

OFFICE OF  
INSPECTOR GENERAL

## Survey Report

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

Third Quarter  
Fiscal Year 2016  
(April 1 - June 30, 2016)

Issued September 7, 2016



FARM CREDIT ADMINISTRATION

**Office of Inspector General’s Survey of Farm Credit System Institutions  
Regarding the Agency’s Examination Function  
Third Quarter of Fiscal Year 2016 Summary Report  
(April 1 – June 30, 2016)**

**Introduction**

During the period April 1 – June 30, 2016, the Office of Examination identified thirteen Farm Credit System (FCS) institutions that were in a position to provide meaningful survey responses.

The Office of Inspector General (OIG) sent surveys to those institutions on July 25, 2016. Eleven of the thirteen institutions surveyed submitted completed surveys (85% 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 Fiscal Year (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 will include FY 2016 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 – Third Quarter FY 2016**

Average numerical responses to survey statements 1–8 ranged from 1.6 to 2.2 for the third quarter.

<b>Average Numerical Response Range to Survey Statements 1–8</b>			
<b>3<sup>rd</sup> Quarter FY15</b>	<b>2<sup>nd</sup> Quarter FY16</b>	<b>1<sup>st</sup> Quarter FY16</b>	<b>4<sup>th</sup> Quarter FY15</b>
1.6 – 2.2	1.5 – 2.2	1.5 – 2.1	1.5 – 2.3

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

<b>Average Numerical Response for all Survey Statements</b>			
<b>3<sup>rd</sup> Quarter FY15</b>	<b>2<sup>nd</sup> Quarter FY16</b>	<b>1<sup>st</sup> Quarter FY16</b>	<b>4<sup>th</sup> Quarter FY15</b>
1.9	1.9	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.

### 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 16	1.6	1.8	1.9		1.8
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

**Comments:**

- The Board felt the scope of examination was appropriate and comprehensive.
- Examination efforts appropriately addressed organizational risk issues and understanding the institution’s enterprise risk management approach to identify, monitor and manage risks in consideration of risk appetite. Further, there was increased examination attention on loan review and internal controls. With loan review, the scope was comprehensive and inclusive of portfolio concentration risk areas, and loans in the industries experiencing stress. The examination of internal controls assured an initial understanding of the institution's system of internal controls, and then completed a more detailed review in various areas (e.g., internal review and audit, delegations of authority, loan disbursements, etc.).
- The scope of examination activities at the institution appeared to be comprehensive and appropriately considered the risks within and facing the organization. The institution has made a considerable investment to develop and maintain a strong control environment and we believe the FCA's examination focus should continue to evolve to be risk and controls based as opposed to substantive testing. Additionally, during the last review cycle, the examiners appeared to increase their leverage of the work performed by the institution's 2nd and 3rd lines of defense to better understand risks within the organization and the underlying control environments prior to developing their review plans.
- On a positive note there seemed to be more focus on credit in this exam where most of the risk is found. **However, time spent on some exam activities was excessive given the size of our institution.**
- The focus on delegated authority transactions and score card overrides was appropriate. **Functions performed by another institution (e.g. Treasury functions) may be more appropriately covered within the scope of that institution’s examination.**

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

**Average Response:** 2.1

Statement 2	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 16	1.9	1.8	2.1		1.9
FY 15	2.0	1.7	1.5	1.8	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

**Comments:**

- We agree that examiners were correct in their application of laws and regulations.
- Examiners demonstrated a sound understanding of laws and regulations, and measured these against institution policies, procedures and practices. Examination findings and conclusions were complete and accurate.
- Completely agree.
- First of all we wish to acknowledge our EIC because she tried as much as possible to bring a balanced view to the discussions that are the subject of this comment. **Our critique is concerning one particular examiner. He has many years of experience, but in our view was overly prescriptive in areas beyond the jurisdiction of an examiner and was reckless with one comment. Specifically, during on-site exam activity in discussion with the CCO, he criticized our repayment capacity underwriting standard and commented that FCA might have to place us under a supervisory agreement if we did not change the standard. (This standard had been in effect for years and stood the test of other examinations without comment.) Additionally, the same examiner was critical of our concentration risk policy and the institution’s single exposure limit methodology (more on this later in the survey).**
- **Some of the examiners interpretations of the regulations were not the same interpretations previously discussed with FCA examiners. A procedure that followed the Whistleblower guidance from July 2015 was not acceptable to the reviewers and an enhancement became a required action. UCS classifications other than Acceptable focused on the loss history of the member rather than considering all the credit factors as outlined in the definitions.**

**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:** 2.1

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 16	2.1	2.2	2.1		2.1
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

**Comments:**

- The recommendations were appropriate and reasonable.
- Management and the Board agreed with the recommendations presented in the report to the Board of Directors.

- The FCA interacted frequently with the Audit Committee Chairman through the various reviews and presented their results in the Board Meeting. We viewed the results as favorable and felt that the related discussions were valuable in the development of our understanding of the related risks. In 2015 through 2016, we saw increased collaboration between the institution and the FCA regarding the management of difficulties in the areas of internal control and standards of conduct and view this as a very effective and efficient process to address the related risks and in the development of remediation plans and actions.
- It was a required action that the board "define an absolute single borrower exposure limit to fully comply with FCA regulation." This limit would presumably apply to loans exceeding the board approved internal hold maximum, but less than the legal lending limit. For years FCA has been satisfied with our practice of approving such loans through our employee Senior Loan Committee and then post approval reporting to the board. **The concern of the board is that FCA is mandating by regulation their involvement in the loan approval process and the board does not believe it is their role to approve individual loan transactions.**
- A few actions assisted with addressing the associated risks, **however, the remaining actions were not associated with significant risks to the institution. After the onsite reviews it became apparent that someone at FCA, who had not been onsite or had any communication with management, was having significant input on the outcome of the review. The understandings between management and the FCA team leaders changed after what we believed were the final discussions.**
- **Recommendations at times are generic. For example...Management should enhance controls to ensure proper credit analyses. Credit analysis is a fairly comprehensive area, making it difficult to know where enhancements are needed.**

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

**Average Response: 1.8**

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 16	1.5	1.5	1.8		1.6
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

**Comments:**

- On-site and electronic examination activities were all handled professionally and efficient.
- The Senior Portfolio Manager and Examiner in Charge conducted the on-and off-site examination activities in an effective and professional manner. In addition, challenges that occurred during the examination due to health issues of the EIC were handled well, especially in communication with the institution's Chief Risk Officer, and also in the handing-off of oversight responsibilities to other qualified examiners.
- The institution was assigned a new EIC for the 2015/2016 examination cycle that was able to quickly step in to support the various reviews. He established a very professional, productive and effective arms-length working relationship with the institution. Additionally, the FCA deployed skilled resources with a breadth of backgrounds (credit, technology, operations risk, assurance, etc.) that were able to effectively and efficiently evaluate the risks within the organization.

- We only took issue with one examiner, other than him the exam team was professional and effective.
- Most examiners were professional, however, a few became overly resistant to management's point of view during some discussions. The new examiners' inexperience with general agricultural practices and terminology created inefficiencies for everyone involved. Recommend additional education in the area of general agriculture and agricultural finance for FCA examiners.
- The EIC was late to our board meeting by 15 minutes to give the final report.

**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 16	1.8	1.7	1.8		1.8
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

**Comments:**

- Overall communications were clear, accurate and timely - particularly with EIC.
- Overall communications were timely and effective, as noted in (4) above. However, the review of internal controls involved off-site examination activities which led to back and forth emails between institution staff and the examiner. That approach can lead to misinterpretation by either party, so it is important that phone calls be held before the email request and/or after the response, ensuring a correct understanding.
- Very good communications with the FCA staff.
- Communications between the FCA and the institution's staff and board were clear, accurate and timely. Additionally, the Chief Risk Officer and the EIC have scheduled regular monthly update calls and the FCA examiners meet quarterly with the institution's Strategic Relations Division staff. These timely communications have proved to be very effective.
- The office of examination staff were not timely in their communications with the institution after being onsite. Communication with the institution was not clear or accurate in a few examination areas.
- Examination activities aligned with communicated scope. FCA staff was sufficiently responsive in communications with institution staff.

**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: 1.6**

Statement 6	1 <sup>st</sup> Qtr	2 <sup>nd</sup> Qtr	3 <sup>rd</sup> Qtr	4 <sup>th</sup> Qtr	FY Average
FY 16	1.7	1.7	1.6		1.7
FY 15	2.0	1.8	1.7	1.9	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

**Comments:**

- Communications were both informative and helpful.
- Board and Audit Committee communication was limited to the presentation of the Report of Examination and the subsequent executive session. Both of these provided institution directors good opportunity to engage in discussion on examination activities and conclusions, as well as to ask clarifying questions. It would be helpful to the audit committee to have some time with the examiners.
- The FCA provided complete and detailed communications in the form of ongoing verbal updates and through the written final Report of Examination.
- Level of communication associated with examination activities was satisfactory.
- Both the report and the read out with the Board were valuable.

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

**Average Response: 1.9**

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 16	1.9	1.8	1.9		1.9
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

**Comments:**

- Examiners were open to dialogue in all areas prior to formulating conclusions.
- Discussion with institution management (and staff) were held throughout the examination process, and contributed to an accurate and fair assessment of institution operations and performance. In addition, from these discussions, it was clear that examiners gained an understanding of institution operations and processes, and also of management's perspective regarding the issue or question raised.
- Board of directors had minimal views or responses for the examiners to consider in formulating their conclusions and recommendations. Exam team and EIC had significant discussions with management as appropriate before finalizing recommendations.
- In most areas after extensive discussions the examiners considered the views of management.

- Examiners appropriately challenged management with recommendations made through the examination process.
- There was positive interaction between FCA examiners and the institution’s credit leadership.
- For the vast majority of issues, there are no concerns. **However, the grain exposure discussion was more theoretical than practical. The examiner was asking for additional risk management while being very general about the actions desired.**

**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 16	1.7	2.2	2.2		2.0
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

**Comments:**

- Guidance is readily available and helpful.
- Guidance from the Office of Examination provides the institution's Board and management with insight to the regulatory view of the topic raised. The examiners demonstrated good judgment when assessing the institution’s response to guidance, taking into consideration the appropriateness and/or applicability of the guidance given the institution’s risk environment and existing business practices.
- FCS-wide guidance from the Office of Examination in the form of the annual National Oversight Plan, various information memorandums, and other non-formal communication are all very helpful in the understanding of direction and requirements.
- Guidance was generally helpful.
- Guidance issued does provide insight relative to how the agency expects risk to be managed by System institutions.

**GENERAL QUESTIONS**

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

**Comments:**

- Open and clear communication with the EIC prior to and during the exam process.
- Prior to completing examination steps, the examiners obtained a clear understanding of the institution's practices and processes. This allowed them to effectively measure institution performance against examination scope items. More specifically, the loan review and internal controls assessments provided value to the Board and management in validating existing institution practices.
- We had good communication and open dialogue with the examiners. The recommendations to the Board were in line with prior discussions. Recommendations presented by the EIC were useful to management and Board.



- Opportunities to collaborate on the various risks facing the organization and the Farm Credit System as a whole. Greater integration in the handling of certain District events.
- The examination team brought to our attention weaknesses in the loan disbursement process via wire transfer. Because of their findings, that process has been evaluated and improved.
- While there are always complaints about being audited we appreciated the friendliness of the entire staff. Insights from some of the examiners was helpful.
- The most beneficial aspect of the examination process is to provide manage with an assessment of their regulatory compliance and risk management ability which in turn provides the board with information to effectively oversee the institution.
- FCA's recommendation to validate the credit score card was aligned with the direction that institution leadership had identified in 2015 and was in the process of completing in 2016.
- Our EIC and examiners allowed plenty of time to discuss findings.
- \_\_\_\_\_ is very good to work with.
- Getting Regulator philosophy on credit classification.

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

**Comments:**

- **The time needed to devote to the overall examination can be burdensome.**
- We did not have any area that we technically found least beneficial. No problems with the examination process or results.
- **Similar to prior feedback provided, there is an ongoing opportunity for lesser experienced examiners to enhance their understanding and knowledge of assigned areas. This would accelerate the reviews and lessen the overall examination burden on the organization.**
- **Communication issues both on and off site. Some of the communication issues occurred due to the inexperience of some of the team leaders which is understandable given the limited time they had been in their positions and apparent lack of confidence their superiors had in their ability to assess situations.**
- **Examination of functions performed by another institution (e.g. Treasury functions).**
- **Too many trainees were brought to the institution. Institution staff could not complete their day to day tasks due to the review.**
- **The insistence that chattel valuations be done by someone independent of the loan officer is illogical.**

**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 considered the overall examination process to be informative, candid and helpful to our institution.
- The Board was pleased with the examination process and the communication both during the examination and at the presentation. There was some discussion about Board size but the Board feels comfortable at its current level at this time.
- The survey has been reviewed by and discussed with the Audit Committee of the Board. The Audit Committee concurs with management's responses to questions 1 to 10 and has no additional

comments. The board as a whole has not discussed the responses to this questionnaire but a copy of the draft responses has been shared with the full board prior to its submission.

- Audits provide some beneficial support to the board in having an outside look at the inside of our institution. **However, considering the number of audits performed they are becoming burdensome. The FCA staff often come up with a certain agenda and seem to be determined to oppose an item no matter what they find when they look into it.** While we appreciate the insights provided we feel that management and other outside resources are providing the detail needed to maintain and govern a sound institution. **We believe FCA's oversight and direction is over stretching its mission and at times requires unnecessary additional expense.** To remain viable our institution must provide financial services to farmers and ranchers at a low cost while remaining safe and sound.
- The Board appreciates the diligence with which the FCA examiners approach this review and finds great value in the report and our discussions with the examiners.