



Compliance Review of FHFA's Process for Reviewing the Enterprises' Proposed FY 2019 and FY 2020 Annual Operating Budgets



COM-2020-003

March 13, 2020

Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) placed Fannie Mae and Freddie Mac (the Enterprises) into conservatorships in September 2008, delegating to their boards of directors and executive management the authority to manage general corporate governance and day-to-day matters, such as establishing their annual operating budgets (budgets). FHFA rescinded the Enterprises' authority to set budgets without Agency review and approval in November 2012. The first fiscal year (FY) for which FHFA reviewed and approved the Enterprises' budgets was FY 2013.

Our 2015 evaluation of FHFA's process for reviewing the Enterprises' proposed budgets found several deficiencies, including FHFA neither performing independent analysis of the budgets nor consulting with other Agency divisions with programmatic expertise in the Enterprises' operations. We made four recommendations regarding the identified deficiencies, all of which FHFA accepted. Our second recommendation was that FHFA "[r]evise the existing budget review process and staff the review process with employees who have the qualifications and experience needed for critical financial assessments of the proposed Enterprise budgets to permit FHFA to determine whether each Enterprise's budget aligns with FHFA's strategic direction and its safety and soundness priorities."

In response to our second recommendation, FHFA committed to hire a financial analyst and to assign other employees "with relevant technical qualification and experience to support the budget review process." FHFA also committed to "strategically consult with staff from FHFA's Division of Housing Mission and Goals [DHMG] and Division of Enterprise Regulation [DER] with expertise on specific budget items and strategic initiatives and staff from FHFA's Office of Budget and Financial Management [OBFM] with expertise on baseline expenditures." We closed the recommendation in April 2016 based on the Agency's staffing actions and the Agency's issuance of budget oversight procedures, which included a provision for FHFA's Division of Conservatorship (DOC) to note the views of internal divisions and/or offices and develop an understanding for the basis of one-time costs.

We initiated this compliance review to determine whether FHFA met its staffing and consultation commitments when reviewing the Enterprises' proposed FY 2019 and FY 2020 budgets. We found that FHFA met both commitments. The budget review was conducted by a DOC employee who appears to possess the needed qualifications and experience, and DOC consulted with other FHFA divisions and offices regarding the proposed FY 2019 and FY 2020 budgets.



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FHFA's management response is reprinted in Appendix A.

This report was prepared by Karen E. Berry, Senior Investigative Counsel, and Alisa Davis, Senior Policy Advisor. This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov.

/s/

Brian Baker

Acting Deputy Inspector General for Compliance & Special Projects

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ABBREVIATIONS

2016 Procedures	Division of Conservatorship's 2016 <i>Enterprise Administrative Budget Oversight Procedures</i>
2018 Procedures	Division of Conservatorship's 2018 <i>Enterprise Administrative Budget Oversight Procedures</i>
Budget	Enterprise Annual Operating Budget
DER	Federal Housing Finance Agency Division of Enterprise Regulation
DHMG	Federal Housing Finance Agency Division of Housing Mission and Goals
DOC	Federal Housing Finance Agency Division of Conservatorship
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
FY	Fiscal Year
OBFM	Federal Housing Finance Agency Office of Budget and Financial Management
OIG	Federal Housing Finance Agency Office of Inspector General

BACKGROUND

FHFA Oversight of the Enterprises' Budgets

FHFA placed Fannie Mae and Freddie Mac into conservatorships in September 2008, but delegated to their boards of directors and executive management the authority to manage general corporate governance and day-to-day matters, subject to FHFA's right to revoke the delegation at any time. Using this delegated authority, the Enterprises set their budgets without Agency review and approval for FY 2009 through FY 2012.¹

In November 2012, FHFA rescinded the Enterprises' authority to set budgets without Agency review and approval, "to ensure that the [Enterprises'] budgets [are] properly aligned with both FHFA's strategic direction and its safety and soundness priorities." The first fiscal year for which FHFA reviewed and approved the Enterprises' budgets was FY 2013.

Prior Reports Identified Deficiencies in FHFA's Oversight of the Enterprises' Proposed Budgets

A 2015 Evaluation Found that FHFA's Analysis of the Enterprises' Proposed Budgets Was Cursory and Recommended Improvements

In a September 2015 evaluation, we reviewed FHFA's process for reviewing the Enterprises' proposed FY 2013, FY 2014, and FY 2015 budgets.² We found that DOC³ relied largely upon the Enterprises' own analyses of their proposed budgets, performing no independent analysis of those budgets' reasonableness or whether they aligned with FHFA's strategic direction and safety and soundness objectives. We also observed that DOC "did not seek formal input from FHFA employees in other FHFA divisions with programmatic expertise in the Enterprises' programs."

We made four recommendations regarding the identified deficiencies, all of which FHFA accepted.⁴ Our second recommendation was that FHFA "[r]evise the existing budget review process and staff the review process with employees who have the qualifications and

¹ Both Enterprises align their fiscal years with the calendar year.

² See OIG, *FHFA's Exercise of Its Conservatorship Powers to Review and Approve the Enterprises' Annual Operating Budgets Has Not Achieved FHFA's Stated Purpose* (Sept. 30, 2015) (EVL-2015-006) (online at <https://www.fhfaoig.gov/Content/Files/EVL-2015-006.pdf>).

³ FHFA renamed the DOC as the Division of Resolutions effective January 30, 2020. For ease of reference and because this division operated under its prior name at all relevant times, this report refers to the division as DOC.

⁴ FHFA agreed to Recommendations 1, 2, and 3, and "generally agreed" to Recommendation 4.

experience needed for critical financial assessments of the proposed Enterprise budgets to permit FHFA to determine whether each Enterprise’s budget aligns with FHFA’s strategic direction and its safety and soundness priorities.”⁵ We did not specify a minimum number of employees necessary for budget review, nor whether budget review work should comprise a certain percentage of an employee’s duties; we appropriately left those considerations to the Agency’s judgment and discretion.

In response to our second recommendation, FHFA committed to hire a financial analyst and to assign other employees “with relevant technical qualification and experience to support the budget review process.” FHFA also committed to “strategically consult with staff from [DHMG] and [DER] with expertise on specific budget items and strategic initiatives and staff from [OBFM] with expertise on baseline expenditures.”

In 2016, FHFA Issued Budget Review Procedures

In May 2016, the Agency issued *Enterprise Administrative Budget Oversight Procedures* (2016 Procedures), which modified the Agency’s Enterprise budget review process. The 2016 Procedures did not specify any particular qualifications or experience for employees performing budget review, but stated that DOC “notes the views of internal divisions and/or offices and develops an understanding for the basis of the one-time costs.” We closed our second recommendation after FHFA issued the 2016 Procedures and tasked three employees who possessed relevant financial and budgeting experience to perform the annual budget review.

In 2017, Our Compliance Review Found Improvements But Also Problems in the Agency’s Budget Review Process

A 2017 compliance review found that DOC had assigned qualified and experienced employees to review the Enterprises’ proposed FY 2017 budgets. While it found that DOC solicited comments and feedback from several FHFA divisions and offices, none provided any feedback. We made no formal recommendations but suggested that DOC leadership more closely oversee the budget review process in the future.

⁵ This Compliance Review does not assess the reasonability of the Enterprises’ budgets nor whether they align with FHFA’s strategic direction and its safety and soundness priorities. In FY 2012 (the final FY for which the Enterprises could set their budgets without FHFA review and approval), the Enterprises recorded administrative expenses totaling a combined \$3.928 billion. Their combined recorded administrative expenses have increased year over year every year since with only one exception (2016), and the combined proposed FY 2020 budgets also represent an increase over the prior year’s spending. See Appendix B.

In 2018, FHFA Revised its Budget Review Procedures

In 2018, FHFA revised its budget review procedures (2018 Procedures). Like the 2016 Procedures, the 2018 Procedures do not specify any required qualifications or experience for employees performing budget review. The 2018 Procedures eliminate many of the requirements in the 2016 Procedures. Of relevance to this compliance review, the 2018 Procedures do not require DOC to confer with other FHFA divisions or offices prior to DOC making a recommendation, even though FHFA, in response to our 2015 recommendation, committed that DOC would strategically consult with staff from DHMG, DER, and OBFM and we relied on this commitment when we closed this recommendation. The 2018 Procedures were in effect when DOC reviewed the Enterprises' proposed FY 2019 and FY 2020 budgets.

FINDINGS

This compliance review tested whether FHFA met its commitments in reviewing the Enterprises' proposed FY 2019 and FY 2020 budgets,⁶ to:

1. Staff the review process with employees who have the qualifications and experience needed for critical financial assessments of the proposed budgets; and
2. Consult with DHMG and DER on specific budget items and strategic initiatives and with OBFM on baseline expenditures.

We found that DOC met both commitments.

Review of the Proposed FY 2019 and FY 2020 Budgets Was Conducted by a DOC Employee Who Appears to Possess the Needed Qualifications and Experience

Our review found that DOC used one employee as the principal reviewer of the Enterprises' proposed FY 2019 and FY 2020 budgets. While DOC had assigned three employees, on a part-time basis, to review the Enterprises' proposed FY 2017 budgets, our 2015 recommendation did not set a minimum number of employees required to conduct the budget review. It focused on whether the assigned employee(s) possessed sufficient qualifications and experience. FHFA reported to us that the primary employee who performed budget review for the proposed FY 2019 and FY 2020 budgets is a financial analyst who previously worked for the Enterprises in this capacity before joining FHFA, has more than a decade of

⁶ We did not assess DOC's reviews of the Enterprises' FY 2018 budgets because those reviews were conducted pursuant to the now-obsolete 2016 Procedures.

experience in financial services and housing finance, and has earned degrees in economics and finance. In 2015, DOC estimated that budget reviews “required the equivalent of one-half to three-quarters of a full-time employee.” A full-time equivalent is deemed to work 2,087 hours annually, so three-quarters (i.e., 75%) of that sum amounts to 1,565 hours spent on budget review as of 2015. FHFA reported to us that this employee spent approximately 1700 hours reviewing the proposed FY 2019 budgets and the same amount of time reviewing the proposed FY 2020 budgets. Based on the information provided by FHFA, the current DOC employee appears to possess the qualifications and experience needed for critical financial assessments of the proposed budgets, and the amount of time spent on budget review has increased since 2015.

DOC Consulted Other FHFA Divisions and Offices Regarding the Proposed FY 2019 and FY 2020 Budgets

DOC’s records reflect that DOC employees insisted that the Enterprises include DOC in their budget formulation activities, met with Enterprise officials regarding their budget and governance processes throughout the development of the proposed FY 2019 and FY 2020 budgets, sought additional data when needed, and assessed whether the Enterprises’ initiatives aligned with FHFA’s Conservatorship Scorecard. These and other steps taken by DOC reflect engagement in reviewing the Enterprises’ proposed FY 2019 and FY 2020 budgets.

We closed a recommendation from our 2015 evaluation based on FHFA’s representations that DOC would consult with other divisions and offices within FHFA to gain the benefit of their experience and insights on the Enterprises’ proposed budgets. This compliance review found that DOC provided the proposed FY 2019 and FY 2020 budgets – along with DOC’s staff analysis memoranda for the budgets – to all FHFA Conservatorship Committee members, among them representatives from DER and DHMG. DOC requested that the recipients review the budget materials and provide comments within a window of time of approximately one week. The DOC budget analyst also reached out to specific offices, as she considered prudent. For example, when assessing the Enterprises’ proposed FY 2020 budgets, the DOC budget analyst solicited by email and received a written response from DER on specific Enterprise initiatives and spending. After the window closed, DOC transmitted the proposed budgets for FY 2019 and FY 2020 and the staff analysis memoranda to the FHFA Director. He subsequently reviewed and approved those budgets.

CONCLUSIONS

In 2015, we recommended that FHFA “[r]evise the existing budget review process and staff the review process with employees who have the qualifications and experience needed for

critical financial assessments of the proposed Enterprise budgets to permit FHFA to determine whether each Enterprise’s budget aligns with FHFA’s strategic direction and its safety and soundness priorities.” FHFA committed to hire a financial analyst and to assign other employees “with relevant technical qualification and experience to support the budget review process.” FHFA also committed to “strategically consult with staff from [DHMG] and [DER] with expertise on specific budget items and strategic initiatives and staff from [OBFM] with expertise on baseline expenditures.”

During this compliance review, we found that FHFA met its staffing and consultation commitments in reviewing the Enterprises’ proposed FY 2019 and FY 2020 budgets. The budget review was conducted by a DOC employee who appears to possess the needed qualifications and experience, and DOC consulted with other FHFA divisions and offices regarding the proposed FY 2019 and FY 2020 budgets.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this compliance review in April 2019 to determine whether FHFA implemented the corrective actions it had committed to undertake in response to the second recommendation in our 2015 evaluation report on the Agency's oversight of the Enterprises' budgets. Our objective was to determine whether, for the Enterprises' proposed FY 2019 and FY 2020 budgets, DOC had taken the following steps it had agreed in 2015 to take: (1) staffing the review process with employees who have the qualifications and experience needed for critical financial assessments of the proposed budgets; and (2) consulting with DHMG and DER on specific budget items and strategic initiatives and with OBFM on baseline expenditures.

To achieve our objective, we reviewed the 2016 and 2018 Procedures, the Enterprises' FY 2019 and FY 2020 draft and final operating budgets, and Agency records supporting the analysis and approval of the Enterprises' FY 2019 and FY 2020 operating budgets. Finally, we interviewed the primary Agency official responsible for reviewing the Enterprises' FY 2019 and FY 2020 operating budgets.

We conducted our compliance review from April 2019 through February 2020 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

FHFA's management response is reprinted in Appendix A.

APPENDIX A: FHFA MANAGEMENT RESPONSE



Federal Housing Finance Agency

MEMORANDUM

TO: Brian W. Baker, Acting Deputy Inspector General, Office of Compliance & Special Projects

FROM: Robert Fishman, Deputy Director, Division of Resolutions *JW dr RF*

SUBJECT: Draft Report: *Compliance Review of FHFA's Process for Reviewing the Enterprises' Proposed FY 2019 and FY 2020 Annual Operating Budgets*

DATE: 3/12/2020

Thank you for the opportunity to respond to the draft report titled, *Compliance Review of FHFA's Process for Reviewing the Enterprises' Proposed FY 2019 and FY 2020 Annual Operating Budgets*. The compliance review determined whether the Agency implemented the corrective actions to address prior Office of Inspector General (OIG) recommendations for the Agency's oversight of the Enterprises' budgets.

I am pleased that the OIG determined that the Agency met its commitments and implemented the agreed upon actions in reviewing the Enterprises' proposed FY 2019 and FY 2020 budgets.

If you have any questions relating to our response, please do not hesitate to call me at (202) 649-3527.

APPENDIX B: THE ENTERPRISES' ADMINISTRATIVE EXPENSES FROM FY 2012 TO FY 2020

The table below shows how the Enterprises' administrative expenses have grown since FY 2012, when FHFA began reviewing and approving the budgets under its conservatorship authority. The Enterprises' combined administrative expenses have grown by about 44% during that period, from \$3.928 billion to \$5.642 billion.

The table includes actual expenses for FY 2012 to FY 2019 and planned figures for FY 2020.

ENTERPRISE ADMINISTRATIVE EXPENSES, FY 2012 TO PRESENT

	2012	2013	2014	2015	2016	2017	2018	2019	2020 (Planned)
Fannie Mae									
Administrative Expenses (\$B)	2.367	2.545	2.777	3.050	2.741	2.737	3.059	3.023	3.108
Change from prior year (%)		7.5%	9.1%	9.8%	-10.1%	-0.1%	11.8%	-1.2%	2.8%
Freddie Mac									
Administrative Expenses (\$B)	1.561	1.805	1.881	1.927	2.005	2.106	2.293	2.564	2.534
Change from prior year (%)		15.6%	4.2%	2.4%	4.0%	5.0%	8.9%	11.8%	-1.2%
Enterprises' Combined Budgets									
Administrative Expenses (\$B)	3.928	4.350	4.658	4.977	4.746	4.843	5.352	5.587	5.642
Change from prior year (%)		10.7%	7.1%	6.8%	-4.6%	2.0%	10.5%	4.4%	1.0%

Sources for the FY 2012-FY 2019 administrative expenses: the Enterprises' Forms 10-K filed with the U.S. Securities and Exchange Commission, 2014-2019.

Sources for the FY 2020 planned administrative expenses: Enterprise information submitted to FHFA.

ADDITIONAL INFORMATION AND COPIES.....

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