

Federal Housing Finance Agency
Office of Inspector General



DBR Adhered to Its Work Program Minimum Frequency Guidelines for Annual Examinations

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Executive Summary

The Federal Housing Finance Agency (Agency or FHFA) Division of Federal Home Loan Bank Regulation (DBR) regulates the eleven Federal Home Loan Banks (FHLBanks) and their fiscal agent, the Office of Finance. DBR examines these entities annually. An examination consists of the performance of certain specified steps, which are commonly known as “work programs.” Multiple work programs performed by DBR in a given examination define the examination’s scope and provide the means by which DBR develops its examination conclusions and ratings. DBR established minimum frequencies (annual, biennial, or triennial) for how often work programs shall be performed. Those frequencies (prescribed by the Minimum Frequency Guidelines, or Guidelines) permit exceptions to be made if adequate justification and supervisory approval are documented in the examination’s workpapers.

In a 2020 audit, we found that DBR did not satisfy the Minimum Frequency Guidelines’ exception documentation requirements. We recommended that FHFA reinforce the Guidelines, including requirements for documenting the justification and approvals for exceptions. In response to our recommendation, DBR revised the Guidelines to clarify when and how exceptions were to be documented and approved. We closed the recommendation on November 13, 2020, based upon DBR’s issuance of the revised Guidelines.

We conducted this compliance review to determine whether DBR satisfied the revised Minimum Frequency Guidelines’ requirements that certain examination work programs for the FHLBanks and the Office of Finance be performed annually and that certain others be performed biennially (i.e., every two years), and if DBR did not meet these frequency requirements, whether exceptions were documented and approved as required. Our review covered each of the 18 DBR examinations for which a final Report of Examination was issued to an FHLBank or the Office of Finance board from March 1, 2021, through September 30, 2022 (review period).

We found that DBR complied with the revised Minimum Frequency Guidelines regarding annual or biennial work programs. We found four exceptions had been made and that all the exceptions had been documented and approved as required. We also identified two work programs that were combined without proper documentation. Nevertheless, we found that the requisite tasks from the combined work programs had been completed.

This report was prepared by Crystal Tsang, Compliance Specialist, and Patrice Wilson, Senior Investigative Evaluator. We appreciate the cooperation of



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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.

/s/

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ABBREVIATIONS

AD	Associate Director
Agency or FHFA	Federal Housing Finance Agency
DBR	Division of Federal Home Loan Bank Regulation
EIC	Examiner-in-Charge
FHLBank	Federal Home Loan Bank
Guidelines or Minimum Frequency Guidelines	2012-DBR-OPB-O3, <i>Work Program Minimum Frequency Guidelines</i>
OIG	FHFA Office of Inspector General
Review Period	March 1, 2021, through September 30, 2022

BACKGROUND

DBR Set Minimum Frequencies for Performing Examination Work Programs

DBR examines each of the FHLBanks and the Office of Finance on an annual basis. Annual examinations consist of the performance of “work programs,” which are sets of steps to be accomplished during the examination; for example, a work program may entail assessing and determining the overall adequacy of an FHLBank’s internal controls or evaluating its risk metrics. Multiple work programs performed during an examination define its scope and provide a framework from which DBR both assesses the entity under examination and develops its examination conclusions and ratings.

DBR Operating Procedures Bulletin, 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (Minimum Frequency Guidelines or Guidelines), establishes the minimum frequencies (e.g., annual, biennial, triennial) for performing the 30 different work programs that DBR may utilize when examining the FHLBanks and the Office of Finance.¹ The minimum frequency with which DBR must perform a particular work program will vary with the relative risk of the area to be assessed by that work program. The Guidelines allow for exceptions to be made to the minimum frequencies, with sufficient justification, provided that supervisory approval is documented in the examination’s workpapers.

In 2020, We Found Exceptions to the Minimum Frequency Guidelines that Were Not Documented or Approved

In a 2020 audit, we reviewed 36 DBR examinations, consisting of 33 FHLBank examinations and 3 Office of Finance examinations.² From those 36 examinations, DBR was required to perform approximately 600 iterations of individual work programs (not including any frequency exceptions allowed by the Guidelines).³ We found that DBR did not perform 28 required work programs, which means that DBR made 28 exceptions to the Guidelines.

¹ FHFA, 2012-DBR-OPB-03, *Work Program Minimum Frequency Guidelines* (issued Dec. 19, 2012; updated Oct. 7, 2016, Feb. 18, 2020, and Oct. 1, 2020).

² OIG, *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) (Sept. 3, 2020).

³ This calculation was based on the application of the work program minimum frequencies (e.g., all work programs with an annual frequency, one half of the work programs with a biennial frequency) to each FHLBank and Office of Finance examination performed. During the audit’s review period, DBR performed 690 individual work programs; certain work programs were performed more frequently than the minimum requirement in the Guidelines.

Of the 28 exceptions, DBR documented 19 (68%) properly with the required justification provided in the pre-examination analysis memorandum and DBR management approval evident in the examination scope memorandum.⁴ The remaining 9 of 28 exceptions (32%) did not comply with the Minimum Frequency Guidelines' exception documentation requirements. In all nine instances, DBR's examination scope memorandum did not reflect examiner-in-charge (EIC) and associate director (AD) concurrence, and for two of those nine, DBR did not prepare or include a pre-examination analysis memorandum that provided the examiners' justification for making the exception. In light of these findings, we recommended that FHFA reinforce the Guidelines, including requirements for documenting the justification and approvals for exceptions.⁵ FHFA agreed with the recommendation.

FHFA Issued Guidance in October 2020 That Clarified Exceptions to Minimum Frequency Guidelines

On October 1, 2020, FHFA issued revised Minimum Frequency Guidelines, which included:

- Clarification that exceptions to the Guidelines must be documented in the pre-examination analysis memorandum, together with the reasons for the exception, and approval by the EIC and AD in the scope memorandum.
- Establishment of a new process to document an AD's concurrence/approval with each such exception.
- Documentation requirements for when examiners prefer to combine work programs (i.e., when they may incorporate work steps from one work program into another).⁶
- Establishment of a separate minimum frequency table specifically for those work programs performed in examinations of the Office of Finance.

We closed the recommendation on November 13, 2020, based on DBR's issuance of revised Guidelines.

⁴ DBR examiners prepare pre-examination analysis memoranda to support the EIC's decision to include or exclude certain risk areas from the examination's scope. The EIC documents the overall examination plan in an examination scope memorandum.

⁵ The report contained one other recommendation that is not within this compliance review's scope.

⁶ For example, an examination may incorporate work steps from the credit risk management work program into the advances and collateral work program (or vice versa).

FINDINGS

We initiated this compliance review to assess whether, from March 1, 2021, through September 30, 2022 (the review period), DBR completed all annual and biennial work programs⁷ that the revised Minimum Frequency Guidelines required, and if not, whether exceptions and supporting reasons were documented properly in the pre-examination analysis memorandum. For each exception, we also assessed whether the examination scope memorandum identified the exception and included EIC and AD approval.

In addition to the items identified above, we sought to identify any instances in which DBR examiners combined multiple work programs, and for any such instances, we sought to determine whether DBR examiners combined the work programs properly and documented their actions in accordance with the Guidelines.

The review period covered 18 DBR examinations that – when taken together – required DBR to perform an estimated 262 work programs, assuming no permitted exceptions were made.⁸

DBR Examinations Adhered to the Minimum Frequency Guidelines

DBR examiners conducted 18 examinations during the review period: 16 of the FHLBanks, and 2 of the Office of Finance. We reviewed each work program in these 18 examinations to determine whether it had been performed as planned, and if not, whether DBR had documented the exception in accordance with the revised Guidelines.

Out of the approximately 262 work programs required during the review period, we found that DBR made exceptions for four. We found that DBR examiners documented all four exceptions in accordance with revised Guidelines, with the required justification provided in the pre-examination analysis memorandum, and each examination scope memorandum reflected concurrence by the EIC and AD. In sum, DBR made exceptions to the Guidelines very rarely, and it complied with applicable requirements when doing so.

⁷ According to the Guidelines, DBR reviews annually those FHLBank and Office of Finance activities or functions that have a relatively greater volume, complexity, or importance in developing examination conclusions and assigning examination ratings. Work programs with comparatively lesser volume are simpler, or are less relevant to developing examination conclusions, and may be reviewed less frequently.

⁸ This calculation was based on the application of the work program minimum frequencies (e.g., all work programs with an annual frequency, one half of the work programs with a biennial frequency) to each FHLBank and Office of Finance examination performed. During our review period, DBR performed 284 work programs; certain work programs were performed more frequently than required by the Guidelines.

During fieldwork, we found that, in one examination, the DBR examiners combined steps from two separate work programs into a single program.⁹ The work program did not clearly identify the particular steps that incorporated one work program into the other. In addition, the examination’s scope memorandum did not clearly document the work program combination in the manner required by the Guidelines. As a result, DBR did not satisfy the Guidelines’ documentation requirements in this one instance, which DBR has acknowledged. This was the only instance during the review period in which we found that DBR did not do so. Although DBR acknowledged that the examiners did not explicitly document the work steps in the scope memorandum, they nevertheless performed and covered all required work steps during the examination. As a result – and because this instance pertained to only 2 of 262 required work programs during the review period (i.e., less than 1% of the universe of required work programs) – DBR may still be characterized fairly as having adhered to the revised Guidelines.

CONCLUSION.....

During the review period, DBR complied with the revised Minimum Frequency Guidelines. We identified and DBR acknowledged one instance in which DBR did not document properly its combination of two work programs. Otherwise, DBR performed all work programs as required and correctly documented and approved the four exceptions made to those required work programs.

OBJECTIVE, SCOPE, AND METHODOLOGY.....

We initiated this compliance review in October 2022 to determine whether DBR completed all work programs required by the Minimum Frequency Guidelines to be completed either annually or biennially, and if not, whether exceptions and supporting reasons were documented in the pre-examination analysis memorandum. We also assessed whether the examination scope memorandum identified the exception and included EIC and AD approval. In addition, we reviewed instances in which annual and biennial work programs were combined to determine if DBR examiners properly documented the deviation in the scope memorandum per the Minimum Frequency Guidelines.

To accomplish our objective, we obtained and reviewed annual and biennial work programs, scope matrices, pre-examination analysis memos, and scope memos for examinations. We

⁹ In one examination, DBR examiners combined two work programs: one concerning derivatives and the other concerning interest rate risk.

analyzed the annual and biennial work programs for 16 examinations of FHLBanks and 2 examinations of the Office of Finance.

We conducted our compliance review from October 2022 through January 2023 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (December 2020), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

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