

**Third Quarter Fiscal Year (FY) 2012 Summary Report
(April 1 – June 30, 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 April 1 – June 30, 2012, the Office of Examination (OE) identified 15 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 15 institutions on July 26. Of the 15 institutions surveyed, 11 submitted completed surveys. If a nonresponding institution subsequently sends a completed survey, it will be included in the next quarterly report.

One institution submitted two responses, one from the CEO and one from the Chair of the Audit Committee. After discussing the matter with the Chair of the Audit Committee, I decided to include both responses, as they varied significantly. Also, two responses to the survey issued for the second quarter of FY 2012 were received subsequent to the second quarter report being issued and are included in this report. Therefore, this report includes a total of 14 responses.

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:

| | |
|----------------------------|---|
| 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 – Third Quarter FY 2012

Average numerical responses to survey statements 1 - 9 ranged from 1.6 to 2.4.

| Average Numerical Responses to Survey Statements 1 – 9 | | |
|--|---------------------|---------------------|
| 3 rd Qtr | 2 nd Qtr | 1 st Qtr |
| 1.6 – 2.4 | 1.7 – 2.1 | 1.7 to 2.1 |

The average response for all survey statements was 2.1.

| Average Response for all Survey Statements | | |
|--|---------------------|---------------------|
| 3 rd Qtr | 2 nd Qtr | 1 st Qtr |
| 2.1 | 1.9 | 2.0 |

In this quarter, there were many more **positive** than negative narrative comments to survey statements 1-8. Nevertheless, the first bulleted comment under survey statement 6 would seem to be particularly troubling. (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 Boards, which was the objective of the question. This quarter, all but one of the Boards' comments were **positive**.

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: **2.1** (Second quarter average was 2.1, first quarter average was 1.9)

Comments:

- Focusing on activities and controls related to governance, funding, financial reporting, and IT was appropriate.
- As an outside director I see the Farm Credit System with a much different view than most of the people I talk to and meet with. The system is a very loosely organized structure with too many accounting systems, no central loan system, no way to easily look at large credits and/or concentrations.

These are the largest in the system and we are not moving quickly to get them under management.

- Strong risk based loan sample and appropriate loan portfolio management oversight.
- Examination was based on management and policies and not as much on risk-based activities.
- We agree the scope of the examination was the right size for asset size, complexity, etc.
- Focused on credit concentrations, large loans, participations.
- The most recent examination focused on several areas including regulatory compliance, internal controls, and other business management areas. All were viewed as appropriate.

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

Average Response: 1.9 (Second and first quarter averages were 1.8)

Comments:

- While we technically agree with this statement as it applies to examination findings and conclusions, we did not feel that the examiners supported the appropriate application of accounting rules as we discussed the allowance for loan loss. The examiners suggested creative ways of justifying a larger allowance account that we do not believe are supported by GAPP.
- The recommendations resulting from the exam were within the context of regulations and best practices.
- Examiners conducted the examination and discussed findings in a very professional manner with institution staff and board members.
- Apply examination guidelines not in regulations or laws.
- There were a few findings (required actions) that were the result of detailed regulatory applications, for which the institution has now taken appropriate corrective action.

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: 2.4 (Second quarter average was 2.0, first quarter average was 2.1)

Comments:

- None we required.
- Examiners pointed out perceived risks in the institution but did not offer the board and management valuable solutions to address them.
- The institution agrees that the recommendations were appropriate for improving the management of related risks.
- Although required actions were appropriate, they do not address risk, as much as technicalities and policies.

- The agency appears to be imposing restrictions beyond the regulator limits. It is concerning that the agency indicates credit administration and risk management is appropriate but indicates more restrictive underwriting guidelines are needed.
- Required actions were discussed with institution staff and board members in detail.
- Management addressed each of the findings with the board to ensure understanding of the applicable regulation, and then explained the action taken or to be taken.

Communications

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

Average Response: 1.6 (First and second quarter averages were 1.7)

Comments:

- Just prior to the presentation of the Exam Report to the institution board and management, we were notified that the Supervisory Examiner had been changed. We felt the new SE was not familiar with our review and in our opinion this was unprofessional. There was also a large lapse of time of almost 4 ½ months between the on-site exam and the final report presentation. This caused inefficiencies for board and management resulting in the need to reacquaint ourselves with the pertinent facts and diminished the recall of important points made during onsite discussions.
- The examiners conducted the exam professionally and were very respectful of the staff's time.
- Examiners were professional, but efficiency could be improved.
- Examiner _____ does a great job in communicating and follow-up.
- We feel that examiners conducted the examination of the institution in a professional and businesslike manner.
- FCA examiners were professional and courteous.

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

Average Response: 1.9 (Second quarter average was 1.9, first quarter average was 1.7)

Comments:

- While we technically agree with this statement as it applies to examination findings and conclusions, we did not feel that the examiners supported the appropriate application of accounting rules as we discussed the allowance for loan loss. The examiners suggested creative ways of justifying a larger allowance account that we do not believe are supported by GAPP. (A repeat response, see survey statement 2)
- Communication from the examiners and the EIC ahead of time and during the exam was excellent.

- Examiners communicated well with institution staff at all times.
- Management reported that for each issue raised by FCA, an opportunity was provided for questions and discussion between FCA and institution staff, and explanations for positions were provided by the examiners.

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: 2.3 (Second quarter average was 1.8, first quarter average was 1.7)

Comments:

- When the report of examination was delivered to the board and management, we were informed that institution management was downgraded from a 1 rating to a 2 in the FIRS. We were not given specific reason for the downgrade so that we might work to improve our practices. However, we were told that we should never have been rated a 1 in the first place, leaving us to wonder about the validity of previous exams and ratings.
- We received the necessary amount of information from the examination team to carry out our oversight responsibilities.
- I have never seen or heard of an organization that did not meet separately with the audit committee.
- Both verbal and written communications of the issues were satisfactory.

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

Average Response: 2.1 (Second quarter average was 1.9, first quarter average was 1.8)

Comments:

- Excellent dialogue between institution management and the FCA exam team. Particularly appreciated the interaction at the board meeting and encourage this on a going forward basis as it enhances our effectiveness here at the institution.
- Examiners discovered findings with management and incorporated the responses into the report.
- Institution spent a great amount of time justifying an obviously strong credit to FCA. The examiner failed to express material concerns to management while on site, which could have been addressed in minutes, while the actual response took hours.
- The agency appears to be imposing restrictions beyond the regulator limits. It is concerning that the agency indicates credit administration and risk management is appropriate but indicates more restrictive underwriting guidelines are needed. (A repeat response, see survey statement 3)
- Examiners listened to staff, management and Board prior to formulating conclusions and recommendations.

- Examiners _____ and _____ were very considerate and pleasant to work with.
- Examiners did not reach conclusions before asking questions of appropriate institution staff.

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

Average Response: **2.3** (Second quarter average was 1.9, first quarter average was 2.0)

Comments:

- Guidance from the OE is typically in response to problems faced by system institutions. The information is normally not proactive.
- It's helpful to know focus areas ahead of time.
- Generally agree. The agency appears to be imposing restrictions beyond the regulator limits. It is concerning that the agency indicates credit administration and risk management is appropriate but indicates more restrictive underwriting guidelines are needed. (A repeat response, see survey statement 3)
- We agree that FCS-wide guidance from the Office of Examination was proactive and helpful.
- Yes, there was good dialogue between FCS and FCA staff during the course of the exam.

Responses to Additional Survey Items 9, 10, and 11

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

- Findings on a few loans brought issues to our attention that we have been able to address and improve credit administration.
- Excellent communications prior to, during, and after the examination.
- Dialogue with the exam team.
- Confirmation of findings and communication of observations ahead of report issuance.
- Identification of some needed enhancements to policies.
- The independent nature of the review providing an outside prospective of the institution's operation and management.
- We view all aspects of this examination as being beneficial.
- The summary review.
- Advance information notification of scope of exam and information needed to conduct exam.
- The review of the final Examination Report with the Audit Committee/Board was most helpful. The report was clear, concise, and accurate.
- Communication of findings.
- The interaction with the EIC and Senior Examiners.
- Hearing from FCA on broader perspectives of System-wide business activity and issues is always beneficial.

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

- We found no value in the on-site presentation of the Examination Report to board and management.
- Timeframe gets too extended. The stress testing recommendations do not seem to take into consideration the size and lack of complexity within our institution.
- The agency appears to be imposing restrictions beyond the regulator limits. It is concerning that the agency indicates credit administration and risk management is appropriate but indicates more restrictive underwriting guidelines are needed. (A repeat response, see survey statement 3)
- We view all aspects of this examination as being beneficial.
- The collection of information prior to the onsite exam still needs improvement. The goal should be a single, complete request.
- Scheduling.
- Our institution is having a very busy year, and review processes always require a certain time commitment from institution staff.

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

- We feel the FCA examiners had difficulty adapting their processes to the uniqueness of our institution.
- The Board appreciates the opportunity for the face-to-face discussion with examiners and leadership following the exam.
- Staff is extremely professional and knowledgeable in their understanding of the regulations. Additional seasoning would be beneficial.
- The Board was pleased with the efficient and timely communication regarding the review as well as the professionalism of the agency staff. The institution management has been very complimentary of the Agency staff and Review team.
- We feel the examination was helpful and constructive.
- Much better communication and cooperation of exam team than previous. Exit conference was beneficial and cordial.
- The Board had excellent rapport with the EIC. His communications with the Board were excellent. He listens well and provided appropriate and helpful responses.
- The Board appreciated the information provided in the closeout and found the process to be useful.