

REDACTED

Federal Housing Finance Agency
Office of Inspector General



**DER Implemented Controls to
Ensure that the Enterprises and CSS
Remediated Adverse Examination
Findings Within FHFA Determined
Reasonable Timeframes**

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

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Executive Summary

The Federal Housing Finance Agency’s (FHFA) Division of Enterprise Regulation (DER) conducts annual safety and soundness examinations of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises) and Common Securitization Solutions, LLC (CSS), a jointly and equally owned affiliate of the Enterprises. During the annual examinations, examiners may identify risk management deficiencies, increases in risk exposure, or violations of laws, regulations, or orders. In response, FHFA may issue Matters Requiring Attention (MRAs) for certain deficiencies or critical supervisory matters that pose a substantial risk to the safety and soundness of an Enterprise or CSS; Violations for certain matters of non-compliance with laws, regulations, or orders; and Recommendations for less critical suggestions to improve policy, procedure, practice, or controls.

Generally, for each supervisory activity that makes up the annual examination and results in a finding, DER communicates the adverse examination findings to the Enterprise or CSS in a findings memorandum attached to a Conclusion Letter. DER issues an annual Report of Examination (ROE) to the Board of Directors of each Enterprise and the Board of Managers of CSS. These ROEs communicate the principal findings of an examination, including all MRAs. For each MRA, DER requires that an Enterprise or CSS establish and execute a remediation plan to resolve the finding. DER examiners monitor progress against these plans and must assess the adequacy of an Enterprise’s or CSS’ remediation efforts before closing the MRA. DER uses its Remediation Tracking System to track adverse examination findings from issuance through closure. DER also uses Remediation Tracking System data to report on its MRA remediation performance measure in FHFA’s Performance and Accountability Report (PAR) – to “[d]etermine that the Enterprises have satisfactorily addressed safety and soundness MRAs in accordance with agreed upon remediation plans and timeframes” with a target of at least 90 percent of the time.

We conducted this audit to determine whether FHFA has implemented controls to ensure the Enterprises’ and CSS’ timely and effective remediation of adverse examination findings for the period from January 1, 2021, through December 31, 2022 (scope period). We focused primarily on DER’s assessment of MRA remediation because MRAs can represent substantial risks to the safety and soundness of the Enterprises and CSS, and [REDACTED]. [REDACTED] Recommendations were closed during the scope period.



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We found that DER implemented control activities to ensure that the Enterprises and CSS remediated adverse examination findings within FHFA determined reasonable timeframes. We reviewed 20 closed MRAs, 15 open MRAs, and 4 open Recommendations in our samples selected for testing. Based on our review, we found DER: (1) assessed the Enterprises' and CSS' MRA remediation plans, monitored progress against these plans, and directed further action when examiners identified concerns; (2) documented a timely, independent assessment of the Enterprises' and CSS' MRA closure packages; (3) monitored remediation activities for Recommendations as required; and (4) accurately tracked remediation activity in its Remediation Tracking System.

Further, FHFA accurately reported that DER met its MRA remediation performance goal in FHFA's fiscal year (FY) 2021 and FY 2022 PAR.

We made no recommendations in this report. While FHFA did not provide a formal written response to this report, we considered management's technical comments to a draft version in finalizing this report.

This report was prepared by Jim Lisle, Audit Director; April Ellison, Audit Manager; and Mike Rivera, Auditor-in-Charge; with assistance from Abdil Salah, Assistant Inspector General for Audits. We appreciate the cooperation of 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.fhfa.gov, and www.oversight.gov.

James Hodge, Deputy Inspector General for Audits /s/

TABLE OF CONTENTS

EXECUTIVE SUMMARY2

ABBREVIATIONS5

BACKGROUND6

 Adverse Examination Findings.....6

 Remediation of Adverse Examination Findings.....7

 Processes for MRA Remediation.....7

 Processes for Recommendation Remediation.....8

 DER’s Remediation Tracking System.....8

 DER’s Performance Measure for Determining MRA Remediation.....9

FACTS AND ANALYSIS.....9

 FHFA Implemented Controls to Ensure That the Enterprises and CSS Effectively Remediated Adverse Examination Findings Within FHFA Determined Reasonable Timeframes9

 DER Complied with Established Remediation Requirements9

 DER Documented Reasonable Explanations for Extended Remediation Periods10

 DER Accurately Tracked and Reported Adverse Finding Activity10

CONCLUSIONS.....11

FHFA COMMENTS AND OIG RESPONSE12

OBJECTIVE, SCOPE, AND METHODOLOGY13

ADDITIONAL INFORMATION AND COPIES17

ABBREVIATIONS

CSS	Common Securitization Solutions, LLC
DER	Division of Enterprise Regulation
FHFA	Federal Housing Finance Agency
FY	Fiscal Year
MRA	Matter Requiring Attention
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
PAR	Performance and Accountability Report
ROE	Report of Examination

BACKGROUND.....

FHFA’s DER conducts annual safety and soundness examinations of the Enterprises and CSS, a jointly and equally owned affiliate of the Enterprises.

Adverse Examination Findings

During DER’s annual examinations of the Enterprises and CSS, DER may identify adverse examination findings classified as MRAs, Violations, or Recommendations.¹

- MRAs are either critical supervisory matters or deficiencies. Critical supervisory matters are those findings that pose a substantial risk to the safety and soundness of an Enterprise or CSS. Deficiencies are those findings that could, if not corrected, escalate and potentially have a negative effect on the condition, financial performance, risk profile, operations, or reputation of an Enterprise or CSS.
- Violations are findings that disclose noncompliance with laws, regulations, or orders.² A violation that may negatively affect the condition or practices of an Enterprise may also be identified as an MRA.
- 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 an Enterprise or CSS to implement a recommendation unless the entity can demonstrate through a reasoned assessment why it should not be.

Generally, for each supervisory activity that makes up the annual examination and results in a finding, DER communicates the adverse examination findings to the Enterprise or CSS in a findings memorandum attached to a Conclusion Letter. In addition, DER issues an annual ROE to the Board of Directors of each Enterprise and the Board of Managers of CSS. The ROE communicates substantive examination conclusions, principal findings (including all

¹ FHFA, Advisory Bulletin 2017-01, [Classifications of Adverse Examination Findings](#), establishes classifications of adverse examination findings that identify priorities for remediation by the Enterprises.

² FHFA can issue orders requiring a regulated entity to take actions to correct certain prudential management and operations standards deficiencies.

MRAs), and the composite and component CAMELSO ratings for each entity.³ Each entity's Board of Directors' or Board of Managers' awareness of significant supervisory issues is critical because the board has responsibility for the organization's safety and soundness.

Remediation of Adverse Examination Findings

DER Operating Procedures Bulletin (OPB), *Adverse Examination Findings: Issuing, Monitoring, and Closing* (January 4, 2022), governed DER's processes for managing Enterprise and CSS adverse findings as of the end of the scope period.⁴ This OPB established updated processes for the remediation of MRAs, Violations,⁵ and Recommendations. Along with DER's OPB *Independent QC Process* (February 24, 2020), it also defined quality control review and management approval requirements for remediation activities during our scope period.

Processes for MRA Remediation

For each MRA issued, DER requires an Enterprise or CSS to submit a written remediation plan of corrective actions that management plans to take. Following receipt of the remediation plan, DER conducts the following remediation activities.

- *Assess Remediation Plans* – Examiners assess the remediation plan for sufficiency and reasonable timeframes for implementing corrective actions and submitting interim and final deliverables. Before January 1, 2022, DER communicated the examiner's remediation plan assessment to an Enterprise or CSS in a written letter. However, beginning January 1, 2022, examiners were not required to communicate their assessment in writing according to the OPB.
- *Monitor MRAs* – Examiners assess an Enterprise's or CSS' MRA remediation activities throughout the remediation process by, for example, holding discussions with Enterprise or CSS management and assessing interim deliverables. Examiners document their work in a Remediation Analysis Memo and submit the memo for

³ CAMELSO is a risk-focused rating system under which each regulated entity is assigned a composite rating based on an evaluation of various aspects of its operations. For the Enterprises, the components evaluated are Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk, and Operational Risk. CSS is only rated on the Management and Operational Risk components.

⁴ DER OPB, *Adverse Examination Findings: Issuing, Monitoring, and Closing* (January 4, 2022) superseded DER OPB, *Remediation* (December 31, 2020), which was in effect for part of the scope period. On November 25, 2022, DER updated its remediation guidance again by issuing DER OPB, *Adverse Examination Findings*, effective for all examination activities starting after January 1, 2023.

⁵ DER can designate Violations meeting the criteria for an MRA as MRAs and assesses their remediation in the same manner as MRAs. DER assesses the remediation of Violations that are not designated as MRAs in a similar manner to Recommendations.

semiannual review and approval by the Examination Manager and Examiner-in-Charge.

- *Close MRAs* – After Enterprise or CSS management completes the corrective actions outlined in the remediation plan, the respective internal audit function validates this completion except in the case of MRAs directed at the entity’s internal audit division. As part of this validation, internal audit assesses the effectiveness and sustainability of corrective actions. Once the internal audit validation is complete, Enterprise or CSS management submits a closure package, including deliverables evidencing management’s remediation of the issue and internal audit validation, to DER. Examiners conduct an independent assessment of the closure package, including testing to determine whether the corrective actions adequately address the concerns that led to the MRA. Examiners are required to complete their assessment and provide it to DER’s Quality Control Branch within 120 days of closure package receipt unless DER approves an extension.⁶ After completing the independent assessment, DER issues a remediation letter communicating its conclusion to the responsible Enterprise or CSS official.

Processes for Recommendation Remediation

For each recommendation issued, DER requires an Enterprise or CSS management to submit a written response within 60 days that describes how the Enterprise or CSS plans to address the finding unless the entity can demonstrate through a reasoned assessment why it disagrees with the recommendation. The examiner tracks the implementation of corrective actions through ongoing monitoring activities, assesses the adequacy of corrective action, and notifies an Enterprise or CSS upon closure.

DER’s Remediation Tracking System

DER uses its Remediation Tracking System to track the status of remediation work throughout the finding lifecycle. Remediation Tracking System data is input to DER’s remediation status dashboard, which DER management uses to monitor the progress of outstanding findings. DER’s Remediation Tracking System reported the following.

- From January 1, 2021, to December 31, 2022, DER closed ■ MRAs.
- As of December 31, 2022, there were ■ open MRAs and ■ open Recommendations. ■ Violations were open as of this date.

⁶ For MRAs issued to an Enterprise or CSS internal audit division, examiners must complete their assessment of the closure packages and provide it to DER’s Quality Control Branch within 180 days of receipt.

DER's Performance Measure for Determining MRA Remediation

In FHFA's PARs for FY 2021 and 2022, FHFA reported a strategic goal to "Ensure safe and sound regulated entities through world-class supervision." FHFA set a performance measure to monitor progress toward achieving the goal to "[d]etermine that the Enterprises have satisfactorily addressed safety and soundness MRAs in accordance with agreed upon remediation plans and timeframes" with a target of at least 90 percent of the time.

FACTS AND ANALYSIS

FHFA Implemented Controls to Ensure That the Enterprises and CSS Effectively Remediated Adverse Examination Findings Within FHFA Determined Reasonable Timeframes

DER Complied with Established Remediation Requirements

We found that DER monitored and assessed MRA remediation and monitored Recommendations in accordance with the established adverse finding guidance for the selected 20 closed MRAs, 15 open MRAs and 4 open Recommendations in our samples.⁷ DER performed the following actions.

- Assessed Enterprises' and CSS' remediation plans and monitored remediation activities for the closed and open MRAs in our samples in accordance with DER guidance. For each remediation plan, DER:
 - Documented a supportable conclusion on the adequacy of the remediation plan;
 - Communicated the conclusion on the adequacy of the remediation plan to an Enterprise or CSS in a timely, written response letter when required;
 - Documented an independent assessment of interim deliverables agreed to in the remediation plan in a Remediation Analysis Memo; and

⁷ For details of the sample selection, see the Objective, Scope, and Methodology section of this report.

- Complied with DER requirements for documented management and quality control review of response letter(s) and Remediation Analysis Memoranda.⁸
- Assessed Enterprises' and CSS' closure packages for all 20 closed MRAs in our sample in accordance with DER guidance. For each closure package, DER:
 - Reviewed documentation of an Enterprise's or CSS' internal audit validation of remediation work, where applicable;
 - Documented an independent assessment of the Enterprises' or CSS' corrective actions, including the independent testing of corrective actions, and made a timely, supportable conclusion on the adequacy of the MRA remediation; and
 - Complied with DER requirements for documented management and quality control review of remediation letters issued to the Enterprises or CSS.
- Received Enterprises' written responses to open Recommendations within established timeframes and tracked their remediation progress in DER's ongoing monitoring workpapers for all 4 open Recommendations in our sample.

DER Documented Reasonable Explanations for Extended Remediation Periods

We reviewed the Remediation Tracking System report and found that MRAs were closed an average of 817 days after issuance during the scope period of January 1, 2021, through December 31, 2022. As of the end of the scope period, open MRAs remained open an average of 563 days since issuance. In our samples of 20 closed and 15 open MRAs, 6 were closed more than 1,000 days (about 3 years) after the MRAs' issuance dates, and 3 were open more than 1,000 days as of December 31, 2022. In all cases, DER complied with established requirements for monitoring and documented reasonable explanations for the extended remediation period.

DER Accurately Tracked and Reported Adverse Finding Activity

We reconciled MRAs reported in the Enterprises' and CSS' calendar year 2021 and 2022 ROEs to those recorded in the Remediation Tracking System and found that the universe of closed and open MRAs in the Remediation Tracking System was complete. Further, we reviewed 251 individual Remediation Tracking System data fields for the 20 closed and 15

⁸ DER waives the DER management review and approval requirement for semiannual reviews of the Remediation Analysis Memo in certain instances, such as when the adverse finding was issued in the previous quarter (resulting in limited monitoring activity) or the examiner planned to issue a remediation letter in the next quarter. We did not take exception when DER documented an approved waiver or the Remediation Analysis Memo documented these instances.

open MRAs and 4 open Recommendations in our samples and found that 249 were consistent with DER’s remediation documentation files (99 percent accuracy rate).

FHFA reported that DER met its PAR measure – to determine that the Enterprises have satisfactorily addressed safety and soundness MRAs in accordance with agreed-upon remediation plans and timeframes at least 90 percent of the time – in both FY 2021 and FY 2022.⁹ We found that the information that DER used to calculate the performance results was generally consistent with the remediation information in the Remediation Tracking System.¹⁰ DER’s calculation of the performance result was consistent with the methodology reported in the FY 2021 and FY 2022 PARs and accurately measured whether remediation closure packages submitted were closed by the end of the fiscal year.¹¹ The calculation was approved by DER’s Deputy Director.

CONCLUSIONS

DER implemented control activities to ensure that the Enterprises and CSS effectively remediated adverse examination findings within FHFA determined reasonable timeframes. We found that DER (1) assessed Enterprises’ and CSS’ MRA remediation plans, monitored progress against these plans, and directed further action when concerns were identified; (2) documented a timely, independent assessment of the Enterprises’ and CSS’ MRA closure packages; (3) monitored remediation activities for Recommendations, as required; and (4) accurately tracked remediation activity in the Remediation Tracking System. We also found that FHFA accurately reported that DER met its MRA remediation performance goal in FHFA’s FY 2021 PAR and FY 2022 PAR.

⁹ FHFA reported performance results for this measure of 100 percent in FY 2021 and 93 percent in FY 2022.

¹⁰ DER did not include two FY 2021 determinations in its calculation that should have been included. We did not take exception to this error because the two determinations were successful and would not have changed DER’s reported result of 100 percent.

¹¹ In the FY 2021 PAR and FY 2022 PAR FHFA described its methodology for assessing the performance measure: “For each MRA for which an Enterprise submits a closure package, which includes the internal audit function’s validation, to FHFA between June 1 of the prior fiscal year and May 31 of the current fiscal year, FHFA reviews the Enterprise’s actions and the internal audit function’s validation by the end of the fiscal year to determine whether the Enterprise has satisfactorily addressed the MRA.” If FHFA finalized its determination by the end of the fiscal year, FHFA reported a successful result. See FHFA’s [FY 2021 PAR](#) and [FY 2022 PAR](#).

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to comment on a draft of this audit report. FHFA provided technical comments, which we considered in finalizing this report. FHFA management chose not to provide a formal written management response because there were no recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to determine whether FHFA implemented controls to ensure the Enterprises' and CSS' timely and effective remediation of adverse examination findings. The scope of this audit covered DER's assessment of the Enterprises' and CSS' remediation efforts from January 1, 2021, through December 31, 2022 (scope period).

To accomplish our objective, we performed the following procedures.

- Reviewed Government Accountability Office's *Standards for Internal Control in the Federal Government* (GAO-14-704G; September 2014) and determined that the control activities and information and communications components of internal control were significant to this objective, and focused on the underlying principles that management should (1) design and implement control activities through policies and (2) use and communicate quality information to achieve its objectives.
- Assessed the following DER Operating Procedures Bulletins and guidance related to DER's assessment of adverse finding remediation:
 - DER OPB, MRA Process (April 23, 2013; rescinded June 21, 2017)
 - DER OPB, Adverse Examination Findings Issuance and Follow-up (June 21, 2017; rescinded October 31, 2018)
 - DER OPB, Examination Processes and Documentation: Issuance of Adverse Examination Findings and Assessment of MRA Remediation (October 31, 2018; rescinded February 24, 2020)
 - DER OPB, Issuance of Adverse Examination Findings and Assessment of MRA Remediation Examination Processes and Documentation (February 24, 2020; rescinded December 31, 2020)
 - DER OPB, Remediation (December 31, 2020; rescinded January 4, 2022)
 - DER OPB, Adverse Examination Findings: Issuing, Monitoring, and Closing (January 4, 2022; rescinded November 25, 2022)
 - DER OPB, Adverse Examination Findings (November 25, 2022)
 - DER Interim Guidance, Remediation Letters Delegation (February 10, 2022)
 - DER Interim Guidance, Sign-off of Remediation Plans (October 4, 2021)

- DER, Frequently Asked Questions (FAQ) For Adverse Examination Findings: Issuing, Monitoring, and Closing Operating Procedures Bulletin (OPB) (January 4, 2022)
- Reviewed prior OIG reports related to DER’s assessment of adverse finding remediation efforts:
 - OIG, [Compliance Review of DER’s Assessments of Enterprise MRA Closure Packages](#) (March 15, 2021) (COM-2021-004)
 - OIG, [Compliance Review of the Timeliness of FHFA’s Assessments of the Enterprises’ Remediation Closure Packages for a Matter Requiring Attention](#) (February 21, 2020) (COM-2020-001)
 - OIG, [Compliance Review of FHFA’s Commitment to Evaluate Its Internal Quality Control Reviews Pertaining to Matters Requiring Attention](#) (September 9, 2019) (COM-2019-007)
 - OIG, [FHFA Requires the Enterprises’ Internal Audit Functions to Validate Remediation of Serious Deficiencies but Provides No Guidance and Imposes No Preconditions on Examiners’ Use of that Validation Work](#) (March 28, 2018) (EVL-2018-002)
 - OIG, [FHFA’s Adoption of Clear Guidance on the Review of the Enterprises’ Internal Audit Work When Assessing the Sufficiency of Remediation of Serious Deficiencies Would Assist FHFA Examiners](#) (March 28, 2018) (EVL-2018-003)
 - OIG, [FHFA’s Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA’s Supervision of the Enterprises](#) (July 14, 2016) (EVL-2016-007)
 - OIG, [FHFA’s Failure to Consistently Identify Specific Deficiencies and Their Root Causes in Its Reports of Examination Constrains the Ability of the Enterprise Boards to Exercise Effective Oversight of Management’s Remediation of Supervisory Concerns](#) (July 14, 2016) (EVL-2016-008)
 - OIG, [FHFA Failed to Consistently Deliver Timely Reports of Examination to the Enterprise Boards and Obtain Written Responses from the Boards Regarding Remediation of Supervisory Concerns Identified in those Reports](#) (July 14, 2016) (EVL-2016-009)

- [OIG, *FHFA's Examiners Did Not Meet Requirements and Guidance for Oversight of an Enterprise's Remediation of Serious Deficiencies* \(March 29, 2016\) \(EVL-2016-004\)](#)
- Interviewed and obtained written responses from DER personnel to understand DER's processes for assessing Enterprises' and CSS' adverse finding remediation efforts and using the Remediation Tracking System. DER personnel included the Deputy Director, Associate Director, Supervision Advisor, Principal Program Analyst, and examination staff responsible for monitoring remediation activities at the Enterprises and CSS.
- Determined that the Remediation Tracking System contained a universe of [REDACTED] closed MRAs, a universe of [REDACTED] open MRAs, and a universe of [REDACTED] open Recommendations within the scope period.¹² We assessed the reliability of data contained in the Remediation Tracking System using the Government Accountability Office's *Assessing Data Reliability* (GAO-20283G; December 2019) and found that this data was reliable. Specifically, we gained comfort regarding the completeness of this universe by reconciling the Remediation Tracking System report to the list of MRAs and Violations issued in the Enterprises' and CSS' ROEs, reviewing the reasonableness of system data fields, and determining the presence of system access controls. We excluded 6 open MRAs and 7 open Recommendations issued after August 1, 2022, as insufficient time had passed by the end of the scope period for sufficiently testable remediation efforts. As a result, the universe of adverse findings subject to sampling included [REDACTED] closed MRAs, [REDACTED] open MRAs, and [REDACTED] open Recommendations.
- Selected a sample of 20 closed MRAs ([REDACTED]) and 15 open MRAs ([REDACTED]). We used a random number generator to select a sample of 15 closed MRAs and 10 open MRAs. We then selected a judgmental sample of 5 additional closed MRAs and 5 additional open MRAs considering factors such as the issuing DER examination branch and the number of days the finding was outstanding. We used this methodology for the purpose of avoiding bias and not for the purpose of projecting results across the universe of open and closed MRAs.
 - For each MRA, we reviewed Remediation Tracking System data fields for consistency with remediation documentation. Further, we reviewed remediation documentation to determine whether it evidenced: (1) a reasonable, supported examiner assessment of the adequacy of management's MRA remediation plan; (2) DER's communication of this assessment to the

¹² [REDACTED]

Enterprises or CSS; (3) a timely, independent, and supported examiner assessment of the Enterprises' or CSS' progress in meeting interim remediation deliverables; and (4) compliance with DER's quality control review and management approval requirements.

- For each closed MRA in our samples, we reviewed DER's remediation documentation to determine whether it evidenced the examiner's timely, independent, supported assessment of management's closure package. We assessed whether DER documented: (1) a determination that the Enterprises' or CSS' management completed all of the remediation plans' corrective actions; (2) a determination that the Enterprises' or CSS' internal audit function completed a validation of the corrective actions; (3) DER examiner's testing of newly implemented processes, and (4) compliance with DER's quality control review and management approval requirements.
- Selected a sample of 4 open Recommendations ([REDACTED]) for testing. We used a random number generator for the purpose of avoiding bias and not for the purpose of projecting results across the universe of open Recommendations. For each open Recommendation selected, we reviewed remediation documentation to determine whether an Enterprise and CSS submitted required written responses and whether the examiner tracked corrective actions in ongoing monitoring workpapers.
- Reviewed the PARs for FY 2021 and FY 2022 and ascertained the results reported for performance measure 1.1.5a for FY 2021 and 1.2.1a for FY 2022. We assessed DER documentation supporting the calculation to determine whether it was consistent with the reported results and information in the Remediation Tracking System and approved by the DER Deputy Director. We reviewed the calculation methodology and determined that it accurately measured whether remediation closure packages submitted were closed by the end of the fiscal year.

We conducted this performance audit from March 2023 to September 2023 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 our 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.

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