

Federal Housing Finance Agency
Office of Inspector General



FHFA's Implementation of Its Automated System to Track Deficiencies Identified in Federal Home Loan Bank Examinations

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Executive Summary

The Federal Housing Finance Agency (FHFA or the Agency) Office of Inspector General (OIG) issued an evaluation report on January 11, 2012, entitled *FHFA's Oversight of Troubled Federal Home Loan Banks* (2012 Evaluation Report). In that report, we found that the Agency's Division of Federal Home Loan Bank Regulation (DBR) lacked an automated information system to track deficiencies, also referred to as findings, identified in its annual examinations of the Federal Home Loan Banks (FHLBanks). Instead, DBR examiners maintained separate and decentralized records of examination findings for each FHLBank. We found that this practice was inefficient and made it challenging for DBR management, FHFA officials, and OIG to determine the status of the FHLBanks' collective efforts to rectify safety and soundness deficiencies. For those reasons, we recommended that the Agency develop and implement a centralized, automated reporting system that would provide readily accessible information about FHLBank findings, planned corrective actions, and their status.

DBR agreed with OIG's recommendation and developed the Findings Management System (FMS) in response. FMS is an automated information system designed to provide DBR with ready access to information about FHLBank findings, such as their status and the dates by which the FHLBanks must remediate them. DBR also developed procedures pursuant to which DBR examiners are expected to input data into FMS and, on December 31, 2012, published them in an Operating Procedure Bulletin. On April 11, 2013, we closed our recommendation based on our review of FMS' design and capabilities, as well as related DBR procedures intended to ensure that FMS data is accurate and timely.

On November 30, 2015, we initiated this compliance review to assess DBR's implementation of FMS and the impact of our recommendation on its operations. We tested DBR's compliance with its established procedures to ensure that the data in FMS was accurate and timely. Specifically, we reviewed documentation for a randomly selected sample of 36 findings identified in FHLBank examinations from January 1, 2014, through September 30, 2015. Through our testing, we determined that DBR complied with its procedures for ensuring the accuracy and timeliness of FMS data. We interviewed DBR officials and supervisory examiners who reported to us that FMS represented a marked improvement over the previous decentralized system that the Agency employed to access DBR's FHLBank examination findings. In light of the results of our testing and our interviews, we concluded that DBR fully and successfully implemented FMS, and that DBR's adoption of our recommendation improved the efficiency of its operations.



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This compliance review was led by Karen E. Berry, Senior Investigative Counsel, with assistance from Wesley M. Phillips, Senior Policy Advisor, and Patrice Wilson, Senior Investigative Evaluator. We appreciate the cooperation we received from FHFA in completing this compliance review.

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

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ABBREVIATIONS

2012 Evaluation Report	<i>FHFA's Oversight of Troubled Federal Home Loan Banks</i> (Jan. 11, 2012) (EVL-2012-001)
AHP	Affordable Housing Program
Bulletin	FHFA Operating Procedure Bulletin 2012-DBR-OPB-04, <i>Findings Management System</i>
DBR	Division of Federal Home Loan Bank Regulation
EIC	Examiner-in-Charge
FHFA or the Agency	Federal Housing Finance Agency
FHLBanks	Federal Home Loan Banks
FMS	Findings Management System
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
ROE	Report of Examination

BACKGROUND.....

In our 2012 Evaluation Report, we assessed the adequacy of the information reporting system used by DBR to access information about DBR’s examination findings of FHLBanks.¹ We also described DBR’s supervision program for the FHLBanks.^{2, 3}

DBR examiners conduct annual on-site examinations of each FHLBank. During an annual examination, DBR examiners may identify risk management deficiencies or violations of law or regulations at an FHLBank, which are called findings. There are three specific types of findings: **Matters Requiring Attention (MRAs), Violations, and Recommendations.** After completing their fieldwork, DBR examiners review the examination work papers and prepare a Report of Examination (ROE), which includes any findings identified during the examination. When finalized, the ROE is presented to the FHLBank’s Board of Directors. When MRAs and violations are identified in an ROE, FHFA requires the affected FHLBank to develop a remediation plan to correct identified deficiencies.⁴ At the subsequent annual examination, DBR examiners formally assess the FHLBank’s corrective actions and determine whether the identified deficiencies have been corrected. DBR may hold open a finding in whole or in part for the following year if it has not been remediated.

MRAs: Serious deficiencies requiring prompt remediation.

Violations: Matters in which there may be non-compliance with laws, regulations, or orders.

Recommendations: Identification of policies, procedures, or practices that could be improved.

As set forth in our 2012 Evaluation Report, we found that DBR lacked an automated information system that provided ready access to current information about DBR’s FHLBank examination findings. At that time, DBR examiners documented their examination findings separately on individual computer-generated spreadsheets, but we found that the content of these spreadsheets varied among examiners and, on occasion, the spreadsheet information was inconsistent with information contained in other Agency examination materials. Our review

¹ The 2012 Evaluation Report contained two additional recommendations that were not within the scope of this compliance review.

² As used in this report, the term “FHLBanks” generally includes the Office of Finance, a joint office of the FHLBanks and the fiscal agent for the Federal Home Loan Bank System. FHFA also supervises the Office of Finance.

³ FHLBank housing mission programs include the Affordable Housing Program (AHP). Under the AHP, the FHLBanks must use a portion of their retained earnings to fund affordable housing and other community support activities.

⁴ Recommendations are advisory in nature and the FHLBanks are not required to implement them.

also demonstrated that the spreadsheets were stored in diverse locations within DBR, making it difficult for DBR managers or other examination teams, FHFA officials, and OIG to obtain information rapidly or comprehensively. We concluded that the lack of an automated system limited DBR's ability to assess in real time the efforts made by individual FHLBanks in correcting findings identified in their respective ROEs.

To address this shortcoming, we recommended that DBR develop and implement an automated reporting system that would enable ready access to ROE findings, planned corrective actions, and the status of those corrective actions. DBR agreed with the recommendation and committed to adopt and employ such an automated system by December 31, 2012.

DBR Adopted and Implemented the Findings Management System in Response to OIG's Recommendation

DBR subsequently adopted an automated information management and reporting system designed to provide DBR examiners and managers, FHFA officials, and OIG, with real time access to the status of examination findings. In an Operating Procedure Bulletin issued on December 31, 2012 (2012-DBR-OPB-04, *Findings Management System* (the Bulletin)), DBR announced the adoption of FMS and established protocols to be used by all DBR examiners to ensure the accuracy and timeliness of the data contained in FMS. These protocols include:

1. Consistency Among Documents – FMS content must be consistent with the information in required supporting documents, such as findings and closing memoranda.

For example, descriptions of FHLBank examination findings contained in FMS must be consistent with the descriptions contained in the findings memoranda.

2. Completeness of FMS – Required supporting documentation should be present in FMS.

Findings memoranda and closing memoranda, where applicable, should be uploaded to FMS.

3. Timeliness of Updates – All FMS fields should be populated completely and in a timely fashion.

The Bulletin requires all FMS fields to be populated at the end of each FHLBank examination. That is, FMS should be populated prior to the issuance of the written ROE to the FHLBank's board of directors.

4. Adherence to Quality Control Procedures – Quality control procedures should be followed.

To ensure the accuracy and completeness of FMS, DBR examination specialists perform a quality control review to verify the reconciliation of FMS data and the required supporting documents. For example, the examination specialists ensure that FMS finding summary data is consistent with information contained in the findings memoranda. The specialists should complete their reviews, and the examination teams must address the specialists’ findings, prior to the issuance of each ROE.

After reviewing FMS’ design and the protocols established in the Bulletin and related internal controls, we determined that FMS’ development and implementation was consistent with our recommendation. Accordingly, on April 11, 2013, we closed the recommendation from our 2012 Evaluation Report.

COMPLIANCE REVIEW RESULTS

In this compliance review, we assessed DBR’s implementation of FMS and the impact of that system on DBR’s operations. As detailed below, we found that DBR examiners have followed the protocols in the Bulletin that are intended to ensure the accuracy and timeliness of FMS data; also, DBR officials reported to us that FMS has improved DBR’s capacity to track the efforts of the FHLBanks to remediate DBR’s findings.

DBR Examiners Have Followed the Protocols Set Forth in the Bulletin to Ensure the Accuracy and Timeliness of FMS Data

We tested DBR’s compliance with the protocols established in the Bulletin over the period January 1, 2014, through September 30, 2015. During that period, DBR completed annual examinations of each of the 12 FHLBanks and the Office of Finance, and made a total of 178 findings.⁵ We selected a random but statistically non-representative sample of 36 of these findings for our testing.⁶ For the 36 sampled findings, we reviewed FMS data in nine key

⁵ Currently there are 11 FHLBanks. In 2015, FHFA approved the merger of the FHLBanks of Des Moines and Seattle. DBR completed separate examinations of the Des Moines and Seattle FHLBanks during our review period.

⁶ The population of 178 records in FMS is statistically small. A statistically representative sample would require almost all 178 records to be tested. Accordingly, we tested a random, but non-representative, sample of 20 percent of the population (36 records). Although our test results cannot be statistically projected to the population, the randomness of the sampling allows for the collection of unbiased, evidential material for assessing the controls for the population. The 20 percent sample of the population exceeds the generally

fields and supporting documentation⁷ to determine whether DBR examiners followed the protocols for three key controls that are intended to ensure the accuracy and timeliness of FMS' data. We also determined whether DBR followed its FMS-related quality control procedures.

For that sample, we found that DBR examiners largely followed the Bulletin's protocols for the three controls tested, with an error rate of 2%.⁸ The following summarizes our findings for the three key controls.

1. FMS Content Was Consistent with the Information in the Findings and Closing Memoranda

For each of the 36 findings that we sampled, we sought to determine whether, as required by the Bulletin, the data in six of the nine key FMS fields matched the corresponding data in the associated findings and closing memoranda.^{9, 10} We determined that, in the vast majority of the 36 cases, the FMS data for the six fields generally matched the data in the associated documents.¹¹ For example, FMS summaries of the findings were consistent with descriptions of them in the findings memoranda. In a few cases, we identified minor typographical errors and in some cases missing data entries.

2. Supporting Documentation Was Present in FMS

We analyzed two of the remaining three key FMS fields to determine whether the required supporting documentation—the findings and closing memoranda—were present in FMS. The required documentation was present in FMS for all of the 36 findings, as applicable.

accepted level for testing small populations. See American Institute of Certified Public Accountants, *Audit Sampling Considerations of Circular A-133 Compliance Audits* (2009).

⁷ The nine FMS fields tested were: (1) finding type; (2) repeat finding; (3) finding description; (4) remediation due date; (5) status; (6) finding closed and reissued; (7) finding memorandum present; (8) closing memorandum present; and (9) date entered.

⁸ To calculate the rate of error, we reviewed the 9 fields applicable to the 36-count sample (9 x 36 = 324 data entries). Of this 324-count population, we found 7 errors resulting in a 2 percent error rate (7/324 = .0216).

⁹ The six FMS fields tested for this key control were: (1) finding type; (2) repeat finding; (3) finding description; (4) remediation due date; (5) status; and (6) finding closed and reissued. The other three FMS fields were not relevant for testing for this particular requirement.

¹⁰ The scope of our work did not include assessing the quality of DBR's bases for reaching findings or closing them.

¹¹ We found 7 errors in the 216 entries for this key control (information in the findings and closing memoranda).

3. FMS Fields Were Populated in a Timely Fashion

We analyzed the final key FMS field—“date entered”—to determine whether the findings were populated in FMS prior to the issuance of the ROE, as required. All of the 36 findings were populated in FMS prior to the issuance of the ROE.

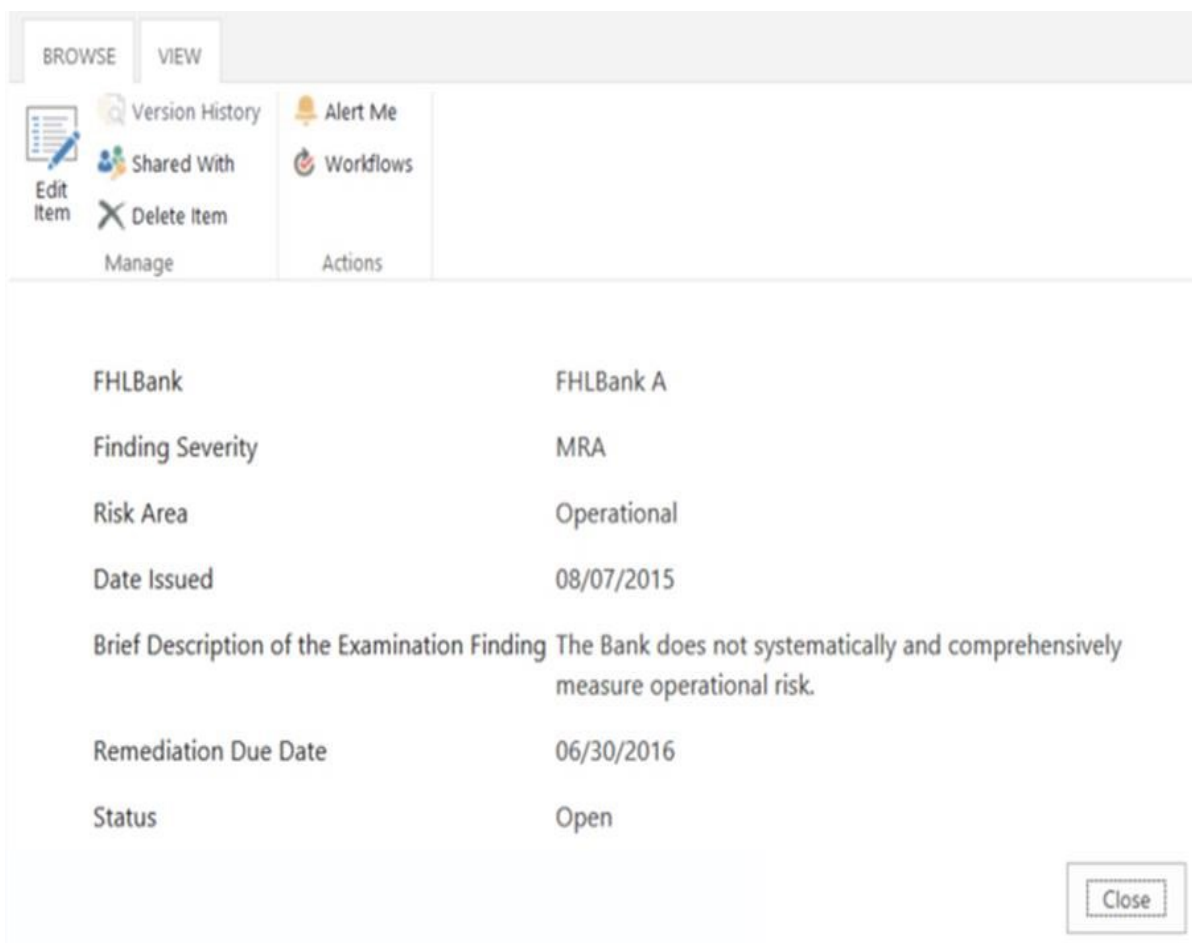
We also tested whether DBR complied with its FMS-related quality control process designed to ensure compliance with the protocol in the Bulletin. We reviewed DBR communications and documentation for the 36 findings in our sample, and we found that DBR generally complied with its quality control process. In particular, the documentary record indicated that, in accordance with DBR policy, the Examiners-in-Charge (EICs) remediated any FMS-related deficiencies identified in the quality control process prior to the issuance of each ROE.

Example of an FHLBank Finding as Depicted in FMS

Figure 1 depicts a hypothetical finding and its status as it might appear in FMS. In this example, the hypothetical finding—an MRA—was issued by DBR on August 7, 2015, and related to deficiencies in the FHLBank’s operational risk management.¹² Specifically, the FHLBank did not systematically measure its exposure to operational risk. DBR directed the FHLBank to remediate the MRA by June 30, 2016. FMS reflects that the MRA status is “open,” and it will remain so until DBR examiners determine that the FHLBank appropriately remediated the problem identified in the finding.

¹² FHFA defines operational risk as an institution’s exposure to loss from inadequate or failed internal processes, people, and systems, or from external events.

FIGURE 1: HYPOTHETICAL FMS SCREEN DEPICTING AN FHLBANK MRA



Source: FHFA-OIG analysis of FMS and FHFA documentation.

DBR Officials View FMS as an Improvement over the Prior Manual System by Which FHLBank Examination Findings were Tracked

During our compliance review, we spoke with DBR’s Deputy Director, the four DBR Associate Directors, and three EICs to obtain their views on FMS’ impact on DBR’s operations since its implementation in late 2012.¹³ Generally, DBR officials viewed the adoption of FMS as a positive development and expressed satisfaction with FMS, especially the ease with which it provides access to information about findings.

¹³ Associate Directors, the executive representatives of DBR to the FHLBanks, are responsible for overseeing the safety and soundness of the FHLBanks, as well as AHP. Two Associate Directors oversee DBR’s examinations of four FHLBanks each, one Associate Director oversees examinations at three FHLBanks and the Office of Finance, and one Associate Director oversees AHP examinations at all of the FHLBanks. EICs are responsible for leading, planning, executing, and documenting each annual FHLBank examination. The EICs also present the examination findings to the FHLBank and the Board of Directors.

The Deputy Director reported to us that FMS is a definite improvement over DBR's former manual processes for tracking examination findings. One Associate Director explained to us that, prior to the adoption of FMS, DBR's decentralized findings management system was inefficient. For example, if a DBR official wanted to compare the status of the findings in multiple FHLBank examinations, the official would have to locate and review each EIC's source documents and then compile the data manually. With the adoption of FMS, however, a DBR official need only run a report in which the findings are compiled automatically – a much less labor intensive effort.

Another Associate Director advised us that DBR can quickly analyze trends in examination report findings and identify issues arising across FHLBanks. An EIC stated to us that FMS is a positive change for DBR because, unlike the manual spreadsheet system it replaced, FMS is simple, intuitive, and provides consistent information across the universe of FHLBank examinations.

CONCLUSION.....

In our 2012 Evaluation Report we found that DBR's inefficient process for tracking FHLBank examination findings impeded its capacity to manage the Agency's FHLBank examination program. Our recommendation was intended to address this shortcoming.

In response to our recommendation, DBR developed and implemented FMS to standardize the collection and storage of information about FHLBank examination findings, and retrieve information about them, including their status.

In this compliance review, we assessed DBR's implementation of FMS and the impact of that system on DBR's operations.

We found, through independent testing, that the data maintained within FMS is accurate and current, and that DBR examiners follow the protocols set forth in the Bulletin to ensure that DBR timely and accurately maintains the data in FMS. DBR officials reported to us that FMS represents a significant improvement over the manual system that DBR previously employed to collect, store, track, and retrieve examination findings. Moreover, FMS has enhanced DBR's ability to oversee the FHLBanks. Accordingly, we conclude that: (1) DBR has implemented and maintained the corrective action proposed in the underlying recommendation; and (2) as a result of DBR's actions, the intended effect of OIG's recommendation has been realized.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our overall objective for this compliance review was to determine whether FHFA management ensured the effective implementation of FMS. Our sub-verification objectives were as follows:

- Determine the views of DBR officials and staff on FMS' effectiveness;
- Verify that FMS content is consistent with the information in required supporting documents, such as findings and closing memoranda;
- Verify that required supporting documentation is present in FMS;
- Verify that all FMS fields are populated completely and in a timely fashion; and
- Verify that all quality control procedures are followed.

To address these objectives, we interviewed the Deputy Director for DBR, the four DBR Associate Directors, three DBR EICs, two DBR Examination Specialists, and a DBR Business Technology Analyst.

In addition, we analyzed FMS guidance, findings data exported from FMS, findings and closing memoranda, and quality control documentation. We also reviewed the live FMS database residing on FHFA's network through read-only access.

As described in the report body, we tested DBR's compliance with the Bulletin and other controls by selecting a random, but statistically non-representative sample of 36 findings from the 178 findings issued during the completed annual examinations of each of the 12 FHLBanks and the Office of Finance from January 1, 2014, through September 30, 2015. For three key controls in the Bulletin, we selected nine key FMS fields to test DBR's compliance from the 36 findings in our sample.

We conducted our Compliance Review during the period November 2015 to February 2016 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 for the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment. The Agency did not provide a management response letter or technical comments.

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