

Federal Housing Finance Agency  
Office of Inspector General



**FHFA’s Use of its Enterprise  
Examination Manual, in Practice,  
Does Not Align with its Goal of  
Promoting a Consistent Examination  
Approach or Meet Management’s  
Expectations**



AUD-2021-013

September 28,  
2021

## Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 with the supervision of Fannie Mae and Freddie Mac (together, the Enterprises); Common Securitization Solutions, LLC (CSS); and the Federal Home Loan Banks (collectively, the regulated entities). Since 2008, FHFA has also served as conservator of the Enterprises.

One of FHFA's strategic goals is to ensure safe and sound regulated entities through world-class supervision. FHFA maintains that it uses a risk-based approach to supervisory examinations that involves identifying existing and emerging risks, evaluating the overall integrity and effectiveness of the entities' risk management systems and controls, and assessing compliance with applicable laws and regulations. Within FHFA, the Division of Enterprise Regulation (DER) is responsible for supervision of the Enterprises and CSS. Examinations, including targeted examinations and monitoring activities, are an essential component of DER's Enterprise Supervision Program.

In March 2020, DER released the Enterprise Examination Manual. This manual was intended to be a resource and reference guide for FHFA examiners performing examination activities, including targeted examinations, at the Enterprises and CSS. DER's Operating Procedures Bulletin (OPB), *Targeted Examinations*, states "**To promote a consistent approach** while allowing flexibility in designing targeted examination procedures, relevant procedures in Enterprise Examination Work Programs should also be taken into consideration ...." (emphasis added)

In FHFA Office of Inspector General's (OIG) September 2021 Management Advisory, *FHFA Must Resolve the Conflicts in its Guidance for Examinations of the Enterprises to Meet its Commitment to Develop and Maintain a World Class Supervision Program* (OIG-2021-003), we determined that DER did not meet its previous commitment to establish clear expectations for use of the Enterprise Examination Manual. Among other things, we noted a discrepancy between the DER Senior Associate Director's expectation – that examiners should start with the Enterprise Examination Manual as a base for performing targeted examinations, and if the examination procedures apply, follow those or document the reason(s) for not using them – and DER's OPB, *Targeted Examinations*, which only requires examiners to "consider" those procedures, not follow them. In that Advisory, we made two recommendations to FHFA: (1) establish specific guidance with respect to the circumstances under which DER expects examiners to follow examination procedures and (2) align its



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OPB with guidance in its Enterprise Examination Manual in order to foster consistent examination practice.

Given the lack of clear expectations for use of the Enterprise Examination Manual, we performed this audit to determine whether DER used its 2020 Enterprise Examination Manual in performing targeted examinations of the Enterprises and CSS initiated and completed from May 1, 2020, to March 31, 2021 (review period).

We found that for 15 of the 25 targeted examinations in our sample (60%), examiners did not use the Enterprise Examination Manual when preparing the targeted examination's procedures document. For 8 of these 15 targeted examinations, examiners did not even consider the manual. DER's use of its Enterprise Examination Manual, in practice, does not align with its goal of promoting a consistent examination approach. Further, we found that the DER Senior Associate Director's expectation – that examiners follow the examination procedures in the Enterprise Examination Manual or document the reason(s) for not using them – was not communicated to examination staff through DER's OPBs or training materials on the Enterprise Examination Manual.

In this report, we reaffirm the two recommendations made in OIG's September 2021 Management Advisory and make one new recommendation. In a written management response, FHFA agreed with the recommendation.

In performing this audit, we also identified a matter for consideration related to DER's cost accounting for its activities and outputs. Federal cost accounting standards require that agencies accumulate and report the costs of their activities on a regular basis for management information purposes. However, DER was unable to produce a record of costs incurred to perform targeted examinations and to develop and conduct training on the Enterprise Examination Manual. DER officials told us that DER "does not track costs to this level of work activity."

While we acknowledge that the standard provides management the flexibility to determine the appropriate level of detail for its cost accounting processes and procedures, it does state that managerial cost accounting should be performed to measure and report the costs of outputs. A cost accounting system that can produce cost information on DER's major outputs, such as examination activities, or other activities like training on the Enterprise Examination Manual, may assist management in making decisions about allocating resources, authorizing and modifying programs, and evaluating program performance.



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This report was prepared by James Lisle, Audit Director; Pamela L. Williams, Auditor-in-Charge; and Philip Noyovitz, Investigative Evaluator; 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 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](http://www.fhfaog.gov), and [www.oversight.gov](http://www.oversight.gov).

Marla A. Freedman, Senior Audit Executive /s/

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## ABBREVIATIONS .....

CSS	Common Securitization Solutions, LLC
December 2020 OPB	Targeted Examinations Operating Procedures Bulletin
Deputy Director	Deputy Director, Division of Enterprise Regulation
DER	Division of Enterprise Regulation
Enterprises	Fannie Mae and Freddie Mac
ERM	Enterprise Risk Management
February 2020 OPB	Targeted Examination Processes and Documentation Operating Procedures Bulletin
FHFA or Agency	Federal Housing Finance Agency
OIG	Federal Housing Finance Agency Office of Inspector General
OPB	Operating Procedures Bulletin
QC	Quality Control
Regulated Entities	Fannie Mae, Freddie Mac, any affiliate of Fannie Mae and Freddie Mac, and the Federal Home Loan Banks
SFFAS	Statement of Federal Financial Accounting Standards

## BACKGROUND.....

The Enterprises were chartered by Congress to provide stability in the secondary housing finance market, promote access to mortgage credit, and increase the liquidity of mortgage investments. As of December 31, 2020, the Enterprises guaranteed or owned approximately \$6.4 trillion in single-family and multifamily mortgages. CSS is a joint venture formed by the Enterprises to issue a single mortgage-backed security.

### **Effective Supervision by FHFA Is Vital to Ensure Safety and Soundness of the Enterprises and CSS**

The FHFA Strategic Plan: Fiscal Years 2021-2024 (October 27, 2020) includes three strategic goals<sup>1</sup> – one of which is to ensure safe and sound regulated entities through world-class supervision. FHFA maintains that it uses a risk-based approach to supervisory examinations that involves identifying existing and emerging risks, evaluating the overall integrity and effectiveness of the entities’ risk management systems and controls, and assessing compliance with applicable laws and regulations. Within FHFA, DER is responsible for supervision of the Enterprises and CSS. The Deputy Director, DER (Deputy Director), is responsible for providing management oversight, direction, and support for all examination activity involving the Enterprises and CSS. Examiners-in-Charge – the central points of contact for communication between DER and the Enterprises – are responsible for the planning, execution, and documentation of examination activities and for ensuring that examination activities are conducted in a manner that adheres to applicable FHFA and DER policies and standards.<sup>2</sup>

According to FHFA, examinations are an essential component of DER’s Enterprise Supervision Program. DER develops risk assessments that identify and assess existing and emerging risks to which the Enterprises and CSS are exposed, and the adequacy of risk management and controls to address these risks. The risk assessments, in turn, are used to develop risk-based examination plans. Examiners execute DER’s examination plans by conducting targeted examinations and monitoring activities. Targeted examinations, which are generally conducted in response to risks that have been identified and prioritized through the risk assessment process, typically focus on a discrete business or functional area(s), program(s), product(s), model(s), process(es), and/or control(s). Monitoring activities enable

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<sup>1</sup> The Strategic Plan establishes three strategic goals for the Agency: (1) ensure safe and sound regulated entities through world-class supervision; (2) foster competitive, liquid, efficient, and resilient national housing finance markets; and (3) position the Agency as a model of operational excellence by strengthening the workforce and infrastructure.

<sup>2</sup> During our review period, a designated senior DER official served as the point of contact for CSS.

examiners to identify significant matters that may affect an Enterprise’s risk profile or financial condition and to respond in a timely manner.

### ***FHFA Has Identified Supervision of the Regulated Entities as a Risk***

FHFA’s Enterprise Risk Management (ERM) program identified supervision risk<sup>3</sup> as a risk and tracked that risk in its 2020 and 2021 ERM Risk Profiles. FHFA defines supervision risk as the risk that:

Supervisory processes may not identify significant risks or risk management deficiencies that could affect the regulated entities’ financial condition or impact the safety and soundness of their operations. Factors affecting supervision risk may include supervisory plan development and execution, quality and timeliness of supervisory guidance, effective remediation of identified deficiencies, resource allocation and expertise, agency support for the examination function, and intra-agency and interagency collaboration.<sup>4</sup>

### **DER’s Supervisory Guidance**

DER’s OPBs establish standards to be followed in supervising the Enterprises and CSS. In addition to OPBs, on March 31, 2020, DER released the Enterprise Examination Manual. This manual is intended to be a resource and reference guide for FHFA examiners performing examination activities at the Enterprises and CSS.

### ***Operating Procedures Bulletins***

DER’s *Targeted Examination Processes and Documentation* OPB (issued February 24, 2020) (February 2020 OPB), taken along with its *Document Management* OPB (issued February 24, 2020), describes processes and documentation requirements for DER’s targeted examinations – organized by the three phases of a targeted examination (Planning, Execution, and

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<sup>3</sup> A risk profile is a prioritized inventory and assessment of the most significant risks facing the agency. Office of Management and Budget Circular No. A-123, *Management’s Responsibility for Enterprise Risk Management and Internal Control*, includes requirements for implementing ERM. Among other things, it requires that agencies maintain a risk profile. The primary purpose of a risk profile is to provide an analysis of the risks that may interfere with achievement of an agency’s strategic objectives and to identify appropriate options for addressing significant risks. Risk profiles should include the following components: (1) identification of objectives, (2) identification of risk, (3) inherent risk assessment, (4) current risk response, (5) residual risk assessment, and (6) proposed risk response. Inherent risk is the exposure arising from a specific risk before any action has been taken to manage it beyond normal operations. Residual risk is the exposure remaining from an inherent risk after action has been taken to manage it.

<sup>4</sup> For further discussion of FHFA’s ERM program, see OIG, *FHFA Followed OMB Guidance in Implementing its Enterprise Risk Management Program But its 2020 Risk Profile Failed to Identify a Significant Action Underway to Address Acknowledged Supervision Risk* (Mar. 17, 2021) (AUD-2021-004) (online [here](#)).

Conclusions and Findings) – and prescribes approval requirements for examination documentation. The February 2020 OPB sets forth that “examiners are expected to consider relevant procedures in Enterprise Examination Work Programs when developing the initial P[rocedures] D[ocument].” DER subsequently updated and renamed the February 2020 OPB. The new OPB, *Targeted Examinations*, was issued December 31, 2020, and effective for work performed beginning with the 2021 examination cycle (December 2020 OPB). Similar to the February 2020 OPB, this OPB states “To promote a consistent approach while allowing flexibility in designing targeted examination procedures, relevant procedures in Enterprise Examination Work Programs should also be taken into consideration when developing the initial P[rocedures] D[ocument].”

### ***Enterprise Examination Manual***

In an email dated March 31, 2020, DER notified DER staff that the Enterprise Examination Manual was “now available.” The email also stated that the Enterprise Examination Manual “generally supersede[d]” the FHFA Examination Manual (issued December 19, 2013) for DER examination work.

DER’s Enterprise Examination Manual contains an overview and two categories of documents: Enterprise Examination Modules and Enterprise Examination Work Programs. The Modules contain an introduction/overview of the topics, background information, illustrative examination objectives, criteria, and a section covering FHFA’s supervisory expectations for risk management. The Work Programs are organized into sections – Examination Planning, Examination Procedures, and Examination Conclusion and Findings – that follow DER’s three phase examination process and set forth objectives and/or procedures for each phase.

### ***Targeted Examination Procedures Documents Template***

The February 2020 OPB states that examiners are required to develop a “procedures document” for each targeted examination that includes, among other things, the criteria, objective(s), and procedures related to the targeted examination.<sup>5</sup> The procedures document is required to include procedures, or work steps, that are intended to enable the examiner to reach an independent conclusion on the targeted examination objective(s).

DER provided examiners with a Targeted Examination Procedures Document Template to assist examiners in preparing procedures documents. This template provides, among other

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<sup>5</sup> According to DER’s December 2020 OPB, criteria refers to the standards that will be used to assess regulated entity activities and reach a conclusion on examination objectives. Objectives describe what is intended to be achieved by the examination activity and procedures outline specifically how examiners will reach a conclusion on the examination objective(s).

things, a structure for recording information about the objectives and scope for the examination, and includes standard procedures for examination planning, as well as a section for the procedures specific to the targeted examination.

### **Prior OIG Evaluations Found Inconsistencies in DER's Supervisory Guidance**

A September 2021 OIG Management Advisory<sup>6</sup> concluded that FHFA must resolve the conflicts in its guidance for examinations of the Enterprises to meet its commitment to develop and maintain a world class supervision program. That Management Advisory discussed how prior OIG reports found that FHFA's guidance for examination of the Enterprises was far more flexible and less prescriptive than the guidance of other federal financial regulators. As a result of that substantial flexibility, DER examiners have significant discretion in conducting examinations, which we found resulted in inconsistent examination practices.

The Management Advisory focused on a 2019 OIG evaluation, which found that FHFA had not finalized many of its supplemental examination modules for examinations of the Enterprises and that many of the supplemental modules remained in "field test" status for more than five years. DER reported that it was developing an Enterprise-specific examination manual, with the objective of providing more comprehensive and detailed Work Programs that would be used consistently year over year, strengthening DER's capability to examine Enterprise risks consistently over time. At the time, we recommended, and FHFA agreed, that FHFA: (1) establish and implement timelines and processes to ensure timely updates and revisions to DER's examination manual and (2) establish and communicate clear expectations for use of revised and new examination modules by DER examiners. DER's failure to implement the second recommendation was the basis for the 2021 Management Advisory.

FHFA agreed with the second recommendation to establish and communicate clear expectations for the use of revised and new examination guidance and committed to issue internal guidance that would communicate management's expectations for use of the Enterprise Examination Manual. The Management Advisory showed that DER's December 2020 OPB, however, did not establish clear expectations as FHFA had agreed to do.

Because DER's less prescriptive December 2020 OPB does not establish clear expectations for examiners, we determined that it did not meet the commitment FHFA made in response to our 2019 recommendation. Accordingly, we closed that recommendation as rejected and made two new recommendations, that FHFA:

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<sup>6</sup> See OIG, *FHFA Must Resolve the Conflicts in its Guidance for Examinations of the Enterprises to Meet its Commitment to Develop and Maintain a World Class Supervision Program* (Sept. 1, 2021) (OIG-2021-003) (online [here](#)).

1. Revise the December 2020 Operating Procedures Bulletin to establish specific guidance with respect to the circumstances under which DER expects examiners to follow examination procedures in the Work Programs; and
2. Align the guidance in the governing Operating Procedures Bulletin with the guidance in the Work Programs in order to foster consistent examination practice.

## FACTS AND ANALYSIS .....

We performed this audit to determine whether DER used its 2020 Enterprise Examination Manual in performing targeted examinations of the Enterprises and CSS initiated and completed from May 1, 2020, to March 31, 2021 (review period). To perform this audit, we sampled 25 of the 37 targeted examinations initiated and completed during our review period. Our sample included 11 Fannie Mae targeted examinations, 10 Freddie Mac targeted examinations, and 4 CSS targeted examinations. The sampled targeted examinations included targeted examinations of risk areas that impacted the operations of the Enterprises and CSS broadly, such as Enterprise-wide risk management, information technology security, and vendor contingency planning, as well as targeted examinations focused on risk areas such as credit, model, and liquidity.

### **DER Examiners Did Not Always Consider or Use the Enterprise Examination Manual when Performing Targeted Examinations**

We found that for 10 of the 25 targeted examinations (40%) in our sample, the examiners used the Enterprise Examination Manual as a source for some of the procedures included in the procedures document. However, for the remaining 15 targeted examinations (60%), we found no documented evidence that the examiners used the Enterprise Examination Manual when preparing the procedures included in the procedures document. In interviews with the lead examiners for these 15 targeted examinations, we were told the following.

- For 7 targeted examinations, the Enterprise Examination Manual was considered but not used for various reasons: the manual did not provide the objectives and/or procedures needed to conduct the targeted examination, the manual did not provide anything additive beyond the 2013 FHFA Examination Manual, and the relevant section in the Enterprise Examination Manual was outdated.
- For 8 targeted examinations, the Enterprise Examination Manual was not considered and not used due to, among other things, oversight on the part of the lead examiner or lack of awareness about the Enterprise Examination Manual (e.g., forgot about the

Enterprise Examination Manual, were not aware that the Enterprise Examination Manual was available for use).

We found that none of these 15 targeted examinations documented the reason(s) why the examination procedures prescribed in the Enterprise Examination Manual were not used.

### **DER Management Did Not Communicate in Policy or Reinforce through Training, its Expectation that for Targeted Examinations, Examiners Use the Enterprise Examination Manual or Document Why the Manual Was Not Used**

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. Another attribute is that management periodically reviews policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity’s objectives or addressing related risks.<sup>7</sup>

As discussed in the OIG September 2021 Management Advisory, DER’s Senior Associate Director stated that it was his expectation that examiners should start with the Enterprise Examination Manual as a base for performing targeted examinations, and if the examination procedures apply, follow those or document the reason(s) for not using them. His expectation that examiners document their reason(s) for not using the Enterprise Examination Manual is not stated in DER’s OPBs or included in any related training materials on the Enterprise Examination Manual. Furthermore, in our view, without documentation and analysis of the reasons why examiners are not using the Enterprise Examination Manual, DER management is inhibited from identifying improvements that may be needed in the Enterprise Examination Manual.

## **FINDINGS .....**

- DER examiners did not always consider or use the Enterprise Examination Manual when performing targeted examinations of the Enterprises and CSS in our sample.
- DER management did not communicate in policy or reinforce through training, its expectation that for targeted examinations of the Enterprises and CSS, examiners use the Enterprise Examination Manual or document why the manual was not used.

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<sup>7</sup> See Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Sept. 2014), Principle 12 (online [here](#)).

## CONCLUSIONS .....

We found that DER examiners did not always consider or use the manual when performing targeted examinations during our review period. Further, we found that the DER Senior Associate Director’s expectation – that examiners follow the examination procedures in the Enterprise Examination Manual or document the reason(s) for not using them – was not communicated to examination staff through DER’s OPBs or in training materials on the Enterprise Examination Manual. In our view, without documentation and analysis of the reasons why examiners are not using the Enterprise Examination Manual, DER management is hindered from identifying improvements that may be needed.

## RECOMMENDATIONS .....

We reaffirm the recommendations in the OIG September 2021 Management Advisory<sup>8</sup> that FHFA: (1) revise the December 2020 Operating Procedures Bulletin to establish specific guidance with respect to the circumstances under which DER expects examiners to follow examination procedures in the Work Programs; and (2) align the guidance in the governing Operating Procedures Bulletin with the guidance in the Work Programs in order to foster consistent examination practice.

Further, based on this audit, we recommend that FHFA:

1. Develop and implement procedures that require: (a) examiners to document their reasons for not using the Enterprise Examination Manual to develop procedures documents for targeted examinations, and (b) management to analyze the documented reasons for not using the Enterprise Examination Manual to make improvements as needed (e.g., improvements to the manual, improvements to training to reinforce management’s expectations, etc.).

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<sup>8</sup> See OIG, *FHFA Must Resolve the Conflicts in its Guidance for Examinations of the Enterprises to Meet its Commitment to Develop and Maintain a World Class Supervision Program* (Sept. 1, 2021) (OIG-2021-003) (online [here](#)).

## MATTER FOR CONSIDERATION

### FHFA Could Expand Its Use of Management Cost Accounting to Support Initiatives Like Its Organizational Optimization Blueprint Project

As part of our audit, we asked DER to provide its costs (e.g., examiner salaries, travel expenses, incidental costs, etc.) to develop the Enterprise Examination Manual, to conduct training on the Enterprise Examination Manual, and to perform the 15 targeted examinations where we found no documented evidence that the Enterprise Examination Manual was used. DER responded:

DER does not track costs to this level of work activity (e.g., examination activity, Enterprise Exam[ination] Manual development, and training on the Enterprise Exam[ination] Manual) so we do not have documentation to provide to the OIG. All of these activities were performed by FHFA employees with no contractor assistance.

Statement of Federal Financial Accounting Standards 4, *Managerial Cost Accounting Standards and Concepts* (SFFAS 4), requires that agencies accumulate and report the costs of their activities on a regular basis for management information purposes. In this regard, management should define and establish responsibility segments.<sup>9</sup>

Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. SFFAS 4 instructs that the managerial cost accounting concepts and standards contained in the SFFAS are aimed at providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The cost information can be used by management in making decisions about allocating resources, authorizing and modifying programs, and evaluating program performance. The cost information can also be used by program managers in making managerial decisions to improve operating economy and efficiency. Accordingly, DER's lack of cost information for activities such as targeted examinations performed and resources expended to develop and train to an examination manual that was not always used is inconsistent with SFFAS 4.

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<sup>9</sup> SFFAS 4 defines a responsibility segment as a component of a reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services. In addition, responsibility segments usually possess the following characteristics: (1) their managers report to the entity's top management directly; and (2) their resources and results of operations can be clearly distinguished from those of other segments of the entity. See *Statement of Federal Financial Accounting Standards 4: Managerial Cost Accounting Standards and Concepts* in *FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended* (Jun. 30, 2020) (online [here](#)).

In a technical comment to a draft of this report, DER asserts that the OIG’s request for cost information was too narrow to conclude that FHFA does not meet the requirements of SFFAS 4. According to FHFA, the Agency tracks and reports costs by organizational unit, and in addition by Strategic Goal for each of the organizational units, and believes that the current practice meets the standards of SFFAS 4. In this regard, SFFAS 4 provides management with flexibility to determine the appropriate level of detail for its cost accounting processes and procedures.

While we acknowledge that the standard provides management the flexibility to determine the appropriate level of detail for its cost accounting processes and procedures, it does state that managerial cost accounting should be performed to measure and report the costs of outputs. A cost accounting system that can produce cost information on DER’s outputs, such as examination activities, or other activities, like training on the Enterprise Examination Manual, may assist management in making decisions about allocating resources, authorizing and modifying programs, and evaluating program performance. While we are not making a finding or a recommendation about this issue at this time, we do want to present it for FHFA’s consideration as it most likely will find more granular cost information useful as it implements initiatives such as its organizational optimization Blueprint project.<sup>10</sup>

## 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 the Appendix to this report. In its management response, FHFA agreed with our recommendation and stated that DER will take the following corrective actions.

- Update its internal examination guidance on targeted examinations to require examiners to refer to the Enterprise Examination Manual when developing procedures documents for targeted examinations. If, after the examiner refers to the Enterprise Examination Manual, the examiner determines that none of the work steps in the

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<sup>10</sup> For further discussion of the organizational optimization Blueprint project, see the Addendums to OIG reports *Despite Prior Commitments, FHFA Has Not Implemented a Systematic Workforce Planning Process to Determine Whether Enough Qualified Examiners are Available to Assess the Safety and Soundness of Fannie Mae and Freddie Mac* (Feb. 25, 2020) (AUD-2020-004) (online [here](#)) and *Despite FHFA’s Recognition of Significant Risks Associated with Fannie Mae’s and Freddie Mac’s High-Risk Models, its Examination of Those Models Over a Six Year Period Has Been Neither Rigorous nor Timely* (Mar. 25, 2020) (EVL-2020-001) (online [here](#)).

Work Programs were relevant to the scope of their planned targeted examination, then the examiner will document these reason(s) in the procedures document.

- Establish internal examination guidance that describes a new process for communicating to the appropriate DER group responsible for updating the Enterprise Examination Manual the reasons why the manual was not used; and for determining whether an update to the manual is warranted.

FHFA stated that DER will implement interim examination guidance to address our recommendation by December 31, 2021, and will incorporate this interim examination guidance into updated examination guidance for targeted examinations by August 31, 2022.

We consider FHFA's planned corrective actions responsive to our recommendations.

## OBJECTIVE, SCOPE, AND METHODOLOGY .....

We performed this audit to determine whether DER used its 2020 Enterprise Examination Manual in performing targeted examinations of the Enterprises and CSS initiated and completed from May 1, 2020, to March 31, 2021 (review period).

To accomplish our objective, we:

- Reviewed Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G (September 2014), and determined that the control activities component of internal control was significant to this objective, along with the underlying principle, Principle 12, that management should implement control activities through policies.
- Reviewed the following FHFA and DER policies, procedures, and guidance in effect during our review period to gain an understanding of how control activities were implemented:
  - Enterprise Examination Manual (including Modules, Work Programs, and Job Aids) (March 2020);
  - Enterprise Supervision Program OPB (February 2020);
  - Targeted Examination Processes and Documentation OPB (February 2020);
  - Targeted Examinations OPB (December 2020);
  - Independent Quality Control Process OPB (February 2020);
  - Document Management OPB (February 2020);
  - Targeted Examination Procedures Document Templates and Job Aids (February 2020 and January 2021);
  - Quality Control Review Results Report Templates (June 2020 and February 2021);
  - Supervisory Policy and Examination Guidance Development and Issuance (April 2020); and
  - Advisory Bulletin 2012-03, *FHFA Examination Rating System* (December 2012).

- Reviewed SFFAS 4, *Managerial Cost Accounting Standards and Concepts* (July 1995) to identify Federal managerial cost accounting standards related to the cost of federal programs, their activities, and outputs.
- Reviewed FHFA's ERM Risk Profiles to gain an understanding of FHFA's assessment of supervision risk.
- Interviewed DER officials to gain an understanding of: (1) DER's process for communicating expectations regarding use of the Enterprise Examination Manual; (2) DER's process for assessing adherence to expectations regarding use of the Modules and Work Programs in the Enterprise Examination Manual when preparing procedures documents for targeted examinations of the Enterprises and CSS; and (3) review procedures that DER's Quality Control (QC) function has put in place to assess examiners' use of and compliance with the Enterprise Examination Manual when preparing procedures documents for targeted examinations of the Enterprises and CSS.
- Performed a search of DER's electronic document repository to obtain the 2020 year-end and 2021 initial examination plans for the Enterprises and CSS and used the examination plans to identify the population of targeted examinations planned for the 2020 and 2021 examination cycles.
- Reviewed sequential order of Activity ID Numbers on examination plans and compared targeted examinations identified on examination plans with DER examination records in its electronic repository system in order to determine completeness of the population.
- Reviewed signed Request Letters and Conclusion Letters for all of the planned targeted examinations identified through the examination plans to identify the population of targeted examinations that were initiated and completed during our review period.
- Confirmed the population of targeted examinations initiated and completed during our review period with DER officials to ensure the completeness and accuracy of the population.
- Stratified the population of 37 targeted examinations that were initiated and completed during our review period and selected a judgmental sample of 25 targeted examinations (11 Fannie Mae targeted examinations, 10 Freddie Mac targeted examinations, and 4 CSS targeted examinations).

- Reviewed executed procedures documents and associated workflows to determine whether: (1) the procedures document was approved by designated DER officials; (2) the procedures document referenced the Enterprise Examination Manual; and (3) the procedures document was prepared using objectives and procedures that align with those in the Enterprise Examination Manual.
- Analyzed testing results for the targeted examinations in our sample to determine whether DER consistently prepared targeted examination procedures documents using the objectives and procedures outlined in the Enterprise Examination Manual in order to achieve its stated purpose to “support a consistent examination approach.”
- Interviewed DER examination staff and officials to discuss testing results for the targeted examinations in our sample and to determine the underlying reason why the Enterprise Examination Manual was not followed for those targeted examinations where the procedures document was not prepared using the Enterprise Examination Manual.
- Reviewed the workflows and QC review reports for the executed procedures documents in our sample to determine: (1) whether the procedures document was reviewed by DER’s QC function; (2) whether or not use of the Enterprise Examination Manual is a focus of the QC reviews; (3) whether the use of and compliance with the Enterprise Examination Manual was reviewed; and (4) whether findings of non-compliance were identified and communicated to DER management.
- Requested DER’s costs (e.g., examiner salaries, travel expenses, incidental costs, etc.) to develop the Enterprise Examination Manual, to conduct training on the Enterprise Examination Manual, and to perform the targeted examinations.

We conducted this performance audit from April 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 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.

## APPENDIX: FHFA MANAGEMENT RESPONSE.....



# Federal Housing Finance Agency

### MEMORANDUM

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

FROM: Andre D. Galeano, Deputy Director, Division of Enterprise Regulation **ANDRE GALEANO**

SUBJECT: Draft Audit Report: *FHFA's Use of its Enterprise Examination Manual, in Practice, Does Not Align with its Goal of Promoting a Consistent Examination Approach or Meet Management's Expectations*

DATE: September 24, 2021

Digitally signed by  
ANDRE GALEANO  
Date: 2021.09.24  
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Thank you for the opportunity to review the Office of Inspector General's (OIG) draft report referenced above (Report). The Report evaluates whether the Division of Enterprise Regulation (DER) used its 2020 Enterprise Examination Manual in performing targeted examinations of Fannie Mae and Freddie Mac (the Enterprises) and Common Securitization Solutions, LLC (CSS). The Report found that DER examiners did not always consider or use the Enterprise Examination Manual when performing targeted examinations, and makes one recommendation, to which we agree.

**Recommendation 1:** *Develop and implement procedures that require: (a) examiners to document their reasons for not using the Enterprise Examination Manual to develop procedures documents for targeted examinations, and (b) management to analyze the documented reasons for not using the Enterprise Examination Manual to make improvements as needed (e.g., improvements to the manual, improvements to training to reinforce management's expectations, etc.).*

**Management Response:** FHFA agrees with the recommendation. With respect to part (a) of the recommendation, DER will update its internal examination guidance on targeted examinations to require examiners to refer to the Enterprise Examination Manual (Manual) when developing procedures documents for targeted examinations. If, after the examiner refers to the Manual, the examiner determines that none of the work steps in the work programs were relevant to the scope of their planned targeted examination, then the examiner will document these reason(s) in the procedures document.

With respect to part (b) of the recommendation, DER will establish internal examination guidance that describes a new process for communicating to the appropriate DER group responsible for updating the Manual the reasons why the Manual was not used; and for determining whether an update to the Manual is warranted.

DER will implement interim examination guidance to address parts (a) and (b) by December 31, 2021 so that the guidance is effective for targeted examinations starting after January 1, 2022. This interim examination guidance will be incorporated into updated examination guidance for targeted examinations by August 31, 2022.

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 a more effective Enterprise Examination Manual for performing targeted examinations of the Enterprises and CSS. If you have any questions related to our response, please do not hesitate to contact Eric Wilson.

cc: Diana Stebick  
Eric Wilson  
Edom Aweke  
John Major

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