

Federal Housing Finance Agency  
Office of Inspector General



**DBR Performed Quality Control  
Reviews of All Substantive  
Workpapers Prepared by  
Examiners-in-Charge During the  
Review Period**

Compliance Review • COM-2024-006 • April 23, 2024



COM-2024-006

April 23, 2024

## Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) regulates and supervises the Federal Home Loan Bank System (FHLBank System), which consists of 11 regional FHLBanks and their fiscal agent, the Office of Finance. The FHLBank System's mission is to provide reliable liquidity to member institutions to support housing finance and community investment.

To further this mission, FHFA's Division of Bank Regulation (DBR) conducts annual safety and soundness examinations of the 11 FHLBanks and the Office of Finance and issues a Report of Examination (ROE) for each. An Examiner-in-Charge (EIC) leads each examination team. DBR conducts quality control (QC) reviews to confirm that ROE workpapers support examination findings, conclusions, and ratings and are consistent with Agency standards.

In a 2019 audit, OIG found that DBR's QC process did not require a review of examination work directly performed by an EIC. We recommended that FHFA revise DBR's QC procedures to ensure that examination workpapers directly prepared by an EIC be subjected to independent review by a person who had not participated in the examination. The Agency issued procedures directing that EIC supervisors or other DBR officials review EIC-prepared workpapers. Accordingly, we closed the recommendation on October 2, 2019.

In a 2021 compliance review, we found that DBR did not follow its new procedures for QC reviews of EIC-prepared workpapers in more than half of the examinations we tested. Accordingly, we reopened the recommendation from our 2019 audit.

In December 2021, DBR again revised its QC process for EIC-prepared workpapers by assigning sole responsibility for reviewing them to the Quality Control Branch (QCB). QCB is an independent unit within DBR that was established to provide "an additional assurance of quality" for DBR examinations. A DBR official said that QCB's independence from the examination process allows it to effectively review EIC-prepared workpapers.

In this compliance review, we determined that, pursuant to the revised procedures, QCB reviewed without exception all applicable EIC-prepared examination workpapers for the period January 1, 2022, through September 30, 2023. Accordingly, we are closing the recommendation from our 2019 audit.



COM-2024-006

April 23, 2024

This report was prepared by Crystal Tsang, Senior Compliance Specialist, and Wesley M. Phillips, Senior Policy 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.fhfaoig.gov](http://www.fhfaoig.gov).

/s/

Brian W. Baker  
Deputy Inspector General, Office of Compliance

**TABLE OF CONTENTS** .....

EXECUTIVE SUMMARY .....2

ABBREVIATIONS .....5

BACKGROUND .....6

    In 2019, We Found that DBR Did Not Subject EIC-Prepared Workpapers to Quality Control Reviews .....6

    We Closed the Recommendation Later in 2019 After DBR Instituted a QC Requirement for EIC-Prepared Workpapers .....7

    DBR Did Not Subject EIC-Prepared Workpapers to QC Reviews for Over Half of the Examinations Tested in 2021.....8

    DBR Revised the OPB to Assign Responsibility for QC Reviews to QCB.....8

FINDINGS.....9

    QCB Met the Current OPB’s Requirements for Reviewing Substantive EIC Workpapers.....9

CONCLUSION.....10

FHFA COMMENTS AND OIG RESPONSE.....11

OBJECTIVE, SCOPE, AND METHODOLOGY .....12

APPENDIX: FHFA MANAGEMENT RESPONSE .....13

ADDITIONAL INFORMATION AND COPIES .....15

## ABBREVIATIONS .....

Agency or FHFA	Federal Housing Finance Agency
DBR	FHFA Division of Bank Regulation
EIC	Examiner-in-Charge
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
OIG	FHFA Office of Inspector General
OPB	Operating Procedure Bulletin on Quality Control, 2018-DBR-OPB-03
QC	Quality Control
QCB	Quality Control Branch
Review Period	January 1, 2022, through September 30, 2023
ROE	Report of Examination

## BACKGROUND.....

Pursuant to the Housing and Economic Recovery Act of 2008, FHFA regulates and supervises the FHLBank System, which consists of the 11 FHLBanks and the Office of Finance, the FHLBanks' fiscal agent. The FHLBank System's mission is to provide reliable liquidity to member institutions to support housing finance and community investment.

DBR oversees the FHLBank System. DBR's objective is to ensure that the FHLBank System operates in a safe and sound manner and achieves its mission. To help carry out its objective, DBR annually performs examinations of each FHLBank and the Office of Finance and produces a Report of Examination (ROE) for each. The ROE sets forth DBR's findings and any required remedial actions to address identified deficiencies.

DBR examinations are conducted by a team of examiners, with support from financial analysts, economists, accountants, and attorneys. The examination team is led by an EIC who reports to a DBR Associate Director. Under the EIC's leadership, the team conducts each annual examination and produces each ROE.

### **In 2019, We Found that DBR Did Not Subject EIC-Prepared Workpapers to Quality Control Reviews**

Like other federal financial regulators, FHFA has recognized that comprehensive QC reviews of examinations are a critical internal control. DBR conducts QC reviews of its examinations to ensure that their findings and conclusions are adequately supported and that DBR's examinations are accurate, complete, and of uniform high quality.

Our July 2019 audit of certain FHLBank examinations found that DBR's QC process had two prongs.<sup>1</sup>

- The first prong was that a particular examination's EIC would ensure that the workpapers generated or compiled for the examination adequately support the work performed and that the workpapers support the ROE's conclusions. To do so, an EIC had to review a sufficient number of workpapers to gain confidence in their adequacy, or otherwise ensure that a combination of the EIC's own workpaper reviews, when taken together with reviews by others, provides that confidence.

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<sup>1</sup> OIG, *FHFA Conducted BSA/AML Program Examinations of 10 of 11 Federal Home Loan Banks During 2016-2018 in Accordance with its Guidelines, But Failed to Support a Conclusion in the Report of Examination for the Other Bank* (July 10, 2019) (AUD 2019-008).

- The second prong was that an independent DBR examination specialist – i.e., one who had not worked on the examination under review – would conduct his or her own QC review of selected examination workpapers.

We found that where an EIC did not merely supervise an examination, but also personally conducted a portion of that examination, the workpapers prepared by that EIC would not necessarily be subjected to either prong of DBR’s QC process.

To eliminate this gap in DBR’s QC process, we recommended that FHFA “[r]evis[e] DBR’s quality control procedures to specifically require that all examination workpapers supporting examination findings, conclusions, and ratings directly prepared by the EIC be reviewed by an individual who did not participate in the examination.” The Agency accepted the recommendation.

### **We Closed the Recommendation Later in 2019 After DBR Instituted a QC Requirement for EIC-Prepared Workpapers**

On September 17, 2019, DBR revised its Operating Procedures Bulletin on Quality Control, 2018-DBR-03 (OPB) to include the following instruction for a new QC review prong for EIC-prepared workpapers:

All examination workpapers supporting examination findings, conclusions, and ratings directly prepared by the EIC must be reviewed by the EIC’s [Associate Director], or have that review delegated by the [Associate Director] to the team’s [Supervisory Examiner]<sup>2</sup> or to another EIC who did not participate on the examination.<sup>3</sup>

OIG closed the recommendation on October 2, 2019, based upon the revised OPB’s requirement that EIC-prepared workpapers be subjected to QC review.

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<sup>2</sup> According to DBR, a Supervisory Examiner supports an Associate Director and is responsible for implementing examination activities of FHLBanks in accordance with FHFA examination policy and practice. The scope of these activities requires close collaboration with staff from other agency divisions with respect to risk assessments, evaluations of financial condition and performance, and off-site monitoring and surveillance.

<sup>3</sup> We also note that the OPB directed that examination workpapers – regardless of whether they were prepared by the EIC on a non-EIC examination team member – be subjected to a second prong of the QC review process by DBR’s QCB. QCB is an independent unit within DBR, which was established to provide an “additional assurance of quality” for DBR examinations.

## **DBR Did Not Subject EIC-Prepared Workpapers to QC Reviews for Over Half of the Examinations Tested in 2021**

Our 2021 compliance review assessed whether DBR had complied fully with the first QC review prong in the revised OPB by having all EIC-prepared examination workpapers reviewed by the EIC's Associate Director, a Supervisory Examiner, or by another EIC who did not participate in the examination.<sup>4</sup>

We found that in 2 of the 11 examinations completed during our review period, no independent QC review was performed upon the EIC-prepared workpapers as required by the OPB. In four of the remaining nine examinations, the EIC had not finished producing all workpapers until after the first QC review prong had concluded. As a consequence, the QC reviews for those four examinations were conducted on an incomplete record, which could not have included all of the EIC-prepared workpapers.

DBR responded to our finding by stating that any EIC-prepared workpapers not reviewed within DBR were reviewed by DBR's QCB in the second prong of the revised QC process. While we confirmed that QCB reviewed the missing workpapers, we rejected DBR's argument because the revised OPB required two QC review prongs. The OPB did not address whether DBR's failure to complete the first prong could be remedied by QCB performing the second prong.

Because DBR had not complied fully with the revised OPB's QC requirements for more than half of the examinations under review, we reopened our 2019 recommendation.

## **DBR Revised the OPB to Assign Responsibility for QC Reviews to QCB**

On December 21, 2021, DBR issued a further-revised version of the OPB in response to our reopening of the 2019 recommendation.

DBR eliminated the prior OPB's first QC prong that EIC-prepared workpapers first be subjected to QC reviews by Associate Directors, Supervisory Examiners, or independent EICs. The current OPB now places all QC review responsibility for EIC-prepared workpapers on the QCB, which was the prior second QC prong. Specifically, the current OPB requires QCB to review all "substantive" workpapers prepared by EICs.<sup>5</sup> The OPB also

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<sup>4</sup> OIG, *Compliance Review of DBR's Quality Control for Examination Work Performed by Examiners-in-Charge* (August 25, 2021) (COM-2021-007).

<sup>5</sup> The revised OPB states that "(S)ubstantive workpapers are those involved in supporting examination findings, conclusions, and ratings directly prepared by the EIC. These would typically include the rating composite memorandum; conclusion, finding, and remediation memoranda prepared by the examination EIC; and any work program area (typically Board of Directors Senior Management) workpapers prepared by the



requires QCB and DBR to verify that the latter has transferred all substantive EIC-prepared workpapers on each examination to QCB for its review.

In January 2022, we asked DBR why it chose to eliminate DBR’s internal QC reviews of EIC-prepared workpapers rather than work to ensure that QC reviews are always performed for such workpapers. A senior DBR official said that the DBR QC reviewers under the prior version of the OPB – an Associate Director, Supervisory Examiner, or EIC who did not participate in a particular examination – are not fully independent as they participate in the DBR examination process themselves.

The DBR official also said that QCB does not have this independence issue. He said that QCB is separate from the examination process, both in participation and in lines of reporting. Moreover, he said that reviewing the work of others is a primary job for QCB staff, instead of a secondary or tertiary responsibility as it is for examination staff. The official suggested that this focus may lead to more diligence and more effective management of resources.

During the fieldwork for this compliance review, the same DBR official said that DBR balanced many considerations in revising the OPB and is satisfied with the outcome after two years of operations.

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

We initiated this compliance review to determine whether OIG might close the now re-opened recommendation. Because DBR significantly amended its QC process in 2021, this compliance review assessed whether DBR is adhering fully to that QC review process for EIC-prepared workpapers, thereby ensuring that all EIC workpapers are scrutinized by QCB. If they are, the new QC review practice should be sufficient to address the concern underlying our recommendation.

### **QCB Met the Current OPB’s Requirements for Reviewing Substantive EIC Workpapers**

We requested that DBR provide documentation for QCB’s reviews of all substantive EIC-prepared workpapers for examinations initiated and completed from January 1, 2022, through

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examination EIC.” Other substantive workpapers may include the supervisory strategy memorandum, the scope memorandum, and the site visitation memorandum.

Notwithstanding the OPB’s requirements that QCB review all substantive EIC workpapers, a QCB official said that separate DBR guidance requires an examination Associate Director to sign electronically the scope memorandum to document their review of it. While the QCB official also said that Associate Directors in practice typically review other EIC-prepared examination workpapers, there is no specific requirement that they document such reviews.

September 30, 2023 (review period). We also requested all email exchanges documenting that DBR had provided all substantive EIC-prepared workpapers to QCB for its review.

DBR provided the requested documentation for 18 examinations initiated and completed during the review period. Our review found that QCB reviewed all EIC-prepared workpapers identified as substantive with no exceptions.

DBR also provided email documentation that QCB verified that it had received all substantive EIC-prepared workpapers for its review for the 18 examinations without exceptions.

## **CONCLUSION.....**

DBR revised the OPB to transfer responsibility for reviewing EIC workpapers to QCB. Our review of QCB documentation for the review period found that the QCB process is intended to be comprehensive with a review of all EIC-prepared substantive workpapers. We found that QCB complied with the OPB’s requirements for reviewing EIC-prepared substantive workpapers during the review period without exception. This means that all substantive EIC-prepared workpapers were subjected to QC review, which addresses the deficiency found in our 2019 audit. For this reason, we are closing the re-opened recommendation.

## **FHFA COMMENTS AND OIG RESPONSE.....**

We provided a draft of this report to FHFA for its review and comment. The Agency’s comments are included in the Appendix to this report.

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

Our objective for this review was to determine whether QCB complied with the revised OPB’s requirements for reviewing EIC substantive workpapers for the period January 1, 2022, through September 2023 (review period).

To meet our objective, we requested and reviewed documentation of QCB reviews of EIC-prepared substantive workpapers during our review period, as well as emails verifying that DBR provided to QCB all such substantive EIC-prepared workpapers. We also interviewed DBR and QCB officials.

We conducted our compliance review from December 2023 through February 2024 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment.

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

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## Federal Housing Finance Agency

### MEMORANDUM

TO: Brian W. Baker, Deputy Inspector General, Office of Compliance

FROM: Joshua Stallings, Deputy Director, Division of FHLBank Regulation **JOSHUA STALLINGS**

SUBJECT: Draft Compliance Report: *DBR Performed Quality Control Reviews of All Substantive Workpapers Prepared by Examiners-in-Charge During the Review Period*

DATE: April 12, 2024

Digitally signed by  
JOSHUA STALLINGS  
Date: 2024.04.15  
13:29:04 -04'00'

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Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft report. OIG assessed whether the Division of FHLBank Regulation (DBR) adhered fully to its quality control review process for workpapers prepared by examiners-in-charge (EICs) by having the Quality Control Branch review all substantive EIC workpapers. We are pleased to hear that the OIG identified no exceptions in our process.

We appreciate the communication of results from the engagement and the continued professionalism of OIG staff. If you have any questions relating to our response, please contact Ed Stolle.

cc: John Major  
Mark David  
Ed Stolle

## ADDITIONAL INFORMATION AND COPIES.....

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