FARM CREDIT COUNCIL

March 31, 2025

Autumn R. Agans, Deputy Director
Office of Agency Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Response to Proposed Rule – *Internal Control Over Financial Reporting*, Farm Credit Administration, Agency; 12 CFR 62012 CFR 630; 89 FR 94615: RIN 3052-AD56

Dear Ms. Agans:

On behalf of the Farm Credit System (the "System"), its Internal Control over Financial Reporting Work Group ("Work Group") and the Farm Credit Council (the "FCC"), we appreciate the opportunity to comment on the Farm Credit Administration's (the "FCA") proposed rule on Internal Control over Financial Reporting that was published in the Federal Register on November 29, 2024.

The System recognized and embraced the importance of internal control over financial reporting (ICFR) as early as 2005 when we voluntarily agreed to adopt the ICFR provisions of the Sarbanes-Oxley Act (SOX) of 2002. SOX was enacted with the goal of restoring the public's confidence in auditing and financial reporting for covered financial institutions following several high-profile fraud events and financial scandals. Its purpose is to protect investors and enhance transparency, accountability and integrity of financial reporting. Notably the System was carved out of the statute's coverage, leaving the FCA's regulatory authority over System institutions intact. Recognizing the desirability of ensuring transparency and financial integrity, the System nevertheless provides the same protections by obtaining an integrated audit at the combined System level (Banks and all Associations). We believe providing combined financial information is most meaningful to investors in Systemwide Debt Securities because the Banks and Associations are financially and operationally interdependent. Each Bank, as joint and several obligors on Systemwide Debt Securities, also obtains an integrated audit on a Bank-only basis that provides an opinion on the Bank's financial statements and internal control over financial reporting.

The Work Group solicited input from System Banks and all Associations prior to submitting this letter to the FCA. This letter represents the results of the Work Group's efforts. The FCC also expects that individual System Banks and Associations may submit their own comment letters further detailing their thoughts on the issue.

Based on the review of the proposed rule and the feedback received, the System respectfully requests that the proposed rule be withdrawn as we disagree that the agency's stated objectives will be met by the rule for integrated audits for individual System institutions with assets above the FCA's thresholds. However, if the FCA believes further guidance is necessary, the System is willing to work with the FCA to provide additional assurance that our current practice is sufficiently outlined. The following sets forth the System's feedback for consideration.

## I. Withdrawal of the Agency's Proposed Rule

The System sets forth its reasons for requesting the proposed rule be withdrawn in the subsections outlined below.

1. Integrated Audits do not address all the risks discussed in the proposed rule

*Concentration Risk*

Concentration risk was mentioned as a concern in the proposed rule and a reason for necessitating integrated audits at many entities. However, an integrated audit is an opinion over the design and operating effectiveness of internal control over financial reporting and does not address concentration risk. Size does not dictate the strength of internal controls; small and large companies alike receive unqualified integrated audit opinions and small and large companies both have reported material weaknesses. The strength of the internal controls and oversight by management dictate the success of the program, not the size or concentration of the company. We believe that the current procedures performed today by all System institutions provide investors in Systemwide Debt Securities the confidence in the System combined financial statements and address the concerns of the FCA.

In addition, mergers between large and small Associations may occur more frequently as an unintended result of this proposed regulation. Additional time and effort to obtain an integrated audit of the larger combined entity would be minimal and a merger would serve to spread the cost over a larger asset base. This, in turn, would do the opposite for controlling concentration risk and would increase concentration risk by creating additional incentive for mergers.

The proposed rule also states the Farm Credit System Insurance Corporation (FCSIC) views concentration risk as an increasing concern. They believe that Association concentration has significantly increased direct loan concentration for the System Banks, which in turn has impacted FCSIC's risks of insuring System Banks. We disagree that increased concentration risk poses an increased risk to the FCSIC's Insurance Fund. Banks and Associations' first line of defense is earnings, which is then followed by capital. While capital to assets has declined over the past few years due to loan growth, entities in the System remain sufficiently capitalized and meet all FCA regulatory capital ratio requirements. An integrated audit does not address the concern related to an entity's capitalization. An integrated audit will report on internal controls around ensuring the completeness and accuracy of the financial statements and reporting but does not include an opinion regarding the sufficiency of the organization's capital. Further, System institutions are charged with meeting their statutory mission of service to agriculture and rural America in a safe and sound manner, but that does not include managing capital levels for "black swan" events that could potentially impact the Insurance Fund.

*Undetected Errors* and Evolving Financial Reporting Risks

It was stated that "By requiring certain Associations to obtain an Integrated audit, FCA's proposed rule would help reduce undetected and evolving financial reporting risks in the System." While integrated audits can detect errors, they do not offer absolute assurance and may not be more effective in identifying additional errors than a financial statement audit. Integrated audits are also not designed to address evolving financial reporting risks. The PCAOB defines reasonable assurance as "The exercise of due professional care allows the auditor to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Reasonable assurance includes the understanding that there is a remote likelihood that material misstatements will not be prevented or detected on a timely basis. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance." The procedures performed as part of the audit and the results of those procedures allow the auditor to express an opinion regarding whether the financial statements are "free of material misstatement."

*Fraud*

The proposed rule quotes an SEC release and states "Risks of fraud and financial statement restatements or misstatements were found to be greater for registrants that would not be subject to a requirement to obtain Attestation Reports." While this comment may be true, the same SEC release also states, "we do not have an observable measure of all latent fraudulent conduct but can only examine fraud that has been detected and that led to some observable action, which may not be a representative sample of all actual fraudulent activity." Regardless of the lack of observable measures, System Banks obtain integrated audits, and the Associations have ICFR controls in place that are well-designed and operating effectively to support the System's integrated audit opinion and their management assessment, where applicable.

In addition, an integrated audit's focus is not to discover fraud. While fraud risks are considered, integrated audits are not designed to identify frauds that involve collusion, for example, due to multiple people circumventing controls. Therefore, an integrated audit is not an answer to fraud risk.

The System created a Fraud Risk Work Group that developed tools and templates, including a fraud response plan, policy and procedures, which have been adopted by each System institution. The COSO Matrix used by all System institutions includes a requirement for a risk assessment, including fraud risk, as it relates to internal control over financial reporting. A template has also been provided to institutions to address common fraud risks, helping to mitigate risk to the System.

2. Key entities receive integrated audits

The proposed rule highlights that the complexity and concentration of System Banks and Associations have changed dramatically leading to increased risk that an internal control weakness or failure could affect the safety and soundness of the System. Furthermore, the proposed rule states that an integrated audit will strengthen shareholder and investor confidence in the System's ICFR. However, the Banks which are jointly and severally liable on Systemwide Debt Securities issued to the investing public are *already* voluntarily obtaining an integrated audit along with the integrated audit at the combined System level.

In order for an external auditor to issue an integrated audit opinion at the System level, they must gain reasonable assurance over the significant financial statement accounts and disclosures by performing audit procedures, informed by a measure of materiality for the combined System, at each entity that individually or in the aggregate present a reasonable possibility of material risk of misstatement to the financial statements. This methodology is set forth in the Public Company Accounting Oversight Board's (PCAOB), the regulator for registered public accounting firms, rule on multiple location audits. Further, "significant locations" are assessed as part of the audit procedures performed by the System's external auditor.

Against this background, the additional regulations could create confusion because the System has obtained an integrated audit opinion since 2005. Further, the Banks that have joint and several liability on the System debt have obtained integrated audits for many years, as noted above.

The proposed rule states "In general, other regulators have established requirements that mandate a regulated entity engage an external auditor to conduct an annual audit of its financial statements as well as, under certain circumstances, an Integrated Audit."

While this is true for Commercial Banks, the Farm Credit System was structured differently by Congress when originally created. The System consists of independent, federated cooperatives, and accordingly, we believe that it is most meaningful to present the Banks and Associations on a combined basis, and an integrated audit is being conducted at the System combined level, similar to organizations with a parent company structure with multiple locations.

3. Robust procedures over ICFR already exist and the ICFR Work Group has been in place and active for many years

As mentioned above, the System has long recognized the importance of ICFR to maintain marketplace credibility so that the System Banks, through its agent, the Funding Corporation, can raise money to fund System loans and invest in securities to provide liquidity, all done through the issuance of Systemwide Debt Securities. Investor confidence in the System depends on full, fair, accurate and timely disclosure and a governance structure over the financial reporting, including ICFR. Each System institution remains focused on maintaining and strengthening its ICFR program ensuring the integrity of System reporting.

The Work Group, consisting of representatives from the Funding Corporation, System Banks and Associations, was established in 2016 to assist System institutions in strengthening and maturing their ICFR programs. Since its establishment, the Work

Group has conducted numerous ICFR training sessions for all System institutions, both in-person and virtually. Furthermore, the Work Group published a comprehensive Practice Aid, which includes detailed guidance and numerous tools and templates, which are consistent with the expectations of the Big Four public accounting firms and public entities, to aid in ensuring all necessary ICFR responsibilities are met at each individual institution. The Practice Aid is updated regularly to address changes to accounting and audit principles and standards, as well as any new financial reporting risks identified. In addition, the Work Group meets at least annually to discuss and debrief on themes identified in the System-wide year-end aggregation of internal control deficiency analysis and to assess enhancements or updates to the Practice Aid, templates and tools to address current or emerging issues and new business matters.

The proposed rule reads "risks arise from inconsistencies in the design and implementation of ICFR at different institutions." However, System institutions utilize the Work Group's Practice Aid tools and templates (or equivalents) to document their ICFR programs driving consistency across the System. General conformance with System guidance is also assessed by the System Banks as discussed in Section III below. As stated earlier, we are willing to work with the FCA to develop guidance that would outline the System's ICFR program that may serve to further increase consistency.

4. General Financing Agreement Reviews

Each Association has a General Financing Agreement (GFA) with its funding Bank. These agreements mandate that Associations submit specific ICFR materials to their Bank for a "program-level" ICFR review. The ICFR program design documentation is reviewed to determine if it is consistent with the System's ICFR Framework and whether it addresses all applicable significant accounts and disclosures. GFA Memos are issued by the Banks with any observations noted. Many of the tools or equivalents mentioned above are provided to the Bank for review. This oversight provides the Banks and the Funding Corporation with the knowledge that each Association is following its ICFR program to meet the requirements to support the System's integrated audit opinion.

5. System Integrated Audit

The System's current integrated audit provides investors in Systemwide Debt Securities reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements at the combined System level, as well as at each Bank, which are jointly and severally liable on such debt. The System's integrated audit also requires select procedures, including tests of controls, at the largest Associations due to their impact on the aggregated balances at the combined System level. These procedures are performed on an annual basis by the System's external auditor based on materiality to the System's annual information statement. As such, each of the largest Associations in the System are already subject to ICFR procedures at their institution related to in-scope balances for the System. In addition to those entities that are in-scope on an annual basis, the System's external auditor performs specific procedures for the remaining Associations that are consistent with the System's ICFR framework on a rotational three-year basis. Therefore, each Association within the System is subject to ICFR procedures by the System's external auditor at a minimum of every three years. This approach has proven to be highly effective with handling issues which have a potentially pervasive impact on more than one entity, while minimizing costs to each institution's shareholders. We believe that the integrated audit performed at the combined System level, the four Banks, and the additional specific procedures at Associations by the System's external auditor provides a high degree of consistency for the implementation of ICFR at all System institutions.

6. Maturation of ICFR

Management at each System institution has matured their ICFR programs by utilizing the Practice Aid materials, tools and templates, and by implementing lessons learned from the various training sessions provided by the Work Group. In addition, with the level of effort involved over the last several years, management teams across the System have added qualified and experienced ICFR resources to their staff. The proposed rule states "the complexity and concentration of System Banks and Associations have changed dramatically, leading to an increased risk that an internal control weakness or failure at one institution could affect the safety and soundness of the entire System." However, the basic business of Farm Credit has remained the same since the inception of the System consistent with its mission to provide credit to rural America and agriculture. The lending and other key functions are well-controlled and tested. In addition, the use of technology has increased in processing these transactions, which in turn has increased the automated controls that are in place. Accordingly, the System's sophistication in ICFR programs has kept pace with the complexity and concentration of System Banks and Associations.

7. Unintended Consequences, including diverting resources away from the Mission

The introduction of required integrated audits comes with increased significant costs – in audit fees, hiring of additional personnel, time, purchasing of technology to support the audit process, consulting fees, training etc., all of which drive unintended consequences. In addition, increased costs would take away from the Associations' retained earnings and may impact the amount of patronage paid to member-borrowers. Associations concerned about the cost of an integrated audit may choose not to grow their balance sheets and remain below the FCA's thresholds. On the other hand, as previously mentioned, the resulting costs to obtain an integrated audit could drive Associations to merge thus increasing concentration risk.

Moreover, the direct and indirect costs that would be necessary to meet the needs of an integrated audit opinion would be diverted from investing and meeting the needs of our customers. This would harm the Farm Credit mission and hinder the goal of serving agriculture and Rural America.

The System is designed to serve agriculture and rural America with reliable, consistent credit and financial services. As cooperatives, System institutions are owned by their member-borrowers. Net income generated by the institutions can be used only in two ways: retained at the institution to build capital or passed on to our customers by way of patronage dividends. As such, the System believes that the existing ICFR framework as described above instills investor confidence in the System's combined financial statements. This approach does not divert System institutions' attention from the mission or negatively impact patronage distributions to member-borrowers.

## II. Outline the System's Existing ICFR Process Through Guidance

As previously mentioned, the System has obtained an integrated audit on the combined System's financial statements since 2005 and in 2007 the FCA codified in regulation the requirement for the Funding Corporation to obtain the integrated audit at the System level. We believe that the FCA can better achieve its objectives without requiring integrated audits for additional System institutions.

1. ICFR Program

   The FCA's proposed rule, section E of Background acknowledges that "…the System has implemented standards, created workgroups and employed other practices…" but concludes that there is the risk of inconsistency in the design and implementation of ICFR at different institutions. We would refute that conclusion. The System's ICFR program requirements align with the guidance issued by the SEC and PCAOB, which is the primary standard for management reporting on ICFR and the external auditor's attestation. These requirements are incorporated into the GFA in place between each Association and its funding Bank and compliance is expected. Noncompliance with these ICFR requirements may also indicate noncompliance with covenants of the GFA, which can have funding implications.

   We propose that instead of implementing a new integrated audit requirement that would divert attention away from the mission without addressing the stated risks of concentration and losses for FCSIC's Insurance Fund, the FCA should consider working with the System to develop guidance that solidifies consistency in the design and implementation of ICFR across all System institutions and have more impact than the requirements of the proposed rule.

2. External Audit Procedures

   As noted above, the System's current integrated audit provides investors in Systemwide Debt Securities reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements at the combined System level, as well as at each Bank, which are jointly and severally liable on such debt. As such, we believe that the FCA's concern related to concentration risk within the System is addressed by the requirements of the System's integrated audit opinion and the FCA could more effectively increase consistency of ICFR programs within the System through guidance for ICFR programs at each Association than requiring costly integrated audits at a few institutions.

## III. Clarification of requirements and rationale within the final rule

The System requests that if the FCA moves forward and finalizes the rule, clarification be made of several of the key points made in the proposed rule.

1. **How does an integrated audit address the increased complexity and**

**concentration risk?** Section A of the Background - the FCA notes that the complexity and concentration of the System Banks and Associations have changed over time leading to increased risk that an internal control weakness or failure at one institution could affect the safety and soundness of the entire System. It goes on to say that this proposed rule would "…decrease risks related to the detection and reporting of internal control weaknesses or failure."

2. **Given the inherent limitation, how does an integrated audit address the risk of undetected error, negligence, fraud event or failure that have occurred or are expected to occur?** Section C of the Background - the FCA seems to expect that an integrated audit will detect …" any material weakness or other development, such as an undetected management error, negligence, fraud event, or failure, that have occurred or are expected to occur…".

   An integrated audit is an audit by the external auditor that provides an opinion on the fair presentation of management's financial statements and on the effectiveness of management's system of ICFR. In the audit of ICFR, the auditor obtains an understanding of ICFR, assesses the risk that a material weakness exists and tests and evaluates the design and operating effectiveness of internal controls based on the assessed risk. The auditor specifically states that there are inherent limitations in ICFR that may not prevent or detect misstatements. The auditor also states that projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or the degree of compliance with policies and procedures may deteriorate.

3. **What inconsistencies are the FCA referring to in ICFR practice? What are the implications of those inconsistencies? I**n Section C of Background - the FCA mentions risks arising from inconsistencies in the design and implementation of ICFR at different institutions. The System has invested considerable time and effort on a standardized approach to address ICFR. The System uses a single auditor for the financial statement audits of approximately 98% of System assets and obtains an integrated audit at the System combined level as well as each System Bank. Therefore, the likelihood of inconsistencies in the process is minimal. While controls will vary between System institutions based on systems, people and processes, the risks to be covered by all institutions are consistently addressed.

4. **How would integrated audits reduce financial reporting risks associated with concentration risk in the System?** Section D of the Background - the FCA correctly points out that concentration has increased throughout the System, and it poses new and different risks. However, the agency has not articulated how requiring attestation reports at individual Associations will further address and/or mitigate concentration risk. Again, these Associations are subject to PCAOB integrated component audits through the System's integrated audit opinion and therefore the detection mechanisms that the FCA is seeking are in place. Requiring integrated audit opinions will only serve to increase compliance costs for these institutions without materially changing the risk

to the combined System.

5. **How does the FCA plan to address potential fluctuations in assets or direct loans regarding the requirement to obtain an integrated audit?** The proposed rule uses a percentage threshold either of System assets or a District Bank's direct loans. Other regulators that require integrated audits use a stable dollar threshold. The direct loan threshold does not seem equitable as 15% in a smaller district could require an integrated audit for an Association of a certain size but would not be required for an Association of the same size in a larger district. This does not drive consistency and equitability across the System and may provide an incentive for Associations to seek reaffiliation with one of the larger districts to avoid the cost and burden of this requirement.

6. **The proposed rule (Section F of the Background) inaccurately indicates that the current ICFR reviews and practices support the opinion at the Funding Corporation and System Bank level.** The ICFR work performed at the Associations and tested by the external auditor only supports the System level opinion. The attestations for the Banks are at the entity level and not at a District level.

7. **Are there examples of different controls and/or different details an attestation report would cover, which are not covered by the current requirements for management's assessment would not?** Section F of the Background - the FCA indicates that the scope of work currently being complete would not be adequate for a standalone audit opinion on the effectiveness of the individual Association's ICFR and that an attestation report would examine different controls and in different detail than current requirements for management assessments. We disagree that the requirement for an attestation report would examine different controls or different financial statement line items and disclosures than current requirements. All Associations with assets of $1 billion or more are required to include management's assessment of ICFR in its annual report and all other Associations are required to have an ICFR program in accordance with its Bank's GFA. The only difference between management's assessment and an attestation is that the external auditor would be testing the controls for the Association's opinion.

8. **In what way does the FCA believe integrated audits reduce financial reporting risks related to complexity and concentration?** Section G of the Background - the proposed regulation states, "...there are safety and soundness benefits to the entire System. Consequently, FCA believes requiring certain System institutions to obtain Attestation Reports will reduce financial reporting risk described above that stem from significant changes in the complexity and concentration of System Banks and Associations justifying the cost to require certain Associations to obtain Integrated Audits. As previously noted, integrated audits were required by SOX to protect investors from fraudulent accounting activities and such protections center on annual financial disclosures. Investors in Systemwide Debt Securities are protected by the integrated audit at the System combined and Bank-only levels.

9. **How would integrated audits improve safety and soundness?** In Section G of the Background - the FCA also discusses safety and soundness benefits to the entire System but does not provide support for this position. The concept of safety and soundness is to ensure that institutions operate in a safe and sound manner, providing overall health and stability to financial institutions and systems, ensuring they can withstand economic shocks and operate effectively. Internal control over financial reporting and integrated audits provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. We are unclear as to how this proposal addresses safety and soundness.

10. **How would FCA staff determine that a material weakness exists?** Section J of the Background – the proposed rule would require the first integrated audits for Associations to begin three years after the effective date of the regulation, unless FCA determines it is appropriate for an Association to obtain one sooner because a material weakness in ICFR is identified or FCA has assessed that other developments have occurred or are expected to occur that could adversely impact or result in significant changes to the Association's ICFR that impacts the safety and soundness of the Association. Material weakness has a very specific definition within ICFR and integrated audits. The FCA exams and reviews cover many areas that are not covered by ICFR. Does the regulator plan to only require an integrated audit if the area of weakness is within the scope of ICFR or for other purposes? Within this same section, the proposed regulation states "Other developments have occurred…that could adversely impact, or result in changes to, the Association's ICFR." This too needs to be further defined as this is very broad and open ended. The application of this clause could be applied vastly differently by different examiners and may not warrant an integrated audit opinion. The following are several related questions:
    a. **How does the FCA view an ICFR material weakness as a safety and soundness issue?** Public companies can have a material weakness in financial reporting which is not considered to be a safety and soundness issue.
    b. **What will be the FCA's expectation if during the three years before the attestation is required, the Association falls below the thresholds outlined in the proposed rule?**
    c. **Would a merger of Associations constitute a "significant" change and require an integrated audit opinion even if the merged Association is under the thresholds set forth in the proposed rule?** Also, within this section, the regulation states "…or are expected to occur…". It does not appear appropriate to require an integrated audit opinion on an Association for the possibility of a problem. We would ask the FCA to define "significant" changes to provide clarity on expectations.
    d. **Lastly, section 620.3 currently uses "material" changes, but this revision uses significant. Does the FCA plan to interpret these terms differently?** The terms material and significant have specific meanings within ICFR and should be aligned within this proposed regulation. Further, FCA examiners are not typically certified in accounting – will FCA be engaging CPAs to make this

material and significant weakness determinations?

11. In Section J of the Background – the FCA inaccurately states, “All System Banks currently obtain an Integrated Audit, as required by the Funding Corporation.” It is not correct that the Funding Corporation requires Banks to obtain an integrated audit. The Banks voluntarily agreed to obtain integrated audits. The Funding Corporation has no authority to require such audits.

## IV. Summary

The Work Group has outlined above the procedures currently in place over ICFR and why we believe it is sufficient to ensure appropriate safety and soundness at entities throughout the System. Accordingly, we do not believe that getting additional third-party opinions on internal controls addresses the FCA’s objectives for the rule.

Testing of controls is already being performed at multiple levels – management, internal audit, and external audit. All the above reviews are done by people that are competent and qualified individuals in alignment with the requirements outlined in the FCA’s Audit & Review Programs guidance. Additionally, all internal audit teams have direct lines to their institutions’ Audit Committees for oversight.

Although all individual Associations do not currently receive an integrated audit, the external auditor still consistently performs internal control audit procedures related to the System-level Audit Opinion as well as the repeating and rotating Associations deeper dive procedures as mentioned in section 1.

As stated above, we believe that management is doing sufficient work to gain comfort over ICFR at both the individual institution and System level. Moreover, since Congress intentionally excluded the System from the integrated audit requirement contained in SOX, we believe the decision as to whether a System institution implements an integrated audit should be left to each institution’s board of directors. As such, again, we respectfully request FCA withdraw this proposed rule.

## V. Conclusion

We appreciate the opportunity to comment on FCA’s ANPRM regarding Internal Control Over Financial Reporting. We trust that our comments, as well as those comments submitted by individual System associations and banks, will assist FCA in such efforts.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Robert Paul Boone III
Senior Vice President of Regulatory Affairs & General Counsel
Farm Credit Council