

Office of Inspector General

Semiannual Report
to the Congress

April 1, 2004
to
September 30, 2004



*Number 31
September 2004*



October 26, 2004

The Honorable Nancy C. Pellett
Chairman of the Board and
Chief Executive Officer
Farm Credit Administration
McLean, Virginia 22102

Dear Ms. Pellett:

Enclosed is the semiannual report on the activities of the Farm Credit Administration's Office of Inspector General for the period from April 1, 2004 through September 30, 2004. We are filing this report in accordance with the Inspector General Act of 1978, as amended (Act). This is the thirty-first 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.

In this first Semiannual Report addressed to you as Chairman, I am optimistic that the Agency has demonstrated a renewed commitment to address some long standing management challenges. I am hopeful that the commitment will translate to closure on a number of agreed upon actions. Over the past several years there has been a steady increase in the number of open agreed upon actions and the number of recommendations without management decisions has increased, as well. I look forward to working with you and FCA managers to reverse these trends.

Respectfully,

Stephen G. Smith
Inspector General

Enclosure

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EXECUTIVE SUMMARY

This semiannual report to the Congress summarizes the activities and accomplishments of the Farm Credit Administration (FCA or Agency), Office of Inspector General (OIG) and covers the period April 1, 2004 through September 30, 2004. Our efforts were directed toward performing audits, inspections, and evaluations of FCA programs and operations, conducting investigations, and providing technical assistance and advice on FCA programs.

During the reporting period, FCA underwent an important transition. The President designated Nancy C. Pellett as Chairman during May 2004. While there was a change in chairmanship, the members of the Board remained unchanged. As with many transitions, the new Chairman has made some changes in top management of the Agency. With such changes, there are opportunities to implement new ideas that can bring about improvements in the Agency. There are also risks that important controls may be lost in the changes.

During this period of transition, management initiated several actions that show promise of resolving some of the long standing recommendations. While the number of unresolved recommendations has increased, the Chairman has demonstrated a good faith effort to tackle the recommendations and address the management challenges by committing resources to correct issues.

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 (Farm Credit Act). FCA is a non-appropriated agency with a fiscal year (FY) 2004 budget of \$38.4 million for administrative costs. The FY 2004 budget for the OIG was \$865,844. FCA is a “designated Federal entity” within the meaning of the Inspector General Act of 1978, as amended.

FCA currently has 287 employees, about half of which are examiners located at five field offices. The OIG maintains five positions. Appendix B displays the board approved organizational structure of FCA and Appendix C displays the OIG within that structure.

MANAGEMENT CHALLENGES

This part of the semiannual report highlights major challenges confronting the Agency as it works to fulfill its mission. These challenges have remained for several years. While some are outside of the Agency’s control, most should be addressed through concerted action by management. Over the past six months, the OIG has observed a renewed commitment by FCA management in addressing the challenges.

Farm Credit System Risk

The Farm Credit System (FCS or System) is a single industry lender and is vulnerable to economic swings. FCS is sound in all material respects. Earnings and capital levels have continued to strengthen and asset quality remains high. While the System is presently sound, there are many challenges facing agriculture and rural America today that raise the question of whether there should be modifications to the Farm Credit Act in order to enhance agricultural and rural economies of the future.

The FCA 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. FCA’s challenge is more complex because it has become increasingly difficult to reconcile significant provisions of the Farm Credit Act with the realities of the agricultural industry, the business environment, and financial markets in the 21st Century. FCA management fully understands this challenge and the Chairman recently provided testimony to Congress on the issue.

In the early 1990s, the General Accounting Office (GAO) conducted a comprehensive study of the cost and availability of credit in rural America. The GAO¹ concluded that the System did not need new statutory authorities in the near term, but that ongoing structural changes in agriculture and rural America could justify such changes in the longer term. GAO noted that over time, as agriculture and rural America continued to change, the System's charter might need to be updated to ensure that the System is not hampered by outdated restrictions.

As a financial regulator, FCA must maintain a flexible and responsive regulatory environment. FCA is pressed to test the limits of its flexibility within the bounds of the Farm Credit Act. The constraints of the Act may be part of the reason that one of the largest institutions recently announced it would be applying to terminate its charter. The FCA Board has faced pressures to consider loan syndications to be "participations" instead of "loans" to avoid certain provisions in the Act. The Board has faced similar issues related to preferred stock. The Chairman's testimony before the House Agriculture Subcommittee on Conservation, Credit, Rural Development, and Research on September 29, 2004 clearly identifies the challenge:

"What we learned is that we must maintain a flexible and responsive regulatory environment. And where appropriate, we should eliminate or revise regulations that unnecessarily impair the System's activities.

However, the limits of that flexibility are currently being tested as the changes in agriculture and rural America have eclipsed the legislative parameters initially granted to the System. The mission-driven desire and sometime financially-driven need of the System to expand its operations, not only within agriculture but also to rural America presents some challenges within existing authorities."

Human Capital

The OIG recommended FCA develop a human capital plan in March 2001. FCA management agreed to this recommendation, yet FCA still does not have a plan. In prior semiannual reports, we noted the problem was the lack of a consistent strategic approach to marshalling, managing, and maintaining human capital to maximize FCA performance and assure its accountability. In 2001, the President identified human capital as a critically needed management reform in the Federal government. The General Accounting Office's (GAO) *High-Risk*² report also identified the human capital challenges that the government faces.

FCA has the opportunity to consider organizational realignment to better achieve results and clarify accountability. Realignment may help FCA pursue organizational approaches that recognize the reality of evolving technology, a changing workforce, and other environmental forces. For example, as competitive sourcing, electronic

¹ GAO/GGD-94-39 *Farm Credit System Repayment of Federal Assistance and Competitive Position*, March 1994

² GAO-03-95

government (E-Government), financial management, and other initiatives lead to changes—how FCA meets its mission may need to change, including the skill sets it needs and how it organizes those skills to meet its mission.

FCA can also improve its performance by building commitment and accountability through involving and empowering employees. FCA staff and its leaders must understand the rationale for making organizational and cultural changes. Everyone has a stake in helping to shape and implement initiatives as part of the Agency's efforts to meet current and future challenges. The cooperation of leaders and employees throughout the organization can lead to effective and sustained changes.

Agency management has made a renewed commitment to develop a human capital plan. Part of that commitment is evidenced by a study that the Chairman announced to FCA staff to evaluate the Agency's needs over a five to seven year planning horizon. The Chairman plans to evaluate the examination function, the regulatory development function and then the functions that support these operations. This approach is promising because it is a methodical and cohesive strategy designed to produce measurable results addressing the human capital needs of the Agency. It is also promising because the Chairman has communicated her plans to all staff—building understanding of and commitment to the organization's needs.

Agency Governance

The Farm Credit Act provides for a full time three-member Board. The Board members are appointed by the President and confirmed by the Senate. A small full-time Board presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the Agency. The Board must be able to engage in professional policy debate and set a sound course for the Agency. The Board and the Agency are most effective when they can focus on the business of the Agency instead of the processes. The Board's rules of operation are a foundation for trust and shared expectations among Board members. A collegial Board founded on mutual trust and respect is essential to FCA's ultimate effectiveness.

The Chairman has taken action to address this challenge by sharing authority and tasking a Board member with the responsibility to lead the Board in its efforts on governance issues. This represents a positive and concrete commitment with accompanying resources to address this longstanding management challenge.

Strategic Planning

The FCA Board adopted a Strategic Plan a year ago. A change in chairmanship is an opportunity for management to refine strategies and alignment to ensure the Board's vision is accomplished

The Board and Agency staff will face the significant challenge of refining performance measures to enhance a results-oriented culture at FCA. The Agency will need to achieve a balance among results, public expectations, and employee issues. FCA should evaluate its performance measures to ensure that they challenge and stretch the organization. Performance measures can be a powerful tool to continue the push into a results-oriented organization. An effective performance management system fosters performance and accountability at the individual, organizational, and ultimately overall Agency levels.

Financial Management

Timely, accurate, and useful financial information is essential for making day-to-day decisions; managing the Agency's operations more efficiently, effectively, and economically; supporting results-oriented management approaches; and ensuring accountability on an ongoing basis. During FY 2001, FCA successfully implemented a financial management system using the services of the Department of Interior's National Business Center. During September 2003, the Agency decided to reprogram funds and purchase a new financial system. Management originally scheduled implementation of the new system during FY 2004. However, implementation has been delayed until June 2005. This reporting period, OIG performed an inspection that showed significant improvements were needed in project management to successfully complete implementation.

Management's challenge is to bring yet another system on line at a reasonable cost to the FCA and concurrently leverage the system to deliver timely financial information critical for making well-informed management decisions. The challenge forces the Agency to develop new measures of financial management success. Financial management success goes far beyond an unqualified financial statement audit opinion. Measures such as delivering financial information that managers can use for day-to-day operations, and developing reports that capture the full cost of programs and projects can help bring about improvements.

Financial management represents a challenge that goes to the fiber of FCA's business operations and management culture. FCA needs to ensure that underlying financial management processes, procedures, and information are in place for effective program management. FCA already has information that is readily available. However, the CFO seems to be stuck in controlling the distribution of the information. This type of information control serves as a roadblock to improved management. FCA needs to take steps to get information into the hands of managers. FCA will also need to improve managers' ability to use the information to measure, control, and manage costs, to manage for results, and to make timely and fully informed decisions about allocating limited resources.

Security and Disaster Preparedness

Recently, management has made significant strides towards improving its preparedness by acting on OIG suggestions for an expedited effort to prepare for an emergency. Management completed a Continuity of Operations Plan, conducted drills and revised procedures based upon those drills. The Agency's level of preparedness is improving but it remains a management challenge to continue to refine procedures to ensure that the Agency reduces its vulnerability to significant disruption in operations in the event of an emergency. The speed of change in the security environment will be a challenge for all government organizations. This is especially true and a challenge for smaller organizations like FCA where an increased emphasis on physical and information security competes with program areas for limited budget funding.

Leveraging Technology

Information technology (IT) is a key element of management reform efforts that can help dramatically reshape government to improve performance and reduce costs. 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's challenge is to establish effective mechanisms to ensure that current and future staff has the skills to use technology to operate in an efficient and effective manner.

Internally, there is an opportunity for IT to complement human capital initiatives to reformulate the work processes of FCA. In order for this to come about, FCA will need to invest in training and reward employees who are able to develop innovative approaches to accomplish Agency goals using technology.

Externally, E-Government offers many opportunities to better serve the public, make FCA more efficient and effective, and reduce costs. FCA has begun to implement some E-Government applications, including the use of the Internet to collect and disseminate information and forms. Here, FCA's challenge is to identify opportunities to develop partnerships with other agencies to develop joint E-Government strategies.

AUDIT AND INSPECTION REPORTS ISSUED

We conduct all audits in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are in accordance with the *President's Council on Integrity and Efficiency's Quality Standards for Inspections*. Copies of most OIG reports are available on FCA OIG Web site (www.fca.gov/oig), or by contacting the OIG on (703) 883-4030, (703) 883-4359 for TTY, or by e-mail at ig_information@fca.gov.

Human Capital: Job Classification

The OIG issued an audit report in June 2004 on the job classification program and position management at the FCA. The audit's objectives were to determine whether the FCA position management is adequately administered and whether the job evaluation program reflects sound management principles. The audit found that if administered properly the FCA job evaluation program is effective in achieving a "performance based system" reflecting equal pay for equal work. It also found that desk audits completed on job positions were generally well documented and completed fairly and objectively. However, it noted the job evaluation system is over 15 years old. To ensure job classification continues to be in alignment with the Agency's values and goals, FCA should periodically revalidate or revise the job evaluation criteria. In addition, management must be held accountable for reasonable decision making on issues that effect job classification. Internal controls should also be improved to ensure position management is effectively administered. The five action items issued in the report remain open.

Project Management

The objective of the inspection was to compare project management techniques of FCA's financial systems to best practices. The systems evaluated are among the Agency's largest technology investments. We found many important elements of sound project management missing in the projects, which resulted in delayed implementations. Some unavoidable technical issues caused delay in the implementation, but other inefficiencies could have been prevented through better project management. Overall the project management of these two systems was below standards. We also found FCA is not fully prepared to comply with Federal Travel Regulations regarding E-Travel. Both projects lacked sufficient authoritative support for their costs and as a result, we questioned over \$250,000 of expenditures associated with implementing these systems. We recommended that both projects be stopped and reevaluated before further implementation. The report provided five recommendations for project management improvement that can be applied to the FCA's future large-scale projects. An evaluation team is convening to provide an appropriate and cost-effective approach for the Agency on the issues raised.

STATUS OF UNIMPLEMENTED AGREED UPON ACTIONS

At the beginning of the period, there were 14 unimplemented agreed upon actions for audits and three unimplemented recommendations for inspections. During this period, five more agreed upon actions and five more recommendations were issued. Management took final action on one of the agreed upon actions. At the end of this reporting period, 18 agreed upon actions and eight recommendations remain unimplemented.

Audits

The following table summarizes the final actions management took on open audit items.

AUDIT AGREED UPON ACTIONS				
Audit Report	Issued	Open during this 6-month period	Final Management Actions during this period	Open on 10/01/2004
Performance Budgeting	03/23/01	2	0	2
Office of Chief Financial Officer	01/24/02	2	0	2
Loan Account Reporting System	08/28/03	5	1	4
FCSBA Business Practices	03/09/04	5	0	5
Human Capital: Job Classification	06/29/04	5	0	5
Total		19	1	18

The OIG issued audit reports on Performance Budgeting over three years ago and the Office of Chief Financial Officer more than two years ago. Two of the original agreed upon actions from each of these reports remain open. The agreed upon actions can serve to partially address the management challenges.

The OIG issued an audit report on the quarterly collection of detailed borrower data (Loan Account Reporting Data) seven months ago that included nine action items. Since the report's issuance, four action items remain open.

The OIG issued an audit report during the last reporting period on the business practices of the FCS Building Association. Although all action items remain open, the OIG has noted substantive progress toward resolving the agreed upon actions.

Inspections

The following table summarizes the final action that management took on recommendations contained in two inspection reports.

INSPECTION RECOMMENDATIONS				
Inspection Report	Issued	Open during this 6-month period	Final Management Actions during this period	Open on 10/01/2004
FCA Board Policies	09/15/03	3	0	3
Project Management	09/09/04	5	0	5
Total		3	0	8

The OIG issued an inspection report on FCA Board Policy Statements a year ago. Management has not made any decisions on the recommendations. However, the new Chairman has requested a Board member to lead a group of staff to address the issues noted in the report.

In the inspection report on FCA's project management, the OIG made five recommendations for improved project management that can be applied to FCA's future large-scale projects. Management has not made a decision on the recommendations.

Investigations

Most OIG Hotline calls and e-mails dealt with borrower complaints concerning FCS institutions and other FCS issues. These were referred to the FCA office responsible for reviewing such matters. All other Hotline calls were addressed or were referred to the appropriate FCA office or other Federal agency.

Three investigations were open at the beginning of this reporting period. Two new investigations were opened and four were closed.

Legislation and Regulations

OIG staff reviewed several FCA regulations in both proposed and final form. Statutory and regulatory compliance issues were reviewed as they arose in the evaluative process. Also, we reviewed and commented on proposed legislation affecting the Inspector General community through the legislation committee of the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency (PCIE/ECIE).

OIG reviewed comments and followed Agency publications on syndication loans, preferred stock, and permanent capital.

This office is involved in workgroups that develop guidelines for use in the investigation review process. Our office will participate in the PCIE/ECIE quality assurance review of investigations.

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 came to our attention during the process of performing other OIG work. In this 6-month period, we advised Agency managers on a range of issues from the record of a Board vote to a comparison of compensation among financial regulators.

Survey of Farm Credit System Institutions

OIG administers an ongoing Agency survey of the regulated institutions of the FCS. This survey provides the FCA Board and senior management with independent feedback about how well FCA performs its examination and enforcement activities. The feedback is based on confidential responses received from FCS institutions following their receipt of FCA's report of examination. OIG reports the results of the survey annually. During this 6-month period, we sent 31 surveys and received 18 responses, equating to a 58 percent response rate. Overall, the responses for this reporting period were similar to the prior semiannual reporting period.

OIG Performance Measures

OIG's performance measures were developed in 1995. Each year we review these measures and issue a report on our performance. It is available on the FCA OIG Web page at www.fca.gov/oig.

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 is 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 in Blacks in Government, FCA Employees' Council, Administrative Burden Reduction Workgroup, the Federal Women's Program, and the Budget Workgroup.

TABLE 1.—AUDIT / INSPECTION REPORTS ISSUED			
Title of Report	Number of Agreed Upon Actions/ Recommendations	Questioned Costs	Recommendations That Funds Be Put to Better Use
Human Capital: Job Classification	5	\$ 0	\$ 0
Project Management	5	\$ 250,000	\$ 0
<i>Total</i>	<i>10</i>	<i>\$ 250,000</i>	<i>\$ 0</i>

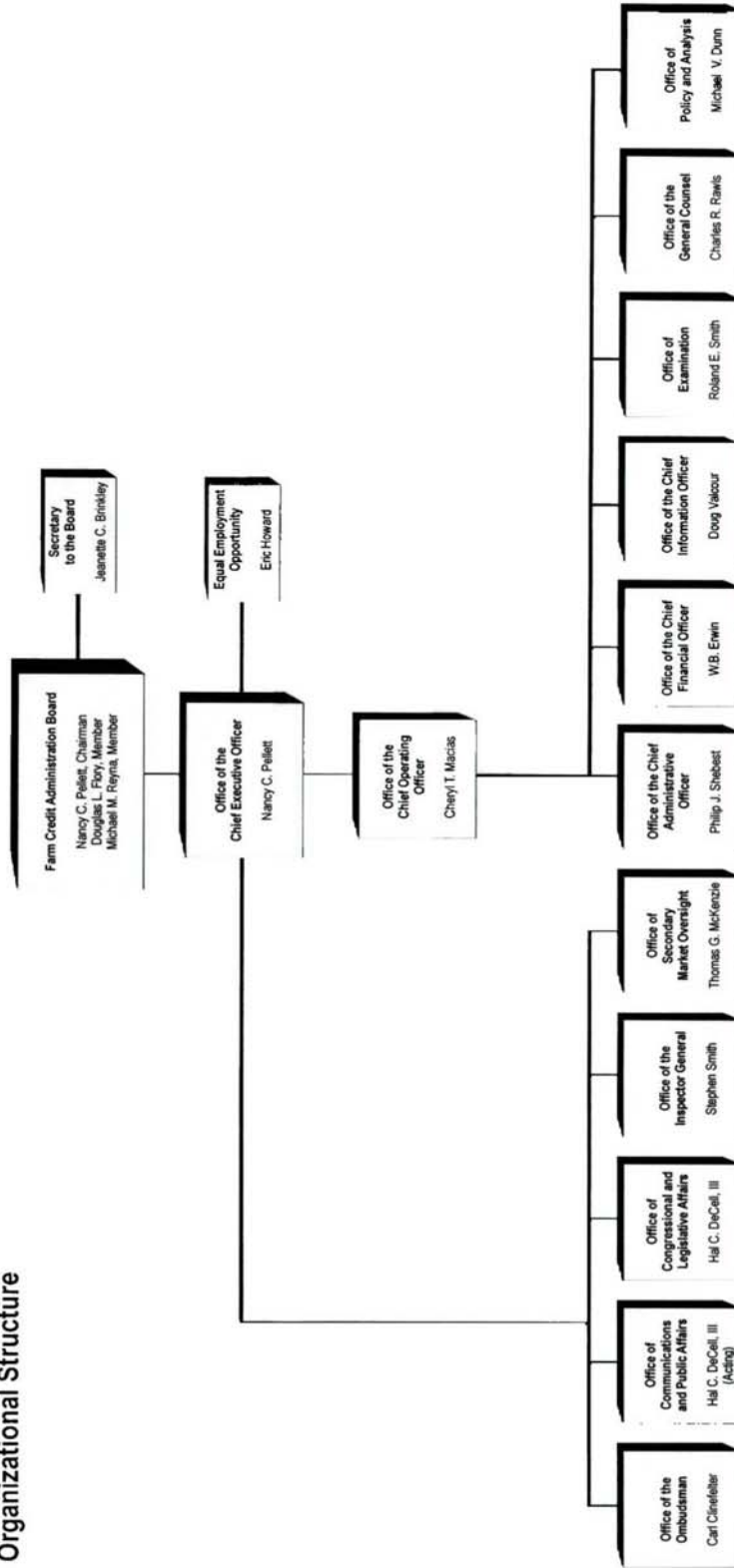
TABLE 2. –REPORTS WITH QUESTIONED COSTS

	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	0	\$ 250,000	\$ 0
<i>Subtotals (A+B)</i>	1	0	\$ 250,000	\$ 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	0	0	\$ 0	\$ 0
D. For which no management decision has been made by the end of the reporting period	1	0	\$ 250,000	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0	\$ 0

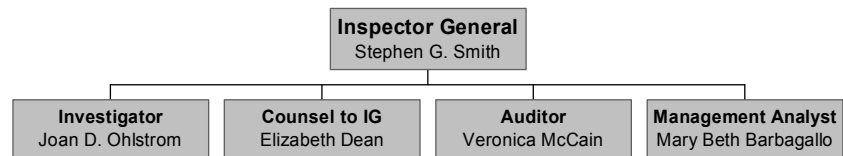
TABLE 3.—REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE

	Number of Reports	Number of Recs.	Dollar Value
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
<i>Subtotals (A + B)</i>	0	0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0
(i) dollar value of recommendations that were agreed to by management	0	0	\$ 0
--based on proposed management action	0	0	\$ 0
-- 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
 Organizational Structure**



Farm Credit Administration Office of Inspector General



R E P O R T


Fraud ❖ Waste ❖ Abuse ❖ Mismanagement




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