

HARVESTING CHANGE



Farm Credit Administration
Office of Inspector General
Management Challenges

2017



October 11, 2017

The Honorable Dallas P. Tonsager, Board Chairman
The Honorable Jeffery S. Hall, Board Member
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Board Chairman Tonsager and Board Member Hall:

As part of the Agency's annual Performance and Accountability Report, the Reports Consolidation Act of 2000 requires Inspectors General to provide a summary perspective on the most serious management and performance challenges facing the Agency. We solicited the FCA Board and Management for thoughts on this issue and identified the following top four management challenges:

1. Examination and Supervision Program,
2. Information Technology,
3. Human Capital, and
4. Organizational Structure and Governance.

We attached a summary of these challenges and the Office of Inspector General's assessment of the Agency's progress in addressing them.

We appreciate the continued, ongoing support of Agency leadership. We will continue to work with you in addressing these and other challenges faced by the Agency in achieving FCA's mission.

If you have any questions, please call me at 703-883-4234.

Sincerely,

A handwritten signature in blue ink that reads 'Wendy R. Laguarda'.

Wendy R. Laguarda
Inspector General

Enclosure

MANAGEMENT CHALLENGES

As part of the Agency's annual Performance and Accountability Report, the *Reports Consolidation Act of 2000* requires Inspectors General to provide a summary perspective on the most serious management and performance challenges facing the Agency. These challenges reflect ongoing vulnerabilities identified by the OIG over recent years as well as new and emerging issues that the Farm Credit Administration (FCA) faces. The chart below summarizes the top management challenges. The pages following the chart provide more depth regarding the challenge and the Agency's progress in addressing the challenge.

Examination and Supervision Program

- Identifying and addressing risks in the Farm Credit System (System) through effective examination and supervision to ensure the System remains safe and sound.

Information Technology

- The ability to leverage investments in information technology while maintaining a secure environment.

Human Capital

- Maintaining a well-trained, sustainable workforce while facing challenges in retirement eligibilities, workforce retention, and diversity.

Organizational Structure and Governance

- Aligning FCA's organizational structure to the goals and priorities of the FCA Board and the Executive Branch reform initiatives while remaining a strong safety and soundness regulator.

CHALLENGE ONE: EXAMINATION AND SUPERVISION PROGRAM

A significant challenge for FCA lies in identifying and addressing risks in the Farm Credit System (FCS or System) through effective examination and supervision to ensure the System remains safe and sound.

The System continues to be impacted by changing risk conditions. Over the last number of years, net farm income has declined and price levels for key commodities have been low. Macroeconomic factors, such as changing interest rates and energy prices, will likely also impact risk in the System. FCS institutions must continue to be proactive and responsive to these risks. Working with borrowers and adapting to increasing risks while maintaining financial capacity will further increase the complexity of the System.

FCA's examination and supervision program must align with evolving threats, risks, and conditions. FCA uses a risk-based approach for oversight of the System. The Agency will require more sophisticated risk evaluation techniques to align with existing and emerging risk factors and identify and deter consequences with the greatest potential impact. Effective oversight will require using new technologies and developing new skillsets within the Agency. The control environment must also evolve to address increasing expectations associated with internal controls.

From time to time, more serious or persistent weaknesses require additional oversight activities. FCA must respond and intervene, when necessary, to protect the System. Effective examination and supervision requires prompt identification of unacceptable risks. Both internal and external factors can cause significant changes in condition in a short period of time. Corrective actions and follow-up are critical to preventing the escalation of issues that impact safety and soundness. The Agency must be agile to monitor and prevent such conditions to protect the System.

Agency Progress

FCA continuously works to address the challenges of the examination and supervision roles and responsibilities. The Office of Examination (OE) has issued Informational Memoranda with guidance for institutions. An Informational Memorandum titled *Servicing Loans to Borrowers in Distressed Industries* (January 21, 2016), highlights risk conditions and encourages System institutions to ready themselves and their customers for less favorable conditions. Another Informational Memorandum titled *Reporting Security Incidents and Business Continuity Events to FCA* (June 27, 2017), addresses reporting such events to FCA. The Agency also conducts systemic risk analyses to identify and monitor emerging risks.

Each year, OE identifies National Oversight Plan risk topics that are emphasized in ongoing examinations and oversight activities. For Fiscal Year 2017, OE identified two risk topics: *Intensifying Credit Risk – Deeper into the Commodities Cycle and Implementing the New Capital Regulations*. For Fiscal Year 2018, two risk topics were identified: *Portfolio Risk – Weathering the Storm and Internal Controls Over Financial Reporting*. Other areas of emphasis in the 2018 plan include stress testing and earnings trends/operating expenses.

The OIG plans to review OE programs during Fiscal Years 2018-2019 to address challenges faced by the examination and supervision program. Our plan includes a review of the Agency's oversight of internal controls and a benchmarking study on the organizational structure of OE. We completed an audit on the Examination of Business Continuity at FCS Institutions in June 2016.

CHALLENGE TWO: INFORMATION TECHNOLOGY

A significant management challenge for FCA is the ability to leverage investments in information technology (IT) while maintaining a secure environment.

Cybersecurity threats and vulnerabilities require an IT security program that is both realistic and forward-looking. The continuous challenge created by cybersecurity threats is highlighted by security incidents and data breaches involving both the public and private sector. Cybersecurity threats could have a direct impact on FCA and other government agencies' abilities to perform their missions. As such, it is imperative to prevent and respond to these types of attacks to ensure that the Agency can continue to perform its mission.

While cybersecurity threats are increasing, FCA is increasingly reliant on IT software to identify and analyze potential risks from the sensitive financial data that the Agency receives from the System. Hence, it is imperative that FCA has the necessary IT tools and staff to stave off cybersecurity threats and to operate more efficiently and effectively. At the same time, the Agency must be prudent and responsible with its spending. Finally, to be effective, FCA needs a well-trained staff that can successfully integrate new tools into its operations.

The successful implementation of IT provides FCA staff with the tools and skills that enable the Agency to continue to:

- Improve the quality and availability of financial data used to examine potential risks across the System without creating an undue burden on the System;
- Streamline business processes and build business intelligence to provide decision-makers with timely management information;
- Develop electronic recordkeeping and management capability for capturing, maintaining, and sharing institutional knowledge; and
- Protect and secure FCA information systems and data from ever-increasing external and internal threats.

Agency Progress

Over the past few years, FCA has invested in various IT tools to increase efficiency and effectiveness. Recently, FCA invested in analytical tools with the goal of improving risk identification in the System by analyzing System loan data. The Office of Information Technology (OIT) provided training for the new analytical tools.

FCA's risk-based information security program continues to mature as it continuously identifies areas to strengthen and improve security. The OIT supplemented its staff with an information security contractor to assist with further development of its security program.

The OIG performs an annual evaluation of FCA's compliance with the Federal Information Security Modernization Act of 2014. Additionally, the OIG will conduct a benchmarking study of the OIT and its use of contractors.

CHALLENGE THREE: *HUMAN CAPITAL*

A significant management challenge for FCA is maintaining a well-trained, sustainable workforce while facing challenges in retirement eligibilities, workforce retention, and diversity. Employees are FCA's most valuable asset. The Agency must continue to invest in its employees and their development.

FCA's success depends on its workforce. When the workforce changes, the disruption can affect the Agency. FCA continues to have a significant amount of retirement eligibilities. This presents a challenge for the Agency because of key person dependencies and a loss of institutional knowledge when these individuals retire. It is important for the Agency to have succession plans in place to pass down the knowledge and experience gained throughout employees' careers and to reduce dependencies.

The Agency also faces a challenge in retaining its workforce. Workforce training and developing takes a significant investment of resources. Specifically, the Commissioning Program at FCA is a four-year program with an extensive amount of training and other resources devoted to its success. Retaining staff should remain a focus for FCA. Using tools, such as data analytics and trending data through collection efforts, can help the Agency identify gaps or areas for improvement.

Increasing diversity also remains a human capital challenge for FCA. As noted in some of our previous work, the Agency must assess and deploy strategies to reach its goals for diversity and inclusion. It can do this by using various tools that: identify and reduce potential barriers to diversity and inclusion; enhance outreach; evaluate the Agency's recruitment data; and heighten awareness through programs that support diversity and inclusion.

Agency Progress

The Agency maintains a Human Capital Plan and has identified specific strategies and goals relating to human capital in its Strategic Plan with two related performance measures. FCA continues to evaluate employees' opinions on surveys and identifies retirement eligibilities. The Agency also has implemented several employee benefits to attract and retain well-qualified employees, including a new Student Loan Repayment Program. The FCA's Special Emphasis Programs, including new ones added over the last few years, increase awareness of, and appreciation for, diversity within the Agency.

The OIG has completed numerous audit and inspections relating to human capital over the last two years. The OIG will conduct an audit of the separating employee process and a benchmarking study on the organizational structure of the OE.

CHALLENGE FOUR: ORGANIZATIONAL STRUCTURE AND GOVERNANCE

A significant management challenge for FCA is to align its organizational structure to the goals and priorities of the FCA Board and the Executive Branch reform initiatives while remaining a strong safety and soundness regulator.

Although the Agency's statutory mission has remained constant, many factors affect the Agency's operations and organization. One factor is the periodic turnover of the FCA Board as reflected by Chairman Tonsager's appointment as Chairman in November of 2016, Board Member Hall's term expiration in October 2018, and the September 2017 Presidential nomination of a new board member. The FCA has the ongoing challenge of responding to the goals and priorities of the rotating Chairman and board members. Another factor affecting the Agency's operations and organization is the Executive Branch reform initiatives, which task agencies with looking for ways to operate more efficiently.

As an arm's length regulator, FCA is uniquely challenged to ensure that it remains independent, equitable, and transparent. This dynamic is especially important for the Board and employees with decision-making authorities. FCA must also be cognizant of how outside forces can affect, or be perceived to affect, regulations and policy. To achieve its mission, the organizational structure must align in a way that ensures a quality staff, dedicated to understanding, addressing, and communicating these issues.

Agency Progress

The Agency plans for the changes in the FCA Board's composition by preparing briefing material for newly-entering board members and ensuring that their on-boarding runs as smoothly as possible. The Agency's senior leaders are led by a Chief Operating Officer (COO) who liaisons day-to-day with the Chairman and board members. This leadership structure has proven to be an effective and efficient way of responding to the goals and priorities of the Chairman and board members and ensuring that all Agency staff is aware of, and responsive to, such priorities.

The Agency actively reviews and develops its Agency Reform Plan in response to the Administration's government-wide reorganization efforts. The Agency continues to focus on identifying key positions and on recruiting, selecting, and developing a diverse and well-trained workforce.

The OIG has audits and evaluations planned to consider the impact of FCA governance and organization on Agency operations and will continue to identify potential audit work in this area.