



**DBR's Examinations during the 2017
through 2019 Examination Cycles
Generally Complied with its
Guidelines, but Some Exceptions to
those Guidelines Were Not
Documented and/or Approved, and
DBR's Quality Control Branch Failed
to Identify these Shortcomings**



AUD-2020-010

September 3,
2020

Executive Summary

Created by Congress in 2008, the Federal Housing Finance Agency (FHFA) is charged by the Housing and Economic Recovery Act of 2008 with oversight of Fannie Mae, Freddie Mac, the 11 Federal Home Loan Banks (FHLBanks), and the FHLBanks' fiscal agent, the Office of Finance. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac.

The FHFA Director delegated to the Deputy Director, Division of Federal Home Loan Bank Regulation (DBR), the duty to supervise the FHLBanks and the Office of Finance. As such, DBR conducts annual safety and soundness examinations of each of these regulated entities. DBR's examination and supervisory activities include an annual examination, periodic visitations, special reviews, and offsite monitoring. DBR relies on these activities to reach conclusions on the overall condition and adequacy of risk management policies, procedures, compliance, and control systems at the FHLBanks and the Office of Finance. DBR established minimum frequencies (annual, biennial, or triennial) for performing work programs that pertain to the FHLBanks and the Office of Finance examinations. (Minimum Frequency Guidelines or Guidelines). The Guidelines allow for exceptions to the minimum frequencies given the requisite justification and approval is documented in the examination work papers. DBR has also established a quality control program that performs reviews of DBR examination workpapers intended to ensure high quality work products that adhere to DBR's standards and requirements.

We conducted this audit to determine whether DBR performed its examinations of the FHLBanks and the Office of Finance in accordance with the Minimum Frequency Guidelines. As part of our audit, we assessed Quality Control Branch's (QCB) review of examinations for compliance with the Guidelines. The scope of this audit covered the 2017, 2018, and 2019 examination cycles (review period).

We found that DBR examinations generally complied with the Minimum Frequency Guidelines but that some exceptions to those Guidelines were not documented and/or approved as required. In addition, DBR's QCB reviews failed to identify these shortcomings.

We make two recommendations to address our findings. In a written management response, FHFA agreed with our recommendations.

This report was prepared by James Lisle, Audit Director; Marco Uribe, Auditor-in-Charge; and Christopher Mattocks, Auditor; with assistance from Abdil Salah, Assistant Inspector General of Audits, and Bob Taylor, Senior



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

The report has been distributed to Congress, the Office of Management and Budget, and others, and will be posted to our website, www.fhfaog.gov, and <https://www.oversight.gov/>.

Marla A. Freedman, Senior Audit Executive /s/

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ABBREVIATIONS

AD	Associate Director
DBR	Division of Federal Home Loan Bank Regulation
EIC	Examiner-in-Charge
FHFA	Federal Housing Finance Agency
FHLBanks	Federal Home Loan Banks
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
QCB	Quality Control Branch

BACKGROUND

Federal Home Loan Bank System

The FHLBank System consists of the 11 FHLBanks and the Office of Finance. As of March 31, 2020, the FHLBank System had combined total assets of approximately \$1.26 trillion with total consolidated obligations of approximately \$1.18 trillion.

The FHLBanks are organized under the authority of the Federal Home Loan Bank Act of 1932, as amended. Their mission is to provide liquidity to member institutions (generally, federally insured depository institutions, insurance companies, and eligible community development financial institutions) to support housing finance and community investment. The Office of Finance facilitates the issuance and servicing of FHLBank debt and prepares the FHLBanks' financial reports.

FHFA's Division of Federal Home Loan Bank Regulation

DBR has adopted a supervision program that it maintains is risk-based and consists of both on-site annual examinations and off-site monitoring of the FHLBanks and the Office of Finance.

Reporting to the Deputy Director, DBR's Examinations Group conducts the annual safety and soundness examinations of each FHLBank and the Office of Finance, as well as community investment examinations of each FHLBank. DBR issues an annual Report of Examination for each FHLBank and the Office of Finance. The Report of Examination communicates examination conclusions, findings (if any),¹ and includes composite and component CAMELSO ratings for each entity.²

DBR Examination Process

The *FHFA Examination Manual* and DBR Operating Procedures Bulletins (OPBs) provide guidance to DBR teams performing examinations within the FHLBank System. Part I of the *FHFA Examination Manual* provides a description of the examination program, sets forth

¹ In its technical comments to a draft of this report, DBR stated that the Report of Examination communicates *principal* findings but not necessarily all findings. It asserted that Matters Requiring Attention, the most serious type of examination finding, are principal findings and are always included but other findings are included on a case-by-case basis.

² CAMELSO is a risk-focused rating system under which each FHLBank is assigned a composite rating based on an evaluation of various aspects of its operations. For the FHLBanks, the components evaluated are Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk, and Operational Risk. The Office of Finance is only rated on the Management and Operational Risk components.

examiner processes, and describes examiner work products. Part II of the *FHFA Examination Manual* includes a general description of the examination modules and links to those modules. Twenty-nine (29) examination modules provide examination instructions and work programs that are applicable to each FHLBank’s risk categories and line of business, and one examination module provides examination instructions for the Office of Finance.

When planning an examination, examiners prepare a “pre-examination analysis memorandum” for each applicable examination module to identify areas of review, define the examination objective(s), and provide an explanation of examiners’ decisions to include or exclude areas from the examination scope. Examiners then prepare work programs for the areas to be examined by selecting work steps from the relevant examination module(s) or developing other work steps to provide sufficient coverage of the objectives identified in the pre-examination analysis memorandum. The examiner-in-charge (EIC) documents the overall examination plan in an “examination scope memorandum.”

DBR Work Program Minimum Frequencies

DBR OPB, 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (Minimum Frequency Guidelines or Guidelines),³ establishes the minimum frequencies (annual, biennial, or triennial) for performing the 30 work programs that pertain to the FHLBanks and the Office of Finance examinations. These minimum frequencies are based on the relative risk of the area assessed by the work program.

The OPB includes the process for which exceptions to the Guidelines can be obtained:

Exceptions to the minimum frequency guidelines of work programs established in this OPB must have the approval of the EIC and associate director [AD] of examinations prior to the commencement of the onsite examination. Reasons for exceptions may be, but are not limited to, no or low volume of activity, absence of prior examination findings or concerns, or resource needs for higher risk areas. Examiners must document exceptions in the attendant pre-examination analysis memorandum. The DBR examination scope memorandum should reflect EIC and AD concurrence to deviate from the minimum frequency guideline.

³ 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (issued Dec. 19, 2012; updated Oct. 7, 2016). This OPB was updated again on Feb. 18, 2020, after our review period.

DBR Quality Control Program

DBR's QCB performs reviews of DBR examination workpapers intended to ensure high quality work products that adhere to DBR's standards and requirements.⁴ In the second quarter of 2017, QCB added a procedure to its review of examination workpapers to determine compliance with the Minimum Frequency Guidelines.

* * * * *

Our audit objective was to determine whether DBR performed its examinations of the FHLBanks and the Office of Finance in accordance with the Minimum Frequency Guidelines during the review period. As part of our audit, we assessed QCB's reviews of examinations for compliance with the Guidelines.

FACTS AND ANALYSIS

DBR Examinations Generally Complied with Minimum Frequency Guidelines but Some Exceptions to those Guidelines Were Not Documented and/or Approved; DBR's QCB Reviews Failed to Identify these Shortcomings

During our review period, DBR examiners conducted 33 examinations of FHLBanks and 3 examinations of the Office of Finance. The Minimum Frequency Guidelines called for approximately 600 individual work programs to be performed for the 36 examinations, barring any exceptions allowed by the Guidelines.⁵ In these 36 examinations, we found 28 exceptions were made to the Guidelines and, as a result of these exceptions, 28 work programs were not performed. Of the 28 exceptions, 19 (68%) were properly documented, with the required justification in the pre-examination analysis memorandum and DBR management approval in the examination scope memorandum. However, 9 of the 28 exceptions (32%) did not comply with the Guidelines:

- For two exceptions, a pre-examination analysis memorandum including justification for the exception was not documented. Further, the examination scope memorandum for the examination did not reflect EIC and AD approval of the exceptions. DBR

⁴ 2018-DBR-OPB-3, *Quality Control Program* (issued Dec. 26, 2018; updated Sept. 17, 2019) sets forth guidance for implementing DBR's quality control program.

⁵ During our review period, DBR performed a total of 690 individual work programs; certain work programs were performed more frequently than the minimum requirement in the Guidelines.

officials acknowledged to us during our fieldwork the shortcomings in the documentation.

- For the other seven exceptions, a justification was documented in the pre-examination analysis memorandum but the examination scope memorandum contained no EIC and AD approval of the exceptions. DBR officials acknowledged to us during our fieldwork that the exceptions lacked the requisite approval.

DBR’s QCB performed reviews of the workpapers for each examination DBR conducted during our review period. Our assessment of the QCB’s reviews found that QCB did not identify the documentation shortcomings for the above nine exceptions. The QCB manager acknowledged that QCB should have identified the two exceptions with no documented justification. For the other seven exceptions, the QCB manager told us that QCB’s reviews did not check for EIC and AD approval when justifications for the exception were provided in the pre-examination analysis memorandum.

FINDINGS

1. We found that 9 of the 28 exceptions (32%) to DBR’s Minimum Frequency Guidelines during our review period did not comply with its requirements. Specifically, DBR failed to properly document its justification and/or EIC and AD concurrence for these exceptions.
2. In addition, QCB’s reviews of examiner workpapers did not detect these documentation shortcomings.

CONCLUSION.....

DBR examinations generally complied with Minimum Frequency Guidelines, but some exceptions to those guidelines were not documented and/or approved as required, and DBR’s QCB reviews failed to identify these shortcomings.

RECOMMENDATIONS.....

We recommend that FHFA:

1. Reinforce DBR’s Minimum Frequency Guidelines, including requirements for documenting the justifications and approvals for exceptions to the Guidelines, to DBR’s examination teams and QCB staff.
2. Evaluate QCB review practices and adjust, as needed, to ensure shortcomings in the documentation of exceptions to the Minimum Frequency Guidelines are detected.

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 as an Appendix to this report. In its response, FHFA agreed with both of our recommendations and stated that it has already begun to take corrective actions by drafting an update to its OPB that establishes the Guidelines, presenting those planned changes to all DBR staff, and creating new examination templates. DBR expects that it will finalize its planned changes to the Minimum Frequency Guidelines by October 30, 2020. Further, FHFA stated that QCB will amend its procedure to improve the overall detection of exceptions to the Minimum Frequency Guidelines and the Deputy Director will meet with all QCB staff to review documentation requirements of exceptions to the Minimum Frequency Guidelines by November 30, 2020.

We consider FHFA’s planned corrective actions responsive to our recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY.....

Our audit objective was to determine whether DBR performed its examinations of the FHLBanks and the Office of Finance in accordance with DBR’s Minimum Frequency Guidelines. As part of our audit, we assessed the review of examinations by DBR’s QCB for compliance with the Guidelines. The scope of this audit covered the 2017, 2018, and 2019 examination cycles.

To accomplish our objective, we performed the following.

- Reviewed the following documentation:

- FHFA Examination Manual (Dec. 2013)
- 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (Dec. 19, 2012; updated Oct. 7, 2016)
- 2016-DBR-OPB-01, *Federal Home Loan Bank Examination Workpaper Standards* (Jul. 29, 2016)
- 2018-DBR-OPB-03, *Quality Control Program* (Dec. 26, 2018; updated Sept. 17, 2019)
- GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014)
- Interviewed DBR personnel to gain an understanding of the Minimum Frequency Guidelines, the examination planning process, and DBR's quality control process.
- Obtained and reviewed the examination scope memorandum with scope matrix, all pre-examination analysis memoranda, and all work programs for each examination performed during the review period.
- Calculated the number of work programs expected to be performed during our review period based on an application of the work program minimum frequencies to each FHLBank and Office of Finance examination performed. This calculation was based on an expectation that all work programs with an annual frequency, one half of the work programs with a biennial frequency, and one third of the work programs with a triennial frequency would be performed in each individual examination. This calculation resulted in an expectation that approximately 600 individual work programs would have been performed over the review period. In actual practice, DBR performed a total of 654 individual work programs in support of FHLBank examinations and 36 individual work programs in support of Office of Finance examinations over the course of our review period. Certain work programs were sometimes performed more frequently than required by the Minimum Frequency Guidelines or performed to address risk as directed by the Office of Finance work program.
- Analyzed the work programs performed during each examination in the review period, compared the results against the requirements of the Minimum Frequency Guidelines and identified any exceptions to the Guidelines.
- Determined whether exceptions to the Minimum Frequency Guidelines were properly documented and approved.

- Reviewed DBR Quality Control Branch workpapers for each examination of an FHLBank and the Office of Finance reviewed from July 2017 through the end of our review period to determine whether compliance with the Minimum Frequency Guidelines was tested. Determined whether the results of the QCB reviews were indicative of any concerns with compliance.

We conducted this performance audit from April 2020 to September 2020 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 the 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: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Marla A. Freedman, Senior Audit Executive

FROM: Andre D. Galeano, Deputy Director, Division of FHLBank Regulation (DBR) 

SUBJECT: Draft Audit Report: *DBR's Examinations during the 2017 through 2019 Examination Cycles Generally Complied with its Guidelines, but Some Exceptions to those Guidelines Were Not Documented and/or Approved, and DBR's Quality Control Branch Failed to Identify these Shortcomings*

DATE: September 1, 2020

Thank you for the opportunity to respond to the draft report titled, *DBR's Examinations during the 2017 through 2019 Examination Cycles Generally Complied with its Guidelines, but Some Exceptions to those Guidelines Were Not Documented and/or Approved, and DBR's Quality Control Branch Failed to Identify these Shortcomings* (Report). Notwithstanding the Report's findings regarding certain exceptions, we appreciate OIG's acknowledgment that DBR generally followed its minimum frequency workpaper guidelines. With respect to the exceptions, the draft Report makes two recommendations, which we agree to address.

Recommendation 1: *Reinforce DBR's Minimum Frequency Guidelines, including requirements for documenting the justifications and approvals for exceptions to the Guidelines, to DBR's examination teams and QCB staff.*

Management Response: FHFA agrees with this recommendation. In anticipation of OIG's report, DBR has already begun work to strengthen our expectations for examination coverage by drafting an update to our Operating Procedure Bulletin that establishes the guidelines, presenting those planned changes to all DBR staff, and creating new examination templates. DBR will finalize its planned changes to the Minimum Frequency Guidelines by October 30, 2020.

Recommendation 2: *Evaluate QCB review practices and adjust, as needed, to ensure shortcomings in the documentation of exceptions to the Minimum Frequency Guidelines are detected.*

Management Response: FHFA agrees with this recommendation. By November 30, 2020, the DBR Quality Control Branch will amend its procedure to improve the overall detection of exceptions to DBR's minimum frequency guidelines and the Deputy Director will meet with all QCB staff to review documentation requirements of exceptions to the Minimum Frequency Guidelines.

cc: Chris Bosland
Kate Fulton
John Major

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