

REDACTED

Federal Housing Finance Agency
Office of Inspector General



**FHFA's Completion of Planned
Targeted Examinations of Freddie Mac
Improved from 2016 through 2018,
But Timeliness Remained an Issue**

This report contains redactions of information that is privileged or confidential.

Audit Report • AUD-2019-013 • September 17, 2019



AUD-2019-013

September 17,
2019

Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 (HERA) with the supervision of Freddie Mac and Fannie Mae (together, the Enterprises), any affiliate of the Enterprises, and the Federal Home Loan Banks (collectively, the regulated entities). Its mission as a federal financial regulator includes ensuring the safety and soundness of its regulated entities so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA maintains that it uses a risk-based approach to supervisory examinations, prioritizing examination activities based on the risk a given practice poses to a regulated entity's safe and sound operation or to its compliance with applicable laws and regulations. Since 2008, FHFA has also served as conservator of the Enterprises.

Within FHFA, its Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises. DER has assigned responsibility for developing and implementing an annual examination plan for Freddie Mac to an Examiner-in-Charge (EIC), who oversees a team of examiners. According to FHFA guidance, DER examiners are to summarize, in an annual Report of Examination (ROE), examination results, conclusions, findings and supervisory concerns from the supervisory activities completed during the annual examination cycle.

Because targeted examinations are a critical component of FHFA's supervisory activities, we have audited different aspects of FHFA's annual examination plans, including planned targeted examinations of Freddie Mac. Since 2016, we have issued three audit reports related to the completion of planned targeted examinations and other supervisory activities of Freddie Mac (two reports in 2016 and one report in 2017).

In light of our findings in a 2016 audit, *FHFA's Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed* (AUD-2016-007), we performed this audit to determine whether DER examiners completed the targeted examinations identified in each examination plan for Freddie Mac from 2016 through 2018, the review period for this audit, and compared the results to those of our 2016 audit. We applied the same methodology to analyze the results found in this audit as we used in our prior audit.

Our audit found that as of July 1, 2019, of the 46 targeted examinations planned by DER for the 2016 through 2018 examination cycles, 37 targeted examinations were completed (81%). Of the 9 targeted examinations that were not completed, 7 were not conducted – either converted to ongoing monitoring



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or a business profile, or cancelled (15%) – and 2 were commenced but not completed (4%). DER's completion rate of 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) is an improvement over the 56% completion rate we found in our 2016 audit.

In our 2016 audit, we also found that DER could not provide documentation regarding the status for 8 of 90 planned targeted examinations. For this audit, DER could account for all planned targeted examinations of Freddie Mac. Furthermore, in our 2016 audit, DER provided risk-based justifications for only a fifth of the planned targeted examinations that were not conducted. For this audit, DER provided risk-based justifications for all seven examinations that were not conducted.

We also found that timely completion of targeted examinations prior to issuance of the ROE improved, but continued to be an issue. In our 2016 audit, we found that 33 of the 90 targeted examinations planned during the examination cycles for 2012 through 2015 (37%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Applying the same methodology to this review period, we found that 27 (59%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Ten (10) of the 46 (22%) were completed in a later examination cycle and were reported, as applicable, in subsequent ROEs. (As shown above, the remaining planned targeted examinations were either converted to ongoing monitoring or a business profile, cancelled, or commenced but not completed.)

Our 2016 and 2017 audits included a total of 11 recommendations, 5 of which were relevant to the objective of this audit. We found that FHFA took appropriate action to address those relevant recommendations.

We make no recommendations in this report.

We are also issuing today, a second report, *FHFA's Completion of Planned Targeted Examinations of Fannie Mae Improved from 2016 through 2018, But Timeliness Remained an Issue; With the June 2019 Issuance of the Single Security, FHFA Should Reassess its Supervision Framework for CSS* (September 17, 2019) (AUD-2019-012), which undertakes the same assessment for DER's targeted examinations for Fannie Mae.

This report was prepared by Tara Lewis, Audit Director; Pamela L. Williams, Auditor-in-Charge; Terese Blanchard, Auditor-in-Charge; and Brian Maloney, Auditor; with assistance from Bob Taylor, Senior Advisor. We appreciate the



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cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov, and www.oversight.gov.

Marla A. Freedman, Deputy Inspector General for Audits /s/

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ABBREVIATIONS

DER	Division of Enterprise Regulation
EIC	Examiner-in-Charge
Enterprises	Fannie Mae and Freddie Mac
FHFA or Agency	Federal Housing Finance Agency
IMS	Information Management System
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
ROE	Report of Examination

BACKGROUND

Effective Supervision by FHFA is Vital to Ensure Freddie Mac’s Safety and Soundness

FHFA maintains that it uses a risk-based approach to supervisory examinations, prioritizing examination activities based on the risk a given practice poses to a regulated entity’s safe and sound operation or to its compliance with laws and regulations. Within FHFA, DER is responsible for supervision of the Enterprises. The Deputy Director, DER, is responsible for developing a supervisory framework and ensuring that the planning process is fully documented and incorporated into official agency records. DER has assigned responsibility for developing and implementing an annual examination plan for Freddie Mac to an EIC, who oversees a team of examiners.

FHFA’s Examination Planning Process

According to FHFA’s *Examination Manual*, risk assessments provide a foundation for determining the supervisory activities to be conducted. Using the risk assessments, a supervisory strategy is prepared for each Enterprise by the DER examination teams. Once the annual supervisory strategy is approved, the strategy is implemented through an annual examination plan, prepared by the EIC for each Enterprise and approved by the Deputy Director, DER.

FHFA’s annual examination plans identify the supervisory activities, both ongoing monitoring and targeted examinations, expected to be completed during that examination cycle. The purpose of ongoing monitoring is to analyze real-time information and to use those analyses to identify Enterprise practices and changes in an Enterprise’s risk profile that may warrant supervisory attention. Ongoing monitoring is also “used to determine the status of the Enterprise’s compliance with supervisory guidance, [Matters Requiring Attention] MRAs, and conservatorship directives[.]” Targeted examinations complement ongoing monitoring: they enable examiners to conduct “a deep or comprehensive assessment” of the areas found to be of high importance or risk. Because each of these supervisory activities has a separate purpose, they are not interchangeable.

DER examiners may identify supervisory concerns or deficiencies occurring at an Enterprise as a result of ongoing monitoring or targeted examinations. MRAs are the most serious

supervisory matters.¹ MRAs fall into one of the following categories: (1) critical supervisory matters that pose substantial risk to the safety and soundness of the regulated entity, such as instances of noncompliance with laws or regulations of a serious nature or repeated criticisms that have escalated in importance because of insufficient attention or action; or (2) deficiencies that are supervisory concerns that FHFA believes could, if not corrected, escalate and potentially negatively affect the condition, financial performance, risk profile, operations, or reputation of the regulated entity.

Because examination planning is a continuous process, FHFA expects that each EIC will adjust the applicable examination plan to reflect changes in risk exposure. DER guidance in effect during the review period of this audit instructed that approved examination plans shall only be adjusted for risk-based reasons, and justifications for the adjustments must be approved by the EIC (after consultation with the Deputy Director, DER, if warranted) and fully documented in the work papers. Adjustments include adding or deleting supervisory activities, or changing the objective, scope, and methodology of a supervisory activity.²

According to FHFA guidance, DER examiners are to summarize, in an annual ROE, examination results, conclusions, findings, and supervisory concerns from the supervisory activities completed during the annual examination cycle. Each ROE, issued to the relevant Enterprise's board of directors, is intended to convey the overall condition and risk profile of the Enterprise, summarize examination activities and findings during the annual examination cycle, and discuss deficient practices and excessive risks giving rise to supervisory concerns. The ROE also includes a list of open MRAs at year-end and a list of MRAs that were closed during the previous calendar year.

¹ In addition to MRAs, FHFA guidance also defines two other types of adverse examinations findings: (1) violations, which are matters in which the examination discloses non-compliance with laws, regulations, or orders; and (2) recommendations, which are advisory in nature and represent suggested changes to a policy, procedure, practice, or control that supervision staff believes would improve, or prevent deterioration in, condition, operations, or performance.

² DER's guidance is explained in its operating procedures bulletin (OPB), 2013-DER-OPB-03.1, *Supervisory Planning Process* (Oct. 29, 2013). This OPB was rescinded on January 18, 2019. DER officials explained that even though the guidance has been rescinded, the expectation is that examiners follow the previous guidance that risk-based reasons and justifications for the adjustments to examination plans must be approved by the EIC (after consultation with the Deputy Director, DER, as warranted) and are fully documented in the workpapers. On April 1, 2019, after our review period (2016 through 2018) ended, FHFA released a new OPB, *Examination Planning Process* (DER-OPB-2.5).

Prior OIG Audit Reports on FHFA’s Implementation of Supervisory Activities of Freddie Mac

Because targeted examinations are a critical component of FHFA’s supervisory activities, we have audited different aspects of FHFA’s completion of its annual examination plan of targeted examinations of Freddie Mac.

- An audit report issued in September 2016 analyzed whether DER examiners completed the planned targeted examinations for Freddie Mac from 2012 through 2015 and, in those instances where the planned targeted examinations were not completed, whether DER documented the deviations from its plan in accordance with its policies and procedures.³ We found that DER planned 90 targeted examinations for Freddie Mac from 2012 through 2015 but completed only 50. We reported that DER’s official system of record lacked adequate supervisory documentation, which hampered our audit and created a significant risk exposure. We made five recommendations to address the findings identified by the audit.
- A second audit report, also issued in September 2016, assessed whether: (1) DER supported its 2014 and 2015 high-priority planned targeted examinations identified in its annual supervisory plans with risk assessments for both Enterprises and (2) completed those planned high-priority examinations.⁴ Of the 61 high-priority targeted examinations planned for the Enterprises for 2014 and 2015, 32 could be traced to the risk assessments. As of June 17, 2016, when our fieldwork for this audit ended, we found that only 25 of the 61 high-priority targeted examinations (41%) had been completed. We made five recommendations to address the findings identified by that audit.
- A third audit report, issued in September 2017 regarding FHFA’s supervision of Freddie Mac’s cybersecurity risks, found, among other things, that DER did not complete either of the two planned targeted examinations during the 2016 examination

³ OIG, *FHFA’s Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed* (Sept. 30, 2016) (AUD-2016-007) (online [here](#)).

⁴ OIG, *FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed* (Sept. 30, 2016) (AUD-2016-005) (online [here](#)).

cycle.⁵ ⁶ We made two recommendations to address the findings identified by the audit.⁷

FACTS AND ANALYSIS

Of the Planned Targeted Examinations for the 2016 through 2018 Examination Cycles, DER Completed 81%, Commenced 4%, and Documented the Reasons for its Determinations Not to Conduct the Other 15%; Timeliness in Completing Targeted Examinations Remained an Issue

In light of our findings in our 2016 audit (*FHFA’s Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed* (AUD-2016-007)), we performed this audit to analyze whether DER examiners completed the targeted examinations identified in each examination plan for Freddie Mac from 2016 through 2018, the review period for this audit, and compared the results to those of the 2016 audit. We used the same methodology as in our prior audit.

Consistent with DER’s guidance, we considered a targeted examination to be “commenced” when DER issued a request letter.⁸ We considered a targeted examination to be “completed” when DER issued a conclusion letter.⁹ We considered a targeted examination to be “not conducted” when DER documents demonstrated that the status of that targeted examination was converted to ongoing monitoring or a business profile,¹⁰ deferred, or cancelled. We

⁵ OIG, *FHFA Did Not Complete All Planned Supervisory Activities Related to Cybersecurity Risks at Freddie Mac for the 2016 Examination Cycle* (Sept. 27, 2017) (AUD-2017-011) (online [here](#)).

⁶ During the 2016 examination cycle, DER did complete three planned ongoing monitoring activities related to cybersecurity risks at Freddie Mac. DER also completed one planned ongoing monitoring activity to oversee Freddie Mac’s remediation of a cybersecurity-related MRA issued in a prior year and closed it during the 2016 cycle.

⁷ The 2017 audit report included two findings related to DER supervisory activities. As part of the scope of this audit, we evaluated one of the two recommendations included in the 2017 audit report.

⁸ FHFA, OPB, *DER Supervisory Activities* (Sept. 19, 2013) (2013-DER-OPB-04). This OPB was rescinded and replaced by DER-OPB-2.1, *Examination Processes and Documentation: Targeted Examinations* (Sept. 27, 2018). FHFA’s new OPB did not change the basis of our analysis.

⁹ According to FHFA’s *Examination Manual*, once the fieldwork for a targeted examination has been completed and the examination team develops its findings, the EIC communicates those findings to the affected Enterprise through issuance of a conclusion letter.

¹⁰ FHFA’s *Examination Manual* describes a business profile as a document that contains a concise executive summary that (1) demonstrates an understanding of the Enterprise’s present condition and current and prospective risk profile, and (2) highlights key emerging issues, changes in business activities, and past examination findings.

considered a targeted examination to be “commenced but not completed” based on DER’s representation that the examination was in progress in one of three phases: fieldwork, management review, or quality control review.

As described below, we performed three tests to determine whether FHFA completed its planned targeted examinations for Freddie Mac during our review period (2016 through 2018), and if it did not, whether it documented the deviations from its plans in accordance with its policies and procedures. We also compared FHFA’s performance with the review period presented in our 2016 audit report (2012 through 2015) and this review period.

Completion of Planned Targeted Examinations Has Improved and DER Could Account for the Status of All Targeted Examinations

As part of our audit, we assessed whether DER completed its planned targeted examinations for Freddie Mac during our review period.

Result of Test: We developed a list of Freddie Mac targeted examinations planned by DER for the review period from annual examination plans and records obtained from FHFA’s Information Management System (IMS), DER’s official system of record, and identified 46 targeted examinations during the three-year review period. Of these 46 planned targeted examinations, DER records show that, as of July 1, 2019: 37 targeted examinations were completed (81%), although a number were not completed during the examination cycle for which they were planned; 7 were not conducted (15%); and 2 were commenced but not completed (4%). Of the 7 that were not conducted, DER documentation established that 2 were converted to ongoing monitoring, 1 was converted to a business profile, none were deferred, and 4 were cancelled.

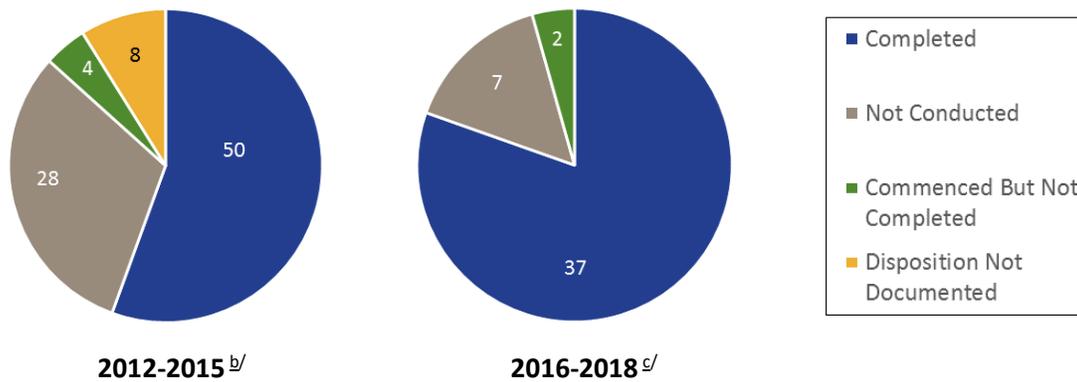
In our 2016 audits, our efforts to track the planning and execution of DER’s supervision activities through documentation maintained in IMS were not successful because a significant amount of documentation was not retained in IMS. We recommended that FHFA develop and implement a control that provides for the tracking of planned targeted examinations, through disposition, in DER’s official system of record. FHFA agreed with this recommendation and implemented a tracking mechanism in 2016. We also recommended that DER revise existing guidance to require examiners to prepare complete documentation of supervisory activities, maintain such documentation in its official system of record, and train DER examiners on the revised guidance. FHFA disagreed with this recommendation and we considered the recommendation to be rejected, and we closed it.

In this audit, we found documentation in DER’s official system of record for each planned targeted examination showing that DER tracked the disposition for each of the 46 targeted examinations planned during the review period. Notwithstanding its rejection of the

recommendation related to its guidance and training, we found that DER did revise its guidance to require examiners to prepare complete documentation of supervisory activities and trained its examiners on the revised guidance.¹¹

Figure 1 below illustrates the results as presented in our 2016 audit (in which we found that 50 of 90 planned targeted examinations (56%) were completed) compared to the results from this audit.

FIGURE 1. EXECUTION BY DER OF 90 PLANNED TARGETED EXAMINATIONS OF FREDDIE MAC FOR 2012 THROUGH 2015 AND OF 46 PLANNED TARGETED EXAMINATIONS FOR 2016 THROUGH 2018^{a/}



^{a/} This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

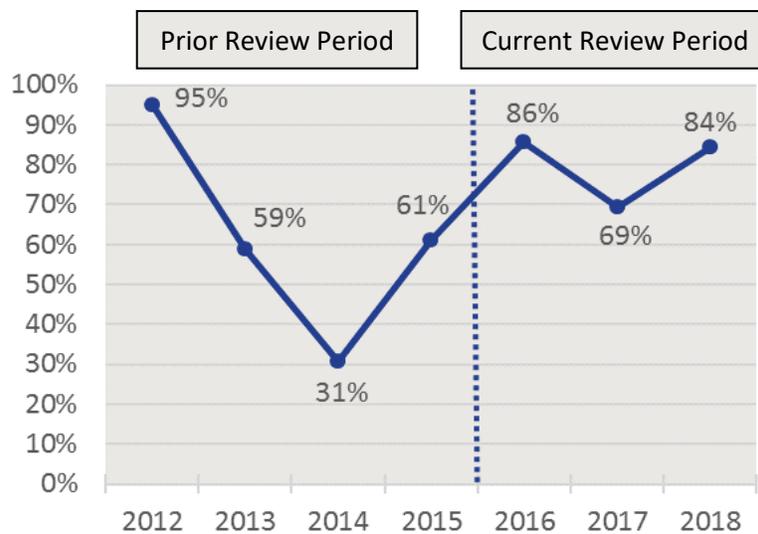
^{b/} Execution of planned targeted examinations for 2012 through 2015 is as of June 17, 2016.

^{c/} Execution of planned targeted examinations for 2016 through 2018 is as of July 1, 2019. All planned targeted examinations for the 2016 through 2018 review period had a documented disposition.

¹¹ We made five recommendations in our 2016 and 2017 audits of FHFA’s supervision of Freddie Mac that were relevant to the objective of this audit. In Appendix 1, we discuss fully the actions taken by FHFA to address these recommendations, even though FHFA did not accept all of them when the audits were issued.

DER’s completion rate of 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) increased 25% compared to the 56% completion rate we found in our prior audit covering planned targeted examinations for the 2012 through 2015 examination cycles. In our 2016 audit, we found that DER could not provide documentation regarding the status for 8 of 90 planned targeted examinations. For the 46 targeted examinations of Freddie Mac planned for the three examination cycles (2016 through 2018) covered by this audit, DER accounted for the status of all of them. Figure 2 captures graphically the percentage of targeted examinations completed from 2012 through 2018.

FIGURE 2. DER’S PLANNED TARGETED EXAMINATIONS FOR FREDDIE MAC – PERCENT COMPLETED FOR 2012 THROUGH 2018 ^{a/, b/, c/}



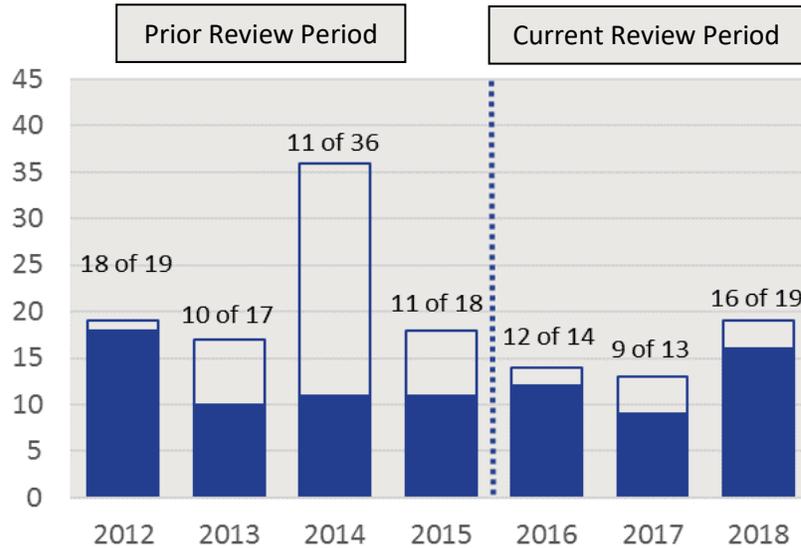
^{a/} This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

^{b/} Percent completed for 2012 through 2015 is as of June 17, 2016.

^{c/} Percent completed for 2016 through 2018 is as of July 1, 2019.

Figure 3 below captures by year the number of targeted examinations planned and completed. For purposes of comparison, we also included the results as they were presented in our 2016 audit report.

FIGURE 3. DER'S NUMBER OF COMPLETED, PLANNED TARGETED EXAMINATIONS FOR FREDDIE MAC FOR 2012 THROUGH 2018^{a/, b/}



^{a/} This chart includes planned targeted examinations that were completed before and after the respective ROE for the examination cycle issued.

^{b/} The performance data in this chart for the completed targeted examinations for Freddie Mac is as of June 17, 2016, for 2012 through 2015, and as of July 1, 2019, for 2016 through 2018.

Timely Completion of Targeted Examinations Prior to Issuance of the ROE Has Improved but Continued to Be an Issue

In our 2016 audit, we found that 33 of the 90 targeted examinations planned during the examination cycles for 2012 through 2015 (37%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). We tested here whether the planned targeted examinations for each examination cycle (2016 through 2018) were completed by DER before the respective ROE issued and compared that completion rate to the completion rate in our 2016 audit.

Result of Test: Of the 46 planned targeted examinations during the three-year review period, we found that 27 (59%) were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). Ten (10) of the 46 (22%) were completed in a later examination cycle and were reported, as

applicable, in subsequent ROEs.^{12 13} (As discussed earlier, the remaining nine were either converted to ongoing monitoring or a business profile, cancelled, or commenced but not completed.) While the rate of timely completion of planned targeted examinations improved during the review period for this audit, timely completion continued to be an issue.

Figure 4 below captures, by examination cycle, the targeted examinations planned and completed from 2012 through 2015, as of June 17, 2016, and 2016 through 2018, as of July 1, 2019. The figure also shows whether the targeted examinations were completed before or after the respective ROE issued.

FIGURE 4. SUMMARY OF DER'S COMPLETED TARGETED EXAMINATIONS FOR FREDDIE MAC FOR 2012 THROUGH 2018^{a/}

	2012	2013	2014	2015	Totals	2016	2017	2018	Totals
Planned Targeted Examinations	19	17	36	18	90	14	13	19	46
Completed Targeted Examinations	18	10	11	11	50	12	9	16	37
Number Completed During the Examination Cycle for Which They were Planned and Before the ROE Issued	13	6	7	7	33	5	8	14	27
Number Completed During a Subsequent Examination Cycle	5	4	4	4	17	7	1	2	10

^{a/} The performance data in this chart for the completed targeted examinations for Freddie Mac is as of June 17, 2016, for 2012 through 2015, and as of July 1, 2019, for 2016 through 2018.

Risk-based Reasons Were Documented for Changes in the Examination Plan

In each year of our review period, DER documented the status of its planned targeted examinations in the year-end examination plans stored in its official system of record.

As previously discussed, 7 of the 46 (15%) planned targeted examinations during our review period were not conducted. DER’s written documentation provided a justification for the change in status for each: 2 were converted to ongoing monitoring; 1 was converted to a business profile; none were deferred; and 4 were cancelled. We assessed the documentation with respect to these seven planned targeted examinations that were not conducted to

¹² For the 10 targeted examinations completed after the ROEs issued, all were completed during the subsequent examination cycle.

¹³ Two of the targeted examinations were completed after the 2018 ROE issued (March 29, 2019) and are expected to be included in the 2019 ROE.

determine if the changes were risk-based and approved by the EIC in accordance with FHFA’s policies and procedures.

Result of Test: We found that all seven changes made to the examination plans were risk-based, documented in the examination workpapers, and approved by the EIC. The seven risk-based reasons included: (1) cancelling one planned targeted examination because additional review of work by Freddie Mac under a separate targeted examination was still pending; (2) converting one planned targeted examination to a business profile given prior work performed and extensive review by Freddie Mac’s internal audit; (3) converting one planned targeted examination to an ongoing monitoring activity because Freddie Mac had not made sufficient progress with the matter that was the subject of the review; (4) cancelling two targeted examinations and using the information that had been gathered to inform other planned examination activities; (5) cancelling one planned targeted examination because a previously issued MRA related to the area under review had not yet been remediated; and (6) converting one planned targeted examination to an ongoing monitoring activity because the subject of the examination fell within the scope of another planned examination activity.

In our prior audit, DER produced documentation for 2014 and 2015 that, in our view, provided risk-based reasons for deviations from the examination plan for only 4 of the 21 planned targeted examinations that were not conducted. During the current review period, as described above, risk-based justifications were documented and approved by the EIC for all seven targeted examinations that were not conducted.

CONCLUSION.....

DER’s completion of planned targeted examinations has improved since our 2016 audit. Specifically, DER completed 81% of its planned targeted examinations for the 2016 through 2018 examination cycles (as of July 1, 2019) compared to the 56% completion rate we found in our 2016 audit covering planned targeted examinations for the 2012 through 2015 examination cycles. Furthermore, in our 2016 audit, we found that DER could not provide documentation showing the status for 8 of 90 planned targeted examinations. For the 46 targeted examinations of Freddie Mac planned for the three examination cycles (2016 through 2018) covered by this audit, DER accounted for all of them. We also found that for each year of our review period, DER documented risk-based reasons for changes in its examination plan.

We found that while timely completion of targeted examinations prior to issuance of the ROE has improved since our 2016 audit, it continued to be an issue. In our 2016 audit, we found

that 37% of targeted examinations planned during the examination cycles for 2012 through 2015 were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle). We found in this audit that 59% of the targeted examinations planned during the three-year review period were completed during the examination cycle for which they were planned (and before the ROE issued for the respective examination cycle) and 22% were completed in a later examination cycle and were reported, as applicable, in subsequent ROEs. The remaining 19% of planned targeted examinations were either converted to ongoing monitoring or a business profile, cancelled, or commenced but not completed.

Since 2016, we have issued three prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Freddie Mac. We made five recommendations in these three audits that were relevant to the objective of this audit. Even though FHFA did not accept all of the recommendations when the audits were issued, we found that FHFA took appropriate action to address the relevant findings and recommendations from these prior audit reports.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this audit report. FHFA provided technical comments on the draft report and those comments were considered in finalizing this report. FHFA also provided a management response, which is included in Appendix 2 of this report. In its response, FHFA acknowledged our conclusion that DER’s completion of planned targeted examinations has improved since the 2016 audit and that FHFA took appropriate action to address the relevant findings and recommendations from prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Freddie Mac.

OBJECTIVE, SCOPE, AND METHODOLOGY.....

We performed this audit to determine whether FHFA completed its planned targeted examinations for Freddie Mac for the 2016, 2017, and 2018 examination cycles and, if it did not, whether it documented the deviations from its plans in accordance with its policies and procedures.

To accomplish our objective, we:

- Reviewed FHFA’s *Examination Manual*; DER’s OPB, *Supervisory Planning Process* (2013-DER-OPB-03.1); DER’s OPB, *DER Supervisory Activities* (2013-DER-OPB-04); DER’s OPB, *Guidelines for Preparing Supervisory Products and Examination Workpapers* (2014-DER-OPB-01); DER’s OPB, *Document Management Guidance* (DER-OPB-4.1); DER’s OPB, *Reports of Examination* (DER-OPB-05.2); DER’s OPB, *Reports of Examination* (DER-OPB-02.4); DER’s OPB, *Examination Processes and Documentation: Targeted Examinations* (DER-OPB-2.1); DER’s OPB, *Examination Planning Process* (DER-OPB-2.5); FHFA’s Advisory Bulletin, *Categories for Examination Findings* (AB 2012-01); and FHFA’s Advisory Bulletin, *Classifications of Adverse Examination Findings* (AB 2017-01);
- Reviewed FHFA’s examination plans for 2016 through 2018 for Freddie Mac and other documentation in FHFA’s IMS to identify the universe of planned targeted examinations;
- Compared the planned targeted examinations for Freddie Mac – as described in FHFA’s examination planning documents – to the targeted examination request letters, conclusion letters, and other relevant documentation in order to determine whether FHFA performed (i.e., completed) its planned targeted examinations for the 2016, 2017, and 2018 examination cycles, and if it did not, to identify the disposition of the examinations (e.g., commenced but not completed, or not conducted);
- Compared DER execution of its planned targeted examinations for Freddie Mac for its 2012 through 2015 examination cycles (as presented in our prior report) to that for the 2016 through 2018 examination cycles;
- Assessed whether DER completed the planned targeted examinations for each examination cycle (2016 through 2018) prior to the respective ROE issued. As part of this assessment, we assessed FHFA’s criteria for reporting MRAs in ROEs;
- Reviewed FHFA’s changes to its 2016 through 2018 examination plans for targeted examinations of Freddie Mac to determine if the changes were risk-based, documented in the examination workpapers, and approved by the EIC in accordance with policies and procedures;
- Evaluated FHFA’s corrective actions for audit recommendations from the following prior OIG audit reports relevant to FHFA’s implementation of its 2016 through 2018 examination plans for targeted examinations of Freddie Mac:

- *FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed* (September 30, 2016) (AUD-2016-005);
 - *FHFA’s Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed* (September 30, 2016) (AUD-2016-007); and
 - *FHFA Did Not Complete All Planned Supervisory Activities Related to Cybersecurity Risks at Freddie Mac for the 2016 Examination Cycle* (September 27, 2017) (AUD-2017-011).
- Interviewed FHFA officials regarding their implementation of the 2016 through 2018 examination plans for targeted examinations of Freddie Mac.

We conducted this performance audit between October 2018 and September 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX 1: FHFA’S IMPLEMENTATION OF RELEVANT RECOMMENDATIONS FROM PRIOR AUDITS ON DER’S SUPERVISORY ACTIVITIES OF FREDDIE MAC.....

Since 2016, we have issued three prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Freddie Mac. Those reports included a total of 11 recommendations. We determined that five of those recommendations were relevant to the objective of this audit and we evaluated DER’s actions to address the recommendations.¹⁴ As discussed below, we found that FHFA took appropriate action to address the relevant findings and recommendations in our prior audit reports on the Agency’s implementation of its examination plans for Freddie Mac.

Audit Reports: FHFA’s Supervisory Planning Process for the Enterprises: Roughly Half of FHFA’s 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed (AUD- 2016-005), and FHFA’s Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed (AUD-2016-007)

- Recommendation 5 (AUD-2016-005) and Recommendation 1 (AUD-2016-007). Revise existing guidance to require examiners to prepare complete documentation of supervisory activities and maintain such documentation in the official system of record and train DER examiners on this guidance.

Status of Recommendation: In its response to our prior audit reports, FHFA disagreed with the recommendation stating that “DER has sufficient guidance in place for documentation of supervisory activities.” Accordingly, we reported the recommendation as closed, rejected, and FHFA recorded a “complete” (closed) date of March 22, 2017, in its OIG recommendation tracking system.

OIG Evaluation: While FHFA disagreed with this recommendation, we found that it did take actions that addressed the intent of the recommendation by revising its guidance, preparing complete documentation of supervisory activities, maintaining the documentation in its official system of records, and training DER examiners. Specifically, FHFA revised existing guidance by issuing two OPBs (one in 2017 and one in 2018), which established requirements for examiners to prepare complete documentation of supervisory activities and maintain such documentation in FHFA’s

¹⁴ One recommendation was made in both audit reports issued in 2016. We are counting that recommendation once in this report.

official system of record (IMS).^{15 16} Additionally, DER provided training to examiners on the new OPBs in division meetings held on April 6, 2017, and September 20, 2018. During this audit, we found that FHFA's documentation of the planning and execution of DER's supervisory activities for the review period were maintained in IMS. In IMS, for example, we found annual examination plans, mid-year updates to those plans, request letters, conclusion letters, and memorandums to file containing justifications for changes to the examination plans and/or the objectives of targeted examinations.

We reported in our 2016 audits that we considered the lack of DER's documentation supporting its supervisory activities, as it related to the objectives of that audit, to create a significant risk exposure. We believe that DER addressed that significant risk exposure during the review period for this audit.

Audit Report: FHFA's Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed (AUD-2016-007)

- **Recommendation 3.** Develop and implement guidance that clearly requires supervisory plans to identify and prioritize the planned targeted examinations that are to be completed for each examination cycle, in order to fully inform the ROE and CAMELSO ratings for that cycle.

Status of Recommendation: In a memorandum dated September 28, 2017, DER reported that all planned actions for this recommendation were completed. Those actions consisted of revising DER's OPB for developing its annual risk assessment for each Enterprise. Subsequently, in October 2017, DER informed our office that it no longer prioritized targeted examinations in examination plans because its expectations were that targeted examinations included in the examination plans are to be conducted during the examination cycle for which they are planned, unless there is a risk-based reason for doing otherwise.

OIG Evaluation: The Deputy Director, DER, informed us that she expects all planned supervisory activities to be completed within the examination cycle unless there is a risk-based or operational justification as to why it should not be completed. We found that a higher percentage of targeted examinations were completed during the examination cycle for which they were planned, and when they were not completed, there was a documented risk-based reason for not doing so. As presented in Figure 4,

¹⁵ FHFA issued DER-OPB-4.1, *Document Management Guidance* (April 3, 2017). This OPB sets forth guidelines for the electronic creation, access, clearance, storage, and disposition of DER documents.

¹⁶ FHFA issued DER-OPB-2.1, *Examination Processes and Documentation: Targeted Examinations* (September 27, 2018). This OPB describes processes and documentation requirements for DER targeted examinations.

there is an increasing trend in the completion of planned targeted examinations during the examination cycle for which they were planned, 2016 through 2018. FHFA's completion rate before the respective ROE issued increased from 5 of 14 (36%) planned targeted examinations in the 2016 examination cycle to 14 of 19 (74%) planned targeted examinations in the 2018 examination cycle.

Furthermore, for those targeted examinations that were converted to ongoing monitoring or a business profile, deferred, or cancelled, we found that DER did document a risk-based reason for not completing them, the reason was approved by the EIC, and the workpapers were documented. We consider the progress made by DER to complete more of its planned targeted examinations within the examination cycle during our review period and to document risk-based reasons for changes to the examination plans as responsive to the intent of the recommendation.

- Recommendation 4. Develop and implement a control that provides for the tracking and documentation of planned targeted examinations, through disposition, in DER's official system of record.

Status of Recommendation: In its response to the recommendation, FHFA agreed and stated that "DER will establish an improved mechanism for tracking the status of activities included on Enterprise examination plans, including changes resulting from the mid-year planning update process and at year-end." In an internal memorandum dated September 22, 2017, DER reported that, in 2016, it developed for beta testing a SharePoint-based tracking mechanism – an added feature to its tracking abilities – for use as part of its examination planning process. According to officials, the tracking mechanism assigns a unique identifier for each planned activity and facilitates the tracking for how each planned activity changes, if at all, from cradle to grave (i.e., from planning through disposition). Specifically, it was developed to list each planned examination activity from the examination plan at the beginning of the year, be updated to reflect additions and changes from the mid-year update planning process, and updated again at year-end to indicate the disposition of each planned activity. DER also plans to continue to assess the effectiveness of its tracking mechanism and look for opportunities for improvement.

OIG Evaluation: We found that DER implemented a SharePoint-based tracking mechanism and has been using some form of it since it was developed in 2016.

In each year of our review period, DER documented the status of its planned targeted examinations for the examination cycle in the year-end examination plans stored in its official system of record. Based on the results of this audit, we found that DER could

account for the status of all planned targeted examinations of Freddie Mac for the three examination cycles we reviewed.

- **Recommendation 5.** Reinforce and hold EICs accountable to follow DER's requirement to fully document the risk-based justifications for changes to the supervisory plan, and that changes to supervisory plans are documented and approved by the EIC. Ensure that examiners follow DER Operating Procedures Bulletin 2013- DER-OPB-03.1 to fully document the risk-based justifications for changes to the supervisory plan, and that changes to supervisory plans are documented and approved by the EIC.

Status of Recommendation: In a memorandum dated September 28, 2017, DER reported that all planned actions for this recommendation were completed. Those actions consisted of revising DER's OPB for developing its annual risk assessment for each Enterprise. FHFA officials reported to us in October 2017 that DER "plans to update this OPB to reflect an enhanced examination planning process that includes (but is not limited to) expectations for mid-year planning update meetings, mid-year plan updates, documentation of rationale for significant updates, and approval requirements for updates to examination plans."

OIG Evaluation: We reviewed the updated OPB, *Examination Planning Process* (DER-OPB-2.5), issued April 1, 2019, and found that it included updated guidance regarding DER's examination planning process. The OPB states that the examination plan may be modified during the course of the year to reflect changes in Enterprise business operations or risk exposures. Any changes should be reflected in revisions to the plan, with documentation of the basis for the revisions. Revisions to a plan must be approved by the EIC and Deputy Director and formally approved as part of the mid-year planning process.

Also, as noted in the Facts and Analysis section of the report, our tests showed that the seven changes (targeted examinations not conducted) to the examination plans (planned targeted examinations that were converted to ongoing monitoring or a business profile, deferred, or cancelled) were risk-based, documented in the examination workpapers, and approved by the EIC.

Audit Report: FHFA Did Not Complete All Planned Supervisory Activities Related to Cybersecurity Risks at Freddie Mac for the 2016 Examination Cycle (AUD-2017-011)

- **Recommendation 3.** Except for rare instances where DER has an urgent need to communicate significant supervisory concerns to an Enterprise board, ensure that all supervisory conclusions and findings reported by DER in the Enterprise's annual

ROEs are based on completed work that has been previously communicated, when required, in writing to the Enterprise.

Status of Recommendation: In internal memoranda dated January 31, 2018, and August 30, 2018, DER reported that planned actions for this recommendation had been completed. Those actions consisted of (1) training of DER examination staff in DER quality control requirements and the content of annual ROEs and (2) issuing DER-OPB-02.4, *Reports of Examination*, in August 2018 that, among other things, states: “The ROE may include any examination conclusion (i.e., a statement supported by examination results) provided that the conclusion has been reviewed by [Quality Control].”

OIG Evaluation: Our tests during this audit found that targeted examinations that resulted in the issuance of MRAs to Freddie Mac (via conclusion letters), during the 2017 and 2018 examination cycles, were reviewed through DER’s quality control process and communicated to Freddie Mac prior to their inclusion in the respective ROE. Specifically, we found that FHFA completed seven targeted examinations before the respective ROE issued that resulted in the issuance of ■ MRAs during the 2017 and 2018 examination cycles, and the results of all seven targeted examinations were communicated to the Enterprise and reviewed through its quality control process prior to their inclusion in the respective ROE. We did not identify any significant supervisory concern identified through a targeted examination that was included in an ROE before the results of the targeted examination were communicated to the Enterprise in a conclusion letter.

We had also recommended in a prior report, as Recommendation 2 in AUD-2016-007, that FHFA assess whether DER had a sufficient complement of qualified examiners to conduct and complete those examinations rated by DER to be of high-priority within each supervisory cycle and address the resource constraints that have adversely affected DER’s ability to carry out its risk-based supervisory plans. We made this recommendation because resource constraints were cited by DER staff as a factor for not completing the planned targeted examinations that were the focus of the audit (notwithstanding, as reported in our 2016 audit, a consistent position of DER leadership and FHFA senior leadership that DER had an adequate complement of examiners and its staffing levels had not adversely affected its ability to meet its supervisory responsibilities). DER partially agreed with the recommendation. In its management response for the audit, DER did agree that it is a sound practice to regularly assess whether staffing levels are sufficient to carry out DER responsibilities for fulfillment of FHFA’s mission, and that this is done as part of the agency-wide budget process for each fiscal year. As of the date of this report, we have an audit in progress of DER’s supervisory workforce planning process, which we initiated in light of this prior recommendation.

APPENDIX 2: FHFA MANAGEMENT RESPONSE



Federal Housing Finance Agency

MEMORANDUM

TO: Marla A. Freedman, Deputy Inspector General for Audits

FROM: Nina A. Nichols, Deputy Director, Division of Enterprise Regulation (DER)^{NAN}

SUBJECT: Draft OIG Report: *FHFA's Completion of Planned Targeted Examinations of Freddie Mac Improved from 2016 through 2018, But Timeliness Remained an Issue*

DATE: September 11, 2019

Thank you for the opportunity to respond to the draft report referenced above (Report). The Report made no recommendations. We appreciate the Office of Inspector General's (OIG) acknowledgment that DER's completion of planned targeted examinations has improved since the OIG's prior 2016 audit, and the OIG's conclusion that FHFA took appropriate action to address the relevant findings and recommendations from prior audit reports related to the completion of planned targeted examinations and other supervisory activities of Freddie Mac.

cc: Chris Bosland
Larry Stauffer
John Major

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