

Office of Inspector General

Board Policy Statements

03-05



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FCA Board Policy Statements

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Farm Credit Administration

Office of the Inspector General
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090



September 15, 2003

The Honorable Michael M. Reyna
Chairman of the Board and
Chief Executive Officer
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Reyna:

The Office of the Inspector General completed an inspection of the Farm Credit Administration's (FCA or Agency) Board Policy Statements. The objective of this inspection was to evaluate the FCA Board Policy Statements to determine if they are consistent with sound business practices in terms of relevancy, timeliness, coverage, and key elements. The establishment of policy is completely within the Board's discretion. We conducted this inspection because policies are a key internal control process for governance of organizations.

The presentation by GAO on governance at the most recent Board meeting provides an excellent segue to this report. The report suggests several FCA Board actions to strengthen its policies consistent with that presentation. We found the policy statements need updating and refinement. It appears the Board's role in overseeing the operations of FCA could be enhanced if it establishes a methodical approach to develop, review and update its policies. These practices would be more consistent with sound business practices and the standards established in the *FCA Examination Manual*. These are the standards FCA examiners use to evaluate management of the institutions it regulates.

The inspection followed the President's Council on Integrity and Efficiency *Quality Standards for Inspections*. We conducted fieldwork during August and September.

I hope that you and the Board members find it useful in addressing governance as it relates to FCA. If you have any questions about the inspection, I would be pleased to meet with you at your convenience.

Respectfully,

Stephen G. Smith
Inspector General

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BACKGROUND

The Farm Credit Administration (FCA or Agency) is an independent Federal financial regulatory agency. FCA has regulatory, examination and supervisory responsibilities for the Farm Credit System (System) banks, associations, and related institutions. FCA employs fewer than 300 people. A 3-person board governs FCA operations. Board members are appointed by the President and confirmed by the Senate.

As part of its responsibilities, the FCA Board votes on and adopts Policy Statements. These Policy Statements provide direction and guidance from the FCA Board and represent a key internal control process. There are currently 22 Board Policy Statements.

The FCA Board has adopted policies falling into two distinct areas. The FCA Board has adopted seven policies that provide general direction to Farm Credit institutions. These policies are closely related to the FCA Board's role as a regulator of the Farm Credit System. An example of this type of policy is Policy Statement No. 73 "Philosophy on Intra-System Competition." The other 15 policies relate to the Board's governance of the Agency and how it conducts business.

OBJECTIVE AND SCOPE

The objective of this inspection was to evaluate the FCA Board Policy Statements to determine if they are consistent with sound business practices in terms of relevancy, timeliness, coverage, and key elements. The scope of the inspection was limited to a review and analysis all existing Board Policy Statements compared to criteria for board governance established by FCA and other organizations such as Price Waterhouse Coopers (PWC) and The Conference Board. We conducted this review following the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

FINDINGS AND RECOMMENDATIONS

Overall, this review disclosed a need for a methodical approach to establishing and maintaining the Board's policies. The Board could improve the Agency's management system by adding policies and revising existing policies to incorporate key elements.

INCONSISTENT PROCESS

The FCA has not established a methodical approach to developing Board Policy Statements. There is little consistency in the level of detail and the type of subjects covered by the statements. For example, some policy statements contain detailed procedures such as "Accountable Property Policy and Inventory Reconciliation." Other policies provide broad philosophy statements such as competition within the Farm Credit System. Policy Statement 64 states that Board Policy Statements should "define the goal(s) to be accomplished." Beyond this, no document specifically outlines the purpose of Board Policy Statements.

According to the *FCA Examination Manual*, “clear and concise policies ... are an essential ingredient in any management system.” The manual further states, “Policies are guides for achieving the established objectives and strategies of the institution... Policies are necessary to ensure sound business practices and policy weaknesses have the potential to cause operational problems.” The American Bar Association states boards’ responsibilities include “adopting policies of corporate conduct and monitoring compliance with those policies ... and other internal controls.”

A methodical approach to establishing Board policies could ensure that all critical aspects of FCA operations are addressed in Board policy. Policy statements address some key parts of the Agency operations. However, some aspects of Agency operations are not addressed at all, only addressed in a cursory manner, or outdated. The following chart outlines critical aspects of FCA operations that Board policies should address. These are areas FCA examines in institutions or are suggested by leading organizations such as PWC.

Key Topic	Comment
Planning	PS-64 covers planning in general terms but it is outdated or not completely followed. It indicates that there is a Strategic Planning Committee responsible for planning and reporting to the FCA Board. However, this committee has been dormant. PS-64 also indicates that there is an Information Resources Planning Committee that is also dormant.
Accounting	Accounting principles are incorporated in Board Policy Statements in a limited manner. PS-69 addresses capitalization of property and PS-66 address cash management and liquidity.
Compensation	Compensation principles such as how FCA defines key issues such as comparable compensation are not incorporated in Board Policy Statements.
Contracting	Contracting principles such as FCA will adopt the Federal Acquisition Regulations unless the Agency adopts its own tailored guidelines are not incorporated in existing Board Policy Statements.
Legal Counsel	PS-64 addresses legal counsel but there have been issues with interpretation of the meaning.
Board Committees	There is no Board policy that governs establishment of Board committees.
Conflicts of Interest	PS-64 addresses conflicts of interest to a limited extent. In addition, PS-44 addresses some conflict of interest issues.
Code of Ethics	The Board has not adopted a code of ethics in its Policy Statements but has adopted supplemental regulations to augment the Office of Government Ethics Regulations.
Succession Planning	Board policy addresses succession planning narrowly. PS-64 address succession in the event of a national emergency. However, with the current Board configuration, it is unclear who succeeds the Chairman because there is no member of the Chairman's party.
Examination	PS-53 and PS-64 establish Board policy on examinations.
Regulations	PS-37 addresses communication during rulemaking. PS-64 addresses the Board’s responsibility for rulemaking.

MISSING ELEMENTS

FCA Board Policy Statements lack critical elements of sound policy. According to the *FCA Examination Manual*, good policies contain six key elements:

- ◆ Purpose / Objective
- ◆ Operating Parameters
- ◆ Authority Delegated
- ◆ Authority Retained
- ◆ Exceptions
- ◆ Reporting

The seven policy statements that provide the FCA Board direction or philosophy to regulated institutions would not necessarily contain these key elements. However, the table below shows the remaining 15 Policy Statements related to Agency operations. It indicates many key elements are missing.

Policy	Purpose	Parameters	Authority Delegated	Authority Retained	Exceptions	Reporting
PS-34	✓	✓	.	.	.	.
PS-37	✓	✓	.	.	✓	.
PS-41	✓	.	.	.	.	.
PS-44	✓	✓	.	.	✓	.
PS-49	✓	.	.	.	.	.
PS-53	✓	.	.	.	.	.
PS-62	✓	✓	.	.	.	.
PS-64	✓	✓	✓	✓	✓	✓
PS-65	✓	✓	✓	.	.	✓
PS-66	✓	✓	.	.	.	✓
PS-67	✓	.	.	.	.	✓
PS-68	✓	✓	✓	✓	✓	✓
PS-69	✓	.	✓	.	.	✓
PS-72	✓	✓	✓	.	.	✓
PS-78	✓	✓	.	.	.	.
Count	15	10	5	2	4	7

OUTDATED POLICIES

The FCA Board Policy Statements are outdated. Several of them refer to practices and operations that no longer exist. The average age of the 22 policy statements is 6 ½ years. The Board has only updated or adopted 1 policy statement in the past three years. According to the *FCA Examination Manual*, boards of Farm Credit Institutions are expected to review their policies annually. PWC states “governance guidelines will ... be regularly refreshed, usually on an annual basis.”

Policy Statement 64 states, “Board Policy Statements and Bookletters should be reviewed at least every five (5) years.” The Secretary to the Board maintains the Policy

Statements but the Office of Policy Analysis has a procedure to review policies every three years. The most recent review was conducted in 1999. A workgroup (including a policy analyst, an attorney, and the Board Secretary conducted the review and recommended changes to 12 of the 22 policies. Three of the policies were ultimately changed. The following table shows the workgroup's recommendations and their disposition.

Recommended Action	No. Of Policies	Board Actions
Keep	10	None required
Repeal	4	Only two policies repealed (PS-70 and PS-63). Board adopted a new policy, PS-78 to replace PS-63.
Technical Amendments	5	No Action.
Substantive Amendments	3 ¹	Only one policy (PS-62) substantively revised.

POLICY STATEMENT 64

Policy Statement 64 is noted as criteria in several of the findings above. It encompasses a broad range of Agency operation and is one of the most significant governance documents at the Agency. As noted on the chart on page 3, the policy contains all key elements of sound policy. However, the Policy Statement does not address all key elements for each subject area contained within the policy. Bundling a broad range of subjects in a single policy increases the likelihood that it will become outdated. It may also make it more difficult for the Board to revise a single issue because it opens the entire policy to revisions.

The OIG has previously suggested that the Board reexamine and obtain consensus on this policy. During this review we noted multiple sections that are in need of substantive review:

- ◆ **Article II Sec. 5** indicates that in the event of a national emergency succession of the Chairman is to the member of the same party and then to the member of the minority party. The policy did not anticipate that the Chairman would be from the minority party.
- ◆ **Article IV Sec. 1** provides the member from the Chairman's party will preside over Board meetings if the Chairman is unable to do so. The policy did not anticipate that the Chairman would be from the minority party.
- ◆ **Article VII Sec. 3** provides for oversight of financial and strategic management. It indicates the Board approves reallocation of budget amounts greater than \$25,000. However, it does not address situations where funds are used from multiple offices, which potentially avoids Board review. This

¹ The workgroup suggested substantive changes to PS-62, PS-64, and PS-65.

- section also establishes the Strategic Planning and the IRM Steering Committees. However, these committees are not in operation. The section does not address the timing of the strategic plans and it leaves out critical planning efforts such as the Financial Management Plan and the Human Capital Plan. Finally, it lacks discussion of performance measures.
- ◆ **Article VII Sec. 4** defines “heads of major administrative divisions” in a manner that is not consistent with the Farm Credit Act. Also, the section is silent with respect to removal of the heads of major administrative sections.
 - ◆ **Article VII Sec. 4** provides for relocation expenses of Board members. It states additional expenses may be authorized but does not delegate authority to any officer to make such a determination.
 - ◆ **Attachment B** address Board oversight with regard to mass mailing but is silent regarding the FCA Website and mass emailing.

RECOMMENDATIONS

- 1) ***The FCA Board should establish a framework or methodology for its policies. The framework should:***
 - a) ***distinguish between policy over FCA operations and philosophy statements or directions provided to the Farm Credit System,***
 - b) ***outline the elements the Board expects its policies will contain,***
 - c) ***provide for more frequent review of and Board action on Policy Statements to ensure they reflect the position of the current Board members, and***
 - d) ***designate the Board Secretary as accountable to apply the framework.***
- 2) ***The FCA Board should review its policies to ensure that it has established appropriate oversight of critical areas of FCA operations. The Board should specifically review the “key topics” noted on page 2 of this report.***
- 3) ***The FCA Board should review Policy Statement No. 64 to consider:***
 - a) ***breaking the policy into several different policies,***
 - b) ***establishing a sunset provision after a change in membership, and***
 - c) ***revising the policy to eliminate oversights, inconsistencies and outdated items.***

APPENDIX – LIST OF POLICY STATEMENTS

Date	Months Old	Policy	Title
3/25/1992	137	FCA-PS-37	Communications During Rulemaking
11/12/1992	129	FCA-PS-44	Travel, Acceptance of Gifts and Travel-Related Expenses, and Acceptance of Honoraria by the Board Members
7/15/1993	121	FCA-PS-53	Implementing the 1992 Amendment to the Farm Credit Act, Providing Flexibility in the Definition of an Examination
3/6/1995	101	FCA-PS-66	Agency Cash and Liquidity Management
3/20/1995	101	FCA-PS-65	Release of Consolidated Reporting System Information
4/13/1995	100	FCA-PS-67	Nondiscrimination in Agency Programs and Activities
5/9/1995	99	FCA-PS-59	Regulatory Philosophy
7/7/1995	97	FCA-PS-68	FCS Building Association Management Operations Policies and Practices
12/11/1995	92	FCA-PS-69	Accountable Property Policy and Inventory Reconciliation
5/30/1996	87	FCA-PS-34	Disclosure of the Issuance and Termination of Enforcement Documents
5/30/1996	87	FCA-PS-49	Disclosure of Camel Ratings
6/13/1996	86	FCA-PS-71	Disaster Relief Efforts by Farm Credit Institutions
2/10/1997	78	FCA-PS-41	Alternative Means of Dispute Resolution
4/9/1998	64	FCA-PS-72	Financial Institution Rating System (FIRS)
7/14/1998	61	FCA-PS-73	Philosophy on Intra-System Competition
12/10/1998	56	FCA-PS-74	Interest Rate Risk Management
12/10/1998	56	FCA-PS-75	Farm Credit System Service to Young, Beginning, and Small Farmers and Ranchers
1/14/1999	55	FCA-PS-76	Temporary Relief for Pork Producers
9/24/1999	47	FCA-PS-64	Rules for the Transaction of Business and Operational Responsibilities of the Farm Credit Administration Board
11/10/1999	45	FCA-PS-77	Borrower Privacy
5/3/2000	39	FCA-PS-78	Official Names of Farm Credit System Institutions
9/12/2002	11	FCA-PS-62	Equal Employment Opportunity Programs and Diversity
Average	80		