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Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate

March 2002

FARM CREDIT ADMINISTRATION

Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved

GAO

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GAO-02-304

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Highlights

FARM CREDIT ADMINISTRATION Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved

Highlights of GAO-02-304, a report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate.

Why GAO Did This Study

Congress is concerned about the availability of credit to young, beginning, and small farmers (YBS). Because of this concern, GAO was asked to review the Farm Credit Administration's (FCA) oversight of the Farm Credit System's (System) compliance with its statutory requirement to serve YBS. GAO reviewed, among other things, a representative sample of 30 fiscal year 2001 FCA examinations of System institutions. GAO also identified characteristics of YBS programs at System institutions. GAO compared YBS program requirements and oversight to that of other regulators who oversee compliance with the special mission or service requirements of government-sponsored enterprises and banks.

What GAO Recommends

GAO recommends that the FCA Board

- promulgate a regulation that outlines specific activities and standards that constitute an acceptable program to implement the YBS statutory requirement,
- ensure that examiners fully execute and document examinations, and
- publicly disclose the results of individual YBS compliance examinations.

FCA agreed with the report findings and agreed to address the issues raised.

What GAO Found

FCA has issued policies and guidance that are consistent with the statutory mission to serve YBS and FCA's oversight responsibilities, and it has developed and relied on examination procedures to assess compliance with the mission requirement to serve YBS. FCA has not, however, promulgated a regulation with specific YBS program activities and standards it expects of System institutions. FCA's regulation restates the broad statutory requirement, which is open to interpretation and results in some System institutions taking no specific actions toward YBS. GAO identified weaknesses in FCA's 2001 examinations that limited the agency's ability to effectively oversee YBS mission compliance. Generally, these weaknesses were incomplete execution of examination procedures and incomplete documentation to support examination conclusions.

The FCA examination reports indicated that just over half of the institutions' YBS programs had features designed to target services specifically to YBS farmers. These features ranged from educational training programs to special loan underwriting standards. Most institutions coordinated with other governmental or private credit sources and nearly a third had established a measurable goal for YBS service. FCA has identified data for System institutions to use in assessing the extent of their YBS service, but the data are limited in important ways.

With the exception of FCA, other regulators with special mission or service requirements issued regulations with specific standards describing what constituted an acceptable program to comply with statutory special mission requirements or service obligations. FCA and all the other regulators monitored program compliance or performance through examinations or reviews and all required reporting. Unlike FCA, other regulators publicly disclosed information on the performance of individual institutions they regulate or required the regulated entities to do so, which could provide an incentive for institutions to improve their programs.

Illustrative YBS Program Activities

- Special underwriting standards, risk parameters, risk pools
- Educational training programs
- Marketing and outreach
- Numeric goals for YBS loans set by individual System institutions

This is a test for developing highlights for a GAO report. The full report, including GAO's objectives, scope, methodology, and analysis is available at www.gao.gov/cgi-bin/getrpt?GAO-02-304. For additional information about the report, contact Davi M. D'Agostino (202-512-8678). To provide comments on this test highlights, contact Keith Fultz (202-512-3200) or e-mail HighlightsTest@gao.gov.

Contents

Abbreviations

AHP	Affordable Housing Program
CIP	Community Investment Program
CRA	Community Reinvestment Act
FCA	Farm Credit Administration
FCC	Farm Credit Council
FCS	Farm Credit System
FHFB	Federal Housing Finance Board
FSA	Farm Service Agency
HUD	U.S. Department of Housing and Urban Development
USDA	U.S. Department of Agriculture
YBS	young, beginning, and small farmers

G A O

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

March 8, 2002

The Honorable Richard Lugar
Ranking Minority Member,
Committee on
Agriculture, Nutrition, and Forestry
United States Senate

Dear Senator Lugar:

This report responds to your request that we review the activities of the Farm Credit Administration (FCA), the regulator of the Farm Credit System (System), to help ensure the System's compliance with its statutory mission requirement to serve young, beginning, and small farmers (YBS).[1] The System is a government-sponsored enterprise (GSE)[2] created by Congress to provide a dependable and affordable source of credit and related services to the agricultural industry.

This report discusses (1) how FCA seeks to ensure that System institutions fulfill the YBS statutory mission, (2) the extent to which FCA examiners follow FCA requirements in conducting examinations for YBS compliance, (3) the characteristics of YBS programs at selected System institutions, and (4) how the requirements for System institutions to serve YBS compare to the special mission or service requirements of other GSEs and banks.

To address these objectives, we reviewed the Farm Credit Act of 1971, as amended, to identify statutory requirements for System institutions' service to YBS. We also reviewed FCA regulations implementing the YBS requirement and a variety of FCA documents that set forth YBS-related requirements for System institutions. In addition, we identified relevant FCA examination protocols for service to YBS. We also identified a

[1] FCA defines young borrowers as farmers, ranchers, or producers or harvesters of aquatic products who are age 35 or younger as of the loan transaction date and beginning borrowers as those who have 10 years or less farming or ranching experience as of the loan transaction date. Small borrowers are those who normally generate less than $250,000 in annual gross sales of agricultural or aquatic products.

[2] As used in this report, a GSE is a federally chartered, privately owned corporation established by Congress to provide a continuing source of credit nationwide to a specific economic sector.

representative sample of reports of examinations of System lending associations that FCA issued in fiscal year 2001. Using the reports in our sample and a data collection instrument, we evaluated examiners' compliance with FCA protocols. On the basis of our review of the examination reports and System banks' annual reports on YBS service, we identified the characteristics of YBS programs. Finally, we reviewed laws and other relevant regulatory documents to compare special mission or service requirements of other GSEs and banks to the System's YBS lending requirement.

We conducted our review from July 2001 through March 2002 in accordance with generally accepted government auditing standards. Appendix I contains a detailed description of the scope and methodology of our work.

Background

As of November 1, 2001, the System's nationwide network of lenders included

- Six Farm Credit Banks,
- One Agricultural Credit Bank,
- 114 associations of the Farm Credit Banks and Agricultural Credit Bank.

The entities within the System that make loans directly to farmers and ranchers are referred to as direct lending institutions—agricultural credit associations, federal land credit and production credit associations—the associations of the Farm Credit Banks. The Farm Credit Banks raise operating funds by selling Systemwide consolidated debt securities to investors. As of September 30, 2001, the System held approximately $99 billion in assets.

FCA is an independent regulatory agency responsible for supervising, regulating, and examining System institutions operating under the Farm Credit Act of 1971, as amended. As the System regulator, FCA is responsible for examining System institutions for safe and sound banking practices and compliance with applicable laws and regulations, including the special mission requirement of providing credit and related services to YBS. To fulfill this responsibility, FCA is to examine System institutions at least every 18 months. FCA provides guidance to System institutions through the issuance of regulations and other types of documents that set forth official policies.

The Farm Credit Act of 1971 was amended in 1980 to require System institutions to serve YBS. Regarding YBS, the act requires the Farm Credit Bank for each district[3] to

- annually obtain, from associations under its supervision, reports of activities under programs developed to serve YBS and
- on the basis of these reports, provide to FCA an annual report summarizing the operations and achievements in its district of programs developed to serve YBS.

The act requires direct lending associations to

- prepare a program for furnishing sound and constructive credit and related services to YBS and
- make YBS programs available in coordination with other governmental and private sources of credit.

Commercial banks and other private lenders serve as significant sources of credit to YBS, as do numerous other governmental sources of credit. The largest governmental source of coordination for the System is the Farm Service Agency (FSA), part of the U.S. Department of Agriculture (USDA), which supports YBS through its guaranteed loan and direct loan programs.

[3] System banks generally serve a specific geographic area or district.

FCA Has Issued YBS Policies and Guidance and Monitors Compliance through Examinations but Has Not Set Standards in Regulation

FCA has issued YBS-related policies and guidance, designed and implemented a YBS examination protocol, and examined System institutions for compliance with YBS requirements. However, FCA has not promulgated regulations to define standards and clarify what constitutes an acceptable YBS program. The existing regulation on YBS restates the broad statutory requirement and does not provide additional guidance or standards. FCA policies and guidance as of January 1, 2002, require each System bank to fulfill annual reporting requirements. The policies and guidance also require System institutions to adopt clearly stated policies for serving YBS and to develop and use a variety of management controls[4] over program operations to help ensure the effectiveness of their YBS programs. Among other things, FCA required System institutions to evaluate the performance of their YBS programs in part by using certain available data on YBS. However, FCA officials and others view the usefulness of these data as limited. According to FCA officials, the lack of quantitative data, along with other factors, makes it challenging for them to ensure System compliance in serving YBS. The protocol for YBS examinations includes a 10-step examination process that reflects YBS mission-related requirements set forth by the Farm Credit Act, as amended, and implemented by various FCA policies.

Current FCA Regulation Restates YBS Statutory Requirement

Following the 1980 enactment of the statutory provisions establishing the System's YBS service mission, the System experienced a financial crisis; and Congress mandated a number of reforms.[5] According to an FCA official that we interviewed, the agency's focus was concentrated for many years on safety and soundness issues because of the crisis. A regulation on YBS, issued in 1981 and amended in 1990, instructed the board of directors of each of the System's direct lender institutions to adopt policies to establish programs that would provide credit and related services to YBS.

[4] Management controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

[5] The System experienced severe financial stress in the mid-1980s, which led Congress to enact reforms to promote the System's safety and soundness, including changing the role of FCA to an independent "arms-length" regulator. We evaluated FCA as a regulator in 1994 and concluded that FCA's examination and monitoring of a selected sample of banks was generally comprehensive and addressed issues of safety and soundness. U.S. General Accounting Office, *Farm Credit System: Farm Credit Administration Effectively Addresses Identified Problems*, GAO/GGD-94-14 (Washington, D.C.: January 7, 1994).

The amended regulation essentially restates the statutory requirement—it does not provide specific guidance or standards for the YBS policies or programs to be established.

FCA Has Issued YBS Policies and Guidance

FCA became more focused on YBS issues in late 1998 when the FCA Board adopted a policy statement and general guidance in the form of a "bookletter." [6] In 1999, FCA's Office of Examination issued an informational memorandum that informed the System institutions that service to YBS would be one of four focus areas for examinations conducted during fiscal years 1999 and 2000.[7]

The 1998 FCA Board policy statement[8], issued on December 10, 1998, again, like the amended regulation, required the System institutions to adopt policies that establish programs to provide credit and related services to YBS borrowers. The policy statement also required the System institutions to establish certain management controls over YBS program operations. These were to include

- goals and objectives,[9]
- evaluation of the results of their YBS program, and
- risk parameters for YBS lending that are appropriate in relation to the institutions' risk-bearing capacity and their YBS program objectives.

The policy statement also encouraged System institutions to better serve YBS borrowers by developing innovative and sound programs, and taking better advantage of coordination opportunities with other parties, including guarantors, such as USDA and the Small Business Administration.

[6] Bookletters are communications from FCA to System institutions. Bookletters must be reviewed by the FCA Board before distribution, and they can transmit a policy adopted by FCA and clarify FCA positions or expectations regarding examinations.

[7] Informational memorandums are official communications from senior FCA officials to System institutions. They do not communicate agency policy, and they do not require review by the FCA Board, but they can provide information on revised examination criteria and procedures.

[8] Farm Credit Administration, *Farm Credit Service to Young, Beginning, and Small Farmers and Ranchers*, Policy Statement-75, December 10, 1998.

[9] Although the Farm Credit Act requires no specific targets for service to YBS, some System institutions establish their own goals, including numeric goals, for providing credit to YBS.

In coordination with the issuance of the policy statement, the Board also issued a bookletter on December 11, 1998, providing guidance for new reporting procedures related to serving YBS. According to the former chairman of FCA, these new procedures were the "culmination of a year long effort by FCA in coordination with System representatives to help the System fulfill its mission of service to YBS customers."[10] The bookletter affirmed FCA's commitment to examining System institutions for their service to YBS. The bookletter advised System institutions to have clearly stated policies for serving YBS and to include in the policies a description of how the programs would be coordinated with other System institutions and with governmental and private sources of credit, consistent with the statutory requirement. The bookletter further advised System institutions to

- set measurable goals, such as the dollar volume of aggregate YBS lending and the number of new and existing YBS served;
- provide specifically designed credit programs and service for YBS borrowers, including loan underwriting standards and the use of guarantees or other credit enhancements that can be conducted in a safe and sound manner;
- establish which program authorities are to be delegated to management and any authorities retained by the board of the institution; and
- detail outreach opportunities available from the institution or other sources.

The bookletter also provided guidance on revised definitions of YBS, as well as how institutions should define loans, categorize loans to YBS borrowers, and report on the number of loans. FCA provided a phase-in period that required System institutions to comply with these three reporting changes by January 1, 2001.

In April 1999, FCA's Office of Examination issued an informational memorandum informing associations that they should analyze the demographics of the territory they served to determine the potential YBS market. It suggested that associations should evaluate how well their lending programs service those markets by determining the market penetration for YBS categories. The memorandum further suggested that the data from the USDA Census of Agriculture might be helpful in

[10] Farm Credit Administration, *Policy and Reporting Changes for Young, Beginning, and Small Farmers and Ranchers Programs*, Bookletter-040, December 11, 1998.

conducting this demographic analysis. FCA senior officials told us that although they were asking System institutions to analyze the demographics of their territory using the USDA data, they understood that the usefulness of these data was limited. The data include the number of YBS living in a region, but not the number seeking or in need of credit. Officials from the FSA and the Economic Research Service, both within USDA, concurred that documenting the unmet credit needs of YBS is difficult.

According to FCA senior officials, FCA intends the market penetration determination to serve as a guide for a System institution in evaluating the adequacy of its service to YBS, but not to serve as a strict measure of success of the institution's YBS program. Moreover, FCA officials stated that year-to-year comparisons of an institution's service to YBS may be the best available indicators of the institution's performance in that regard, given the lack of meaningful data on the unmet credit needs of YBS.

As the result of a year-long effort in 1998, FCA officials created an examination "leadsheet," which is essentially a map for examiners to follow, as discussed in detail later in this report. According to FCA officials, some System institutions resist FCA monitoring for compliance with the special mission requirement to serve YBS. However, the director of the System's President's Planning Committee stated that most System institutions were making good-faith efforts to serve YBS and cooperating fully with FCA's examination efforts related to YBS.[11] Our interviews with institution officials generally supported the director's comments. Most institution officials said that they had no particular issues with FCA examination protocols for YBS. The director said that he wished FCA's examinations of YBS could be more focused. He also said that some parts of FCA's YBS examination should not be repeated every year, once FCA had established that an institution was in compliance in certain areas.

FCA Has Established YBS Reporting Policies

FCA has issued several memorandums to the System banks about their responsibilities to report on YBS activities, as required by the amended Farm Credit Act of 1971. A January 8, 2002, FCA memorandum required

[11] According to the director of the President's Planning Committee, this committee consists of a group of System representatives that comprises district bank presidents, and representatives from some of the larger System associations. The committee meets regularly to discuss policy issues for the System and represents the System's interests in various task forces.

banks to provide districtwide reports summarizing quantitative information about YBS business activity, including

- volume and number of all loans meeting YBS definitions and
- volume and number of new loans and number of new loans meeting YBS definitions.

The memorandum also required banks to provide a districtwide summary presenting qualitative data on YBS business activity, including narrative that describes any districtwide YBS initiatives. FCA uses those reports to compile Systemwide information for its publicly available annual report to the Congress, according to FCA officials.

Each System bank is required to submit its 2001 YBS report to FCA by February 28, 2002. The banks are to collect qualitative data on the YBS efforts of each of the associations in their respective districts. FCA provides a questionnaire for the banks' use in collecting the qualitative data from the associations. This survey focuses on program management, credit components and noncredit components, and outreach activities. The program management components section of the survey includes questions on whether the institution has established performance targets or goals for their service to YBS. It also asks about the market penetration of the institution's service to YBS. The credit component section includes questions about the existence of special underwriting standards and the types and extent of coordination with other governmental or private sources of credit. The last section of the survey includes questions on the types of training or services offered by the institutions, as well as the types of outreach activities for YBS at the institutions.

FCA Sees Challenges to Ensuring System Compliance with Serving YBS

FCA officials told us that they feel challenged to enforce YBS-related policies and procedures. They cited the broad nature of the YBS statutory provision, which is repeated in the FCA's regulation; limitations of available data on unmet credit needs; and resistance from some System institutions as concerns (as described later in this report). However, the officials also acknowledged that FCA has adequate authority as a regulator to promulgate specific standards to implement the YBS statutory provision and to use its enforcement powers if needed to ensure compliance. According to FCA officials, the current practice has been to avoid requiring institutions to take specific actions to address issues in YBS program performance that arise in the course of compliance examinations.[12] Instead, in 1998 to 2001—which officials termed as a period of evolution for the programs and FCA oversight—FCA encouraged institutions to further develop and improve their initiatives and programs to serve YBS through policies, guidance, and the examination program.

A broad regulation, such as the current FCA regulation on YBS, is open to broad interpretation. FCA's expectations for YBS program elements and performance are unclear in the current language of the regulation. Alternatively, regulation that provides specific guidance or standards for YBS programs would afford FCA and System institutions greater certainty about what is appropriate and adequate for YBS programs. Regulations are legally enforceable by FCA and, under the Administrative Procedure Act, are subject to a process of public notice and comment. Such a process would facilitate review and input from the institutions regulated and other parties affected by the regulation—including YBS in this instance. As we will discuss later in this report, other regulators, operating under both specific and broad statutes, have promulgated regulations with standards for fulfilling their statutory special mission or service requirements.

[12] In general, according to FCA policy and on the basis of our discussions with FCA officials, when an FCA examiner identifies a compliance problem, FCA is to respond in several ways, depending on the circumstances. First, an examiner identifies a violation of YBS compliance—for example, the lack of an institution board policy. FCA may cite the violation in an examination report and require the institution to take specific corrective action, such as requiring that the board adopt a policy for YBS within 60 days. If the institution fails to take corrective action, the FCA can institute a formal enforcement action to obtain a cease and desist order or civil money penalties.

FCA Office of Examination Formalized Oversight of YBS through Creation of Examination Leadsheet

As shown in figure 1, the leadsheet itemizes 10 steps for examiners to follow in evaluating an institution's YBS mission compliance. Each of the steps may involve a number of procedures for example, the first step involves three procedures. As stated in the FCA Examination Manual, examiners are to summarize pertinent information gathered during examination work; these tasks are often best achieved through a leadsheet. According to FCA officials, leadsheets have been used successfully in other examination segments. The leadsheet is available electronically and may be used to create an electronic workpaper record of the examination. The Examination Manual states that the extent of workpaper documentation should vary, depending on factors such as examination scope, risk present in the institution, and experience level of examiners. At a minimum, according to the Examination Manual, workpapers should demonstrate completion of each examination objective and substantiate all conclusions reached in the Report of Examination. When an examination is completed, the examiner is to write the report of examination, which is to be provided to the examined institution. A meeting for discussion of the examination findings may also be held with officials of the examined institution.

Figure 1: YBS Examination Steps, as Provided by the YBS Examination Leadsheet

1. Determine if the institution had clearly stated YBS policy, numeric goals for serving YBS, and if the board of the institution is receiving periodic reporting on service to YBS and is evaluating the results of these programs.
2. Determine what specific programs or service are in place to serve YBS and the soundness of those programs. Determine if the programs have been adjusted based on results of demographic studies and related portfolio and territorial analysis.
3. Determine if the institution uses special loan underwriting standards, risk parameters, or risk pools for extending credit to YBS market segments.
4. Determine to what extent the institution is using its Web site, Internet, advertising, etc. to reach YBS.
5. Determine if demographic studies have been completed and analyzed for the lending area and the loan portfolio and what plans or strategies have been developed to address disparities, if any.
6. Determine to what extent the institution coordinated with federal, state, or other governmental or private credit sources to service YBS, such as loan guarantee programs or joint lending or credit enhancements to ensure safe and sound extensions of credit.
7. Evaluate and test the institution's processes and internal controls over verifying the designation of YBS, the accuracy of the institution's database, and the quality of reporting to the board and FCA in accordance with FCA's program definitions.
8. Complete a chart or graph to analyze the market, current market penetration, trends and overall program effectiveness. Make conclusions on the effectiveness of program administration and participation and select an appropriate chart or graph for use in the report of examination.
9. Complete a Summary Conclusions Table and make conclusions on the overall results and effectiveness of program administration.
10. Develop report-ready overall conclusions on the institution's administration and reporting of its YBS lending programs and its effectiveness in meeting the credit needs of these market segments within its industry.

Source: FCA Examination Leadsheet for YBS.

Properly Executed, YBS Leadsheet Should Provide Useful Information to FCA

As a result of our analysis, we found the examination leadsheet for YBS to be a useful tool for FCA in examining institutions for compliance with the special mission requirement of serving YBS. If properly executed, the examination process set up by FCA, including the use of the leadsheet, should provide FCA with useful information on a System institution's service to YBS.

In analyzing the leadsheet, we traced each of the procedures in each of the steps to requirements of the Farm Credit Act and FCA regulation, policy, and guidance. For example, we noted that in completing the first procedure in step 2 and the procedure in step 6, examiners would be determining the institution's extent of compliance with explicit statutory YBS requirements. For this reason, we refer to these as *examination procedures for statutory compliance*. We found that the procedures in steps 1 to 7 otherwise focus on (1) determining if the institution has in place FCA-required management controls over program operations, (2) evaluating those controls, or (3) determining if the YBS program is sound and whether it is meeting its stated objectives. We refer to these as *examination procedures for regulatory compliance*. Steps 8, 9, and 10 are procedures intended to help the examiner accurately summarize conclusions and develop report-ready conclusions on the institution's service to YBS. We refer to these as *administrative examination procedures*.

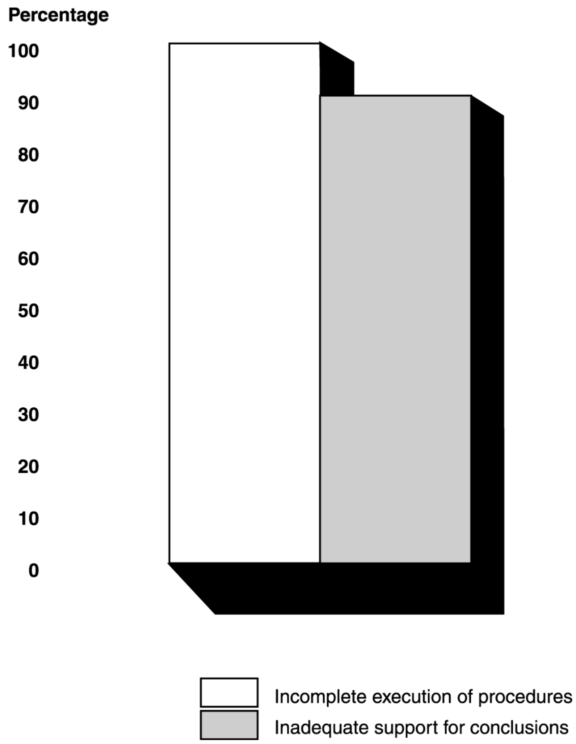
Weaknesses in Examinations for YBS Compliance Limited FCA's Ability to Effectively Oversee Institutions' YBS Programs

In our review of a representative sample of 30 recent FCA reports of examinations issued in fiscal year 2001, we found weaknesses that limited FCA's ability to effectively oversee YBS programs. Generally, these weaknesses can be described as not fully following examination procedures and not completely documenting examination conclusions. FCA senior officials said that examiners may not have followed examination procedures because they used a risk-based approach in determining the scope of their examination, did not have time due to limited resources, or met with resistance from System institution officials.

Examiners Usually Did Not Complete All Examination Steps

As shown in figure 2, of the 30 examinations reports we reviewed, none had completely executed all examination procedures, and 27 (90 percent) had inadequate support for conclusions. As shown in figure 3, as a result of our analysis of the extent of completion of examination procedures for statutory compliance, we found that in 29 reports (97 percent), the examiner completed the first examination procedure for statutory compliance, which required examiners to determine what specific programs or service are in place to serve YBS. However, only 12 reports (40 percent) showed completion of the second examination procedure for statutory compliance, which requires the examiner to determine the extent to which the institution coordinated with federal, state, or other governmental or private credit sources.[13]

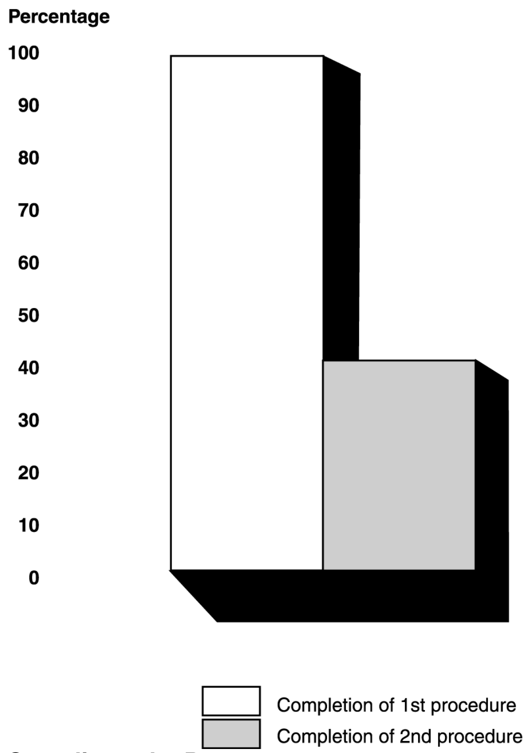
Figure 2: Percent of Weaknesses in FCA's Examinations of System Institutions



Source: GAO analysis.

[13] We found incomplete responses in 13 of the examination reports; no response in 4 reports; and in 1 report, the examiner noted that the procedure was not applicable.

Figure 3: Extent of Completion of Examination Procedures for Statutory



Compliance by Percent

Source: GAO analysis.

In further analyzing the incompleteness of the reports, we found at least a third of the reports had no review of 7 (54 percent) of the 13 examination procedures for regulatory compliance. The procedures concerning regulatory compliance that were most frequently not completed included

- evaluation of the quality of reporting to the board and FCA in accordance with FCA's program definitions (80 percent of examinations),
- determination of whether the program is accomplishing its objectives for reaching YBS (53 percent of examinations), and
- determination that the program has been adjusted on the basis of results of demographic studies and related portfolio and territorial analysis (47 percent of examinations).

The procedures that were most consistently completed included determining if an institution used special underwriting standards or risk pools for extending credit to YBS, and determining if an institution conducted a demographic study of its service to YBS.

In our view, the number of examination procedures for regulatory compliance that were not completed in a substantial number of instances indicates improvements are needed in FCA oversight to better ensure the effectiveness and efficiency of System operations related to YBS programs.

Examiners Did Not Provide Supporting Examination Workpapers

In the 30 examination reports we reviewed, we found that examination workpapers often did not include documentary support for findings. In nine reports we reviewed (30 percent), examiners concluded that regular reporting to the institution's Board of Directors had occurred, but the workpapers provided no documentation to support that finding. In 21 of the reports (70 percent), examiners either relied exclusively on interviews with association officials or provided no workpapers to support findings related to data quality.

The data quality findings that lacked support were those corresponding to item seven of the leadsheet, which focuses on evaluating and testing the institution's processes and internal controls for verifying (1) the designation of YBS, (2) the accuracy of the institution's database, and (3) the quality of the reporting to the board. Inadequate evaluation of the management controls for classifying loans to YBS and accurately reporting to the board undermines FCA's ability to help ensure the effectiveness and efficiency of System operations related to YBS programs. FCA's efforts in this area are particularly important, in that accurately reporting on the number of loans made to YBS directly relates to the usefulness of any market penetration studies of YBS, and comparisons of service to YBS from one year to the next.

The examiners' inadequate supporting documentation raises questions about the credibility of their conclusions and the quality of evaluations. For example, in the examination workpapers of one institution, an examiner concluded, on one hand, that the association's designation of YBS in its database was inaccurate but, on the other hand, that the association had processes to ensure that YBS loans were appropriately designated in the database. The workpapers provided no supporting documentation for either of these conclusions. In three examination reports, we found that the only support provided for a finding that YBS-related definitions and database systems were accurate were statements that the institutions' chief of operations or chief executive officer had said this in an interview. Professional standards do not support testimonial evidence from the auditee as sufficient support for the finding.

FCA Senior Officials Said Examiners May Not Have Followed All Examination Procedures for a Number of Reasons

FCA senior officials offered several explanations for incomplete execution of procedures in YBS examinations. Primarily, they said that some examiners may have exercised a risk-based approach to YBS examinations, which would lead examiners to focus selectively on operations that are most important in their material impact on the extent of service to YBS. We recognize that a risk-based approach can be appropriate and useful for regulators. However, we question whether a risk-based approach to the YBS compliance examination would have been appropriate in 2001, the first full year of FCA's expanded examinations for YBS compliance. Examiners need to establish a baseline of knowledge about an institution's YBS efforts before deciding where to focus an examination effort.

FCA senior officials also noted that examiners may not have been able to complete all examination steps due to limited time and resources. They also stated that examiners encountered resistance from some System institutions during the YBS portion of the examination. According to these officials, examiners would not typically document such resistance in examination workpapers. Regarding constraints on examinations imposed by limited time and resources or by some System officials' resistance, we note that professional standards require examiners to report such constraints to avoid misunderstandings concerning the work that was and was not done to achieve the examination objectives. However, in our review of examiners' workpapers, we found no explanations for examination procedures that were not executed.

System Efforts to Serve YBS Varied

The sample of examination reports we reviewed indicated that the characteristics of YBS programs at institutions in the System varied significantly (e.g., the program activities shown in fig. 4).[14] Slightly more than half had some type of specific YBS program or service in place. Nearly a third of the institutions in the sample had established some type of numerical goal for YBS service, although most institutions were not conducting demographic studies. Half had YBS marketing and outreach efforts in place and a majority were coordinating their YBS offerings with federal, state, or other governmental or private credit sources, as required by the Farm Credit Act. Most commonly, System institutions coordinated with the Farm Service Agency (FSA) Guaranteed Farm Loan program. All of the System institutions support YBS activities through the Farm Credit

[14] We did not independently verify the existence of YBS programs at System institutions.

System Foundation (Foundation), which was formed in 1991 with contributions from System banks. In fiscal year 2000, the System provided billions of dollars in loans to YBS, according to annual reports that the System banks submitted to FCA.

Figure 4: Illustrative YBS Program Activities

Illustrative YBS Program Activities

- Special underwriting standards, risk parameters, risk pools
- Educational training programs
- Marketing and outreach
- Numeric goals for YBS loans set by individual System institutions

Source: GAO analysis.

Slightly More Than Half of the Institutions Had Some Type of Specific YBS Program or Service

FCA examination reports indicated that although all of the institutions had a policy statement for serving YBS, slightly more than half of the institutions (16) had some type of specific program or service in place to serve these groups. Specific programs included special underwriting standards, targeted educational training, and outreach programs to attract YBS. For example, one institution offered loans to individuals in which it waived the coverage ratio of greater than 125 percent, and borrowers with limited equity as low as 20 percent may be considered.[15] Another institution offered the New Generation Loan Program, which provided reduced interest-rate spreads for the first 5 years and underwriting standards to accommodate the financial needs of YBS loan applicants. Some other institutions, though, did not use any special loan underwriting standards, risk parameters, or risk pools for extending credit to YBS

[15] A coverage ratio is determined by dividing a lender's projected net income by the costs of loan debt service. This ratio should be over 1 because it means the property is generating enough income to pay its debt obligations. In the eyes of the lender, the higher the coverage ratio, and therefore the more net operating income from which the owner can make debt service payments, and the lesser the loan risk, the greater the cash flow to the owner.

market segments. YBS borrowers were generally required to meet the same underwriting standards as other applicants, although in some cases exceptions were permitted.

Nearly a Third of the System Institutions Had Some Type of Numeric Goals for Their Service to YBS

Of the 30 institutions' examinations we reviewed, 9 had measurable goals for their service to YBS. System institutions established measurable goals in different ways. One institution incorporated lending to YBS as a key performance area. Managers at this institution would earn higher ratings as the volume of new YBS lending increased. Another institution included in their business plan a goal for YBS lending of 5 percent of the volume of new loans. A third institution set a goal of 20 percent of outstanding loans to young farmers and 20 percent of outstanding loans to beginning farmers, by number and volume.

Half of the Institutions Have Made Marketing and Outreach Efforts

According to FCA examinations that we reviewed, System institutions have made a variety of efforts to market credit opportunities to YBS. They have utilized Web sites with specific links to special YBS programs, met with Young Farmer chapters, offered educational programs, and used radio and television advertisements. Eleven of the institutions in our sample had no formal marketing or outreach efforts to YBS.[16]

Farm Service Administration Loan Guarantees Represented System Institutions' Most Significant Coordination Efforts

Most of the institutions in our review coordinated with federal, state, or other governmental or private credit sources to provide credit to YBS, as explicitly required by the Farm Credit Act. Most commonly, System institutions coordinated with the FSA Loan Guarantee program. FSA will guarantee loans made by the Farm Credit System and other conventional lenders in amounts up to 95 percent of the principal loan amount. FSA is required by law to target 25 percent of its guarantees for farm ownership loans to beginning farmers. Similarly, 40 percent of its guarantees for farmoperating loans must be targeted to beginning farmers. Beginning farmers are generally defined as farmers or ranchers who have not operated a farm or ranch for more than 10 years, and who will substantially participate in the operation of the farm or ranch.

[16] It was not clear from the examination workpapers whether or not four institutions had marketing or outreach efforts to YBS.

The extent of use of FSA loan guarantees by System institutions varied. According to our review of examinations, one institution reported 334 loans to YBS, totaling over $26 million, with outstanding FSA guarantees. Another institution had FSA guaranteed loans to 32 YBS borrowers, for a total of $2.3 million. This represented 74 percent of the total number of guaranteed loans made by the institution and 78 percent of the dollar volume. One institution was reportedly the largest user of FSA-guaranteed loans in the state, with 377 borrowers and $42 million in such loans. For this institution, FSA-guaranteed loans to YBS represented 80 percent of the total number of its FSA-guaranteed loans and 75 percent of the dollar volume of its FSA guaranteed loans. Other institutions, however, made far less use of the FSA loan guarantees. According to the results of a special review by one institution's management group, only 8.8 percent of the loans reviewed at that institution had an FSA guarantee.

System Associations Support Programs for YBS

System institutions also support YBS activities through the Farm Credit System Foundation (Foundation), which grew out of the Farm Credit Council, the System's trade group. The Foundation's mission is to help YBS and ranchers to thrive. The Foundation was formed in 1991 with contributions from System banks. The director of the Foundation told us that its ongoing activities include sponsoring organizations with programs that benefit agriculture's youth and provide development opportunities for those pursuing a career in agriculture. For example, the Foundation provides financial support and or scholarships for agriculture-related training that is provided by groups like the Future Farmers of America, 4-H Clubs, and the Progressive Farmer Foundation. It also sponsors research on issues important to YBS farmers. A "major step" for the Foundation, according to the director, has been an Internet-based survey of YBS conducted in 2001. The survey was designed to obtain information about the credit needs of YBS, their experiences obtaining credit, and other issues. The director told us that he expected a final report, titled Barriers to Success, to be available in 2002 and that it may include policy options for improving access to credit for YBS.

The System Provided Billions of Dollars in Loans to YBS in Fiscal Year 2000

The amended Farm Credit Act of 1971 requires Farm Credit banks for each district to submit to FCA reports of activities under programs developed to serve YBS for the associations under their supervision. The act also requires that an annual report summarizing the operations and achievements in its district for these programs be submitted to FCA.

According to YBS reports that were submitted to FCA for fiscal year 2000,[17] the associations made close to $3 billion in loans to beginning farmers and ranchers in fiscal year 2000, approximately $2 billion in loans to young farmers and ranchers, and nearly $5 billion in loans to small farmers and ranchers.[18] In the annual reports, some of the banks reported that they did very little to sponsor YBS activities in their district and deferred to their associations for these activities. Other banks reported having jointly sponsored YBS initiatives with their associations, as well as having supported individual state programs. Some of the types of activities sponsored by banks included state cooperative councils, and the National Young Farmer Education Institute.

The System's Special Mission Requirements Are Less Specific Than Those of Housing GSEs

Like the System, the housing GSEs—the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac),[19] and the Federal Home Loan Bank System (FHLBank System)[20]—were created by Congress to provide a continuing source of credit nationwide to a specific economic sector. However, the special mission obligations of the GSEs, with the exception of the YBS obligation of the System and the Community Investment Program (CIP) obligation of the FHLBank System, are established by statutory language that includes measurable numeric goals or requirements or establishes a goal-setting mechanism. Without measurable goals or specific qualitative standards to help define compliance with mission requirements, System institutions

[17] YBS reports for fiscal year 2001 were not yet available at the time of our review.

[18] FCA officials told us that they review the quantitative data submitted by the System banks to identify any obvious mistakes, and they discuss any inconsistencies with the banks.

The totals for loans provided to YBS are not mutually exclusive, and depending on characteristics, a borrower may be counted in two or even all three categories.

[19] Fannie Mae and Freddie Mac buy mortgages from a variety of institutions that lend money directly to home buyers such as mortgage companies, banks, and credit unions. They retain some mortgages in portfolios and pool others to create mortgage-backed securities (MBS) that are sold to investors in the secondary mortgage market. They raise money to purchase mortgage assets by selling bonds and MBS to investors throughout the world.

[20] The FHLBank System raises the money it uses to lend to members (advances) in three ways: by issuing bonds known as consolidated obligations (CO), by accepting deposits from member institutions, and by selling capital stock to members. The FHLBank System members (commercial banks, savings institutions, credit unions, and insurance companies) may use advances generally to support home mortgages, small business, community development, and agricultural loans.

and FCA face challenges similar to those faced by banks and thrifts and their regulators in connection with their obligations under the Community Reinvestment Act (CRA) of 1977. CRA requires regulators of banks and thrifts to encourage those financial institutions to help meet credit needs in all areas of the communities they serve—including low- and moderate-income areas, consistent with safe and sound operations. Neither the CRA nor CIP requirements set numeric goals or provide a goal-setting mechanism. Regulators who oversee compliance with CRA and CIP, however, make an overall assessment about the regulated entities' performance efforts. In addition, those regulators publicly disclose their assessment and/or make information available about the performance of individual entities that they regulate.

Housing GSE's Have More Specific Special Mission Requirements than System

As part of our review, we compared the System's YBS mission requirements to special mission requirements of other GSEs—specifically, the housing GSEs, Fannie Mae, Freddie Mac, and the FHLBank System. We found that the GSEs generally operated under statutory language that provides numeric goals or requirements or a goal-setting mechanism, as shown in table 1. The exceptions to this included the YBS service obligation of the System and the obligation of the FHLBank System to establish a Community Investment Program.

Table 1: Comparison of GSE Statutory Missions and Special Mission Requirements

GSE	Statutory mission	Special statutory mission requirements
Fannie Mae and Freddie Mac	To provide stability, increase liquidity, and improve the distribution of capital in housing credit markets.	The U.S. Department of Housing and Urban Development is required to establish regulatory numeric goals for these GSEs to meet in purchasing mortgages serving targeted groups, including low- and moderate-income borrowers.
Farm Credit System	To provide a dependable and affordable source of credit and related services to the agricultural industry.	Each association is to prepare a program for furnishing sound and constructive credit and related services to YBS borrowers and make YBS programs available in coordination with other governmental and private sources of credit. Reports of program activities and progress toward objectives are to be made to the regulator.
FHLBank System	To extend mortgage credit by making loans, called advances, to its member institutions who in turn may use such advances to support home mortgages, small business, community development and agricultural loans.	Each FHLBank is required, under the Affordable Housing Program (AHP) to provide subsidized advances to members to support the financing of housing for low- or moderate-income households. Each FHLBank is required generally to contribute annually to the AHP 10 percent of its net earnings or its prorata share of a FHLBank Systemwide aggregate of $100 million. Each FHLBank is also required to establish a Community Investment Program to provide advances at cost plus administrative fees to members to support the financing of housing and economic development activities that benefit low- and moderate-income households and neighborhoods.

Source: GAO analysis of GSE documents and statutes.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 required the secretary of Housing and Urban Development to issue regulations to establish, monitor, and enforce housing goals for Fannie Mae and Freddie Mac. The act mandated that the secretary establish targeted goals for low- and moderate-income mortgage purchases as well as mortgage purchases for very-low income families and low-income families living in low-income areas and mortgages on housing in geographically underserved areas. After an interim period in 1993 to 1995, during which time goals were set by Congress, the secretary published a regulation in 1995 that established new goals effective in 1996. By subsequent regulation dated October 2000, the secretary raised the goal levels effective in 2001. The goals are to be based on six factors, including the ability of the GSEs to lead the industry in making mortgage credit available for very-low, low- and moderate-income families, and families living in underserved areas.

The FHLBank System's special mission requirements, found in statute, include the requirement that FHLBanks make specified annual contributions of earnings to the AHP, and the CIP requirement, which does not mandate any specific quantitative requirements or goals. An additional statutory provision authorizes but does not require the FHLBanks to offer additional Community Investment Cash Advance (CICA) programs, and does not mandate any specific quantitative requirements or goals for such programs. The FHLBanks' regulator, the Federal Housing Finance Board, has promulgated regulations implementing all three statutory provisions.

The System's YBS Mission Requirement Creates Challenges Similar to Those Created by CRA

In certain respects, the challenge that FCA faces in overseeing the System's compliance with its statutory YBS mission requirement is similar to the challenge that bank and thrift regulators[21] face in assessing CRA compliance for banks and thrifts. Enacted in 1977, CRA requires these regulators to encourage banks and thrifts to help meet credit needs in all areas of the communities they serve—including low- and moderate-income areas—consistent with safe and sound operations. Without specifying a credit allocation goal or any mechanism to set such a goal, CRA also requires the regulators to assess institutions' CRA performance during examinations, taking into account an institution's individual circumstances. Bank and thrift regulators also are to take an institution's

[21] These regulators include the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

CRA performance into account when approving applications for, among other things, mergers of bank and thrift organizations.

In implementing CRA, bank and thrift regulators have been challenged to find an effective approach, as evidenced by the many concerns expressed by banks and thrifts over the years and repeated major revisions of the CRA examination procedures. For example, in a broad 1993 review of issues identified in many studies of bank regulation and its effects on the banking industry, we found that bankers expressed more concern about the burden associated with CRA than about any other single area of bank regulation. One of the many specific concerns of bankers, we reported then, was that the vagueness of the statute and the subjectivity of the examination process made compliance difficult. [22]

The current CRA regulations (which are now being reviewed for possible revision to improve the efficacy of the regulations) provide several approaches, based in part on lender size, that lenders can use to illustrate their compliance with CRA regulations. Large retail institutions can opt to be assessed by their regulator with regard to their lending record, investments in community development activities, and systems for delivering retail banking services. Another option allows banks to develop a strategic plan detailing how the bank proposes to meet its CRA obligations. The institution tailors the plan to the needs of the community by informally seeking suggestions from the public during plan development. Once the plan is developed, the institution must publish notice of the plan and solicit written public comment for at least 30 days. After the comment period, the institution is to submit the plan to its regulator for review and approval. Small institutions (not over $250 million in aggregate assets or if affiliated with a holding company, with total assets of less than $1 billion) are evaluated under a streamlined test that focuses primarily on lending.

[22] U.S. General Accounting Office, *Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives*, GAO/GGD-94-28 (Washington, D.C.: December 13, 1993).

All Regulators, Except FCA, Issued Regulations for Special Mission Requirements and Disclose or Require Disclosure of Information on Performance of the Individual Regulated Institutions

In reviewing FCA's oversight of the special mission to service YBS borrowers, we compared their efforts with those of other regulators responsible for overseeing special mission or service obligations: the Department of Housing and Urban Development (HUD), the mission regulator of Fannie Mae and Freddie Mac;[23] the Federal Housing Finance Board (FHFB), the regulator and supervisor of the FHLBank System; and bank and thrift regulators. All of the regulators conducted some type of periodic examination or review of performance and required periodic reporting on program status. All of the regulators except FCA had issued regulations with specific standards describing what constituted an acceptable program and/or setting quantifiable goals. In addition, all of the regulators except FCA publicly disclosed information about the special mission or service obligation performance of individual institutions, or required the regulated entities to do so.

Oversight obligations of each regulator are described as follows:

- FCA, as discussed earlier, issues policy and guidance and conducts periodic examinations that include reviews of System institutions' compliance with YBS requirements. FCA collects information from System banks about YBS programs and reports on YBS programs, in aggregate form, in its annual report to the Congress.
- HUD has statutory authority to obtain the necessary data from Fannie Mae and Freddie Mac for monitoring their compliance with the goals HUD sets. According to a HUD official, HUD has a number of procedures in place to assess the data supplied by Fannie Mae and Freddie Mac.[24] Analyses of Fannie Mae's and Freddie Mac's performance, based on the GSE's data, are periodically published in HUD reports. HUD also releases annually a public-use database containing the nonpropietary portions of the data. According to HUD officials, analyses of data submitted by each GSE under HUD's final rule, effective for 1996 through 2000, showed that both GSEs achieved their housing goals during this period.

[23] The Federal Housing Enterprises Financial Safety and Soundness Act gave HUD general regulatory authority over Fannie Mae and Freddie Mac in all areas other than the GSEs' safety and soundness. This same act also created the Office of Federal Housing Enterprise Oversight, an independent office within HUD, which has authority exclusive of the secretary, with regard to the GSE's financial safety and soundness.

[24] We recommended in a 1998 report that HUD develop a program to assess the data. See U.S. General Accounting Office, *Federal Housing Enterprises: HUD's Mission Oversight Needs to Be Strengthened*, GAO/GGD-98-173 (Washington, D.C.: July 28, 1998).

- FHFB, as required by law, promulgated regulations that, among other things, specify eligible program activities and establish uniform standards for subsidized advances to finance homeownership and affordable rental housing for low- or moderate-income families under the Affordable Housing Programs (AHP). The law required each FHLBank to establish an advisory council to advise the FHLBank on the AHP. Through regulation, FHFB required each FHLBank to adopt a written AHP implementation plan and have its advisory council review the plan. Each FHLBank reports annually to the FHFB, which conducts compliance reviews of each AHP, and reports on the AHP to the Congress annually. FHFB also publicizes actions that FHLBanks take under their programs, as do the FHLBanks themselves.

  The law does not require the FHLBanks to make a specified contribution of funds to the required CIP. Through regulation, however, FHFB, has set standards for assessing FHLBanks' compliance with CIP requirement. For example, the regulation authorizes the FHLBanks to provide CIP advances to members for, among other things, funding loan originations and purchasing mortgage revenue bonds, as long as the loans financed by such bonds meet CIP-eligibility requirements. CIP advances generally are made available at cost plus administrative fees to FHLBank members (banks, thrifts, credit unions, and insurance companies) which, in turn, make loans for CIP-eligible purposes.

  The law also authorizes FHLBanks to offer CICA programs in addition to their CIP and AHP programs. FHFB issued regulations to provide the FHLBanks with an array of specific standards for housing and economic development projects, targeted beneficiaries, and targeted income levels that the FHFB determined support community lending under CICA programs. While CICA programs are optional for the FHLBanks, the FHFB determined that establishing clear and specific CICA standards would be more likely to increase economic development activities in targeted communities; and they would also make CICA programs easier to implement and monitor.

  Bank and thrift regulators, as noted previously, conduct periodic on-site examinations that include assessments of CRA performance. CRA compliance reports and performance ratings are released publicly and are available on the Internet sites of the bank and thrift regulators as well as a centralized Internet site.[25] In reviewing Bank Holding Company merger and other applications, regulators have a statutory responsibility, established by the Bank Holding Company Act of 1956 and CRA to take into account an institution's record of community credit performance when evaluating the application. Regulators also have similar responsibilities under the Gramm-Leach-Bliley Act of 1999 when considering bank permission to engage in activities newly authorized under the act. However, CRA does not provide regulators with enforcement authority on the basis of their compliance examination findings.

Conclusions

As the regulator of the System, FCA is to ensure that the System appropriately fulfills its statutory mission requirements, including the requirement to serve YBS. The guidance that FCA has issued represents a constructive effort to direct System institutions to comply with the YBS mission requirement and set general standards to use in examining compliance. FCA has issued a regulation on YBS, but it essentially restates the statutory provision and does not provide the level of detailed guidance found in the applicable FCA Board policy statement, bookletter, and informational memorandums. FCA's efforts to guide System institutions in establishing and implementing meaningful, result-oriented YBS programs, and clarify its expectations for System performance would be strengthened by setting clear, qualitative standards in regulation. Given the challenge of identifying any unmet need for credit to YBS and the limited data on YBS, it would seem appropriate for FCA to focus on qualitative rather than quantitative standards. For example, such standards could include requiring System institutions to establish or participate in educational and community outreach programs for YBS and to use FSA guarantees where appropriate. In addition, clear standards set forth in regulation would facilitate FCA's ability to render an overall assessment of each System institutions' performance in complying with the mission to serve YBS.

As a result of our analysis of FCA reports of examination for YBS compliance, we found weaknesses due to incomplete execution of examination of procedures and incomplete documentation to support examination findings. These weaknesses impair FCA's ability to oversee System compliance in meeting the mission requirement of serving YBS.

[25] The statute provides for both a public and a confidential section to protect the privacy of individuals.

The System mission to serve YBS is more like the CRA requirement imposed on banks and thrifts and the CIP requirement imposed on FHLBanks than the special requirements for affordable housing set for Fannie Mae, Freddie Mac, and the FHLBanks. Regulators who oversee compliance with CRA and CIP, however, make an overall assessment about the regulated entities' performance efforts. In addition, those regulators publicly disclose their assessment and/or make information available about the performance of individual entities that they regulate, or require that the entities do so. Such disclosure can afford an incentive for the entities to better their performance while providing privacy for individuals. In contrast, FCA does not disclose the results of its assessments of individual System institutions' performance in serving YBS. FCA does disclose information on System service to YBS, but only in aggregate form.

Both FCA and the System itself have taken steps to promote service to YBS and to attempt to measure that service. Clear program expectations and standards set in regulation, thoroughly complete and well-documented examination reports, and disclosure of the performance of System institutions would enhance FCA's oversight and support the System's efforts to govern itself in achieving its special mission to serve YBS.

Recommendations

To strengthen FCA in its oversight role of the System, promote compliance, and highlight the System's efforts to provide service to YBS, we recommend that the FCA Board

- promulgate a regulation that outlines specific activities and standards that constitute an acceptable program to implement the YBS statutory requirement;
- ensure that examiners follow the guidance and complete the appropriate examination procedures related to YBS, and adequately document the work performed and conclusions drawn during examinations; and
- publicly disclose the results of the examinations for YBS compliance for individual System institutions.

Agency Comments

We provided FCA a draft of this report for their review and comment. FCA agreed with the information presented in the draft report and agreed to address the issues we raised. FCA's letter is reprinted in appendix II. FCA provided technical clarifications, which we have incorporated into this report where appropriate.

We are sending copies of this report to the chairman of the Senate Committee on Agriculture, Nutrition, and Forestry; the chairmen and ranking minority members of the Senate Committee on Banking, Housing, and Urban, Affairs; the House Committee on Financial Services; the House Committee on Agriculture; and the chairman and chief executive officer of the Farm Credit Administration. The report will be available on GAO's Internet home page at http://www.gao.gov.

If you have any questions about this report, please contact me or M. Kay Harris at (202) 512-8678. Andy Pauline and Desiree Whipple were major contributors to this report.

Sincerely yours,

Davi M. D'Agostino

Davi M. D'Agostino
Director
Financial Markets and Community Investment

Appendix I: Scope and Methodology

As agreed with our requestor, the objectives of this report were to study (1) how the Farm Credit Administration (FCA) seeks to ensure that requirements for the Farm Credit System (System) institutions fulfill the mission of serving young, beginning, and small farmers (YBS); (2) the extent to which FCA examinations follow FCA requirements in evaluating System compliance in serving YBS; (3) the characteristics of YBS programs at selected System institutions; and (4) how the requirements for System institutions to serve YBS compare to the special mission or service requirements of other government-sponsored enterprises and banks.

To study FCA's requirements for the System to fulfill the mission of serving YBS, we reviewed the Farm Credit Act of 1971, as amended, to identify requirements for the System institutions' service to YBS. We reviewed FCA's regulations implementing the YBS requirement, its examination program, including the Examination Manual, policies, bookletters, and informational memorandums. We compared FCA's requirements with provisions of the act. We interviewed officials from FCA, System institutions, the System's President's Planning Council, the System's Farm Credit Foundation, and the Farm Credit Council to obtain their views on the requirements and FCA's interpretations. We also interviewed officials of the U.S. Department of Agriculture's Economic Research Service and Farm Service Agency, regarding agricultural credit and special programs to serve YBS.

To study the extent to which FCA examiners followed FCA requirements in evaluating System compliance in serving YBS, we analyzed selected examinations and compared them with FCA's own examination requirements. In addition, we reviewed the supporting examination workpapers for the selected associations. We documented whether examination questions were completed, the extent to which the examiners included supplemental information in their workpapers, and whether the examiner followed the procedures specified by FCA policies. We met with FCA officials and examiners to discuss our findings and observations about the examinations reviewed and to clarify any questions we had about FCA policies and procedures. We randomly selected our sample of 30 examinations from the universe of 69 examinations of associations issued during fiscal year 2001. We limited our selection of examination reports to those issued in fiscal year 2001, since 2001 was the third year that System institutions had been expected to comply with FCA's revised examination procedures for assessing compliance with serving YBS. Reports issued in fiscal year 2001 were also the most recent available for our review. We selected two additional examinations for our sample. We had to replace 2 of the original 30 examinations because 2 of the examinations had actually not been issued in fiscal year 2001.

To obtain information on the characteristics of YBS programs at selected System institutions, we documented the existence of specific YBS programs and services as reported by FCA examiners in our sample of examination reports and related workpapers. We also reviewed the annual YBS reports submitted to FCA by the System banks. We did not contact individual System institutions to verify this information or inquire about other services they might offer YBS.

To study how the requirements for System institutions to serve YBS compared to the special mission requirements of other government-sponsored enterprises and banks, we reviewed laws, other relevant regulatory documents, and our past work on these entities and their regulators. We analyzed the requirements and enforcement mechanisms as specified in law and implemented by regulators' policies to make our comparison.

Our work was done in accordance with generally accepted government auditing standards. We did the work for this report between July 2001 and March 2002 at FCA offices in McLean, Virginia.

Appendix II: Comments from the Farm Credit Administration

Farm Credit Administration

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

FCA
FARM CREDIT ADMINISTRATION

February 25, 2002

Ms. Davi M. D'Agostino
Director, Financial Markets and Community Investment
General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Ms. D'Agostino:

Thank you for the opportunity to review and comment on your draft report entitled Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved.

We find the report to be factually correct and believe it accurately reflects Farm Credit Administration's (FCA) current policies and practices. Our agency is committed to an effective program of financial and regulatory oversight of the Farm Credit System. As such, we will address the issues your report raises regarding the need for a more specific regulation on Young, Beginning, and Small Farmers' programs. Furthermore, we will ensure that our examination guidance relative to this important area is followed and work performed and conclusions reached are fully documented by FCA examiners.

We appreciate the effort of your staff in conducting this review. Technical comments were provided to your evaluators separately. If you have any questions, please call me at (703) 883-4005.

Sincerely,

Michael M. Reyna

Michael M. Reyna
Chairman and Chief Executive Officer

cc: Ann Jorgensen
FCA Board Member

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