

Office of Inspector General

Semiannual Report
to the Congress

April 1, 2006
to
September 30, 2006



*Number 35
October 2006*



October 24, 2006

The Honorable Nancy C. Pellett
Chairman of the Board
Farm Credit Administration
McLean, Virginia 22102

Dear Chairman Pellett:

Enclosed is the semiannual report on the activities of the Farm Credit Administration's (FCA or Agency) Office of Inspector General (OIG) for the period April 1, 2006 through September 30, 2006. This is the thirty-fifth report since the establishment of the OIG on January 22, 1989.

I am submitting this report in accordance with the Inspector General Act of 1978, as amended (IG Act). Section 5(b) of the IG Act requires that you send this report to the appropriate Congressional committees and subcommittees within 30 days after the date of this transmittal along with management's report on the status of audit recommendations.

During this reporting period, eight previously open action items were closed. Four resulted from management's completion of agreed upon actions. Four resulted from your decision to not continue with the redesign of the Loan Account Reporting System. I am confident that the Agency will continue its commitment to address the management challenges delineated in this report and to implement open action items.

I look forward to a continuing positive relationship between the OIG and your office, which I view as a partnership, striving to strengthen Agency operations.

Respectfully,

A handwritten signature in black ink that reads 'Carl A. Clinefelter'. The signature is written in a cursive style with a large, sweeping 'C' at the beginning.

Carl A. Clinefelter
Inspector General

Enclosure

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
BACKGROUND	2
MANAGEMENT CHALLENGES	2
Human Capital	3
Financial Management	4
Leveraging Technology	4
Agency Governance	4
Strategic Planning	5
A Changing Environment	5
AUDIT AND INSPECTION REPORTS ISSUED	6
AUDIT AND INSPECTION REPORTS IN PROGRESS	6
Independent Financial Audit for FY 2006	6
Independent Federal Information Security Management Act (FISMA) Review for FY 2006.....	7
FCA Board Committees.....	7
Inspection of FCA's Enforcement Program	7
STATUS OF UNIMPLEMENTED RECOMMENDATIONS	7
Audits	8
INVESTIGATIONS	8
LEGISLATION AND REGULATIONS	9
OTHER ACTIVITIES	10
Observations	10
Survey of Farm Credit System Institutions	10
Staff Participation in Activities of the Professional Community	10
Staff Participation in Agency Organizations	10
Staff Development	10
APPENDICES	11
Appendix A—Index of Reporting Requirements	11
Appendix B—Audit/Inspection Reports Issued	12
Appendix C—Reports with Questions Costs.....	12
Appendix D—Reports with Recommendations that Funds be Put to Better Use	13
Appendix E—Farm Credit Administration Organization Chart	14
Appendix F—Office of Inspector General Organization Chart.....	15

EXECUTIVE SUMMARY

This Semiannual Report to the Congress summarizes the activities and accomplishments of the Farm Credit Administration's (FCA or Agency) Office of Inspector General (OIG) and covers the period April 1, 2006 through September 30, 2006. Our efforts were directed toward performing audits, inspections, and evaluations of FCA programs and operations; conducting investigations, as necessary; and providing technical assistance and advice on FCA programs.

The FCA Board Chairman continues to demonstrate a commitment to resolve open OIG recommendations and agreed-upon actions and to address the management challenges delineated in this report.

The relatively new Agency senior management team continues to develop and refine operating processes, and solidify as a unit. This ongoing evolution creates the opportunity for the further strengthening of the performance and effectiveness of the Agency, a Federal financial regulator. However, additional time will be required before the results of major organizational, personnel, and process changes may be fully measured.

BACKGROUND

FCA is an independent Federal agency of the United States government responsible for the regulation and examination of Farm Credit System (FCS or System) institutions chartered under the Farm Credit Act of 1971, as amended (Farm Credit Act). FCA is also a "designated Federal entity" within the meaning of the Inspector General Act of 1978, as amended (IG Act).

As a non-appropriated agency, FCA funds its expenses primarily through assessments to the institutions it regulates. The Agency's fiscal year (FY) 2007 budget is \$45.7 million. Assessments by FCA to FCS institutions for FY 2007 totaled \$41.5 million with other sources of funding totaling \$4.2 million. The OIG's FY 2007 budget is \$1,016,578.

At the end of this semiannual period, FCA had 256 employees, about half of which are examiners located in five field offices. This is a 3.6 percent increase in staffing during this reporting period and a 1.9 percent decrease from the same reporting period last year.

The OIG maintains five positions. During this reporting period, the OIG's Management Analyst retired. A position was announced for an Administrative Assistant and the position was filled. An auditor position remains vacant. Appendix E and Appendix F display the organizational structure of FCA and the OIG, respectively.

MANAGEMENT CHALLENGES

This part of the semiannual report highlights major challenges confronting the Agency as it works to fulfill its mission. The OIG is required by Federal law to identify these challenges and present them in the Agency's Performance and Accountability Report. These challenges have remained for several years. Most can be addressed through concerted action by management. Over the past year, the OIG has observed progress by FCA management in addressing the challenges. For example, strategic studies were completed in 2005 that resulted in the initiation of significant organizational change designed to enable the Agency to further address the challenges.

A major change was the transition to a new Chief Examiner. This resulted in a substantive transformation in the Office of Examination's organization and operating methodology. While well underway, these changes will take some time yet to become fully institutionalized and reach full efficiency.

Another substantive change was to reconsolidate into a single office, the Office of Management Services (OMS), the Agency's personnel, financial, and information

technology functions under the umbrella of a new manager. This has evidenced proactive results. For example, the Agency's financial services function, including accounting, financial reporting, contracting, and procurement, were outsourced to the Department of the Treasury's Bureau of the Public Debt effective April 1, 2006. The goal of this outsourcing was to achieve cost and performance efficiencies for the Agency. To date there have been transitional hurdles to overcome and the full achievement of the desired efficiencies will take time to be realized.

Additionally, the Agency's Office of Regulatory Policy and, to a lesser extent, the Office of General Counsel, reorganized to promote the utilization of a matrix approach to management.

All these changes in Agency organization are designed to promote improved efficiencies in the utilization of human capital, communication between the FCA Board and staff, and decision-making and oversight of the Agency by the FCA Board.

Human Capital

In March 2001, the OIG recommended FCA develop a human capital plan and FCA management agreed to this recommendation. Under Chairman Pellett's leadership, senior managers have focused on the challenge of marshalling, managing, and maintaining human capital to assure accountability and maximize FCA performance. The Agency also made a significant investment in strategic studies in 2004 and 2005. The objective of the strategic studies was to create a picture of the System and the credit needs of rural America in 5 to 7 years and identify organizational and human capital opportunities to help FCA adapt. Chairman Pellett's leadership in initiating the strategic studies, in reorganizing the Agency, and in emphasizing the importance of human capital has resulted in the completion in this reporting period of a comprehensive 5-year strategic human capital plan. The plan identifies five human capital goals and six human capital initiatives, including succession planning and knowledge management.

A critical component in implementing the human capital plan is providing for management succession. Individuals with the potential to become managers should be identified, provided developmental opportunities, and, when appropriate, promoted to higher positions. This, as part of a human capital plan, should be linked to the Agency's Strategic Plan for long-term achievement of the Agency's mission.

FCA's challenge will be to implement the human capital plan to ensure organizational approaches that enable FCA to adapt to evolving technology, a changing workforce, and other environmental forces. In addition to achieving full transformation of the Agency's organization and processes, how FCA meets its mission will be heavily dependent on quality of its human capital, having the

appropriate skill sets, and how it organizes to meet its mission. A significant step in this direction was the completion of the 5-year strategic human capital plan.

Financial Management

Timely, accurate, and useful financial information is essential for:

- making day-to-day decisions;
- managing the Agency's operations more effectively;
- supporting results-oriented management approaches; and
- ensuring accountability on an ongoing basis.

In April 2006, FCA outsourced financial reporting, contracting, and procurement functions to the Bureau of the Public Debt, Department of the Treasury. While the transition is still underway, its ultimate success will still need to be measured by whether the Agency and its managers are receiving timely service, useful financial reporting, and improved efficiencies. To measure this, the Agency will need to develop performance measures to assess the achievement of goals related to this outsourcing.

Leveraging Technology

Information technology (IT) is a key element of management reform efforts that can help dramatically reshape government to improve performance and reduce costs. The Agency has recognized that in order to meet the constraints of its budget, it must be able to maximize its return on investment in technology. Internally, there is an opportunity for IT to complement human capital initiatives to reformulate the work processes of FCA. There is also an opportunity to capture knowledge of employees who are approaching retirement. Externally, E-Government offers many opportunities to better serve the public, make FCA more efficient and effective, and reduce costs. FCA has begun to implement some E-Government applications, including the use of the Internet to collect and disseminate information. FCA's ongoing challenge is to establish effective mechanisms to ensure that current and future members of staff have the skills to use technology to operate in an efficient and effective manner.

Agency Governance

The Farm Credit Act provides for a full-time three-member Board. The Board members are appointed by the President and confirmed by the Senate. A small full-time Board presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the Agency. The Board must be able to engage in professional policy debate and set a sound course for the Agency.

The Board's rules of operation are a foundation for trust and shared expectations among Board members. A collegial Board, founded on mutual trust and respect, is essential to FCA's ultimate effectiveness.

The Chairman has taken action to address this challenge by sharing authority and creating an environment at the Board level that promotes a constructive working relationship between Board members. Board members have made large and obvious strides to remain current and knowledgeable in the dynamic agriculture, financial and regulatory environments.

Strategic Planning

The FCA Board adopted its 2004-2009 Strategic Plan in December 2003. Since adoption, the Agency has a new Chairman and a new Board member. The changes in top leadership provide an opportunity to revise the plan to ensure the Board's vision is accomplished. The challenge is to establish a strategic plan that is ongoing in nature and in pace with the Agency's environment. In 2005, the Board established a Strategic Planning Committee, one of three committees established to facilitate the Board's oversight responsibilities and communication between the Board and Agency staff. This committee has the potential to catalyze the strategic planning function and address this challenge.

The Board refined the performance measures in January 2005. FCA should evaluate its performance measures on an ongoing basis to ensure that they challenge and stretch the organization. Performance measures can be a powerful tool to continue the push into a results-oriented organization. An effective performance management system fosters performance and accountability at the individual, organizational, and ultimately overall Agency levels.

A Changing Environment

The System is a single industry lender and is vulnerable to economic swings. The FCS remains sound in all material respects. Earnings and capital levels have continued to strengthen and asset quality remains high. However, there are many challenges facing agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act in order to enhance agricultural and rural economies of the future. In the early 1990s, the Government Accountability Office (GAO) conducted a comprehensive study of the cost and availability of credit in rural America.¹ The GAO concluded that the System did not need new statutory authorities in the near term, but that ongoing structural changes in agriculture and rural America could justify such changes in the longer term. GAO noted that over time, as agriculture and rural America continue to change, the

¹ GAO/GGD-94-39 Farm Credit System Repayment of Federal Assistance and Competitive Position, March 1994.

System's charter may need to be updated to ensure that the System is not hampered by outdated legislation.

The FCA must balance the often competing demands of ensuring the FCS fulfills its public policy purpose, proactively examining risk in the regulated institutions both individually and systemically, and controlling the cost of the regulator. FCA's challenge is complex because it has become increasingly difficult to reconcile significant provisions of the Farm Credit Act with the realities of the agricultural industry, the business environment, and financial markets in the 21ST Century.

The Agency can anticipate that the System will press for broader powers through regulatory interpretations of the Farm Credit Act. At the same time, FCA must anticipate that the System's competitors will press for the Agency to be a strict interpreter of the Farm Credit Act. As a financial regulator, FCA must maintain a flexible and responsive, yet independent and objective, regulatory environment.

AUDIT AND INSPECTION REPORTS ISSUED

We conduct all audits in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are in accordance with the *President's Council on Integrity and Efficiency's Quality Standards for Inspections*. Copies of most OIG reports are available on FCA OIG Web site (www.fca.gov/oig), or by contacting the OIG at (703) 883-4030, (703) 883-4359 for TTY, or by e-mail at ig_information@fca.gov.

There were no audit or inspection reports issued this reporting period.

AUDIT AND INSPECTION REPORTS IN PROGRESS

Independent Financial Audit for FY 2006

The Accountability of Tax Dollars Act of 2002 extended to FCA and certain other agencies a requirement to submit to the Congress and the Office of Management and Budget (OMB) an audited financial statement each fiscal year. Also, the President's Management Agenda states agencies must continue to improve their financial performance by improving timeliness, enhancing usefulness, and ensuring reliability by obtaining and sustaining a clean audit opinion.

In continuing to assist the Agency in meeting these requirements, the OIG contracted with Harper, Rains, Knight & Company, P.A. (HRK) to perform the audit of FCA's financial statements for FY 2006. This audit is in process.

Independent Federal Information Security Management Act (FISMA) Review for FY 2006

The OIG contracted with HRK to also perform a review of the Agency's information security program's compliance with FISMA for FY 2006. The evaluation is in progress and being performed using guidelines established by FISMA, OMB Circular A-130, GAO's Federal Information System Controls Audit Manual, and the National Institute of Standards and Technology.

While not yet final at the close of this reporting period, HRK's evaluation did not reveal any information security control matters that were deemed to be significant deficiencies that must be reported under FISMA.

FCA Board Committees

An audit is in progress to evaluate whether FCA Board committee operations reflect sound business practices and determine if the committees' work is assisting FCA Board members with their oversight responsibilities.

Inspection of FCA's Enforcement Program

An inspection is underway to evaluate the status of FCA's enforcement program and readiness of FCA to impose an enforcement action.

STATUS OF UNIMPLEMENTED RECOMMENDATIONS

At the beginning of the reporting period, there were 14 unimplemented agreed upon actions or recommendations from audits. Eight agreed upon actions were closed. At the end of the period, 4 agreed upon actions and 2 recommendations remain unimplemented from audits.

Audits

The following table summarizes the final actions management took on open audit items.

Audit Agreed-Upon Actions and Recommendations				
Audit Report	Issued	Open during this 6-month period	Final Management Actions during this period	Open on 10/01/2006
Performance Budgeting	03/23/01	2	2	0
Office of Chief Financial Officer	01/24/02	2	2	0
Loan Account Reporting System	08/28/03	4	4	0
Performance Measures and Internal Controls	07/01/05	2	0	2
Records Management & Preservation of Institutional Knowledge	02/21/06	4	0	4
Total		14	8	6

The OIG issued audit reports: Performance Budgeting over 5 years ago, and the Office of Chief Financial Officer more than 4 years ago. Management provided documentation to successfully close all recommendations from these reports.

The OIG issued an audit report on the quarterly collection of detailed borrower data (Loan Account Reporting System) 3 years ago that included nine action items. Management provided documentation to successfully close the remaining four action items.

The audit report on Performance Measures and Internal Controls has two recommendations that remain open.

The audit report issued 7 months ago on Records Management and Preservation of Institutional Knowledge has four agreed upon actions, all of which remain open at the end of this reporting period.

INVESTIGATIONS

OIG Hotline calls and e-mails dealing with borrower complaints concerning FCS institutions and other FCS issues were referred to the FCA office or other Federal agency responsible for reviewing such matters.

No investigations were open at the beginning of this reporting period and none were opened during the reporting period.

LEGISLATION AND REGULATIONS

In the furtherance of the OIG's mandate to review existing and proposed legislation and regulations, the IG or Counsel to the IG attends joint briefings of the Board on regulations at the proposed and final stages. The Counsel or staff attended joint briefings on the following:

Proposed Rule

- 1) Processing and Marketing

Final Rules

- 2) Termination of FCS Status
- 3) Privacy and Security
- 4) Regulatory Burden
- 5) Disclosure and Reporting

Briefings

- 6) Other Credit Needs and Similar Entities
- 7) FCA Syndication and Assignment Study
- 8) Bond Pilot Program
- 9) Investments in Rural America
- 10) Collateral on Loans
- 11) Investments in Farmers Notes
- 12) Basel and Risk Based Capital Rules
- 13) Adverse Effects of Drought on Agriculture

OIG also forwarded the Executive Order, Improving Assistance for Disaster Victims, to the Chairman of the Agency.

OTHER ACTIVITIES

Observations

The OIG utilizes Observations to provide feedback to management on issues that come to our attention while performing other OIG work. However, in this 6-month period, we did not issue any Observations.

Survey of Farm Credit System Institutions

The OIG continued to work with the Office of Examination to revise the OIG survey of FCS institutions regarding their feedback on the quality of the Agency's examination process.

Staff Participation in Activities of the Professional Community

OIG staff members are encouraged to take part in organizations that contribute to the mission of the Inspector General community, as well as their individual professional development. Most staff is actively involved in one or more professional organizations, as well as ad hoc activities of the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE).

The IG continues to meet monthly with Inspectors General from the other Federal financial regulatory agencies and participates as a member of the PCIE/ECIE Inspection and Evaluation Committee.

The IG General Counsel meets at least monthly with counsels to the IGs. She participated on the ECIE Awards Nomination Review Board. Counsel also attends Directors of Investigations meetings.

The OIG auditor meets periodically with the Federal Audit Executive Committee.

Staff Participation in Agency Organizations

Staff is active on several Agency workgroups and task forces. During this reporting period, the OIG was represented in Blacks in Government, Administrative Burden Reduction Workgroup, and the Combined Federal Campaign.

Staff Development

OIG employees continually seek ways to improve skills and become knowledgeable in Inspector General community efforts. The auditor received the designation, Certified Government Auditing Professional. In addition, the Counsel to the IG attended various legal courses and a writing and editing course at the IG Academy.

APPENDIX A

INDEX OF REPORTING REQUIREMENTS

INSPECTOR GENERAL ACT CITATION AND REQUIREMENT	PAGE
Section 4(a)(2) Review of Legislation and Regulations.....	9
Section 5(a)(1) Significant Problems, Abuses and Deficiencies	none
Section 5(a)(2) Recommendations for Corrective Action.....	none
Section 5(a)(3) Prior Recommendations Not Yet Implemented.....	7-8
Section 5(a)(4) Matters Referred to Prosecutive Authorities.....	none
Section 5(a)(5) Summary of Instances Where Information..... Was Unreasonably Refused or Not Provided	none
Section 5(a)(6) List of OIG Audit/Inspection Reports Issued During the Period	none
Section 5(a)(7) Summary of Significant Reports Issued During the Period	none
Section 5(a)(8) Statistical Table on Management Decisions	12
with Questioned Costs	
Section 5(a)(9) Statistical Table on Management Decisions on	13
Recommendations that Funds be put to Better Use	
Section 5(a)(10) Summary of Each Audit Over Six Months Old for	8
Which No Management Decision Has Been Made	
Section 5(a)(11) Significant Revised Management Decisions	none
Section 5(a)(12) Significant Management Decisions with Which	none
the Inspector General Disagreed	
Section 5(a)(13) Compliance of Agency Financial Management System.....	4

APPENDIX B

Audit / Inspection Reports Issued			
Title of Report	Number of Agreed Upon Actions/ Recommendations	Questioned Costs	Recommendations That Funds Be Put to Better Use
None			
<i>Total</i>	<i>0</i>	<i>\$ 0</i>	<i>\$ 0</i>

APPENDIX C

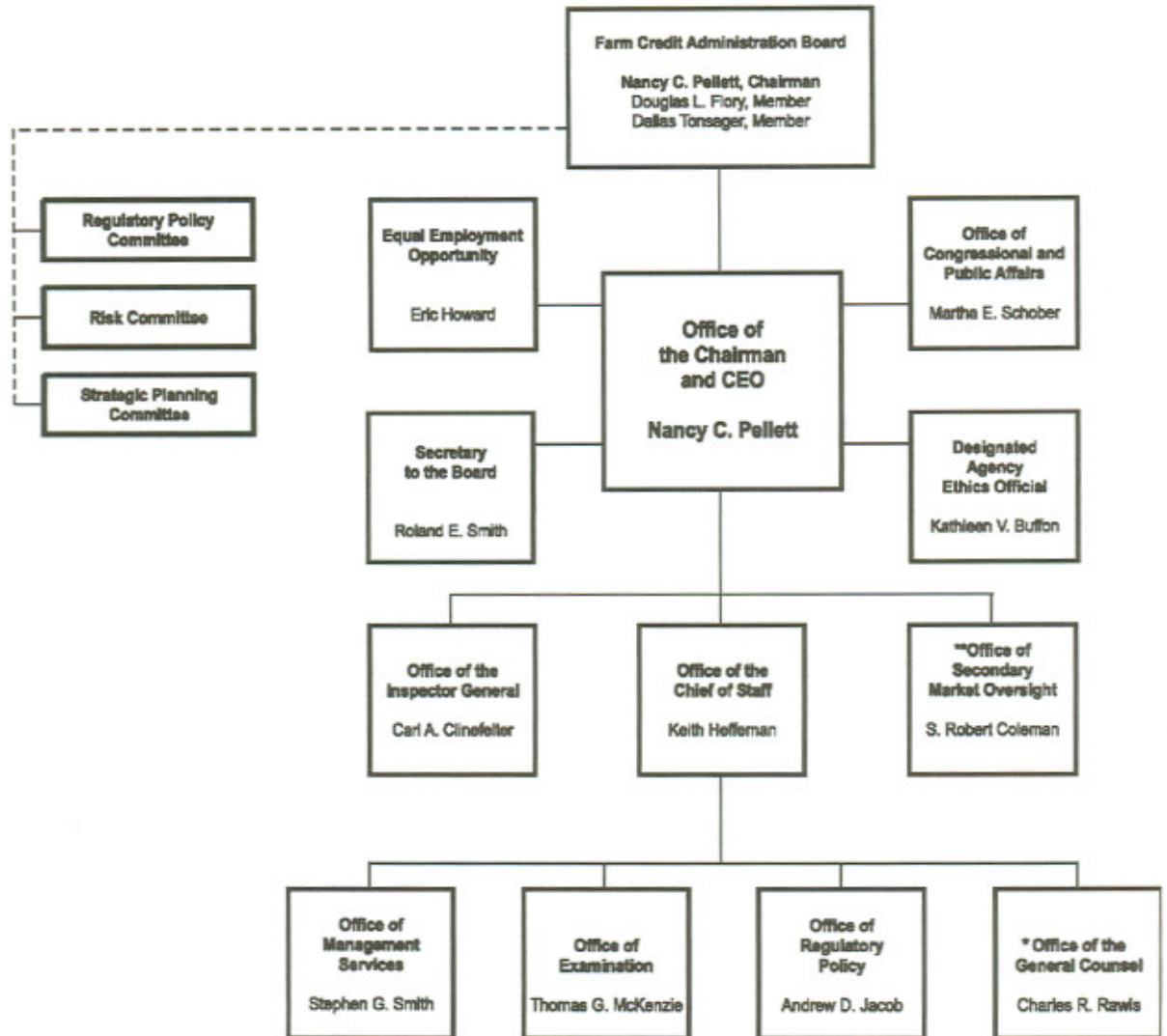
Reports with Questioned Costs				
	Number		Dollar Value	
	Reports	Recom- mendations	Questioned Costs	Unsupported Costs
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0	\$ 0
<i>Subtotals (A+B)</i>	0	0	\$ 0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0	\$ 0
(i) dollar value of disallowed costs	0	0	\$ 0	\$ 0
(ii) dollar value of costs not disallowed	0	0	\$ 0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0	\$ 0

APPENDIX D

Reports with Recommendations that Funds be Put to Better Use			
	Number of Reports	Number of Recommendations	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0
<i>Subtotals (A + B)</i>	0	0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0
(i) dollar value of recommendations that were agreed to by management	0	0	\$ 0
—based on proposed management action	0	0	\$ 0
— based on proposed legislative action	0	0	\$ 0
(ii) dollar value of recommendations that were not agreed to by management	0	0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0

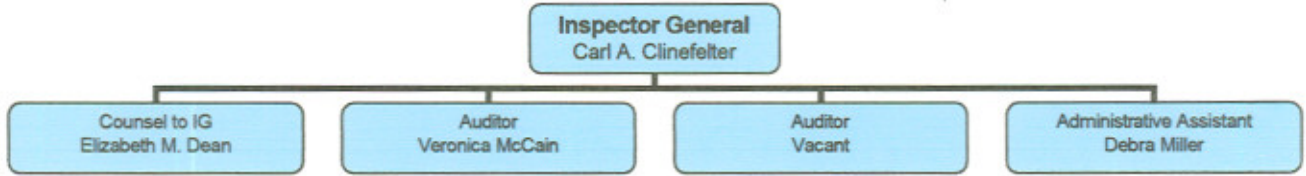
APPENDIX E

**Farm Credit Administration
 Organizational Structure**
 As of January 3, 2006



*Maintains a confidential advisory relationship with each of the Board members.
 ** Reports to the Board for policy and to the CEO for administration.

Office of Inspector General Organization Chart



R E P O R T

Fraud ❖ Waste ❖ Abuse ❖ Mismanagement



FARM CREDIT ADMINISTRATION OFFICE OF INSPECTOR GENERAL

☎ phone: Toll Free (800) 437-7322

(703) 883-4316

📠 Fax: (703) 883-4059

🖱 e-mail: fca-ig-hotline@starpower.net

✉ mail: Farm Credit Administration
Office of Inspector General
1501 Farm Credit Drive
McLean, VA 22102-5090