

OFFICE OF
INSPECTOR GENERAL

SURVEY REPORT

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

Fourth Quarter Fiscal Year 2018
(July 1 - September 30, 2018)

Issued January 31, 2019



FARM CREDIT ADMINISTRATION



Executive Summary

Survey of Farm Credit System Institutions Regarding the Agency's Examination Function Fiscal Year 2018 Fourth Quarter Report (July 1 – September 30, 2018)

The FCS institutions asked to respond to the survey are those institutions that:

1. Received a Report of Examination during the FY quarter; or
2. Had significant examination activity and interface with OE during the same period.

The survey asks respondents to rate eight survey statements as:

- | | |
|----------------------------|---|
| Completely Agree | 1 |
| Agree | 2 |
| Neither Agree nor Disagree | 3 |
| Disagree | 4 |
| Completely Disagree | 5 |
| Does Not Apply | 6 |

Each fiscal year (FY) quarter, the Farm Credit Administration (FCA) Office of Examination (OE) identifies several Farm Credit System (FCS) institutions that are in a position to provide meaningful survey responses for that period. The OE identified 14 FCS institutions to survey for the period July 1 – September 30, 2018. The Office of Inspector General (OIG) sent surveys to those institutions in November 2018 and 11 of 14 institutions completed the survey (79% response rate).

For the fourth quarter of FY 2018, average numerical ratings ranged from 1.4 to 1.9 (with "1" reflecting a positive rating and "5" reflecting a negative rating). The total average numerical rating for all survey statements was 1.6. For comparison, we provide data from the prior three quarters below.

FY 2018 Quarter	Average Numerical Rating Range	Total Average Numerical Rating
4 th	1.4 – 1.9	1.6
3 rd	1.3 – 2.0	1.7
2 st	1.9 – 2.2	2.0
1 st	1.5 – 2.6	1.9

Consistent with prior quarters' responses, we received more positive than negative comments about the examiners and the examination process.

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ACRONYMS

EIC	Examiner in Charge
FCA	Farm Credit Administration
FCS	Farm Credit System
FY	Fiscal Year
MRA	Matters Requiring Attention
OE	Office of Examination
OIG	Office of Inspector General
ROE	Report of Examination

BACKGROUND AND METHODOLOGY

Each fiscal year (FY) quarter, the Farm Credit Administration (FCA) Office of Examination (OE) identifies several Farm Credit System (FCS) institutions that are in a position to provide meaningful survey responses for that period. The criteria for including an FCS institution in the survey are:

1. The institution received a Report of Examination during the FY quarter; or
2. There was significant examination activity and interface with an institution during the same period.

The Office of Inspector General (OIG) provides a survey report for FY quarters ending December 31, March 31, June 30, and September 30. This fourth quarter report includes FY 2018 summary data.

When outstanding responses from prior quarters are received, they are included in the next quarterly report.

The survey asks respondents to rate eight survey statements from "1" (Completely Agree) to "5" (Completely Disagree), or "6" if the statement does not apply. The rating choices are:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5
Does Not Apply*	6

*We do not include ratings of "6" in rating averages because a "6" will skew the numerical average negatively even though the statement is not applicable to the institution.

We provide the current FY quarter's average numerical rating for survey statements 1-8 and, for comparison, the prior two FYs' data.

Survey statements 1-4 pertain to the examination process and statements 5-8 pertain specifically to communications during the examination. Statements 9-11 are general questions about the overall process. Respondents may submit comments for each of the 11 survey statements.

Narrative responses are provided verbatim, except any information identifying the institution or examiners has been removed and obvious spelling errors are corrected. Any bracketed text is for the purpose of removing information that identifies an institution or an examiner or providing clarification to a response. Perceived negative comments of any degree are color coded in red.

At the end of the survey we ask whether the respondent would like the OIG to contact the institution confidentially to discuss the submitted responses.

SURVEY RESULTS

EXAMINATION PROCESS

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 Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.8	1.9	1.7	1.7	1.8
2017	1.8	1.6	1.8	2.1	1.8
2016	1.6	1.8	1.9	1.7	1.8

Comments:

- We agree.
- Audit areas were consistent with the Examination Focus Areas provided by FCA.
- **In conversation it seemed that all institutions regardless of size needed the same require the same roles (for example, a CIO needed).** In deeper review the examiners agree that not all organizations need the same roles.
- The scope was deeper and broader than prior examinations.
- **The scope of exams has continued to expand even though our business model has remained very simple.**
- The board agreed with FCA's priorities and focus on the areas examined.

Statement #2

Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.8	2.0	1.9	1.5	1.8
2017	1.8	1.7	1.8	2.1	1.9
2016	1.9	1.8	2.1	1.8	1.9

Comments:

- 100%.
- We appreciate that the examination team asks thoughtful questions and encourages discussion especially in the area of allowance, liquidity and capital to help establish a baseline of understanding.
- Certain interpretations are new and not clearly defined in regulations. Two specific examples are the definition of collection language for distressed loans and farm related service business loans.
- Laws and regulations were appropriately applied in most cases. However, in several situations, issues were identified as Matters Requiring Attention that were not based on regulation.

Statement #3

The matters requiring attention and any supervisory agreement with FCA assisted the board and management in addressing the risks of the institution.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	2.6	2.1	1.9	1.6	2.1
2017	1.8	1.8	2.2	2.4	2.1
2016	2.1	2.2	2.1	2.0	2.1

Comments:

- Yes, we agree and further feel that our EIC and exam team have been very effective in this regard.
- Generally, yes.
- Effective in communication. Presence at the Board meeting was appreciated.
- We consider some of the MRAs in our ROE to be an overreach.

Statement #4

The examiners were professional and efficiently conducted examination activities.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.5	2.1	1.3	1.4	1.6
2017	1.8	1.5	1.4	1.6	1.6
2016	1.5	1.5	1.8	1.3	1.5

Comments:

- Highly professional team, well led and well organized.
- The examination team acted in a very professional manner.

COMMUNICATIONS

Statement #5

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

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.8	2.1	1.5	1.6	1.8
2017	1.6	1.5	1.7	2.0	1.7
2016	1.8	1.7	1.8	1.6	1.7

Comments:

- Absolutely agree with this, our EIC, exam team and senior examiner are very organized, communicate regularly and are available for discussions.
- Generally, yes.
- Some reports were being sent only minutes before scheduled conference calls.
- The examiners communicated effectively and clearly during their time with our institution, resulting in a very efficient and structured examination.
- FCA's staff showed a decided engagement in understanding the institution's particular risks and the effect of extraordinary natural disaster impacting the island.

Statement #6

Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.8	1.9	1.7	1.9	1.8
2017	1.8	1.6	1.7	2.1	1.8
2016	1.7	1.7	1.6	1.6	1.7

Comments:

- Overall we agree, from management's perspective we would encourage FCA to be sure to clarify as it relates to the "Management and Board rating" any expectations for the Board.
- Generally, yes.
- Reports were laid out well.

Statement #7

Examiners fairly considered the views and responses of the board and management in formulating conclusions and matters requiring attention.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.9	2.2	1.7	1.6	1.9
2017	1.6	1.8	2.1	2.1	1.9
2016	1.9	1.8	1.9	1.8	1.9

Comments:

- The FCA examination team was good at encouraging discussion and listening to detail and explanation.
- While we agreed with most of the issues identified as MRAs in our report, we didn't believe they all rose to the level of an MRA. Our well supported arguments seemed to largely be disregarded.
- The examination team gave consideration to our perspective on matters that required discussion.
- The examiners demonstrated an openness to discussion on topics prior to formalizing their conclusions and final recommendations.

Statement #8

FCS-wide guidance from the Office of Examination was proactive and helpful.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
2018	1.9	2.0	2.0	1.7	1.9
2017	2.0	2.0	1.9	2.3	2.1
2016	1.7	2.2	2.2	1.8	2.0

Comments:

- FCA has done an excellent job of proactive communication.
- I agree and appreciate the disclosure of focus areas for the coming year. The timing of the announcement can be burdensome if the institution is in the middle of the review when the new focus areas are released, especially when the new focus areas are a result of some issue or situation that has arisen somewhere else in the system. In these instances, the institution has little time to respond or prepare for the new focus area.
- While FCS-wide guidance is helpful, it seems to have sometimes taken the place of regulation changes which are required to go through a public comment period.
- The examination team was collaborative over the span of the examination process, and shared insight when possible and appropriate.

GENERAL QUESTIONS

Statement #9

What aspect of the examination process did you find most beneficial?

- Open and clear communication, when we had questions the exam team was willing to either explain positions to us or willing to investigate further and provide us with perspective.
- The open dialogue on important or emerging issues.
- Phone calls to review findings, reports and board presentations.
- Discussions with examiners while on site are most beneficial, in which we learn about various ways other institutions address certain issues.
- The audit committee and board appreciates the dialogue with the examiners during the exam as well as the closeout. Discussion is helpful.
- We enjoy the dialogue with our EIC and examination teams because it helps us identify gaps or ways to improve our controls and processes. We have a good, open relationship with our EIC.
- The examination was thorough, however the tone was collaborative and the team was willing to share insight on certain matters when possible.
- The asset quality review is the most useful part of the exam.

- The exam team's ability to provide advice or guidance based on the best practices they've identified throughout the FC System.
- The communication process with FCA's staff with the board to discuss findings and recommendations.

Statement #10

What aspect of the examination process did you find least beneficial?

- Need to have more frank discussions with the board regarding expectations around committee structures and depth of duties regarding HR as it relates to the audit committee role related to the director of internal audit.
- The need to react to questions that are promulgated by emerging issues in the system.
- Some of the MRAs identified in our ROE were issues that had already been corrected or were in the process of being corrected or issues that didn't rise to the level of an MRA. The new approach of classifying all findings the same regardless of severity made our ROE look worse than it actually was.
- Although there seems to be some improvement in this area, it still seems a couple of the questions we received were the result of a lack of consideration given to the differences in the district funding mechanisms and shared service arrangements.

Statement #11

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

- We need clarity around shareholder creation.
- Board members had communication with the examiner in charge during the examination process and felt the interaction was helpful for both parties to understand the significant issues and initiatives being addressed by the board.
- 1. Examiners have a difficult time adequately defending the regulation which requires the names of stockholders who are known to be UNQUALIFIED to be director, to be provided to the nominating committee for consideration and possible selection as director candidates. We will abide by the regulation, but we do not understand the logic for it. 2. Examiners have a difficult time adequately defending FCA's position which says that co-stockholders (example, a husband and wife) must ALL be considered as separate and distinct potential director candidates by the nominating committee, yet they both CANNOT be given separate and distinct voting rights to vote in the director election itself. Due to this, a person may be selected as director who is not eligible to vote since they are not the designated voter for the co-owned stock. We will abide by this guidance, but we do not understand the logic for it. Thank you for the opportunity to provide comments.
- The board appreciates the professionalism shown by our EIC and the exam team. The board agrees with comments made elsewhere in this survey.

- Our board has seen the process evolve over the years to a more open dialogue when the examination results are shared. The occasional insights and discussions into certain risk areas are helpful. We appreciated the thoroughness of the exam results and the time spent working through the full scope of the exam so that we can get a clear view of the exam work. Explanations were consistently available and helpful.
- The examination team did a good job, especially in communicating with the board on the process, findings, and actions needed. The final examination report was very beneficial.

Request for OIG Contact

Would you like the Office of Inspector General to contact you confidentially to discuss your survey responses and/or the examination?

This quarter, one institution indicated that they would like a call from the OIG. When contacted institution staff provided additional positive feedback regarding their experience with the examination process.

FISCAL YEAR 2018 SUMMARY REPORT

Ratings for Survey Statements 1–8

The table below provides cumulative data for the FY 2018 ratings for survey statements 1-8. During FY 2018, the OIG sent surveys to 51 FCS institutions and received 44 responses. This is an 86% response rate, down 5% from FY 2017's response rate of 91%. The overall average rating for survey statements 1-8 was 1.8 for FY 2018, compared to 1.9 for FY 2017. For FY 2018, 87.2% of the ratings were either "completely agree" (1), or "agree" (2), compared to 90.2% for the total of those two rating categories in FY 2017.

Number and Percentage per Rating Category

Statement	Completely Agree (1)		Agree (2)		Neither Agree nor Disagree (3)		Disagree (4)		Completely Disagree (5)		Does Not Apply* (6)		Average Numerical Rating
	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage	
1	14	32%	26	59%	4	9%	0	0%	0	0%	0	0%	1.8
2	15	34%	24	55%	4	9%	1	2%	0	0%	0	0%	1.8
3	11	25%	26	59%	5	11%	0	0%	2	5%	0	0%	2.1
4	24	55%	16	36%	2	5%	1	2%	0	0%	1	2%	1.6
5	18	41%	21	48%	4	9%	1	2%	0	0%	0	0%	1.8
6	16	36%	23	52%	3	7%	2	5%	0	0%	0	0%	1.8
7	17	39%	20	45%	4	9%	3	7%	0	0%	0	0%	1.9
8	12	27%	24	55%	8	18%	0	0%	0	0%	0	0%	1.9
Total Responses	127	36.1%	180	51.1%	34	9.7%	8	2.3%	2	.6%	1	.3%	1.8

*Ratings of "6" (Does Not Apply) are not included in average numerical ratings.

**FARM CREDIT ADMINISTRATION
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