

April 30, 2002

The Honorable Michael M. Reyna  
Chairman of the Board and  
Chief Executive Officer  
Farm Credit Administration  
McLean, Virginia 22101

Dear Mr. Reyna:

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 from October 1, 2001 through March 31, 2002. We are filing this report in accordance with the Inspector General Act of 1978, as amended (Act). This is the twenty-sixth report since creation of the office on January 22, 1989. Section 5(b) of the Act requires that you send this report to the appropriate Congressional committees and subcommittees within 30 days after the date of this transmittal, with management's report on the status of audit recommendations.

I would like to complement you and Board Member Jorgensen for your diligence in focusing management on the resolution of agreed upon actions. Monthly reporting to the FCA Board members by the Audit Follow-up Official combined with appropriate questions to the parties responsible for taking action has resulted in a greater emphasis on meaningful corrective actions. Management completed final action on 15 agreed upon actions. Actions have also become more timely with management completing final action on 9 of the 15 most recent agreed upon actions.

I am looking forward to continuing our relationship and helping the Agency in making positive changes, becoming a better place to work, and being a more efficient organization. We appreciate the confidence you and the Board have expressed in our work and the constructive relationship that it demonstrates.

Respectfully,

Stephen G. Smith  
Inspector General

Enclosure

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## ACCOMPLISHMENTS

**We issued two audit reports, one inspection report and one review during this period. Based on recommendations and agreed upon actions made in these and earlier reports, as well as other Office of Inspector General activity, we achieved the following:**

- *Issued audit of the Office of Chief Financial Officer. Identified approximately \$196,000 in questioned cost and \$49,00 in funds be put to better use.*
- *Contracted with Harper, Rains, Stokes & Knight's, P.A. for audit of FCA's financial statement. FCA received an unqualified opinion.*
- *Continued to help the Agency make progress toward a streamlined planning process. Office budget and operating plans have been integrated, along with basic workforce planning so that each office has a consolidated operating and performance plan. These plans link resources to performance goals and the Agency's strategic plan.*
- *Completed an inspection of the Personnel Security Program. Inspection revealed that although the Agency has well written procedures in place, they are not always being followed.*
- *Contracted with Delclos/Walsh Associates for a study of the Agency's Early Warning System. The study was highly complementary of the quality and professionalism of the work produced by FCA examiners.*
- *Contributed to improving practices concerning FCA's requirements for the use of social security numbers.*
- *Provided information to improve the marketing of FCA to perspective employees. Additionally, provided a mechanism for the Agency to measure its operations from departing employees.*

## **BACKGROUND**

The FCA is an independent Federal agency of the United States government responsible for the regulation, examination and supervision of institutions chartered under the Farm Credit Act of 1971, as amended. FCA is a nonappropriated agency with a fiscal year (FY) 2002 budget of \$38,033,000 for administrative costs. The FY 2002 budget for the Office of Inspector General (OIG) is \$829,601. FCA is a “designated Federal entity” within the meaning of the Inspector General Act of 1978, as amended.

FCA currently has 265 employees, about half of which are examiners located at five field offices. Also included in the Agency positions are five approved positions for the OIG. Appendix II displays the current organizational structure of FCA and Appendix III displays the OIG within that structure.

## **MANAGEMENT CHALLENGES**

This section of the report outlines major challenges confronting the Farm Credit Administration as it works to fulfill its mission. These challenges fall into two general categories. First are the challenges related to the FCA’s core mission of ensuring a dependable supply of credit to agriculture through the institutions it has chartered. These challenges are often shaped and influenced by events that are outside the control of the Agency. Second, but no less important, are those challenges related to the Agency’s operations. These management challenges were incorporated in the previous semiannual report but have been updated to reflect changes and progress in meeting the challenges.

### **Organizational Leadership**

The Farm Credit Act provides for a full time three-member Board of Directors. The Board members are appointed by the President and confirmed by the Senate. The rapidly changing complex financial and banking environment makes the Board’s task both challenging and important. The Board must be able to engage in healthy professional policy debate and set a sound course for the Agency. A full strength Board is an important element in setting clear priorities and deliberating fully on the issues. In the 15 years since the inception of the FCA Board, it has been at full strength for less than half of that time. It has been missing one Board member since January 2000 except for a brief 20-day period.

A relatively small full-time Board also presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the Agency. As the membership on the Board changes, it needs to update its rules of operation to ensure it fulfills its statutory role in the governance of FCA.

## **Farm Credit System Risk**

The Farm Credit System (FCS) is a single industry lender and therefore is vulnerable to economic swings in the industry. The Farm Credit Administration is challenged to balance the often-competing demands of ensuring the FCS fulfills its public purpose, proactively examining risk in the regulated institutions both individually and systemically, and controlling the cost of the regulator.

## **Financial Management**

FCA's financial management system has undergone almost continuous change over the past five years. During this reporting period, the Agency completed its first financial statement using the services of the Department of Interior's National Business Center. With a successful implementation, management's challenge will be to leverage the system to deliver timely financial information that is critical to well informed management decisions.

## **Security**

In the aftermath of the events of September 11, 2001, security remains a major challenge for the Agency. In the recent report on information security, the OIG found a strong foundation for security practices. However, the speed of change in the security environment will be a challenge for all government organizations. This is especially true for smaller organizations like FCA where an increased emphasis on physical and information security will compete with program areas for tight budget funding.

## **Human Capital**

FCA needs to develop a comprehensive, integrated approach to human capital issues. The FCA has not adopted a human capital strategy. In light of the changes in the competitive environment, advances in technology, and the tenure of its workforce, FCA needs to closely evaluate business processes, their associated costs, and alternatives.

## **Leveraging Technology**

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. FCA will need effective mechanisms to ensure that current and future staff has the technical skills to use technology to operate in an efficient manner.

## **AUDIT AND INSPECTION REPORTS ISSUED**

We issued an audit of the Office of Chief Financial Officer (OCFO) and an inspection of the Personnel Security Program during this reporting period. We also issued reports on the FCA Financial Statements as of September 30, 2001. We conduct all audits in accordance with audit standards established by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are conducted in accordance with the President's Council on Integrity and Efficiency's

*Quality Standards for Inspections.* In addition to the audit and inspection reports, we issued a study of the Agency's Early Warning System. Copies of all OIG reports are available on FCA's Web site ([www.fca.gov/oig](http://www.fca.gov/oig)), by contacting the Inspector General's (IG) office on 703/883-4030, or by e-mail at [IG\\_information@fca.gov](mailto:IG_information@fca.gov).

### **Office of Chief Financial Officer**

The OIG completed an audit of the OCFO at the FCA. The objectives of this audit were to evaluate whether the OCFO was operating efficiently and determine whether initiatives to improve the office have been effective. We found that the implementation of the Federal Financial System is a promising step towards improving the OCFO efficiency. However, OCFO still lacks key elements to ensure the office is operating in the most cost effective manner. Specifically, the Chief Financial Officer is not effectively managing staff, the OCFO is not issuing financial products timely and funds are wasted on products and services. As a result in FY 2001 OCFO expended approximately \$196,000 in questioned costs and \$49,000 in funds be put to better use. Management agreed to recommendations to develop a workforce planning strategy; improve staff skills; provide timely financial data; and manage expenditures more efficiently.

### **Independent Financial Audit**

In December 2001, the OIG transmitted Harper, Rains, Stokes & Knight's, P.A. (HRSK) reports on the audit of the FCA's financial statements for the fiscal year ended September 30, 2001. HRSK issued an unqualified opinion. HRSK opined the financial statements present fairly, in all material respects, the financial position of FCA as of September 30, 2001 and 2000, in conformity with generally accepted accounting principles. HRSK issued two other reports. The report on the internal control noted no matters involving the internal control and its operation that HRSK considered to be material weaknesses. The HRSK report on compliance with laws and regulations did not note any instances of noncompliance. In addition to the three reports, a management letter was also issued.

### **Personnel Security Program**

The OIG completed an inspection of the Personnel Security Program. The objective of this inspection was to evaluate the progress made in addressing seven suggested actions contained in an OIG Management Letter to strengthen FCA's Personnel Security Program, dated May 10, 1999. We found that management addressed the suggested actions made in the OIG Management Letter. However, employees have not always been following the procedures that were revised to address the weaknesses found in the letter. Further, we found the personnel security program at FCA still lacks emphasis on its importance to the Agency. In short, although the Agency's policies and procedures are thorough and well written, employees are not judiciously following those procedures. Additionally, we found that records were inaccurate, position sensitivity levels need updating, and personnel security procedures are not consistently being followed.

### **Study of the Early Warning System**

The OIG contracted with Delclos/Walsh Associates to study the Early Warning System (EWS) used by the Office of Examination. The study was highly

complementary of the quality and professionalism of the work produced by examiners. It found the EWS is an effective quality control tool for the Office of Examination. However, it is not necessarily a mechanism that predicts quality conditions of institutions in the future. The study includes several suggestions that could help the Agency leverage its investment in the EWS.

## STATUS OF UNIMPLEMENTED AGREED UPON ACTIONS

At the beginning of the period there were 16 unimplemented agreed upon actions. During the reporting period, management took final action on six of these. Two were from audit reports and four were from inspection reports. During this period, 15 additional agreed upon actions resulted from two reports, one inspection report and one audit report. At the end of this reporting period, 16 agreed upon actions remain open, 14 from two audits and two from an inspection.

### Audits

The following table summarizes the final actions management took on open agreed upon actions. One new audit report was issued concerning OCFO containing 9 agreed upon actions.

| <b>AUDIT AGREED UPON ACTIONS</b>                                  |                                 |   |                   |
|---|---------------------------------|---|-------------------|
| Audit Report  | Open during this 6-month period | Final Management Actions during this period | Open on 4/01/2002 |
| Performance Budgeting<br>.....Issued March 23, 2001               | 12                              | 2   | 10                |
| Office of Chief Financial Officer<br>.....Issued January 24, 2002 | 9                               | 5   | 4                 |
| <b>Totals</b>   | <b>21</b>                       | <b>7</b>                                    | <b>14</b>         |

The audit report of Performance Budgeting was issued more than 12 months ago. Ten of the original 14 agreed upon actions remain open. This audit found that although the Agency currently creates many planning documents, a more streamlined and cohesive planning process is needed. The Agency should consolidate individual office planning documents to enable the Board to have more comprehensive information linking office resources and goals to the Agency's Strategic Plan and performance measures. We also found two areas, financial planning and human capital planning, that need to be addressed.

### Inspections

Management took final action to close four remaining agreed upon actions on the Affirmative Employment Program Action Plan inspection. An inspection report was issued



this period on the Agency's Personnel Security Program that resulted in 6 agreed upon actions. However, management took action to close 4 of those agreed upon actions during this reporting period. At the end of the reporting period, only one inspection has open items. The following table lists final actions on agreed upon actions from the inspections.

| <b>INSPECTION AGREED UPON ACTIONS</b>                                  |                                 |   |                   |
|--|---------------------------------|---|-------------------|
| Inspection Report  | Open during this 6-month period | Final Management Actions during this period | Open on 4/01/2002 |
| Affirmative Employment Program Action Plan<br>.....Issued May 23, 2001 | 4                               | 4   | 0                 |
| Personnel Security Program<br>.....Issued December 20, 2001            | 6                               | 4   | 2                 |
| <b>Totals</b>  | <b>10</b>                       | <b>8</b>                                    | <b>2</b>          |

**Investigations**

Most OIG Hotline calls dealt with Farm Credit System borrower complaints and were referred to the FCA office responsible for researching such matters. Four other complaints were received through the OIG Hotline or written correspondence. All four of these complaints were closed after a preliminary review showed that the allegations were unsubstantiated. All other Hotline calls and emails were not investigative in nature and were referred to the appropriate FCA office or other Federal agency.

There was one open investigation at the beginning of this reporting period. This open investigation was closed during this period resulting in advice on changing a Board policy. Two new investigations were opened this period, with one being closed unsubstantiated. Currently there is one investigation open.

**Legislation And Regulations**

We reviewed several FCA regulations in both proposed and final form. We also reviewed statutory and regulatory compliance issues as they arose in audits and investigations. We have reviewed and commented on proposed legislation affecting the Inspectors General community through the legislation committee of the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE).

**Agency Financial Management System**

The financial management system has been a serious management challenge facing the Agency. The Federal Financial Management Improvement Act of 1996 (FFMIA) requires agencies to implement and maintain financial management systems that substantially comply with Federal financial management requirements, government accounting standards, and the United States government standard general ledger. The FFMIA also requires the OIG to report on the Agency's compliance.

Management implemented Federal Financial System (FFS) as managed by the Department of Interior (DOI) National Business Center. The implementation of FFS corrected previously reported systemic weaknesses. The audit of the financial statements for the fiscal year ended September 30, 2001, did not note any non-compliance with laws or regulations including FFMIA.

## **Other Activities**

### **Management Advisories**

During this reporting period, the OIG has continued the use of management advisories. These advisories provide management with feedback on issues that come to our attention during the process of performing other OIG work. In this 6-month period, we advised Agency managers on issues including a Board policy on operational responsibilities, professional memberships for employees, financial management, mail handling, emergency preparation, employee exit interviews, and use of social security numbers by FCA.

### **Security Briefing**

To heighten awareness of risks in today's post 9/11 world, OIG hosted a briefing by experts on personal security. OIG is planning another briefing on identity theft during the upcoming period.

### **Survey of Farm Credit System Institutions**

OIG administers an ongoing Agency survey of the regulated institutions of the FCS. This survey program is designed to provide the FCA Board and senior management with independent feedback about how well FCA performs its examination and enforcement activities. This feedback is based on confidential responses received from FCS institutions. We survey the chairman of the board and the chief executive officer of each FCS institution following their receipt of FCA's report of examination for their voluntary feedback on the quality and consistency of the examination and enforcement processes. OIG reports the results of the survey annually. During this period we mailed 50 surveys and received 43 responses. This is an 86 percent response rate. Overall, the average rating for the questions answered during this reporting period was very good (1.38) [1=completely agree; 5=completely disagree] which improved since the last reporting period (1.68).

### **OIG Performance Measures**

OIG developed performance measures during FY 1995 and implemented them in FY 1996. We have refined the measures in each subsequent year. The FY 2001 OIG Performance Report is available on the OIG Web page. We welcome feedback.

### **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 are actively involved in one or more professional organizations as well as ad hoc activities of the PCIE/ECIE.

**Staff Participation in Agency Organizations**

Staff is active on several Agency workgroups and task forces. During this reporting period the OIG was represented on Blacks in Government, Fellow in Council for Excellence in Government, Employees' Council, Administrative Burden Reduction Workgroup, the Federal Women's Program and the Budget and Planning task force.

**AUDIT / INSPECTION REPORTS ISSUED BY FCA OIG**

| TITLE OF REPORT                     | NUMBER OF RECOMMENDATIONS/<br>AGREED UPON ACTIONS | QUESTIONED COSTS  | RECOMMENDATIONS<br>THAT FUNDS BE PUT TO<br>BETTER USE |
|-------------------------------------|---|-------------------|---|
| Office of Chief Financial Officer   | 9   | \$ 196,000        | \$49,000  |
| Personnel Security Program          | 6   | \$ 0              | \$ 0  |
| Agency Financial Statements FY 2001 | 0   | \$ 0              | \$ 0  |
| <b>Total</b>                        | <b>15</b>   | <b>\$ 196,000</b> | <b>\$49,000</b>                                       |

APPENDIX Ia

**INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS**

|   | Number  |       | Dollar Value     |                   |
|---|---------|-------|------------------|-------------------|
|   | Reports | Recs. | 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  | 1       | 2     | \$196,000        | \$ 0              |
| Subtotals (A+B)   | 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   | 1       | 2     | \$196,000        | \$ 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 Ib**

**INSPECTOR GENERAL ISSUED REPORTS WITH  
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE**

|   | Number  |       | Dollar Value |
|---|---------|-------|--------------|
|   | Reports | Recs. |              |
| 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         |
| Subtotals (A + B)   | 0       | 0     | \$ 0         |
| C. For which a management decision was made during the reporting period                       | 1       | 1     | \$49,000     |
| (i) dollar value of recommendations that were agreed to by management                         | 1       | 1     | \$49,000     |
| --based on proposed management action   | 1       | 1     | \$49,000     |
| -- 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         |

## **Farm Credit Administration Organization Chart**

**FCA Office of Inspector General Organization Chart**