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 fiscal year 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

There is also an available response of "6" (Does Not Apply) for each survey statement. These responses are not included in averages.

Narrative responses are provided verbatim, except 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 2014**

Average numerical responses to survey statements 1–8 were 2.0 to 2.2. (For the first quarter FY 2014 the range averaged 1.4 to 2.1.)

The average response for all survey statements was 2.2. (For the first quarter FY 2014 the average response was 1.8.)

In this quarter, there were more positive than negative narrative comments to survey statements 1–8. (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 First Quarter 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:** 2.2 (first quarter was 2.0)

**Comments:**

- For some years now, we have had an effective internal credit review process and it has been identified as “Satisfactory” by the FCA in prior years’ Reports of Examination. **Yet from our experience, the level of reliance by the FCA on our own Internal Credit Review results has not changed over the years as we would have expected.**
- The most recent FCA examination of our institution focused on material safety and soundness issues, internal controls, portfolio management, and regulatory compliance. These are areas we would anticipate for review.
- **Are they still focused on safety and soundness—seems like we are in peripheral areas.**
- **Examination activities were disproportionately focused on areas of immaterial risk to the institution.**
- The scope of the FCA examination was consistent with the guidance provided by FCA and was centered on items that could bring risk into the institution.
- **The Standard of Conduct for our Directors has not been an issue in the past, so we’re not sure the risk is truly present.**
- Encourage FCA to consider increased use of electronic data in support of more examiners working offsite at their office locations. Would anticipate significant cost savings.

- The Examination focused on many risk areas associated with an institution of our size as well as following up on other items noted from previous examinations during the year.

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

**Average Response:** 2.1 (first quarter was 1.8)

**Comments:**

- There were a couple "required actions" noted in our exam report that were directly tied to regulatory criteria as would be viewed as appropriate by our institution.
- A lot of Standards of Conduct discussion when it was good the year before, enhanced since then and then issues never before brought up.
- Examiners introduced new interpretations of laws and regulations to justify examination findings without giving regulated institutions the opportunity of prior notice and comment. Examination findings are often without factual support or sound reasoning.
- Examination recommendations were informative to the institution and useful in identifying areas where the institution could improve policy clarity and improved implementation of procedures.
- Process for conducting NEA/MEA is effective in providing detailed findings regarding examination topic for institution participants and for other System institutions.
- We would lift up the concern that the regs are not being applied equally across every system institution. FCA can literally place one institution at a disadvantage versus another simply by enforcing requirements differently in various institutions. Standard of Conduct issues are one of those issues.

**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 was 1.7)

**Comments:**

- There were also three "recommended actions" noted in the exam report that were reviewed by Board and management, and agreed to be appropriate processes or practices and of benefit for our institution. In each case, required and recommended actions were taken as prescribed by FCA.
- The most burdensome recommendations and required actions in the examination report bear no substantive relationship to the risk the institution actually faces.
- Examination findings are clearly presented in the report with process for communicating management's correct action response.
- Portions of the Supervisory Agreement were redundant and the overlap added to the institution's compliance cost.

- The recommendations and required actions noted in the Report of Examination validated some actions already noted by the institution in which actions have been taken or are planned to be taken.

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

**Average Response:** 2.2 (first quarter was 1.4)

**Comments:**

- FCA Examiners were in each instance professional and courteous.
- Communication good, follow through good. Professional.
- Examiners' demeanor was professional, but **examination activities were not efficient. Too much time and too many resources at both the institution and the agency have been devoted to issues that never should have been raised based on the materiality of the risk to the institutions involved and the weakness of the regulatory basis for the finding.**
- The exam team was flexible in their use of the institution's new "Auditor Website," a technological solution to providing FCA examination team members with needed information regarding loans under exam.
- Our exam team and leader were very professional and cooperative.
- **The institution's and FCA's time would have been better spent answering all questions during one conference call/meeting instead of multiple calls/meetings with various examiners.**
- Institution makes concerted effort to provide information needed to facilitate the examination. No issues with examiners.
- Examiners were very professional in doing their jobs. We would continue to challenge examiners to work toward a greater efficiency in conducting the examinations.
- The examination team on this examination was professional throughout this particular examination.

## COMMUNICATIONS

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

**Average Response:** 2.2 (first quarter was 1.6)

**Comments:**

- **1) Communications regarding issues or concerns about Board leadership, governance and responsibilities should be communicated directly with the Board earlier in the examination process. If FCA needs a management liaison for facilitating Board communications, then the FCA should work with the Board to determine and develop the best process. Although using management as the liaison has not created Board/management issues with the current management team, it has created Board/management tension with past management. The Board wants to avoid this issue going forward.**

The Board prefers a process that provides FCA a direct and accurate Board perspective. Going directly to the Board with Board issues makes for an effective and efficient process and provides the Board with the confidence that their perspective has been clearly and accurately communicated.

2) Significant time elapsed between the completion of fieldwork and the reporting of findings and recommendations to management. 3) Within the credit area, examiners often do not have a basic understanding of our business prior to beginning the examination, leading to several hours of “education” on our part. We have tried to short circuit this by having a webinar prior to the beginning of the work such that examiners could come better prepared as to the business model and how it differs from that of a primary lender (another FCS institution).

- The 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 situations with questions.
- [Name removed] did this VERY well.
- Overall communication with EIC and staff are excellent. Communication by EIC with individual board members is welcome but the need and purpose of the calls should be examination related. It would also be helpful if the frequency of the communication be challenged and the practice of asking multiple directors the same question be avoided except when it is considered necessary based upon examination findings.
- Communications from OE staff were timely, but not clear or accurate. The legal and factual basis for examination findings were not well supported.
- Seemed to be rushed and disorganized during the examination. Questions could be sent ahead of time and we could have all answers for them upon arrival.
- The EIC did a good job of communicating with the institution.

**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:** 2.2 (first quarter was 2.1)

**Comments:**

- 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.
- Exam thorough enough to assure a look by FCA at most areas.
- In some areas, communication was appropriate, but in other areas, the legal and factual basis for examination findings was not well supported and was of no value to the Board/Audit Committee as a guide to managing the institution’s risk.
- The examination team maintained open communication with the Board and management throughout the examination cycle.

- Please reference the list of Considerations that the institution Board shared with FCA's Lead Examination Team members during the closeout.
- Findings are clearly communicated and segmented by degree of concern to help the Board's understanding and oversight of institution's corrective regs.
- The overall positive results of the examination findings appear to validate the safety and soundness of the institution as well as the positive operations of the institution from a management and board perspective.

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

**Average Response:** 2.2 (first quarter was 1.8)

**Comments:**

- [Same answer given to No. 5] 1) Communications regarding issues or concerns about Board leadership, governance and responsibilities should be communicated directly with the Board earlier in the examination process. If FCA needs a management liaison for facilitating Board communications, then the FCA should work with the Board to determine and develop the best process. Although using management as the liaison has not created Board/management issues with the current management team, it has created Board/management tension with past management. The Board wants to avoid this issue going forward. The Board prefers a process that provides FCA a direct and accurate Board perspective. Going directly to the Board with Board issues makes for an effective and efficient process and provides the Board with the confidence that their perspective has been clearly and accurately communicated. 2) Significant time elapsed between the completion of fieldwork and the reporting of findings and recommendations to management. 3) Within the credit area, examiners often do not have a basic understanding of our business prior to beginning the examination, leading to several hours of "education" on our part. We have tried to short circuit this by having a webinar prior to the beginning of the work such that examiners could come better prepared as to the business model and how it differs from that of a primary lender (another FCS institution).
- 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.
- Discussions and thoughts were objective.
- Examiners went through the motions of attempting to hear the views and responses of the Board and management, but there is no evidence that they listened. The examination report included a statement of management's objections, but did not answer them, other than to re-assert the examiners' original findings.
- Generally we are in agreement with the view, however because we were provided a very limited amount of time to review the draft report, we were not able to provide additional information that could have addressed some of the report comments.

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

**Average Response:** 2.2 (first quarter was 2.0)

**Comments:**

- Yes, there was good dialogue between our institution and FCA staff on the varied topics and issues that arose during the course of the exam.
- We felt we were being examined on Standards of Conduct with direction that had just come out. Overreach but we understand and understood what material issues were.
- With respect to the contested issues, FCS-wide guidance did not notify the institution of the regulatory interpretation and was not helpful at all. Notice through examination findings was the first and only notice that our institution received of any regulatory issue.
- FCS-wide guidance continually provides opportunities for management teams to proactively evaluate current practices in each part of our organization.  
Appreciate Office of Examination annual sharing the National Oversight Plan Focus/Risk Topics.

**GENERAL QUESTIONS 9, 10, and 11**

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

- Hearing from FCA on broader perspectives of system-wide business activity and practices is always beneficial.
- The in-person meeting with the Board helped provide context for the written report.
- Discussions at closeout around how to understand what was really intended in the report in Standards of Conduct.
- Examination results were well communicated, fair, and balanced.
- It is difficult to say that any part of the process was beneficial. The institution appreciated the opportunity to present its objections to the examiners. Unfortunately, this opportunity did not have any meaningful impact.
- FCA separate meeting with Board Chairman, and Audit Committee Chairmen was beneficial. Also, guidance regarding effective nominating committee policy and charter.
- We appreciate FCA staff sharing “best practices” from other FCS institutions with us. As a relatively small, regional institution, it is difficult to keep up with what the rest of the Farm Credit world is doing.
- Communication with management and staff was excellent. The examination team was fair and open in their discussions regarding the current activities at the institution.
- Sharing themes of common issues and best practices.
- I found the wrap-up meeting after the examination to be helpful.

- Appreciate them sharing best practices from other institutions.
- The opportunity to review and respond to draft examination findings and confirmation that the institution was complying or needed improvement.
- FCA seems to have adopted an attitude that it is ok to try and help institutions develop ideas for how to meet requirements. To be clear, examiners are not telling us how to do it, but giving ideas and suggestions for ways to possibly meet those requirements. That is helpful, while keeping the accountability at the institution where it should be.
- [Same answer given to No. 6] The overall positive results of the examination findings appear to validate the safety and soundness of the institution as well as the positive operations of the institution from a management and board perspective.

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

- Today's business environment is always busy. Review processes require a certain time commitment by management that takes away from conducting other areas of business responsibility.
- Standards of Conduct
- Individual questions or conversations on a particular issue may be duplicated during the course of examination activity.
- The examiners' use of a novel regulatory interpretation that appears to have been created on an ad hoc basis solely to support an examination objective unrelated to the purpose of the regulation that was cited.
- It seems that examiners are increasingly regulating through Informational Memorandums, Bookletters, and other guidance which has made it difficult to ensure that our institution is in compliance with FCA regulations.
- The first stab at utilizing the institution's Audit Website posed some challenges for the examination team, additional experience with the new technology will further improve the institution's ability to deliver information to FCA.
- Some focus areas in the review.
- The inefficiency of time and meetings with the various examiners that ask the same questions.
- Multiple exit conferences discussing the same topics each time. The lead examiners met with our Board at our monthly Board meeting at the conclusion of the two-week review to discuss the exam; the lead examiners scheduled a teleconference call with senior management and Board members the following month to discuss the review; and then met onsite with our Board the month after that for the final report.
- The number of visits throughout the year to various locations of the institution; however we recognize the necessity of the examination process.

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

- [Same answer given to No. 5] 1) Communications regarding issues or concerns about Board leadership, governance and responsibilities should be communicated directly with the Board earlier in the examination process. If



FCA needs a management liaison for facilitating Board communications, then the FCA should work with the Board to determine and develop the best process. Although using management as the liaison has not created Board/management issues with the current management team, it has created Board/management tension with past management. The Board wants to avoid this issue going forward. The Board prefers a process that provides FCA a direct and accurate Board perspective. Going directly to the Board with Board issues makes for an effective and efficient process and provides the Board with the confidence that their perspective has been clearly and accurately communicated.

- The preceding responses take into consideration the Board's input.
- Exam process was fine.
- The Board believes that the FCA examination function has lost sight of FCA's role as an arm's length safety and soundness regulator and has inappropriately used the examination process to achieve management objectives to eliminate the benefits of the federated cooperative structure. The Board appreciated the open communications with EIC and Supervisory Examiner throughout the year.
- A list of considerations was presented by the Board to the leaders of the Examination Team.
- The transition of our new EIC went smoothly.
- The board and management team as a whole appreciates the feedback and open dialogue from the examination process.