

FARM CREDIT SYSTEM INSURANCE CORPORATION POLICY ON INTERNAL CONTROLS AND AUDIT COVERAGE

Purpose

The purpose of this policy is to ensure:

- the quality, integrity and transparency of FCSIC's operations and financial reports;
- FCSIC's compliance with all applicable legal requirements and prudent business practices; and that
- FCSIC management carries out the Board's commitment to a strong system of enterprise risk management and internal controls.

Background

The Farm Credit System Insurance Corporation (Corporation or FCSIC) Board of Directors (Board) has demonstrated its commitment to accurate and transparent financial reporting since 1990 by directing the preparation of financial statements and requiring an annual independent audit of those statements in voluntary compliance with the primary requirements of the Chief Financial Officers Act of 1990. The results of the audit are published each year in the Corporation's Annual Report, which is mailed to stakeholders and posted on the Corporation's web site.

Since 1981, the Office of Management and Budget (OMB) Circular No. A-123 (A-123) and the Federal Managers' Financial Integrity Act (FMFIA) have been at the center of Federal requirements to improve accountability in Federal programs and operations. In July 2016, OMB updated Circular A-123 by adding enterprise risk management to an agency's internal control process. According to this revised policy, the efficient and effective operation of the Corporation is promoted by an integrated risk management and internal control system that includes not only accounting controls but also administrative controls over its business activities to ensure attainment of program goals and objectives, compliance with all applicable statutes, and accurate and timely external financial reporting. Management is responsible for designing and implementing an enterprise risk management program and internal control process throughout the entire organizational structure and areas relative to strategic decisions, budget, program management, and operations support. In designing an enterprise risk management program, management must identify risks, quantify them, and establish a risk tolerance threshold so that corrective action options for control deficiencies can be selected. Possible corrective action options include acceptance, avoidance, mitigation, and transfer/sharing of the risk.

Adequate internal controls over financial reporting and the assessment of the effectiveness of these controls serve to enhance the quality of reporting, identify any potential weaknesses, and maintain confidence in stakeholders of Corporation reports. Thus, FCSIC management makes representations three times a year on the adequacy of the internal control environment. Management reviews internal controls and compliance with laws and policies in its management representation letters to the independent external auditor for the special purpose audit for government yearend as requested by OMB, and its calendar yearend General Accepted Accounting Principle (GAAP) based financial statement audit. FCSIC management also makes representations on the adequacy of internal controls in its annual report to Congress and OMB pursuant to the FMFIA.

OMB designated FCSIC a “significant” component agency for the purpose of the combined financial statements of the U. S. Government due to the size of its balance sheet. OMB requested a special purpose audit as part of FCSIC’s filing of the fiscal yearend reports. The independent auditor, following the agreed-upon procedures and the materiality threshold approved by the Government Accountability Office (GAO), the auditor for the financial statement of the U. S. Government, audits the Corporation’s material line items such as investments in U.S Treasuries and the premium receivables as of September 30th. The special purpose audited financial statements for fiscal yearend are then included in the Financial Report of the United States Government.

The calendar yearend GAAP audit provides assurance to Congress and other stakeholders of the Corporation. It is included in the Corporation’s annual report to Congress. The audited calendar yearend financial statements are also included in the Federal Farm Credit System Funding Corporation’s annual information statements. Regardless of calendar or fiscal yearend audits, the independent auditor conducts its audits in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in U.S. Government Auditing Standards issued by the Comptroller General of the United, and Office of Management and Budget Bulletin for the applicable year, *Audit Requirements for Federal Financial Statements*.

Traditionally, the independent auditors considered the Corporation’s internal control to determine the appropriate audit procedures for the purpose of expressing an opinion on the financial statements. Although their report on internal control over financial reporting includes any control deficiencies that come to their attention, the objective of the report is not to express an opinion regarding the effectiveness of the Corporation’s internal controls. Therefore, the independent auditor does not express an opinion in its “*Independent Auditors’ Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with U. S. Government Auditing Standards*” on the effectiveness of the Corporation’s internal control. To increase the integrity of the Corporation’s financial reporting, FCSIC will augment its audit policy to require, effective beginning for the 2017 calendar yearend audit, the independent auditors to annually attest to and report on the effectiveness of its internal controls over financial reporting.

To establish its commitment to the concept of a strong enterprise risk management and internal control system, and provide clear direction to management, the Board adopts the following policy statement.

Policy Statement

The Corporation shall establish and maintain a comprehensive risk management process and integrate it with a cost effective system of accounting and administrative internal controls to provide the following reasonable assurances that:

- i. All goals and objectives of the Corporation are planned and carried out in accordance with applicable provisions of laws, regulations and Board policies;
- ii. All obligations and costs are safeguarded against waste, loss, or unauthorized use;
- iii. All funds, property, and other assets are safeguarded against waste, loss or unauthorized use;

- iv. All revenues and expenditures applicable to Corporation operations are properly recorded and accounted for to maintain accountability over the assets and to permit the preparation of financial statements in accordance with generally accepted accounting principles and the requirements set out in U.S. Department of Treasury's Financial Manual (TFM); and
- v. All programs and administrative activities are managed efficiently to fulfill the mission of the Corporation.

The establishment and maintenance of the Corporation's internal control system shall be executed in accordance with the Board's direction, the requirements of the FMFIA, and guidelines set forth by the GAO and the OMB. The Corporation's internal control system shall include the following components:

- A financial management system that conforms to Federal Financial Management System Requirements;
- An enterprise risk management program which identifies, measures, and control risks;
- Certification by the officers who approve financial reports that those reports are financially accurate and that the Corporation is in compliance with applicable legal requirements that have a direct and material effect on those reports. The signatories will state in the certification that they have reviewed the reports. If anyone refuses to sign, then the person and reason for the refusal will be disclosed. The Corporation's annual report will be dated and signed or electronically approved by the FCSIC Chairman;
- An annual report to the Audit Committee of the review of the Vulnerability Assessment and corrective actions performed according to the requirements of the FMFIA;
- Policies and procedures that foster compliance with laws, regulations and government ethics, including annual ethics training and maintenance of a policy, procedures, and delegation manual related to administrative and program functions available to staff and reviewed and updated annually;
- Whistleblower Procedures that provide how employees may report suspected wrongdoing, how FCSIC officers will report complaints to the Audit Committee and how FCSIC will respond to employee complaints;
- An annual report by the Corporation's General Counsel to the Audit Committee on whistleblower activity affecting the Corporation.
- A financial statement audit conducted annually by an independent public auditor free of potential conflicts of interest. Corporation audit engagements shall be conducted in accordance with the Board's audit committee charter;
- To avoid conflicts of interest or the appearance thereof, the independent audit firm cannot have an accounting partner or concurring partner, or lead audit team member who was an employee, officer or director of the Corporation for the 12 months prior to contracting for audit services or within one year of its conclusion. In addition, the qualified public accounting firm must rotate the lead and reviewing audit partners after five consecutive years of service for a five-year time-out period;

- The independent auditor's attestation to, and report on, the effectiveness of the Corporation's internal control over financial reporting. The report, effective beginning with the 2017 calendar yearend audit, will state whether the internal control over the financial reporting process is effective, report internal control weaknesses, if any, and recommend corrective action, if needed;
- Regular reports from senior management to the Board addressing the Corporation's compliance and operational risk oversight responsibilities;
- Periodic operational audits conducted by an independent audit firm or other appropriate experienced consultant;
- Opening and annual audits of any receiverships; and
- Quarterly reports to the Board regarding the results of any audits conducted during the period and the status of incorporating any recommendations made by the auditors.