

**Farm Credit Administration
Office of Inspector General**

Inspection Report

Farm Credit Administration's Process for Merger Activities in the Farm Credit System

I-23-02

September 28, 2023

FCAOIG

Farm Credit Administration
Office of Inspector General



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The Honorable Vincent G. Logan, Board Chairman and Chief Executive Officer
The Honorable Jeffery S. Hall, Board Member
The Honorable Glen R. Smith, Board Member
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Logan and Board Members Hall and Smith:

The Office of Inspector General (OIG) completed an inspection of the Farm Credit Administration's (FCA or Agency) Process for Merger Activities in the Farm Credit System (System). The objective of this inspection was to evaluate FCA's process to review, and take action on, merger activity in the System. We found that FCA established cross-organizational processes to review and analyze merger activities in the System. The process included consideration of circumstances unique to each merger; specific communications with merging institutions on key information and decisions; and FCA Board consideration and voting within required timeframes. The Agency also developed a database to track and document corporate applications, with a file for the Agency's review of each merger activity.

We identified opportunities to improve FCA's process to review merger activities. Specifically, FCA had not established a complete system to fully and consistently document reviews of mergers. Information was housed in multiple locations and processes were not fully documented in policies and procedures. We also found that the Agency conducted a Merger Structure Study with a series of six reports.



The OIG made seven recommendations to improve merger processes. FCA management agreed or partially agreed with the recommendations and provided corrective actions that were responsive to our recommendations.

We appreciate the courtesies and professionalism extended by FCA to our staff during the inspection. If you have any questions about this inspection, we would be pleased to meet with you at your convenience.

Respectfully,

A handwritten signature in black ink that reads 'Sonya K. Cerne'.

Sonya K. Cerne
Assistant Inspector General for Audits, Inspections, and Evaluations

EXECUTIVE SUMMARY

Farm Credit Administration's Process for Merger Activities in the Farm Credit System

Report No. I-23-02

September 28, 2023

Objective

The objective of this inspection was to evaluate FCA's process to review, and take action on, merger activity in the System.

Recommendations

The Office of Inspector General made seven recommendations to the Office of Regulatory Policy to improve merger processes. The recommendations focused on updating policies and processes, designing and implementing controls, addressing concerns with existing systems, and evaluating whether new processes are needed.

Agency Response

Management provided responsive corrective actions for the recommendations made in the report. Management agreed with recommendations 1, 2, 3, 4, 5, and 6. Although management only partially agreed with recommendation 7, the actions planned by ORP address the weaknesses found in the report.

Why We Did This Inspection

The Farm Credit Administration (FCA or Agency) is an independent federal agency responsible for regulating and supervising the Farm Credit System (System). FCA ensures System institutions conduct corporate activity in a safe and sound manner in accordance with statutory and regulatory requirements and Agency guidance. Certain actions taken by System institutions require prior approval requests that involve issuance of, amendment to, or cancellation of System charters, including mergers, consolidations, liquidations, or terminations of System institution status. Because of the importance of such processes to the System and FCA, we conducted this inspection to ensure FCA's merger process was designed and implemented in an effective and efficient manner.

How We Did This Inspection

We reviewed FCA's process for merger reviews and approvals and tested information to verify steps performed. We sampled merger activities from January 1, 2013, through April 1, 2023. For each activity, we verified steps completed by sampling items incorporated in merger files. We reviewed four different document repositories to identify sampled items. [REDACTED]

What We Found

FCA established cross-organizational processes to review merger activities in the System. The process included: a merger workgroup; merger analyses with consideration of circumstances unique to each merger; approvals in an automated workflow; FCA Board consideration and voting on merger decisions within required timeframes; verification of required steps for final approval; and updates to applicable systems and reporting. The Agency also developed a database to track and document corporate applications, with requirements addressed in Agency policies and procedures.

However, we identified opportunities to improve FCA's merger process. Specifically, FCA had not established a complete system to fully and consistently document reviews of mergers in accordance with recordkeeping requirements. We also found that while FCA conducted a Merger Structure Study, [REDACTED]

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BACKGROUND

Farm Credit Administration

The Farm Credit Administration (FCA or Agency) is an independent federal agency responsible for regulating and supervising the Farm Credit System (System). The Agency is responsible for ensuring that all System institutions are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America.

As part of achieving this mission, FCA ensures System institutions conduct corporate activity in a safe and sound manner in accordance with statutory and regulatory requirements and Agency guidance. There are certain actions taken by System institutions that require corporate applications. Corporate applications are prior approval requests that involve issuance of, amendment to, or cancellation of System charters, including mergers, consolidations, liquidations, or terminations of System institution status. A plan of merger must be submitted to FCA for approval before two or more System banks or associations may merge into a single entity. The Farm Credit Act of 1971, as amended, gives FCA specific responsibility to approve mergers.

Roles and Responsibilities

The FCA Board has overall responsibility for the Agency's process to evaluate corporate applications and the decision whether to approve or disapprove a specific activity. In addition, the FCA Board Chairman issues new charters or charter amendments for merging institutions. FCA's Office of Regulatory Policy (ORP) has primary responsibility for FCA's merger review process. ORP is led by an Office Director, Deputy Director, and three Associate Directors. As of July 2023, ORP had 23 staff members.

The Operations, Management, and Accounting Team (OMAT) leads the merger review process within ORP. OMAT assigns the project manager, who serves as the lead for the merger activity review. In addition, OMAT analyzes merger proposals and financial information, coordinates the merger workgroup, consolidates analyses from other offices, corresponds with merging institutions, develops key communications from FCA on the merger, develops merger files and documentation, and reviews documents for final approval of the merger.

Laws, Regulations, and Guidance

Merger requirements are addressed in laws, regulations, and guidance. Title VII of the Farm Credit Act of 1971, as amended, addresses the ability of banks and associations to merge into a single entity. FCA provides additional requirements and guidance on merger activities through regulations, informational memorandums, and a booklet, as shown below:

REGULATIONS

- 12 C.F.R. § 611.1020 Requirements for Mergers or Consolidations of Farm Credit Banks
- 12 C.F.R. § 611.1122 Requirements for Association Mergers or Consolidations
- 12 C.F.R. § 611.1123 Association Merger or Consolidation Agreements
- 12 C.F.R. § 611.1126 Reconsiderations of Mergers and Consolidations

INFORMATIONAL MEMORANDUMS

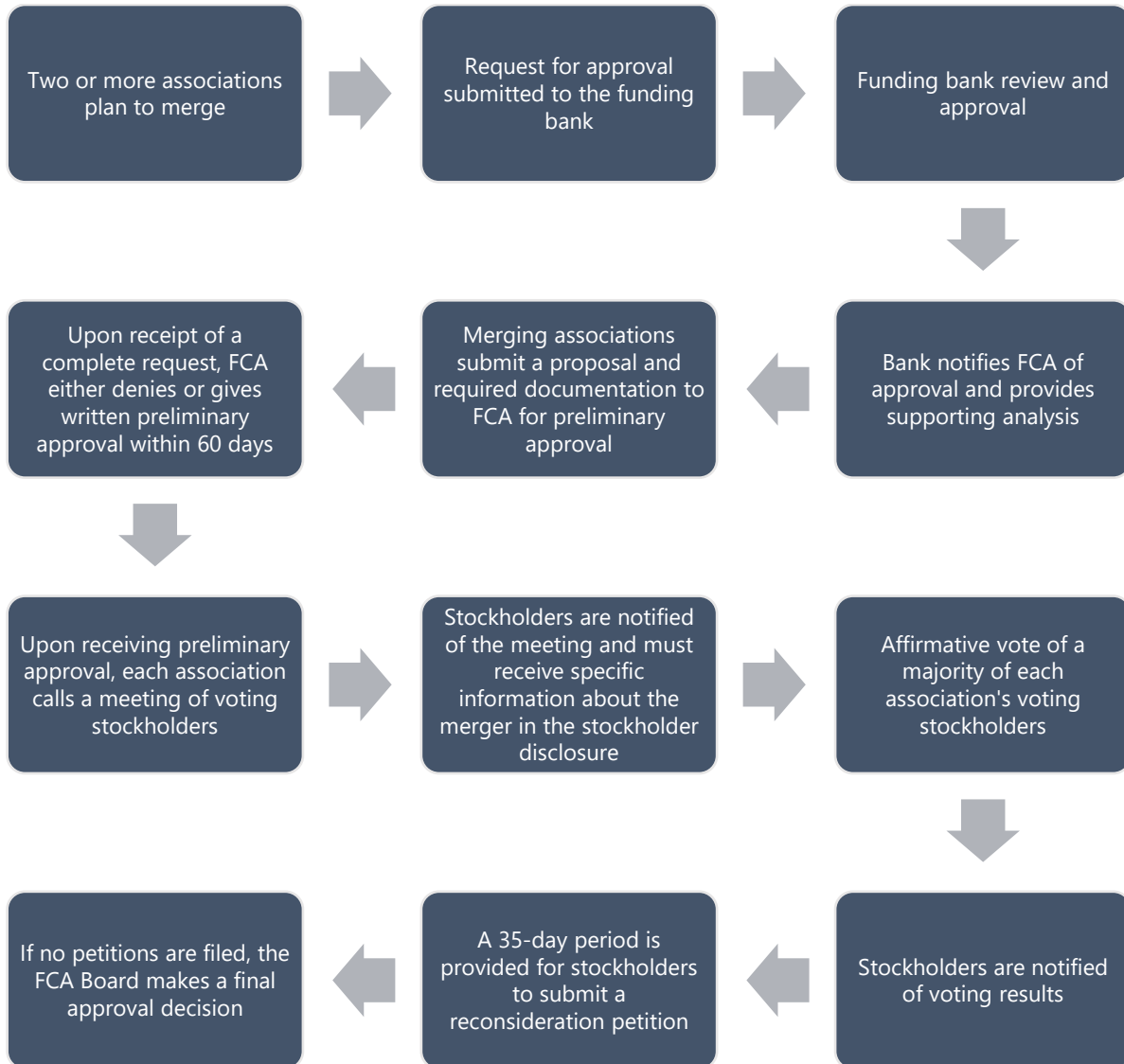
- Revised Guidelines on Submission of Proposals to Merge or Consolidate Farm Credit System Banks and Merge or Consolidate Farm Credit System Associations (June 2016)
- My thoughts on Association Mergers in Economically Challenging Times (November 2009)

BOOKLETTER

- BL-063, Farm Credit System Bank Merger Applications (July 2010)

Merger Process

Given the System's structure, the majority of mergers involve associations. FCA Regulation 611.1122 provides the required steps for association mergers, as follows:



Agency Review Process

FCA's merger review process begins with a notification of a proposed merger. ORP sends an acknowledgement letter to the merging institutions confirming receipt of the merger application package. A project manager is then assigned to the merger from OMAT and an attorney is assigned from the Office of General Counsel (OGC). The merger package is shared with OGC, the Office of Examination (OE), the Office of Data Analytics and Economics, and the Farm Credit

System Insurance Corporation (FCSIC)¹ for their respective inputs. When the project manager and assigned attorney determine the package is complete² it is provided to the FCA Board, along with briefings to gather preliminary feedback. When each FCA Board member considers the package complete a letter is sent to the merging institutions with applicable dates for the Agency's 60-day required review period.

An official merger workgroup is formed with representatives across relevant offices. Applicable offices conduct specific analyses in different financial, examination, legal, and risk-related areas. The workgroup's analyses are consolidated by the project manager into an executive summary, detailed analysis summary, and appropriate attachments. These documents set forth analyses and recommended actions on the proposed merger for consideration by the FCA Board. In addition to FCA's action on the merger, the recommendation may include conditions of approval or conditions of merger.³ The FCA Board reviews preliminary approval documentation and votes whether to approve or disapprove the merger.⁴ If approved by majority vote, ORP sends a preliminary approval letter to the merging institutions specifying documentation needed for final approval. The FCA Board may disapprove a corporate application if the request includes unresolved deficiencies; does not conform to statute, regulation, or ORP policy and guidelines; or there are concerns about safety and soundness.⁵ Denial of a proposal by the FCA Board is sent in writing to the institutions with the associated justification.

After preliminary approval, merging institutions' stockholders receive the stockholder disclosure and vote on the merger, and stockholders and FCA are notified of the results. A 35-day period is provided for stockholders to submit a reconsideration petition.⁶ If voters approve, the 35-day

¹ 5.61A of the Farm Credit Act of 1971, as amended (12 U.S.C. § 2277a-10a), requires FCA to coordinate with FCSIC on certain corporate approvals. FCSIC is a separate agency from FCA.

² A complete merger proposal package includes items identified in the documentation checklist in FCA informational memorandum "Revised Guidelines on Submission of Proposals to Merge or Consolidate Farm Credit System Banks and Merge or Consolidate Farm Credit System Associations." ORP does not consider the package complete if there is misleading, inaccurate, or missing information that is needed for voting stockholders to make an informed decision.

³ FCA may impose conditions of approval and conditions of merger under Section 5.25(a) of the Farm Credit Act of 1971, as amended (12 U.S.C. § 2261(a)). Conditions become effective after the merger is final. Conditions of approval allow FCA to continue to treat the continuing associations as one entity for most regulatory purposes. Conditions of merger address other requirements, such as safety and soundness, and are incorporated in the disclosure document delivered to stockholders before the stockholder vote. Conditions of merger are tracked by OE.

⁴ In FCA Board Policy Statement 64, the FCA Board delegated authority to the Chairman to approve corporate applications from associations requesting to merge provided the application is deemed noncomplex, noncontroversial, and low risk. No noncomplex, expedited reviews were identified within the scope of this inspection.

⁵ No disapprovals were identified within the scope of this inspection.

⁶ Regulation 611.1126 describes reconsiderations of mergers and consolidations. Voting stockholders have the right to reconsider their approval of a merger or consolidation, provided the petition is filed with FCA on time and in accordance with requirements. If the petition is properly filed, a reconsideration vote must be conducted to determine whether the merger will take place.

reconsideration period has passed, stockholders of either institution do not file a reconsideration petition, requirements for final approval are met, and nothing has occurred between the date of preliminary approval and final approval that would cause the FCA Board to reconsider its preliminary approval, final approval is confirmed. Generally, the FCA Board acts only once on a merger application. The FCA Board grants preliminary and final approval with one vote, provided that the institutions meet specified requirements.

Policies and Procedures

The Agency's process for reviewing mergers is primarily documented in ORP Directive 23, *Corporate Applications* (January 2016).⁷ The directive addresses receipt and tracking of applications, analysis of applications for compliance with statute and regulations, review and clearance of the package for the FCA Board, FCA Board action on the application, and assessment of final approval requirements.

ORP Directive 23 also describes processes for documenting Agency reviews of corporate applications, including mergers. It states all corporate applications are processed using an internal Corporate Applications Database. The Corporate Applications Database serves as a document repository for all final documents. Further, it allows information to be shared among offices while tracking pending applications.

Other ORP directives applicable to mergers include:

- ORP Directive Risk Analysis Division (RAD)-4, *Financial Viability Analysis* (September 2003);
- ORP Directive RAD-1A, *Expedited Processing of Noncomplex Corporate Applications* (April 2005); and
- ORP Directive 22, *Coordination with FCSIC* (February 2015).

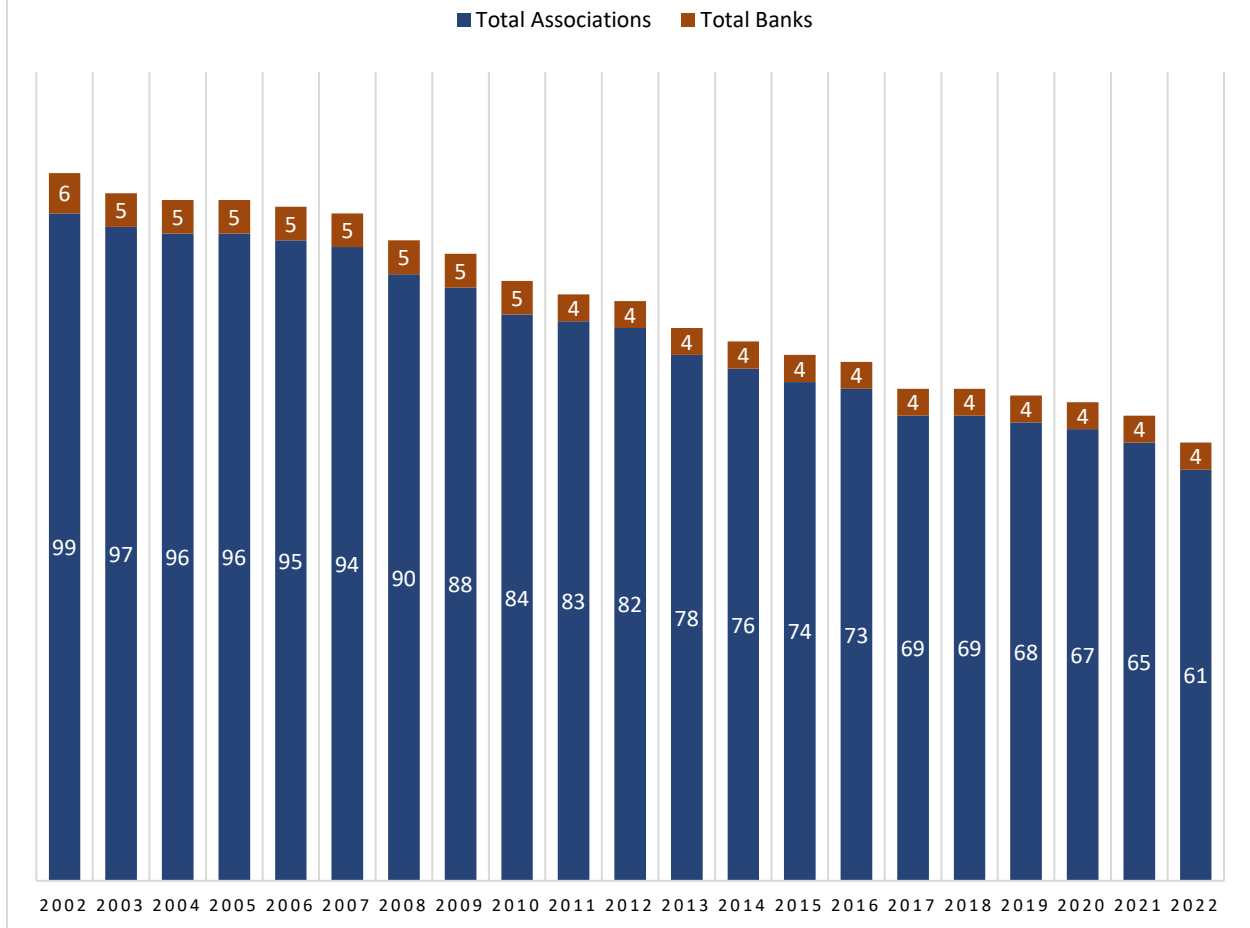
Historical Merger Activity

FCA reports on corporate activities on its public website each quarter. Reporting addresses FCA Board approvals of corporate applications and the number of banks and associations by type and district. We analyzed reporting on the total number of institutions from 2002 to 2022.⁸ Over the last 20 years, the System has continued to consolidate. Since 2002, the number of banks has decreased by two (33 percent) and the number of associations has decreased by 38 (about 38 percent).

⁷ ORP Directive 23 was originally issued in 1998, revised in 2005, and revised again in 2016.

⁸ In addition to quarterly reporting, annual data is reported by FCA as of January 1st of each year. Reporting for 2009 was as of January 4, 2010. We reviewed reporting on FCA's website covering January 1, 2003 (year 2002) through January 1, 2023 (year 2022).

TOTAL SYSTEM BANKS AND ASSOCIATIONS BY YEAR



Prior OIG Reports Relating to FCA's Merger Process

OIG issued an audit in September 2019, *FCA's Stress Testing Guidance and Use of Data and Analytical and Examination Tools (A-19-01)*, to evaluate FCA's progress in updating stress testing guidance and related data and analytical and examination tools. The review found that ORP completed a stress testing project that resulted in recommendations to improve stress testing in the System and oversight by FCA. However, FCA had not developed a project plan on implementing the recommendations. The report included one recommendation to the Office of the Chief Operating Officer to develop a project plan with milestones to ensure the timely completion of tasks related to stress testing. The recommendation was closed in January 2021.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of this inspection was to evaluate FCA's process to review, and take action on, merger activity in the Farm Credit System.

Scope

The scope of the inspection was limited to merger activity from January 2013 through March 2023. We also analyzed historical information on the number of banks and associations from January 1, 2003, through January 1, 2023. The inspection was conducted at FCA's headquarters in McLean, Virginia from April to August 2023.

Methodology

We took the following steps to accomplish the objective:

- Identified and reviewed applicable laws, regulations, guidance, and other background information applicable to the objective.
- Identified and reviewed applicable internal FCA policies and procedures.
- Reviewed prior FCA OIG and other external reviews related to the inspection objective.
- Interviewed relevant ORP and Office of Information Technology (OIT) personnel responsible for FCA's merger review process or databases and recordkeeping involved in the process.
- Reviewed the Merger Structure Study led by ORP with reports issued between June 2018 and January 2020.

Tests Performed

- Reviewed reporting on FCA Board approvals of corporate applications from January 1, 2013, through April 1, 2023, and compared the listing to information provided by ORP to identify merger activities within the period.
- For the 22 merger activities in the period, we judgmentally sampled 25 items to assess completion of required steps, documentation of approvals, and documentation of project management steps. We used the following factors in determining the sample: key analyses documents, key timeline documentation, key decisional documentation, internal control documents, and whether the document was applicable to all merger reviews. To identify sampled documents, we reviewed documentation in four locations: the Corporate Applications Database, the OMAT site on the Agency's web-based document repository, ORP shared drive files, and ORP's workflow routing system. Relevant ORP shared drive files were transferred to the OMAT site on the Agency's web-based document repository for accessibility during our review. We noted documents that were complete, partially

complete, or missing and the location of each item. We did not review paper files during our inspection. We tested items in electronic files based on existing guidance and procedures. We did not test documentation against policies and procedures that are no longer operative. Because our sample was judgmental, it cannot be projected to the population.

- Reviewed merger files for 60-day letters to determine whether preliminary approval was granted within the required period. We also reviewed files to determine whether waivers were documented, as applicable.
- Reviewed the institution directory to determine whether it reflected changes resulting from merger activities. For each of the activities in our scope, we determined whether merged institutions were removed from the directory and continuing associations were incorporated.
- Reviewed the Correspondence Tracking System for entries related to mergers. We filtered entries to determine the total categorized as “merger requests” in the tracking system and the date range for the entries. We identified additional entries related to merger activities that were not categorized as “merger requests.” These items were not included in our review.
- We selected a judgmental sample of 18 items from ORP Directive 23, *Corporate Applications*, and the merger template to determine whether they were incorporated in merger analyses. We reviewed executive summaries and detailed analysis summaries for sampled items for the most recent six mergers in our scope. Because our sample was judgmental, it cannot be projected to the population.
- Determined whether activities occurred that did not follow the standard merger process by reviewing the 22 merger activities in our scope and discussing merger-like activities with ORP personnel. [REDACTED]
- Analyzed accesses to the Corporate Applications Database, OMAT site on the Agency’s web-based document repository, ORP shared drive, and Correspondence Tracking System with reports provided by OIT and ORP. Access levels were confirmed with OIT and the OMAT Associate Director.
- Analyzed historical merger activities from January 1, 2003, through January 1, 2023. We reviewed corporate activity reporting on FCA’s public website as well as one report provided by ORP.

Quality Standards for Inspection and Evaluation

This inspection was performed in accordance with Council of the Inspectors General on Integrity and Efficiency’s Quality Standards for Inspection and Evaluation. These standards require that we plan and perform the inspection to obtain sufficient and appropriate evidence that provides a reasonable basis for our findings, conclusions, and recommendations. We assessed internal controls and compliance with laws and regulations to the extent necessary to satisfy the objective.

Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our inspection. We assessed the information and data collected during the inspection and determined it was sufficiently reliable and valid for use in meeting the inspection objective. We assessed the risk of fraud related to our inspection objective while evaluating evidence and had no matters come to our attention indicating fraud or illegal acts were occurring. Overall, we believe the evidence obtained is appropriate and sufficient to provide a reasonable basis for our findings and conclusions based on the inspection objective.

INSPECTION RESULTS

We determined that FCA established cross-organizational processes to review and analyze merger activities in the System. The process included:

- Specific communications with merging institutions on key information and decisions;
- Development and regular meetings by a merger workgroup;
- Merger analyses with consideration of circumstances unique to each merger;
- Presentation of recommended actions on the merger with applicable support;
- Approvals in an automated workflow;
- FCA Board consideration and voting on merger decisions within required timeframes;
- Continued verification and documentation of required steps for final approval; and
- Updates to the Agency's institution directory and public reporting on corporate activities.

The Agency also developed a database to track and document corporate applications with a file for the Agency's review of each merger activity. The database and review requirements were addressed in Agency policies and procedures.

However, we identified opportunities to improve FCA's process to review merger activities. Specifically, FCA had not established a complete system to fully and consistently document reviews of mergers in accordance with recordkeeping requirements. Information was housed in multiple locations and processes were not fully documented in policies and procedures. We also found that while FCA conducted a Merger Structure Study with a series of six reports,

[REDACTED]

Verification of Steps Performed

Merger Review Documentation

FCA had not established and implemented a consistent process for documenting merger reviews. ORP Directive 23, *Corporate Applications* (January 2016) describes the Corporate Applications

Database as the final document repository for reviews of corporate applications, including mergers. It states that the Corporate Applications Database should contain final documents, including FCA letters to merging institutions; analyses conducted of merger proposals; and control checklists. In addition, ORP Directive RAD-4, *Financial Viability Analysis* (September 2003), describes the process for developing and documenting workpapers and written reports to support the Agency's financial analysis decisions as part of the Corporate Applications Database.

However, we found that merger documentation was maintained in various locations and did not follow the documented guidance. In addition to the Corporate Applications Database, documentation supporting merger reviews was maintained in the Agency's web-based document repository, ORP's shared drive, and ORP's workflow routing system. Specific types of documentation were not always in the same location, with variation across the merger activities reviewed.

Testing of Merger Reviews

From January 1, 2013, through April 1, 2023, FCA completed reviews for 22 mergers. Over this 10-year period, ORP implemented multiple changes to the merger review process and had significant personnel changes. In addition, during this same period the office changed the documentation system. Therefore, processes in place in 2013 would differ from those in place in 2023 and should be considered in the following analyses.

To test whether FCA followed its merger review process and to verify steps were taken and documented, we sampled 25 items included in the Agency's merger review process for each of the 22 mergers in our scope. Sampled documents included analyses completed by different FCA offices, approvals by Agency officials, file checklists, letters developed by the Agency to communicate key information and decisions to merging institutions, and information from merging institutions reviewed by FCA. To evaluate the full scope of completed documents, we reviewed merger files in the following four locations: the Corporate Applications Database, the OMAT site of the Agency's web-based document repository, ORP's shared drive, and ORP's workflow routing system. We noted where each document was located and whether it was complete or partially complete.⁹

Overall, we did not identify all 25 sampled items for any of the 22 merger activities in our scope. Specifically, the total number of sampled documents identified across reviewed locations ranged from 8 to 24 for each merger activity. This included both complete and partially complete documentation. Overall, of the 550 documents sampled across 22 merger activities: 53 percent were located in the Corporate Applications Database, 9 percent were located in ORP's shared drive files, 3 percent were located in the OMAT site of the Agency's web-based document repository,¹⁰

⁹ Documentation was considered partially complete if it was in final form but missing key information. Documentation that was not in final form or that did not open due to technical issues was noted as missing.

¹⁰ ORP transitioned from maintaining merger files in shared drives to the Agency's web-based document repository for its review of a merger that was effective in July 2022.

3 percent were located in ORP’s workflow routing system,¹¹ and 32 percent could not be located in electronic files reviewed.

Over the 10-year period reviewed, documentation improved. The most recent six files in our scope included most of the 25 sampled items (between 19 and 24). ORP officials attributed items we noted as missing to the age of the merger application, FCA Board-directed process changes, and the use of paper files for certain documentation.

Sample Detail

We also evaluated the overall completion of sampled documentation. An executive summary and conditions of approval were identified for each merger activity. The executive summary is one of the main documents compiled by ORP, with recommended actions on the merger for the FCA Board. We also identified a 60-day letter and OE review for 21 of the 22 activities. Conversely, documentation of coordination with OE before final approval was identified for six reviewed activities. In addition, the final version of the stockholder disclosure and documentation of OGC’s analyses were identified for 7 of the 22 activities. In total, across the 22 activities reviewed, documents were identified as follows:

Summary of Merger Documentation Testing

Document	Total Completed in Merger Files Reviewed	Total Partially Completed in Merger Files Reviewed	Not identified in Files Reviewed
Acknowledgement letter	19		3
60-day letter	21		1
Bank resolution approving merger	17		5
OE analysis	21		1
FCSIC review	19		3
Financial analysis	19		3
OGC analysis	5	2	15
Executive summary	22		
Preliminary approval letter	20		2
Conditions of approval	22		
Preliminary approval routing	13		9
FCA Board vote	16		6
Stockholder voting records	15		7
Final stockholder disclosure	7		15
Notification to stockholders on final voting results	13		9
Signed Agreement and Plan of Merger	9		13
Reconsideration period email	9		13

¹¹ ORP began using a workflow routing system to track approval signatures across the Agency in October 2020.

Coordination with OE before final approval	6		16
Final approval letter	18		4
Congratulatory letter with amended charters	14		8
Final approval routing	11	1	10
Central files checklist	13	2	7
Project management form	12	5	5
Final approval checklist	5	6	11
Disclosure checklist	11		11

ORP collaborates with other offices and combines applicable analyses and responses from OE, OGC, and FCSIC.¹² However, files did not consistently document these types of reviews. For example, officials stated that the assigned OGC attorney is involved throughout the merger review process and their review was encompassed in the executive summary for several of the items we noted as missing. While the executive summary notes the name of the attorney who reviewed the document, this notation did not provide the specific analysis or response received from OGC. Further, there are inconsistencies in how OGC’s review was documented across different merger reviews. As another example, officials noted that coordination with OE before final approval was addressed in the workflow routing system, which incorporated final approval signatures of the Chief Examiner and Deputy Chief Examiner. However, this process differed from ORP Directive 23, which stated the project manager would email applicable Examiners-in-Charge to confirm there is no reason FCA should not go forward with final approval.

In response to our report, ORP officials stated that additional documents were located in electronic files, paper files, and the Correspondence Tracking System that were cited as missing in the inspection. ORP also changed its process in October 2020 to automate and document preliminary and final approvals for mergers, which could have eliminated the need for certain steps in the process tested. While this process is not documented in policies and procedures, there is an opportunity to modernize and consolidate file documentation requirements and clarify how reviews from other offices will be captured, if necessary.

Controls Over Merger Files

The Corporate Applications Database incorporates various forms and checklists to track specific merger information and documentation. The database included a project management form, checklist of items to confirm for final approval, and a “central files” checklist. These items track required review timelines and receipt of required documentation to ensure merger review steps are followed. However, for the 22 merger activities we reviewed, these controls were not fully implemented and completed. For example:

¹² There are specific requirements when FCA must coordinate with FCSIC. Although not required, most files contained documentation showing coordination with FCSIC personnel. Therefore, we included FCSIC communication in our testing.

- The project management form tracks target and completion dates for key steps of merger analysis and processing. The project management form was complete in 12 files, but the other 10 were either not complete or partially complete.
- The final approval checklist includes dates and confirmation of specific steps related to FCA's final approval decision, as well as fields for stockholder voting results from merging institutions. The checklist was complete in 5 files, partially complete in 6, and not complete for the remaining 11 files reviewed.
- ORP Directive 23 describes "central files" as the administrative record for corporate applications. The "central files" checklist lists corporate papers, correspondence, stockholder disclosure, and bylaw files and whether such documentation was complete. While some of these items are now maintained electronically, we noted the "central files" checklist was completed for 13 activities reviewed and partially completed for another 2. The "central files" checklist was not completed for the remaining 7 files reviewed.

We also reviewed approval signatures for the Agency's preliminary and final approval of merger activities. Approval routings document key reviews, including the project manager, assigned OGC attorney, ORP Deputy Director, ORP Director, General Counsel, Chief Operating Officer, and FCA Board members. For the 22 merger activities reviewed, preliminary approvals were completed in 13 files and not identified in the remaining 9 files. Final approvals were completed in 11 files and partially completed or missing for the remaining 11 reviewed activities.

As noted above, in October 2020, FCA began using a web-based workflow to automate and document preliminary and final approvals for mergers. Preliminary and final approvals that used the newly established workflow process were all documented accordingly.

Recordkeeping

Additional clarification is needed on the implementation of recordkeeping practices. In addition to other records retention policies for the Agency, FCA's comprehensive records schedule states:

"Corporate Restructuring and Prior Approval Records. These records include correspondence, background documentation and work papers, drafts and other documentation pertaining to corporate restructurings and prior approvals, including shareholder disclosure documents that are not needed for long term preservation. Disposition: destroy/delete 7 years after close of the project or close of the institution, or when no longer needed for reference purposes, whichever is applicable."

However, it did not appear there was a process to assess and dispose of electronic merger records accordingly. For example, there are merger records in the Corporate Applications Database from November 2000, nearly 23 years old, that are still maintained. There did not appear to be a process to determine whether files were needed beyond the retention period for reference purposes. ORP may want to list the circumstances when files should be retained beyond the retention period, such as those files dealing with unique, challenging, or particularly complex corporate activities.

Despite the transition to electronic files, the Agency was still receiving paper copies of certain merger documentation. While we did not review paper files, officials stated that for the mergers that became effective in January 2022, ORP retained the original paper copy of the merger application submission and paper copies of all documentation required for final approval in the OMAT Associate Director's office. Since ORP has transitioned away from paper files, generating new paper records is problematic. Multiple copies and electronic and paper versions of the same file can cause recordkeeping issues and create confusion about which is the final, complete version. Further, Federal guidance instructs agencies to manage all permanent and temporary records in an electronic format to the fullest extent possible by June 30, 2024.¹³

Merger Correspondence

In addition to merger review files, ORP uploaded merger correspondence information in the Agency's Correspondence Tracking System. The Correspondence Tracking System was developed to allow FCA offices to share and track correspondence, and to house documentation outside of individuals' email. The tracking system contains different correspondence categories, including "merger requests," which the user can select based on the type of communication. As of May 2023, the Correspondence Tracking System included 194 entries categorized as "merger requests" dating back to January 1994. Entries included copies of emails as well as attachments with merger documentation submitted to the Agency.

We also reviewed accesses to the Correspondence Tracking System, and determined information categorized as a "merger request" was accessible by the entire Agency. However, only personnel with a need-to-know in support of their duties need access to these records.

Merger Studies Conducted by FCA

FCA had not yet [REDACTED] its Merger Structure Study. [REDACTED] in 2016, the FCA Board requested an updated study to [REDACTED]. To accomplish the objectives of the study, the Agency devoted resources across Agency units forming a workgroup with representatives from ORP, OGC, OE, and FCSIC. The workgroup held a series of meetings and prepared documentation to support the study's six reports, which were completed between June 2018 and January 2020. The principal objectives of the reports were to:

- [REDACTED]
- [REDACTED]

¹³ Office of Management and Budget and National Archives and Records Administration Memorandum M-19-21, *Transition to Electronic Records* (June 28, 2019). Office of Management and Budget and National Archives and Records Administration Memorandum M-23-07, *Update to Transition to Electronic Records* (December 23, 2002), reinforces requirements established in M-19-21, reaffirms the underlying goal of the transition to electronic records, and updates the previous target dates described in M-19-21. The update was to account for delays in the electronic records process due to the COVID-19 pandemic.

- [Redacted]
- [Redacted]

[Redacted]



[Redacted]

[REDACTED]

[REDACTED]

[REDACTED]

- [REDACTED]

- [REDACTED]

- [REDACTED]

[REDACTED]

Root Causes

Documenting Current Processes

FCA's merger process and documentation requirements were not fully documented. ORP Directive 23, *Corporate Applications*, was last revised in January 2016 and ORP Directive RAD-4, *Financial Viability Analysis*, was last revised in September 2003. In 2022, ORP developed an internal memorandum describing changes to the current merger review process from those documented in ORP Directive 23. In addition, the memorandum included recommended steps to improve the process. While the memorandum explained deviations from ORP Directive 23, the policies and procedures were not revised to reflect important processes, including:

- Development of the merger workgroup;
- Documenting analyses completed by other offices;

- Development of the detailed analysis summary;
- Current roles and responsibilities;
- Approval requirements in ORP's workflow routing system;
- Use of the Agency's web-based document repositories; and
- Current steps for closing and disposing of review files.

FCA also developed a template with steps and questions for offices to answer as part of merger analyses. The Agency began using the template for mergers that became effective as of July 2022. However, the template did not fully document the current merger evaluation process. The template described steps to evaluate impacts to district and System concentrations, but the indexes and analyses described were deemed inapplicable and not utilized. Documenting processes, responsibilities, and controls supports the development of complete and consistent merger files. Updating policies and procedures also provides an opportunity to modify and formalize current processes going forward.

Control Structure

Inadequate controls also contributed to incomplete documentation in merger files. Approvals and checklists were established; however, they did not fully address merger file documentation and were not always completed. While it is understandable that for a 10-year period, systems, staffing, and documentation requirements change, additional controls are needed to verify merger documentation is complete and available in an organized system. The Government Accountability Office's *Standards for Internal Control in the Federal Government* discusses the importance of implementing control activities through policies and reviewing policies, procedures, and related control activities for continued relevance and effectiveness. There is an opportunity for ORP to potentially streamline processes to address critical risks in the process and apply the appropriate controls.

Corporate Applications Database

Technical issues with the Corporate Applications Database also contributed to documentation issues. We identified various documents that did not open from the database, even though it is the Agency's repository for merger files. During our review, an OIT official stated they had not been made aware of these technical issues, and they were not sure what caused them. The official stated the Corporate Applications Database was one of a few remaining Agency systems that was migrated from a legacy system. An OIT official stated that there was an active project to modernize the Corporate Applications Database; however, it had been pushed back due to resource constraints. As part of evaluating and documenting current systems and processes for documenting merger files, the Agency should address technical issues to ensure records are easily retrievable.

Merger Records and Retention

ORP had not established processes to maintain merger records. During our review, ORP was working with the Agency's Records Officer to address records management. ORP was in the process of inventorying records and destroying paper files in accordance with the records schedule. In April 2023, the Records Officer completed a review of ORP's records inventory and made recommendations, including:

- Some business processes need to be realigned to reflect the records management requirements of a fully digital environment. Additional review by ORP and the records liaison will be needed to eliminate any remaining analog records generation;
- ORP must ensure dispositions are applied to all records; and
- ORP will need to develop an internal policy that addresses authorized storage locations and recordkeeping systems for all staff.

In line with the Records Officer's recommendations regarding ORP records at-large, electronic recordkeeping systems and retention specific to merger records should be addressed in ORP policies and procedures. Policies and procedures addressed finalizing paper and electronic merger files. ORP Directive 23 states the project manager is responsible for transmitting original paper files to "central files" within 30 days of FCA's issuance of final approval. Further, the project manager is responsible for marking the project "complete" in the project management form to lock the project. However, this process was not consistently implemented. Procedures did not address records retention periods and steps for evaluating and removing applicable records. Because ORP has changed its processes and systems, it has an opportunity to ensure an efficient process is developed moving forward.

Duplicate Records

Duplicative electronic and paper records were being generated in FCA's merger review process. Officials stated paper records were received from merging institutions based on language in FCA's June 2016 informational memorandum, *Revised Guidelines on Submission of Proposals to Merge or Consolidate Farm Credit System Banks and Merge or Consolidate Farm Credit System Associations*. Procedures in the informational memorandum instruct merging institutions to provide six copies of their merger proposal as well specific documents for final approval. Because these documents are also maintained electronically, this process creates unnecessary records. In addition, ORP is in the process of eliminating unnecessary paper records; therefore, generating new paper files is counterproductive.

Correspondence Tracking System

The Correspondence Tracking System was being used as another electronic system for merger documentation, although its purpose was unclear. ORP uploaded merger correspondence and applicable attachments in the Correspondence Tracking System. However, once uploaded, we could not determine how the information was being utilized in the current merger review process. ORP officials stated they did not use merger information from the Correspondence Tracking

System, and it is duplicative because information in the tracking system does not serve as the official copy. This process creates additional work and potentially unnecessary repositories that must be safeguarded and managed. Because the process was implemented under very different circumstances, ORP has an opportunity to determine whether this duplication fills a need for the Agency or if it can be eliminated under a more modern environment and current process. As previously noted, the documentation for mergers exists from 1994 in the Correspondence Tracking System. What worked for the Agency in the 1990s may not be needed for mergers given the extent of other recordkeeping systems currently used by the Agency.

Leadership and Staffing Changes

ORP has gone through significant leadership and staffing changes in the recent past. For example, the office has an entirely new internal leadership team with a new office director, deputy director, and two associate directors. In addition, the office was restructured in 2019 with the creation of FCA’s Office of Data Analytics and Economics. These changes contributed to many of the new processes and requirements for merger reviews.

In addition, ORP officials stated that the Merger Structure Study was initiated at the request of the FCA Board. FCA had not looked at the System’s structure since 2002, and the FCA Board wanted to understand increased merger activity and the creation of larger and larger institutions. An official also stated that the scope of the study kept expanding, which led to additional reporting and extended timeframes. As reports in the series were being completed, Board and FCA leadership changed. These leadership changes came with changing priorities and focus areas, which impacted consideration of areas identified in the report.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Recommendations

To improve FCA's process for merger activities:

1. The Office of Inspector General recommends the Office of Regulatory Policy update policies, procedures, and the merger template to reflect current systems, processes, recordkeeping, and controls for merger reviews.
2. The Office of Inspector General recommends the Office of Regulatory Policy design and implement controls over merger files to ensure information is fully documented in an organized system.
3. The Office of Inspector General recommends the Office of Regulatory Policy address technical issues impacting documentation availability in the Corporate Applications Database, in coordination with the Office of Information Technology.
4. The Office of Inspector General recommends the Office of Regulatory Policy eliminate the generation of duplicative paper records for future merger reviews.
5. The Office of Inspector General recommends the Office of Regulatory Policy evaluate use of the Correspondence Tracking System for merger information, determine appropriate access controls, and remove legacy data for files that are no longer needed.
6. The Office of Inspector General recommends the Office of Regulatory Policy engage with the Farm Credit Administration Board, or designee, on [REDACTED] [REDACTED] the Merger Structure Study Report Series.
7. The Office of Inspector General recommends the Office of Regulatory Policy [REDACTED] [REDACTED]

FCA Response

FCA management agreed or partially agreed with the seven recommendations. Specifically, management stated they will:

- Update policies, procedures, recordkeeping, templates, and controls governing the merger process;
 - Design and implement controls, including implementing a quality assurance review process to independently confirm merger file documentation is complete before file closing;
 - Continue to work with OIT to address technical issues impacting document availability;
- [REDACTED]

- Work with FCA's Records Officer to develop a plan to eliminate the duplicative generation of paper records in support of files created to document actions taken during the merger process;
- Evaluate use of the Correspondence Tracking System as it pertains to merger information, work with OIT to decide proper access controls, and remove legacy data for files no longer needed;
- Engage with the FCA Board to [REDACTED] the Merger Structure Study Report Series; and
- [REDACTED]

Management estimated the actions will be completed by October 2024.

OIG Response

OIG finds the actions responsive to our recommendations. Management agreed with recommendations 1, 2, 3, 4, 5, and 6. Although management only partially agreed with recommendation 7, the actions planned by ORP address the weaknesses found in our report. In official comments, management stated that paper files were the primary method of recordkeeping prior to 2020, despite utilizing a variety of electronic systems, as noted in our report. OIG acknowledges the office's use of paper files, the duplicative nature of the practice, and the work needing to be done in this area in our recommendations. Management also stated that OIG did not revise findings based on the office locating certain documentation we noted as missing. OIG performed the test work on four electronic systems, despite the confusion in the process. We acknowledged the contributing factors, such as changes to processes over time, and the need to document practices in our recommendations.

Management comments can be found in the subsequent section of the report. The Agency waived an exit conference.

MANAGEMENT COMMENTS

Memorandum

Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
(703) 883-4000



September 22, 2023

To: Wendy R. Laguarda
FCA Inspector General

From: Kevin J. Kramp
Director, Office of Regulatory Policy (ORP)

Subject: Response to the Office of Inspector General's draft inspection report titled, Farm Credit Administration's Process for Merger Activities in the Farm Credit System

This memorandum responds to the draft inspection report from the Office of the Inspector General (OIG), dated August 28, 2023, titled *Farm Credit Administration's Process for Merger Activities in the Farm Credit System*. The stated objective of the inspection was to evaluate FCA's process to review, and take action on, merger activity in the Farm Credit System. We appreciate the OIG's inspection and efforts to identify opportunities to improve FCA's merger review process.

We note the inspection did not include review of paper files and the report did not fully consider database and recordkeeping changes, which occurred during the sample period, January 1, 2013, to April 1, 2023. Prior to 2020, paper files were the primary method of recordkeeping. ORP Directive 23 *Corporate Applications* (January 12, 2016) also continues to require maintenance of paper recordkeeping processes. We believe the OIG's conclusion that 32 percent of the sampled items for merger activities could not be located in electronic files may be overstated. We located many of these documents in electronic files and provided this information to the OIG; however, the OIG chose not to amend the inspection report findings. Finally, we were not aware of the technical issues created by FCA systems impacting electronic documentation availability in the Corporate Applications Database, which contributed to the number of missing documents identified in the inspection report until notified by the OIG. We will work with the Office of Information Technology to address this issue.

The draft inspection report included recommendations identifying opportunities to improve the Farm Credit Administration's (FCA or Agency) merger review process. We agree with most of the report's recommendations. Accordingly, we will update policies, procedures and templates governing the merger process to reflect our current processes, controls, and FCA's recordkeeping standards. However, we only partially agree with the recommendation to [REDACTED]



Thank you for the opportunity to respond to the draft report. We will provide timely updates on corrective actions taken in response to the OIG's recommendations.

ACRONYMS

FCA or Agency	Farm Credit Administration
FCSIC	Farm Credit System Insurance Corporation
FY	Fiscal Year
OE	Office of Examination
OGC	Office of General Counsel
OIG	Office of Inspector General
OIT	Office of Information Technology
OMAT	Operations, Management, and Accounting Team
ORP	Office of Regulatory Policy
RAD	Risk Analysis Division
System	Farm Credit System



Farm Credit Administration
Office of Inspector General

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