DBR Generally Followed its Guidance to Assess the Remediation of Adverse Examination Findings Issued to the FHLBanks and the Office of Finance
Executive Summary

Created by the Housing and Economic Recovery Act of 2008, the Federal Housing Finance Agency (FHFA or Agency) is charged with, among other things, 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 Division of Federal Home Loan Bank Supervision (DBR) conducts annual safety and soundness examinations of each of the FHLBanks and the Office of Finance. During these examinations, examiners may identify adverse examination findings that pose a risk to the safety and soundness of an FHLBank or the Office of Finance, or instances of non-compliance with laws and regulations. DBR issues an annual Report of Examination (ROE), which communicates principal findings of the examination, to the board of directors of each of the FHLBanks and the Office of Finance. For each adverse examination finding, DBR’s examiners work with the respective FHLBank or the Office of Finance to establish a remediation plan that documents the steps necessary to resolve the adverse findings. DBR examiners then assess the FHLBank’s or the Office of Finance’s remediation efforts against this remediation plan. DBR uses its examination findings management system (FMS) to track adverse examination findings from issuance through remediation.

We conducted this audit to determine whether DBR tracked and assessed the remediation of adverse examination findings in accordance with its guidance. The scope of this audit covered the 2018, 2019, and 2020 examination cycles (review period).

We found that DBR followed its guidance to assess the remediation of adverse examination findings issued to FHLBanks and the Office of Finance for 37 of 38 sampled adverse examination findings. For the other sampled adverse examination finding, DBR closed the finding without ensuring its complete remediation. Prematurely closing adverse examination findings may lead to safety and soundness findings and violations not being remediated, and not fully informing the board of directors of such. In addition, we found that a required review by DBR of FMS data input was not consistently performed for all 2020 examinations and, when it was performed, the review did not catch certain input errors. Data input errors could hinder the usefulness of FMS data by DBR management. Further, we found two control activities that DBR examiners were expected to perform were not in written policy; this increases the risk that the activities may not be consistently performed or documented in accordance with management’s expectations.
We make two recommendations to address our findings. In a written management response, FHFA agreed with the 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 for Audits; James Hodge, Deputy Assistant Inspector General for Audits; and Bob Taylor, Senior 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.fhfaoig.gov, and www.oversight.gov.

Marla A. Freedman, Senior Audit Executive /s/
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## Abbreviations

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BACKGROUND

Federal Home Loan Bank System

The FHLBank System consists of the 11 FHLBanks and the Office of Finance. 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’ combined financial reports.

As of March 31, 2021, the FHLBank System had combined total assets of approximately $771 billion with total consolidated obligations of approximately $720 billion.

FHFA’s Division of Federal Home Loan Bank Regulation

The FHFA Director delegated to the Deputy Director, DBR, the duty to supervise the FHLBank System. As such, DBR conducts annual safety and soundness examinations of each of the FHLBanks and the Office of Finance. 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. During these examination and supervisory activities, examiners may identify adverse examination findings that pose a risk to the safety and soundness of the FHLBanks or the Office of Finance or instances of non-compliance with laws and regulations. FHFA guidance classifies adverse examination findings as Matters Requiring Attention (MRAs), Violations, or Recommendations.

- MRAs are designated as either a critical supervisory matter or a deficiency. MRAs designated as critical supervisory matters mean that the findings pose a substantial risk to the safety and soundness of the FHLBanks or the Office of Finance. MRAs designated as deficiencies mean that DBR believes that the findings could escalate and potentially have a negative effect on the condition, financial performance, risk profile, operations, or reputation of the FHLBanks or the Office of Finance. MRAs require corrective actions from the FHLBank or Office of Finance.

1 FHFA Advisory Bulletin (AB) 2017-01, Classifications of Adverse Examination Findings, establishes classifications of adverse examination findings that identify priorities for remediation by the regulated entities. AB 2017-01 is available on the FHFA website here.
Violations are matters in which an examination discloses noncompliance with laws, regulations, or orders. Violations require corrective actions from the FHLBanks or the Office of Finance to correct, if possible, the past noncompliance with requirements and to change a program or practice to prevent recurrence.

Recommendations are advisory in nature and suggest changes to a policy, procedure, practice, or control that supervision staff believes would improve, or prevent deterioration in, condition, operations, or performance. Implementation is discretionary, although FHFA expects the FHLBanks or the Office of Finance to implement a recommendation.

DBR issues an annual ROE to the board of directors of each of the FHLBanks and the Office of Finance. The ROE communicates substantive examination conclusions, principal findings, and the composite and component CAMELSO ratings for each entity. Board of directors’ awareness of significant supervisory issues is critical because the board is ultimately responsible for the organization’s safety and soundness.

During the 2018 through 2020 examination cycles, DBR conducted 36 annual examinations of the FHLBanks and the Office of Finance and issued 466 adverse examination findings (217 MRAs, 5 Violations, and 244 Recommendations). Of those adverse examination findings, 318 were closed as of April 9, 2021 (146 MRAs, 4 Violations, and 168 Recommendations).

**Remediation of Adverse Examination Findings**

For each adverse examination finding, DBR’s examiners work with the respective FHLBank or the Office of Finance to establish a remediation plan that documents the steps necessary to resolve the adverse findings. These steps serve as the basis of an institution’s remediation plan, including due date(s) for each adverse finding. Examiners need to establish due dates appropriately reflecting the urgency in addressing the adverse finding and in discussion with the FHLBank’s or Office of Finance’s management.

DBR examiners assess the FHLBank’s or the Office of Finance’s remediation efforts against the remediation plan and document their analysis and conclusions in a remediation memorandum. According to DBR’s Operating Procedures Bulletin (OPB), 2017-DBR-OPB-01, *Federal Home Loan Bank Examination Adverse Findings Processes* (issued April 19, 2017; updated August 27, 2020), in evaluating whether an FHLBank or the

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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.
Office of Finance has remediated a finding, an examiner needs to consider the totality and quality of the remedial actions the entity completed to address the finding substantively. A finding’s primary focus, as expressed in the finding memorandum’s introductory statement and explained in the “basis section” of the finding memorandum, carries through to the remediation points in the finding memorandum (and vice versa). When concluding that an FHLBank or the Office of Finance has substantively remediated a finding, an examiner may conclude that the entity did not satisfactorily address a particular finding’s remediation point (or points). If an examiner reaches such a conclusion, the examiner needs to determine the appropriateness of drafting a new finding memorandum for the remediation point (or points) not addressed satisfactorily, alone or with other newly identified remediation points.

DBR’s Examination Findings Management System

DBR’s FMS is a central repository for tracking adverse examination findings issued at the conclusion of FHLBank or Office of Finance examinations. Among the things tracked in FMS are the status of the corrective action in the remediation plan for each finding. DBR’s OPB, 2012-DBR-OPB-04, Findings Management System (issued December 31, 2012; last updated March 3, 2020), defines FMS data fields and provides guidance for completing documents.

Quality Control Reviews

DBR’s OPB, 2018-DBR-OPB-03, Quality Control Program (issued December 26, 2018; updated September 17, 2019), provides guidance for quality control reviews of DBR work products. According to the guidance, the Quality Control Branch (QCB) performs a “general review” and “sectional reviews” of workpapers and related documents prepared by DBR’s examination offices. The general review is to assess overall aspects of the examination workpapers and includes assessing the accuracy, consistency, and sufficiency of the documents as well as compliance with FHFA and DBR requirements for the documents, such as finding (e.g., MRAs) and closing memoranda, and FMS entries. A general review is “in essence a macro review of the workpapers.” The sectional review is to assess the workpapers of a specific examination activity typically associated with an examination work program area (e.g., Credit Risk Management, Interest Rate Risk Management). The review is “a comprehensive assessment of summary memorandum and supporting documentation in the section” being reviewed.

FACTS AND ANALYSIS

We performed this audit to determine whether DBR tracked and assessed the remediation of adverse examination findings in accordance with its guidance. To perform this audit, we reviewed DBR’s adverse finding remediation processes and guidance, and selected a random
sample of 38 closed adverse examination findings from the 318 adverse examination findings closed during the 2018 through 2020 examination cycles, as of April 9, 2021 (review period). Our sample included 28 closed MRAs, 2 closed Violations, and 8 closed Recommendations.

With One Exception, DBR Followed its Guidance to Assess the Remediation of Adverse Examination Findings Issued to the FHLBanks and the Office of Finance

For 37 (97%) of the 38 adverse examination findings in our sample, we found DBR assessed the remediation efforts by the FHLBanks and the Office of Finance and either closed the finding (35 findings) or carried forward an incomplete remediation point to a new finding (2 findings) in accordance with DBR’s standard. However, for the other adverse examination finding – an MRA related to information security access controls at one FHLBank – DBR closed the finding without ensuring complete remediation. In an interview, the Examiner-in-Charge (EIC) acknowledged that the adverse examination finding should have remained open.

Prematurely closing adverse examination findings may prevent the FHLBank’s board of directors from ensuring that critical supervisory issues that may lead to safety and soundness concerns are remediated.

DBR Did Not Consistently Perform a Required Review of FMS Data Input

The FMS tracking system is used by DBR to: (1) monitor the status of adverse examination findings for each FHLBank and the Office of Finance, (2) analyze trends, and (3) support continuity within the supervision process as DBR examiners rotate to different FHLBanks and the Office of Finance. To ensure the accuracy of data in FMS, a March 2020 update to 2012-DBR-OPB-04 requires that a second examination team member verify that the EIC or designee populated FMS appropriately. We found no evidence that a second review was performed for 3 of the 12 annual examinations completed during 2020 that were subject to this requirement.

For the 9 annual examinations that were reviewed in accordance with the 2020 requirement, we found 29 adverse examination findings where the data in FMS was incomplete or incorrect. Specifically, 28 adverse examination findings had status fields that were blank when they should not have been, and 1 had an incorrect status (a field was incorrectly

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3 We found that DBR’s QCB performed general reviews of all examinations during the review period. However, QCB failed to detect that DBR closed this adverse examination finding without determining complete remediation. The QCB manager acknowledged the shortcoming should have been detected by the QCB process.

4 We found 18 blank “closed and reissued” status fields and 10 blank “carryforward” status fields.
marked “yes” when it should have been marked “no”). DBR officials acknowledged the errors and told us they would be corrected.⁵

Two Control Activities that DBR Management Expected Examiners to Perform Were Not in Written Policy

Federal standards for internal control state that management should implement control activities through policies. An attribute of this principle is that management communicates to personnel the policies and procedures so that personnel can implement the control activities for their assigned responsibilities.⁶ Our review of DBR’s OPBs and discussions with DBR officials found that the OPBs cover the critical aspects of the adverse examination findings remediation process, including:

- Procedures for establishing remediation plans, and assessing and concluding on the FHLBanks’ and Office of Finance’s remediation actions;
- Supervisory review and approval requirements for the remediation of adverse examination findings;
- Workpaper standards for adverse examination findings memoranda, remediation plans, remediation point(s) with due dates, and remediation memoranda;
- Procedures for maintaining FMS; and
- Procedures to communicate the status of all principal findings to the board of directors of each FHLBank and the Office of Finance.

We also found two practices in DBR’s adverse examination findings remediation process that had not been reduced to writing in DBR’s OPBs. Specifically, the Deputy Director told us that he expects that the internal audit functions’ reviews of remediation efforts of the FHLBanks or the Office of Finance will be included in the remediation packages and reviewed by DBR examiners. However, we found four adverse examination findings in our sample (11%) where the FHLBank’s internal audit review of remediation actions was not documented. For one of these adverse examination findings, the FHLBank’s internal audit review was not available according to the FHLBank’s remediation package submitted for DBR review; for the other three adverse examination findings, the examiners asserted that the FHLBank’s internal audit reviews were reviewed on a secure terminal, but the examiners did not document their review.

⁵ For the three annual examinations completed during 2020 for which there was no evidence of a second review, we found no instances where the data in FMS was incomplete or incorrect.

This expectation was not included in DBR’s OPBs. Similarly, DBR officials expect that the EIC and the Associate Director will approve any extension of a remediation point due date, and these approvals will be documented; but this expectation also was not included in DBR’s OPBs.  

**FINDINGS**

- With one exception in our sample, DBR followed its guidance to assess the remediation of adverse examination findings issued to the FHLBanks and the Office of Finance.
- DBR did not consistently perform a required review of FMS data input for all examinations, and when it did the review, the review did not catch certain input errors.
- Two control activities that DBR management expected examiners to perform were not in written policy.

**CONCLUSIONS**

We determined that DBR followed its guidance to assess the remediation of adverse examination findings issued to FHLBanks and the Office of Finance for 37 of 38 sampled adverse examination findings. For the other sampled adverse examination finding, DBR closed the finding without ensuring its complete remediation. Prematurely closing adverse examination findings may lead to safety and soundness findings and violations not being remediated, and not fully informing the board of directors of such. In addition, we determined that a required review by DBR of FMS data input was not consistently performed for all 2020 examinations and, when it was performed, the review did not catch certain input errors. Data input errors could hinder the usefulness of FMS data by DBR management. Further, we determined that two control activities that DBR examiners were expected to perform were not in written policy; this increases the risk that the activities may not be consistently performed or documented in accordance with management’s expectations.

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7 We found that all due date extensions were documented and approved.
RECOMMENDATIONS

We recommend that FHFA:

1. Reinforce to DBR examiners, through supervision and training, to ensure: (a) all remediation points for adverse examination findings are addressed or carried forward in accordance with DBR guidance prior to closing the finding, and (b) required reviews of FMS data input are performed and documented, and errors corrected.

2. Update DBR guidance to include written requirements to address management’s expectations that: (a) reviews by the FHLBanks’ and Office of Finance’s internal audit functions are included in adverse finding remediation packages and reviewed by DBR examiners, and (b) approvals of adverse finding remediation due date extensions are documented.

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 DBR would take the following corrective actions by January 31, 2022.

1. Emphasize to its staff, by way of Deputy Director communication and specific training, that remediation points be addressed or carried forward appropriately. Furthermore, DBR will (a) reinforce the expectations for complete and accurate entries in FMS during a targeted training session for all examination staff responsible for remediating findings and QCB, (b) create a review template to ensure more comprehensive and consistent secondary reviews of FMS, (c) explore technical changes to FMS itself to reduce errors of omission, and (d) correct FMS errors found by OIG staff.

2. Amend its written procedures to include: (a) an expectation that examiners review internal audit closure assessments of DBR examination findings, and (b) a memorialization of DBR’s current processes for granting and documenting extensions of examination findings.

We consider FHFA’s planned corrective actions responsive to our recommendations.
OBJECTIVE, SCOPE, AND METHODOLOGY .............................................

Our audit objective was to determine whether DBR tracked and assessed the remediation of adverse examination findings in accordance with its guidance. The scope of this audit covered the 2018, 2019, and 2020 examination cycles (review period).

To accomplish our objective, we performed the following:

- Determined that the control activities component of internal control was significant to this objective, along with the underlying principle that management should implement control activities through policies. We assessed the following FHFA and DBR policies, procedures, and guidance and the extent to which these policies, procedures, and guidance were consistent with internal control standards:
  - AB 2017-01, Classifications of Adverse Examination Findings (March 13, 2017)
  - 2016-DBR-OPB-01, Federal Home Loan Bank Examination Workpaper Standards (July 29, 2016; last updated September 9, 2020)
  - 2018-DBR-OPB-03, Quality Control Program (December 26, 2018; updated September 17, 2019)

- Reviewed prior OIG reports on DBR’s assessment and remediation of adverse examination findings and related topics:
  - OIG, FHFA’s Use of Inconsistent Criteria Mattered Affected its Reporting of Remediation of Serious Deficiencies in its 2015 Performance and Accountability Report (November 9, 2016) (EVL-2017-001) (online here)
  - OIG, DBR’s Unwritten Procedures and Practices for Oversight of Efforts by Federal Home Loan Banks to Correct Deficiencies Underlying the Most Serious Supervisory Matters Are Inconsistent with the Written Oversight Requirements Promulgated by FHFA (September 30, 2016) (COM-2016-006) (online here)
Interviewed DBR personnel to gain an understanding of DBR’s process for assessing the remediation of adverse examination findings.

Reviewed the sequential order of adverse examination finding numbers for each FHLBank and the Office of Finance to determine completeness of the data.

Compared the principal findings listed in each of the FHLBank and Office of Finance ROEs during our review period to FMS to determine whether all MRAs were reported in accordance with 2017-DBR-OPB-01, Federal Home Loan Bank Examination Adverse Findings Processes.

Selected a non-projectable sample of 38 adverse examination findings (MRAs, violations, and recommendations) from a population of 318 safety and soundness adverse examination findings opened during the 2018 through 2020 examination cycles and closed as of April 9, 2021. Our sample included 28 MRAs, 2 Violations, and 8 Recommendations randomly selected out of a population of 146, 4, and 168, respectively. We tested these adverse examination findings to determine whether they were tracked and assessed in accordance with DBR guidance. Specifically, we performed the following:

- We determined whether each adverse examination finding had a documented remediation plan with due dates that were developed based on discussions with FHLBanks or the Office of Finance management.

- We determined whether the remediation documentation supported the adverse examination finding closure determination (i.e., the FHLBank or the Office of Finance has fully, substantively, or to a limited extent remediated the adverse examination findings) and confirmed that remediation points that remained open were carried forward to a new finding.

- We determined whether the closure determination was properly approved (i.e., EIC approval for closure of findings that were found to be fully remediated, Associate Director approval for closure of findings that were substantively remediated or found to be remediated between annual on-site examinations).

- For examinations completed in 2020, we determined whether a second examination team member verified that the EIC or designee populated FMS
with the appropriate attributes and uploaded supporting documents upon completion of the examination.

- Obtained and reviewed the finding memorandum and finding remediation memorandum for adverse examination findings with a remediation point to be carried forward and determined whether the remediation point to be carried forward was included in a new finding. For findings that were substantively remediated, we determined whether Associate Director concurrence with the determination was documented.

- Reviewed DBR QCB workpapers for each examination of an FHLBank and the Office of Finance during the review period to determine whether inaccuracies within FMS were identified.

- Made inquiries of DBR management and determined how the performance result for performance measure 1.3.1 (Determine that the regulated entities have satisfactorily addressed safety and soundness Matters Requiring Attention in accordance with agreed upon remediation plans and timeframes) is calculated and obtained DBR’s documentation supporting the calculation.\(^8\)

We conducted this performance audit from March 2021 to September 2021 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.

\(^8\) Our review of DBR’s documentation of calculation found no exception.
MEMORANDUM

TO: Marla A. Freedman, Senior Audit Executive, Office of Inspector General

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

SUBJECT: Draft Audit Report: DBR Generally Followed its Guidance to Assess the Remediation of Adverse Examination Findings Issued to the FHLBanks and the Office of Finance

DATE: August 30, 2021

Thank you for the opportunity to respond to the Office of Inspector General’s (OIG) draft report referenced above (Report). The Report evaluates whether Division of FHLBank Regulation (DBR) tracked and assessed the remediation of adverse examination findings in accordance with its guidance for 2018-2020 examinations. While the Report found that we generally followed our guidance, it noted some exceptions and gaps, and makes two recommendations, to which we agree.

**Recommendation 1:** Reinforce to DBR examiners, through supervision and training, to ensure: (a) all remediation points for adverse examination findings are addressed or carried forward in accordance with DBR guidance prior to closing the finding, and (b) required reviews of FMS data input are performed and documented, and errors corrected.

**Management Response:** FHFA agrees with the recommendation. With respect to part a of the recommendation, DBR will emphasize that remediation points are addressed or carried forward appropriately by way of a Deputy Director communication to examination staff and training to staff specifically addressing remediation processes.

With respect to part b of the recommendation, DBR will 1) reinforce the expectations for complete and accurate entries in the FMS during a targeted training session for all examination staff responsible for remediating findings and for the Quality Control Branch, 2) create a review template to ensure more comprehensive and consistent secondary reviews of FMS, 3) explore technical changes to the FMS itself to reduce errors of omission, and 4) correct the FMS errors found by OIG staff.
DBR will complete these actions by January 31, 2022.

**Recommendation 2:** Update DBR guidance to include written requirements to address management’s expectations that: (a) reviews by the FHLBanks’ and Office of Finance’s internal audit functions are included in adverse finding remediation packages and reviewed by DBR examiners, and (b) approvals of adverse finding remediation due date extensions are documented.

**Management Response:** FHFA agrees with the recommendation. By January 31, 2022, DBR will amend its written procedures to include a) an expectation that examiners review internal audit closure assessments of DBR examination findings and b) a memorialization of our current processes for granting and documenting extensions of examination findings.

I appreciate the professionalism and courtesy of the OIG staff who conducted this audit. I find the results valuable and I believe they will lead to more efficient operations here in DBR. If you have addition questions, please feel free to contact Rick Dalton.

cc: Edom Aweke  
    John Major  
    Richard Dalton
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