

**Third Quarter Fiscal Year (FY) 2011 Summary Report
(April 1 – June 30, 2011)**

**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, 2011, the Office of Examination (OE) identified 12 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 12 institutions on July 28, 2011. Of the 12 institutions surveyed, 10 submitted completed surveys. If the nonresponding institutions subsequently send a completed survey, they will be included in the next quarterly report.

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 nine 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 2011

Average numerical responses to survey statements 1 - 9 ranged from 1.5 to 2.4.

Average Numerical Responses to Survey Statements 1 – 9		
3 rd Qtr	2 nd Qtr	1 st Qtr
1.5 – 2.4	2.0 – 2.2	1.4 to 2.1

The average response for all survey statements was 1.9.

Average Response for all Survey Statements		
3 rd Qtr	2 nd Qtr	1 st Qtr
1.9	2.1	1.7

The above represents a slight improvement this quarter in the average numerical rating. There was one “5” (Completely Disagree) rating and two ratings of “4” (Somewhat Disagree). The “5” rating was with respect to survey statement 5 and the “4” ratings were with respect to survey statement 9.

In this quarter, there were more positive than negative narrative comments to survey statements 1-9. (Negative comments of any degree are **color coded in red.**)

Survey item 10a asks for feedback on the most beneficial aspects 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 10b asks for feedback on the least beneficial aspects of the examination process. As would be expected, most were negative. However, several comments do provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments. Of particular note is the comment (in red) in the 4th bullet which states “**FCA’s shift to regulation compliance and lack of concern about credit is of deep concern for the system.**”

Responses to Survey Statements 1–9

Examination Process

Survey Statement 1: The scope and frequency of examination activities focused on areas of risk to the institution and were appropriate for the size, complexity, and risk profile of the institution.

Average Response: 1.8 (2nd Quarter was 2.0, 1st Quarter was 1.8)

Comments:

- We also support the shortened examination cycle in conjunction with our merger.
- Focus has changed appropriately with changes in our institution’s size and complexity.
- **This year a fair amount of time was dedicated to reviewing the Audit Committee charter. While this is certainly important, the time dedicated did not seem to correlate to the risk level. Becoming fixated on minor issues like the Audit Committee charter (required info was in an exhibit to charter instead of charter) hurts credibility of examination teams on more important issues.**
- Every 18 months is sufficient to monitor our risks.

Survey Statement 2: The examination process helped the institution understand its authorities and comply with laws and regulations.

Average Response: 1.7 (2nd Quarter was 2.1, 1st Quarter was 1.9)

Comments:

- The exam confirmed our understanding of laws and regulations.
- Examination needs to be consistent in good times and bad. Examination has a tendency to over correct when economic conditions change.
- The examination brought out some interpretation on DLR Letters that we had failed to incorporate into our process.

Survey Statement 3: The results and recommendations of the examination process covered matters of safety and soundness, and compliance with laws and regulations.

Average Response: 1.7 (2nd Quarter was 2.0, 1st Quarter was 1.5)

Comments:

- Yes, we feel that the results covered all matters for safety and soundness along with compliance.
- A number of recommendations bordered on management of the institution versus compliance or safety and soundness.

Survey Statement 4: Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.

Average Response: 1.8 (2nd Quarter was 2.2, 1st Quarter was 1.9)

Comments:

- In general, we find the examiners to be knowledgeable and focused on important areas. As indicated in #1 above [3rd bullet under survey statement 1], some of the recommendations regarding the Audit Committee charter did not seem consistent with industry best practices. For example, the recommendation that all items in the Audit Committee calendar should be incorporated into the body of the charter when the calendar is an exhibit to the charter.
- There was a team of reviewers with several being in a training status. However, all were knowledgeable and had adequate supervision from senior examiners.
- We had a training crew. As would be expected, the experienced examiners were knowledgeable and used good judgment in application of laws, regulations, etc. The trainees were not as proficient on either front.

Communications and Professionalism

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

Average Response: 1.9 (2nd Quarter was 2.0, 1st Quarter was 1.4)

Comments:

- While we accept the findings of the FCA Special Examination, we believe the examination could have been more productive if FCA management had examined the reporting of events by the EIC, in addition to their challenging the reporting of events by institution management.
- Frequent and meaningful communications.
- We value the open communication we have with the examination team as this allows us to reach reasoned resolutions to important matters.
- All were clear, accurate, and timely. No problems.
- The EIC did a very poor job of coordinating communication from members of his team to the institution. There was a lot of duplication of requested information because of the lack of coordination.

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: 1.5 (2nd Quarter was 2.0, 1st Quarter was 1.7)

Comments:

- Audit reports need to give credit for institution portfolio management on commodity concentrations. Our report discussed concentrations and did not show ratios reflecting credit enhancements via FAMC standby guarantees or securitizations.
- Frequent and meaningful communications.
- Exit conference covered all questions the Board and Audit Committee had.
- A draft narrative on the findings in sections of the examination focus areas was provided in advance of the on-site exit conference. This was helpful, particularly for Board Audit Committee members in attendance, in framing and preparing for the exit conference.

Survey Statement 7: The examiners were organized and efficiently conducted examination activities.

Average Response: 2.1 (2nd Quarter was 2.0, 1st Quarter was 1.5)

Comments:

- Yes, audit was completed on site in one week.

- Training crews and shifting them and other examiners in and out impedes efficiency and organization. The EIC did as well as could be expected given these circumstances.
- When on-site they were organized. The organization prior to the on-site exam was lacking.

Survey Statement 8: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 1.7 (2nd Quarter was 2.0, 1st Quarter was 1.8)

Comments:

- Improving trends in commodity concentrations and patronage adjustments to build capital could have been better put into perspective in the written report. Without an historical trend the report reader comes to a different conclusion about progress by the institution. Concentrations less than 100% of risk funds may be a best practice but as our Board members stated in the closeout, that is not a realistic goal for this institution when serving a chartered area with a high single commodity concentration. We did acknowledge the progress and plan to reduce a specific commodity exposure and that was well received. The quality of credit administration, staff experience, and history of chargeoffs for the specific institution needs to be considered when discussing concentrations.
- Discussions as per findings were open and meaningful.
- Communication is good.
- Yes, we feel all Board and Management views were considered.

Survey Statement 9: FCS-wide examination guidance from the Office of Examination (e.g., examination bulletins, informational memoranda, etc.) was timely, proactive and helpful.

Average Response: 2.4 (2nd and 1st Quarters were 2.1)

Comments:

- FCS-wide guidance is burdensome. Informational Memorandums and other guidance appear to be a widespread approach that causes additional work by all FC institutions. Examples include guidance on Nominating Committees and Cooperative Operating Philosophy. If there are entities that are weak in these areas the approach needs to be more directed rather than making mass pronouncements. When we have to deal with additional documentation it reduces the resources available to serve our members.
- In general, such guidance is helpful. On occasion though it seems such guidance attempts to align the FCS with other regulatory bodies that are not relevant to FCS.
- Yes, we maintain a matrix that tracks all FCA correspondence to insure we are always up to date on any guidance.

- The information is helpful; however, not well organized for institution reference.
- Informational memoranda too great in length. Could be more concise, particularly when it comes to Board reading and understanding.

Responses to Additional Survey Items 10a, 10b, and 11

Survey Item 10a: What aspects of the examination process did you find **most** beneficial?

- The frequent guidance from OE helps tremendously as we work to be the best.
- Interaction with examiners on specific credits.
- We get a great deal of added value from our discussions with two of our examiners. They bring best practices into our discussions and suggestions that have enhanced our institution. Communication with our EIC works well. The new “ongoing exam” process rather than a one-time comprehensive audit of everything at one time is working ok.
- Open exchange and discussions.
- The discussions during the exam to understand areas of focus and questions before the exam team reaches conclusions.
- FCA focused on areas of risk to the institution and was appropriate for the size, complexity, and risk profile of the institution.
- Best practices from Senior Examiners.
- The meeting with the Full Board to explain the Report of Examination and the Recommended Actions in the report.
- Providing the draft of examination comments/findings prior to the on-site exit meeting.
- The area of regulatory compliance.

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

- While we understand that training of new staff is necessary for the FCA and we welcome training teams in the future, it would serve the process well to better delegate exam areas based on staff expertise related to the area risk level.
- Asset Liability Management continues to be an area that FCA has preconceived opinions not relevant to our use of call options.
- We have SOX, internal reviews, PWC, bank, and FCA audits. This over-regulation is a financial burden on the stockholders at smaller coops.
- Explaining procedures to younger trainee auditors.
- Recommendations for additional reporting that are not related to compliance with laws and regulation and marginally helpful in safety and soundness.

Survey Item 11: Please provide any additional comments about the examination process and related communications.

- We are pleased to have a new EIC assigned to our institution. We appreciate the EIC’s significant early actions to build a productive relationship.

- The examination process is an opportunity for us to share views on events within the FCS, such as our suggestion that if Farmer Mac's authorities are expanded then their capital requirements should increase, as well.
- Sometimes there is so much communication from bookletters that it is difficult to understand the point. There is a lack of confidence between regulators and institutions.
- The Examiners were very professional and explained their positions very well. The Audit Committee and Full Board really appreciate being able to communicate with the examiners face to face. The true risk in institutions lies in credit and the quality of loans. FCA's shift to regulation compliance and lack of concern about credit is of deep concern for the system.
- Providing the draft of examination comments/findings prior to the on-site exit meeting.