

March 31, 2024

Via Electronic Mail

Autumn R. Agans, Deputy Director
Office of Regulatory 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 Parts 620 and 630; 89 FR 94615 (November 29, 2024)

Dear Ms. Agans:

I am writing on behalf of Farm Credit Illinois (“FCI”) to comment on the Farm Credit Administration’s (“FCA”) Proposed Rule on Internal Control over Financial Reporting published in the Federal Register on November 29, 2024 (the “Proposed Rule”).

**FCI Agrees With the Comments
Submitted by the Farm Credit Council**

FCI agrees with the comments submitted by Robert P. Boone, III on behalf of the Farm Credit Council (the “Council”). FCI submits the following comments to emphasize issues of particular importance to FCI and why FCI believes FCA should withdraw the Proposed Rule. If FCA believes the System’s ICFR regime is somehow inadequate, it should instead develop guidance to remedy the inadequacies.

**The Proposed Rule Would Require
FCI to Obtain an Integrated Audit Each Year**

As of December 31, 2024, FCI had assets of just under \$7 billion¹ and the Farm Credit System had total assets of \$544 billion.² Because FCI’s assets exceed one percent of the total System assets, the Proposed Rule, if enacted, would require FCI to obtain an integrated audit.

Notably, FCI does not meet the other threshold set forth in the Proposed Rule because FCI’s direct note to its funding Bank only constitutes about 4 percent of the Bank’s direct loans to associations, which is far below the 15 percent threshold set forth in the Proposed Rule.

¹ Farm Credit Illinois 2024 Annual Report, p.2.

² Federal Farm Credit Banks Funding Corporation 2024 Annual Information Statement of the Farm Credit System, p. 3.

FCI's Current Controls and Oversight

The comment letter submitted by the Farm Credit Council summarizes the robust procedures System institutions currently have in place regarding ICFR.

Consistent with the Council's comments, FCI takes ICFR very seriously. FCI has a separate internal ICFR Committee, and its voting members include FCI's CFO, CRO, Vice President of Finance, and Vice President of Operational Risk. The ICFR Committee's responsibilities and authorities include, but are not limited to: (a) understand the scope and reliance of the ICFR program in relation to the financial statement preparation, the general financing agreement with its funding Bank, and the Farm Credit System audit, (b) review program updates and results of testing, (c) assess the severity of and monitor deficiencies, (d) monitor ICFR key risk indicators, and (e) present and coordinate updates to the Board Audit Committee. Additionally, FCI's ICFR Working Forum monitors the Program's status, collaborates on concerns, identifies enhancement opportunities, and ensures action on any control deficiencies. FCI utilizes the comprehensive Practice Aid, templates, and tools published by the System ICFR Work Group and continues to receive updates as they are produced, consistent with the process mentioned on pages 4 and 5 of the Council's comment letter.

FCI's internal audit department annually assesses the design of the ICFR framework and tests the adequacy of the ICFR controls. Further, the adequacy of controls design is reassessed as part of project implementations, as needed.

FCI's general financing agreement (GFA) with its funding Bank, requires FCI to establish and maintain an ICFR program. The GFA requires FCI to comply with the System ICFR Framework. The GFA further requires FCI to annually submit specific information to the Bank regarding FCI's ICFR program. The Bank then reviews FCI's ICFR program documentation to determine whether it is consistent with the System ICFR Framework, and whether it addresses all significant accounts and disclosures. If the Bank identifies any gaps in FCI's program, the Bank will notify FCI, and FCI must provide a remediation plan to the Bank within 45 days.

The GFA further provides that the Bank will examine FCI's ICFR program design at appropriate intervals, taking into account whether or not FCI obtains an Integrated Audit Opinion. The Bank last examined FCI's 2024 ICFR program, providing a letter confirming the acceptability of the program on February 20, 2025.

Thus, FCI's funding Bank, which obtains its own integrated audit, provides meaningful oversight to ensure FCI and the other associations in the Bank's district have an effective ICFR program that meets the requirements of the System ICFR Framework. This process also helps to ensure the System will be able to obtain its own integrated audit opinion.

FCI's controls are further reviewed by FCI's external auditor, including annually obtaining an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances. Additionally, the System's external auditor performs specific procedures on FCI's ICFR program on a recurring basis. This process often takes place annually, but in no event does it occur less often than every three years.

Given that FCI's ICFR program is monitored by FCI's ICFR Committee, internal audit department, its Bank, and the System's external auditor, it would not seem likely that an additional examination would identify many issues, let alone an issue that, if not detected, would lead to consequences so significant that they would materially impact investor confidence and public trust in the entire System.

The Cost of an Integrated Audit to FCI Would Be Significant

Integrated Audits are costly, both in terms of external audit fees and internal personnel time. FCI estimates it would incur one-time costs from \$200,000 to \$300,000 and annual recurring costs between \$250,000 and \$650,000.

These significant costs include external audit fees to obtain the integrated audit opinion as well as internal resources necessary to support a separate integrated audit from that obtained at the combined System level. Clearly, the smaller the association, the more significant fixed costs like these become relative to the association's asset base.

An Integrated Audit Requirement Would Reduce FCI's Ability to Pay Patronage and Fund Mission Related Programs

Increased costs that do not provide a corresponding financial benefit necessarily reduce an association's operating income. Such costs create pressure on a small association because there are only a limited number of ways to deal with them. In the end, expenses of this nature ultimately only impact two things: (a) retained earnings (i.e., safety and soundness), or (b) patronage and mission-related programs. FCI's board and management will continue to ensure the safety and soundness of FCI, so any money needed to pay costs attributable to an integrated audit would necessarily result in a reduction of FCI's patronage or mission related initiatives.

FCI pays patronage, so one option would be for FCI to pay for an integrated audit by reducing the patronage it pays to its member-borrowers. A reduction in patronage would mean that the farmers FCI serves would bear the costs of an integrated audit.

In addition to paying patronage, FCI also funds many programs to further the System's mission. Among others, FCI funds a robust young and beginning farmer program, a scholarship program, and a program to fund investments in our rural marketplace.

FCI funds its own "FreshRoots" program, which helps young and beginning farmers through reduced interest rates, relaxed lending standards, reimbursement of fees for FSA guarantees, and cash incentives to encourage participation in FCI-developed educational programs.

In addition, each year FCI donates 50 basis points of its net income to Rural Marketplace Investments, targeting youth, ag education, and non-FCI programs supporting young, beginning, small, women, urban, veteran farmers, and local charities. Last year FCI's net income was approximately \$105 million, so FCI will donate approximately \$525,000 through its Rural Marketplace Investments program this year.

FCI also has a scholarship program. In 2024, FCI awarded a total of \$75,000 in scholarships to high school seniors pursuing agriculture-related majors and careers. Each of the 30 recipients received a \$2,500 agriculture scholarship.

As previously stated, FCI estimates the initial cost of an integrated audit will range from around \$200,000 to \$300,000 and the continuing annual cost will range from around \$250,000 to \$650,000. These costs are very significant when compared to the funds FCI currently is able to spend on its scholarship and mission related investment programs. Indeed, the anticipated cost of an integrated audit would be many, many times the cost of FCI's scholarship program, which materially benefits 30 young agricultural scholars each year. Clearly, any cuts in these programs of the size needed to offset the cost of an integrated audit would severely diminish the benefit the programs currently provide. Associations have limited resources, and FCA should consider whether the benefit an integrated audit might provide is worth the cuts that may occur in programs that provide real, tangible, and impactful benefits to farmers, young agricultural scholars, and rural communities.³

**The Proposed Rule Would Increase Fixed Costs,
Which Would Increase the Pressure on Associations to Merge**

The Council's response pragmatically warns that "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." (Council response, p. 2). FCI, which has approximately 1.3% of System assets and about 4% of its Bank's direct loans to associations, is one of the smaller associations that would be required to obtain an integrated audit.

Under the Proposed Rule, when an association crosses either of the Proposed Rule's thresholds and must obtain an integrated audit, its fixed costs will surge significantly, and the pressure on it to merge will increase. Thus, the Proposed Rule will incentivize the very same System consolidation that the Proposed Rule calls out as a cause of increasing System risk.⁴ The end result for the System may be that very few associations exist just above either threshold, with associations either being smaller than both thresholds or much larger than either of them.

FCI encourages FCA to very carefully consider (a) the additional cost an integrated audit will have on associations like FCI, (b) the negative effects that may occur as associations act to deal with those additional costs, and (c) whether the potential benefit of an integrated audit outweighs those negative effects.

³ Even if such programs were not immediately and directly reduced by the cost of an integrated audit, any future expansion of the programs that otherwise would occur may well be limited.

⁴ The Proposed Rule states, "[t]he association concentration mentioned above has significantly increased direct loan concentration for System banks, which in turn has impacted FCSIC's risks of insuring System banks. Concentrated associations pose significant inherent risks to their banks and FCSIC's Insurance Fund." (89 FR at 94617).

**The Proposed Rule Contains No Genuine Cost-Benefit
Analysis to Show the Benefits of an Integrated Audit Justify the Cost**

The Proposed Rule states:

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the Proposed Rule will not have a significant economic impact on a substantial number of small entities. **Each of the banks in the Farm Credit System, considered together with its affiliated associations,** has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not “small entities” as defined in the Regulatory Flexibility Act.

(89 FR at 94618) (bolding supplied). Even though it may not be required by the Regulatory Flexibility Act, FCI believes any good policy-making process should include a good faith attempt to determine the economic impact a new regulation will have on the associations it will impact, as well as a realistic cost-benefit analysis. While the bolded language above focuses on each of the Banks combined with their affiliated associations, the impact on each Bank district as a whole is not the issue (unless FCA desires to encourage further mergers). Unfortunately, the Proposed Rule does not include a cost-benefit analysis for the associations that will be impacted by the Proposed Rule.

There is no question the cost of an integrated audit would be significant, especially to the smaller associations impacted by the Proposed Rule. While the cost is apparent, the Proposed Rule makes no attempt to quantify any benefit that would be gained.

The Proposed Rule contains some statements that an integrated audit, under some circumstances, might provide some benefit. For example, the Proposed Rule states:

The SEC Release No. 34-88365 noted the following:

- 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. From 2003 to 2020, non-accelerated U.S. filers (which did not obtain Attestation Reports) accounted for 62 percent of the total U.S. financial statement restatement.
- Registrants not subject to a requirement to obtain Attestation Reports were found to have higher levels of ineffective ICFR compared with issuers subject to that requirement. **Over 40 percent of non-accelerated filers (not required to obtain Auditor Attestations) had ineffective ICFR,** compared to less than approximately nine and five percent of accelerated and large accelerated filers, respectively (accelerated filers were subject to Integrated Audit requirements).

While the referenced SEC insights pertain to public companies, FCA believes that this information provides meaningful insights into reporting risks and their reduction at System institutions. Although there are costs in obtaining an Integrated

Audit for each institution, 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 risks described above that stem from significant changes in the complexity and concentration of System banks and associations justifying the cost to require certain associations obtain Integrated Audits.

(89 FR at 94618) (bolding supplied).

The bolded language in the second bullet point above (i.e., “Over 40 percent of non-accelerated filers (not required to obtain Auditor Attestations) had ineffective ICFR”), indicates the problem is not the lack of an integrated audit, but rather the lack of effective ICFR.

The Proposed Rule similarly states:

The Securities and Exchange Commission (SEC), has considered various studies when promulgating audit requirements for regulated entities that show Integrated Audits offer two benefits compared to financial statement audits:

- Integrated Audits have been found to provide information to investors about the reliability of the financial statements. For example, a 2011 SEC Staff Study highlighted evidence that Attestation Reports generally resulted in the identification and disclosure of material weaknesses that were not previously identified or whose severity was misclassified when identified by management in its assessment of ICFR.
- The reliability of the financial statements can be enhanced through the execution of Integrated Audits. Studies considered in SEC Release No. 34–88365, Amendments to the Accelerated and Large Accelerated Filer Definitions, documented a significant correlation between audits of ICFR **and the maintenance of better internal controls**, thereby improving reliability of financial statements. **The SEC also found that a failure to maintain effective ICFR has been associated with** a higher rate of future restatements and lower earnings quality and a higher rate of future fraud revelations (among other things).

(89 FR at 94617) (footnote omitted).

Once again, the bolded language indicates the real issue is whether a company’s ICFR is effective, rather than whether there was an integrated audit. Notably, nothing in the Proposed Rule suggests the System or any of the associations do not currently have effective ICFR programs.

Moreover, there is very little reason to believe System associations are comparable to the public companies that were included in the SEC data. For example, it is very doubtful those public companies were part of a larger system that (a) contractually required each of the companies to implement an ICFR program based on a well-developed ICFR framework, (b) reviewed each

company's ICFR program, and (c) issued its own system-wide combined financial statements that were subject to an integrated audit.

Because the System already has an effective ICFR regime that involves many checks and redundancies (see the Council's response, pp. 4-6), SEC Release No. 34-88365 does not support a conclusion that integrated audits would provide the identified potential benefits to the System. Given the extensive ICFR programs that already are in place in the System, the Proposed Rule sets forth no data or other evidence that provides any basis to conclude additional integrated audits would provide a material benefit to the System or its associations, let alone a benefit that would justify the significant additional cost.

Given the System's Entire ICFR Regime, Additional Association Integrated Audits Are Not Needed

FCI acknowledges that redundant protective practices reduce risk. First level controls have the greatest benefit, and the first check on a control can have a significant benefit. However, the marginal benefit of each additional check or redundancy diminishes as each new layer is added. Thus, while redundancy can be beneficial and appropriate, redundancy upon redundancy adds cost and is unlikely to yield a better result.

FCI has effective ICFR in place, which is tested by its internal audit department and monitored by several layers of management and the Board Audit Committee. The next level of assurance is the Bank GFA and Bank supervision. The third level is the review by the System's external auditor to the extent necessary to allow the external auditor to provide an integrated audit opinion for the combined Bank financial statements and System financial statements. The System's existing ICFR regime is redundant, robust and effective. Additional integrated audits will never be able to eliminate the risk of misstatements as the integrated audit opinion itself specifically acknowledges, "[b]ecause of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements." Given that FCI's ICFR program is monitored by FCI's ICFR Committee, internal audit department, its Bank, and the System's external auditor, it would not seem likely that an additional examination would identify many issues, let alone an issue that, if not detected, would lead to consequences so significant that they would materially impact investor confidence and public trust in the entire System.

The Proposed Rule does not show why the System's ICFR regime would miss material issues that additional association-level integrated audits would identify. To justify the cost of requiring many more System institutions to obtain expensive integrated audits, such issues would have to be quite material indeed. FCI respectfully suggests that the System's very robust ICFR regime provides ample assurance to the investing public regarding the System's ICFR. The substantial additional cost of requiring more associations to obtain integrated audits would provide minimal benefit.

Conclusion

The types of problems the Proposed Rule seeks to avoid are caused by ineffective ICFR programs, rather than by an absence of integrated audits. While an integrated audit helps to ensure a particular ICFR program is effective, there is no showing an integrated audit will provide material benefits to an organization that has an effective ICFR program.

The Farm Credit System has a well-constructed, enforceable, redundant, System-wide ICFR regime in place which ensures the System has effective ICFR. The Proposed Rule does not assert otherwise. The System's ICFR regime includes:

- A System ICFR Framework, developed and consistently updated by a System work group;
- GFA provisions that impose enforceable, contractual obligations on each association to establish and maintain an ICFR program that conforms to the System ICFR Framework;
- Review by the association's internal auditors;
- Bank review of each association's ICFR program;
- Bank examination of each association's ICFR program at appropriate intervals, taking into account whether or not the association obtains an integrated audit; and
- Review by the System's external auditor to the extent necessary to allow the external auditor to provide an integrated audit opinion for the combined System financial statements.

FCI respectfully suggests that, given the System's robust and redundant ICFR regime, the additional redundancy that would be provided by more association-level integrated audits would not perceptibly increase the effectiveness of the System's ICFR or the assurance provided to the investing public regarding the System's ICFR. However, the substantial additional cost of requiring additional integrated audits would negatively impact the patronage and mission related initiatives associations can provide and would potentially lead to more mergers and System concentration.

Accordingly, FCI respectfully requests FCA to withdraw the Proposed Rule. If FCA believes the System ICFR regime is somehow inadequate, FCA should instead develop guidance to remedy those inadequacies.

Thank you for the opportunity to comment on FCA's Proposed Rulemaking on Internal Control Over Financial Reporting. We very much appreciate FCA's consideration of our observations and suggestions. If you have any questions, please feel free to contact me.

Sincerely,



Robert H. Rhode
Senior Vice President & General Counsel