Federal Housing Finance Agency
Office of Inspector General

FHFA Can Strengthen Controls over Its Office of Quality Assurance

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Synopsis

September 30, 2013

FHFA Can Strengthen Controls over Its Office of Quality Assurance

Why OIG Did This Report

The Office of Quality Assurance (OQA) of the Federal Housing Finance Agency (FHFA or the agency) is a crucial internal control for the agency's examinations of the housing government-sponsored enterprises (GSEs). Internal controls, when effective, give FHFA management greater assurance that the agency can achieve its mission, operate effectively and efficiently, report reliably, and comply with applicable laws and regulations.

Per its charter, OQA conducts internal reviews of FHFA's divisions that directly meet the agency's statutory supervisory and regulatory mission (i.e., examination and examination support functions). The agency uses OQA reviews to enhance the effectiveness of FHFA's supervision of the housing GSEs, helping to ensure that they operate in a safe and sound manner and provide liquidity for the housing market. OQA reviews also can complement oversight by the Government Accountability Office (GAO) and the FHFA Office of Inspector General (OIG).

OIG conducted this performance audit to assess controls related to the (1) effectiveness of OQA's review of FHFA's examination and examination support functions and (2) extent of OQA's coverage of other FHFA functions that may pose significant risks.

What OIG Found

OQA generally conducted effective, risked-based reviews of FHFA's examination and examination support functions. Further, OIG validated that in four of OQA's reports the conclusions, findings, and recommendations were supported by adequate evidence.

However, most of OQA's 22 recommendations have not been fully or promptly resolved, primarily because OQA did not (1) require FHFA to respond formally in writing and commit to specific timelines for completing corrective actions and (2) follow up on corrective actions. As of March 31, 2013:

- 8 recommendations remained open, 6 of them for 520 or more days. These included suggesting:
    - the Division of Enterprise Regulation (DER)—responsible for supervising the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the enterprises)—to establish a comprehensive quality control review process for examination work products, and
    - the Division of Bank Regulation (DBR) to assess examination resource needs and priorities to ensure it provides sufficient coverage of the Federal Home Loan Banks (FHLBanks).

- 14 recommendations were reported as "closed," but OQA had not validated 7 to ensure that the proposed corrective actions had been implemented or adequately addressed the recommendations. For example, without confirming that corrective actions had been implemented, OQA closed recommendations intended to ensure that DER monitors examination findings to verify that appropriate reporting occurs.

Addressing OQA recommendations in a complete and timely manner can help FHFA ensure the quality of its examinations and maximize the value of its investment in OQA.

In addition, OQA's risk-based reviews do not cover all of FHFA's offices. The present focus of OQA on examination and related support functions excludes key agency operations, such as the Office of Conservatorship Operations (OCO), which approves management decisions affecting the enterprises. FHFA needs to assess the potential benefits of broadening the scope of OQA's operations, which can help ensure that the most critical risks to FHFA receive commensurate oversight.

What OIG Recommends

FHFA should strengthen controls over OQA reporting and follow up. In addition, FHFA should evaluate the roles and responsibilities of OQA across the agency and revise OQA's charter accordingly. FHFA should also assess the risks across all agency operations for purposes of planning OQA review coverage, and direct performance reviews of those areas that pose the most significant risks to FHFA.

FHFA provided comments agreeing with the recommendations in this report.

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ABBREVIATIONS

COO	Chief Operating Officer
DBR	Division of Bank Regulation
DER	Division of Enterprise Regulation
DEPS	Division of Examination Programs and Support
DHMG	Division of Housing Mission and Goals
DSPS	Division of Supervision Policy and Support
ECIC	Executive Committee on Internal Controls
Fannie Mae	Federal National Mortgage Association
FHFA or agency	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
Freddie Mac	Federal Home Loan Mortgage Corporation
GAO	Government Accountability Office
GSE	Government-Sponsored Enterprise
OCO	Office of Conservatorship Operations
OIG	Federal Housing Finance Agency Office of Inspector General
OMB	Office of Management and Budget
OMWI	Office of Minority and Women Inclusion
OQA	Office of Quality Assurance
OSI	Office of Strategic Initiatives
ROE	Report of Examination

PREFACE

As a federal agency, FHFA is required to implement internal controls that help it meet its mission, goals, and objectives and to minimize risks associated with its programs and operations. One such control is the agency's OQA, which is intended to enhance the effectiveness of FHFA's supervision of the housing GSEs. OQA reviews the agency's divisions that directly meet the agency's statutory supervisory and regulatory mission. These divisions are responsible for ensuring that the GSEs operate in a safe and sound manner.

In June 2012, OIG reported on internal control matters associated with FHFA's quality assurance processes for FHLBank examinations.[1] In a related internal audit memorandum, OIG identified several matters that warranted attention and encouraged FHFA to prepare annual OQA plans related to FHLBank examinations, to prepare guidance for OQA staff regarding FHLBank examination quality activities, and to document the process for addressing OQA recommendations. Subsequently, OIG initiated this performance audit to assess the (1) effectiveness of OQA's review of FHFA's examination and examination support functions and (2) extent of OQA's coverage of FHFA's other functions that pose significant risks.

OIG is authorized to conduct audits, evaluations, investigations, and other studies pertaining to FHFA's programs and operations. As a result of its work, OIG may recommend policies that promote economy and efficiency in administering FHFA's programs and operations, or that prevent and detect fraud, waste, and abuse in them. OIG believes that this report's recommendations will improve FHFA's internal controls to help it achieve its mission.

OIG appreciates the cooperation of all those who contributed to this audit, which was led by Alisa Davis, Acting Assistant Inspector General for Audits, who was assisted by Mai Nguyen, Audit Manager, and Theodore Kirby, Senior Auditor.

This audit report will be distributed to Congress, the Office of Management and Budget, and others, and will be posted on OIG's website, www.fhfaoig.gov.

Russell A. Rau
Deputy Inspector General for Audits

[1] OIG, *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management* (AUD-2012-004) (June 1, 2012); online at http://www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf).

BACKGROUND

FHFA's Mission and the Office of Quality Assurance

The Housing and Economic Recovery Act of 2008 established FHFA as the regulator and supervisor of the GSEs: Fannie Mae, Freddie Mac, and the 12 FHLBanks. FHFA's mission is to ensure the GSEs are safe and sound and that they serve as a reliable source of liquidity and funding for housing finance and community investment.

FHFA's *Strategic Plan Fiscal Years 2013-2017* sets four strategic goals for FHFA:[2]

1. Ensure Safe and sound housing GSEs;
2. Facilitate stability, liquidity, and accessibility in housing finance;
3. Preserve and conserve enterprise assets; and
4. Prepare for the future of housing finance in the United States.

To accomplish its mission and strategic goals, FHFA has organized itself into several divisions and offices to provide supervision, regulation, and housing mission oversight of the GSEs and to manage the conservatorships of Fannie Mae and Freddie Mac.

FHFA's **supervision and housing mission divisions** consist of DBR, DER, the Division of Supervision Policy and Support (DSPS),[3] and the Division of Housing Mission and Goals (DHMG).

FHFA's other offices include, but are not limited to, the Office of the Director, OCO, the Office of Strategic Initiatives (OSI), and the Office of Minority and Women Inclusion (OMWI).

Supervision and Housing Mission Divisions

Division of Bank Regulation is responsible for supervising the FHLBanks and the Office of Finance and performs monitoring and examinations of these entities.

Division of Enterprise Regulation is responsible for supervising Fannie Mae and Freddie Mac and performs monitoring and examinations of them.

Division of Supervision Policy and Support provides support and specialized resources for both DBR and DER examinations.

Division of Housing Mission and Goals is responsible for overseeing the housing mission and goals of the enterprises and of the housing finance and community and economic development mission of the FHLBanks.

[2] FHFA, *Strategic Plan Fiscal Years 2013-2017,* at 2 (October 9, 2012); accessed August 26, 2013, at http://www.fhfa.gov/webfiles/24790/Final%20FHFA%20Strategic%20Plan-10-9-12.pdf.

[3] DSPS was formerly structured as the Division of Examination Programs and Support (DEPS).

FHFA established OQA in 2011 to perform internal reviews of FHFA's supervision and housing mission divisions: DBR, DER, DSPS, and DHMG. FHFA's strategic plan states that the agency will use quality assurance reviews to enhance the effectiveness of its supervision, which entails ongoing monitoring and targeted examinations.

OQA started performing reviews in March 2011 but was formally chartered in September 2011. OQA reports to the chief operating officer (COO). OQA began with one associate director, two managers, and seven staff. As of March 31, 2013, OQA had one manager and eight staff. The associate director and one manager transferred to other FHFA divisions.

Importance of Internal Controls

FHFA has various internal controls, one of which is OQA.[4] GAO issues standards for internal control in the government, and the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, provides the specific requirements for assessing and reporting on controls. Internal control is an "integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." Internal control is a major part of managing an organization.

One of the internal control standards—monitoring—addresses assessing the quality of internal control performance over time and ensuring that the findings of audits and other reviews are promptly resolved.[5]

OQA's Internal Reviews

Through March 2013, OQA completed 27 quality assurance reviews and quality control checks. OQA defines a review as an objective internal assessment of the effectiveness of the system of internal controls employed by FHFA and management to achieve its goals. Reviews are designed to assess the business unit's processes or specific operations, or to address special requests made by FHFA management. According to OQA, reviews incorporate risk management techniques as well as aspects of application controls and technology.

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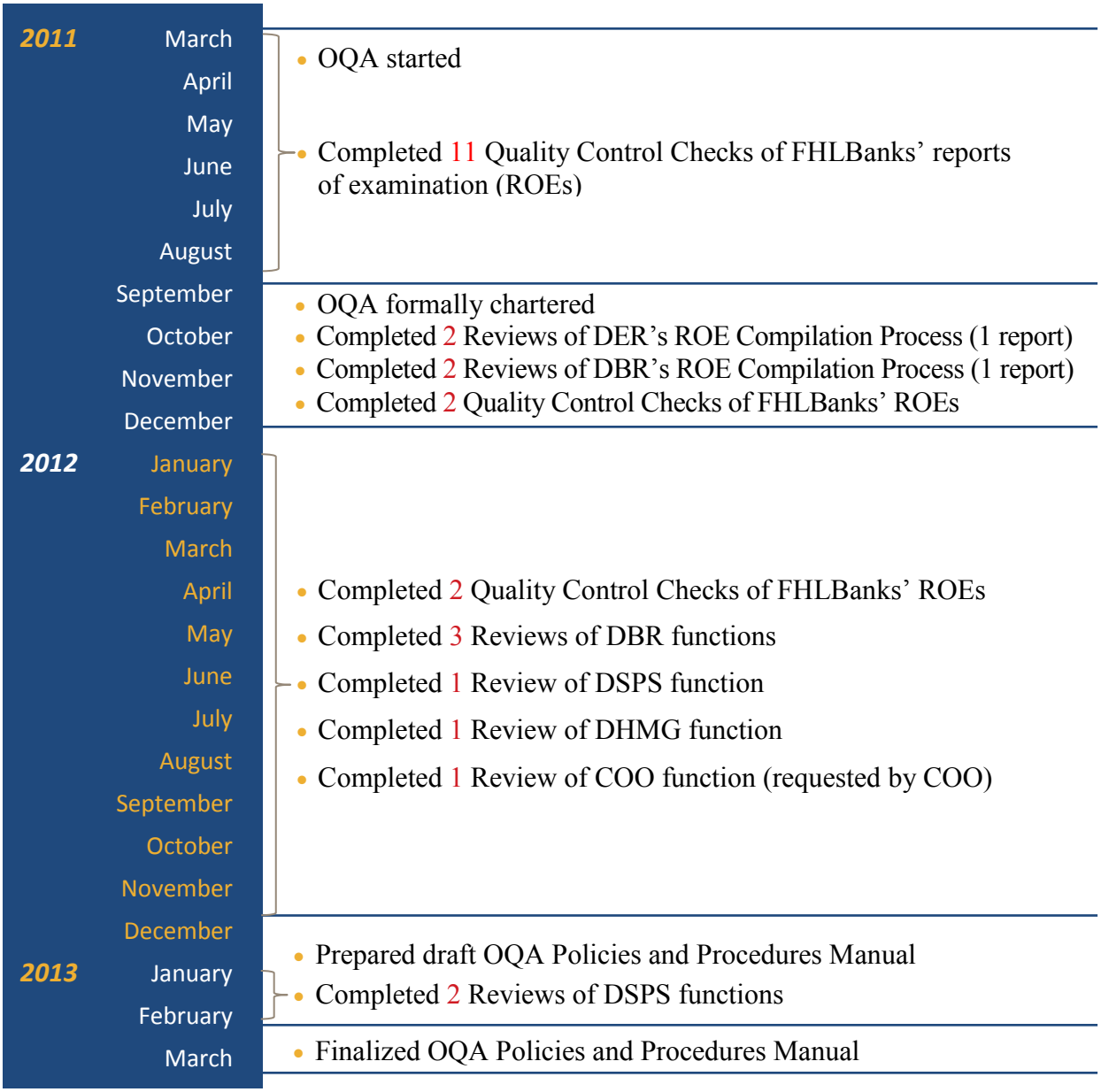
[4] FHFA established the Executive Committee on Internal Controls (ECIC) in April 2012 to comply with OMB Circular A-123, which recommends that agencies form senior management councils to assess and monitor deficiencies in internal controls. One of the ECIC's tasks is to monitor and track findings, deficiencies, recommendations, and corrective actions from internal and external evaluations and reviews.

[5] Internal control standards and the definitions of internal control are based on GAO, *Standards for Internal Control in the Federal Government* (November 1999).

In contrast, an OQA quality control check is an assessment of the quality of a division's interim product before the deliverable is finalized. OQA no longer performs these quality control checks because it has focused on the more robust quality assurance reviews. See Figure 1 for a timeline of the work performed by OQA.

FIGURE 1. TIMELINE OF OQA'S WORK



Source: OIG analysis based on information provided by FHFA.

FINDINGS

1. OQA's Effectiveness Can Be Enhanced by Strengthening Its Reporting and Follow up on Recommendations

Overall, OQA was effective in evaluating FHFA's supervisory and regulatory functions because it completed or was in the process of completing all of its planned work for 2012, reviewed all areas it deemed to be high risk, and reported findings and recommendations that led to management improvements. Additionally, OQA's risk assessments, work plans, and completed work products were adequate for the reviews performed. For example, OQA completed a risk assessment that identified the relative risk of FHFA's examination functions, and OQA performed work based on the areas posing the more significant risk. When doing so, it considered external and internal risks, consistent with internal control standards. Further, OIG validated that four OQA reports were based on the evidence supporting OQA's findings, recommendations, and conclusions.

However, OQA did not consistently ensure that FHFA management promptly resolved reported findings and recommendations, closed certain recommendations without validating whether management actions addressed them, and did not require written responses to recommendations.

OQA Recommendations Remain Open for Extended Periods

As of March 31, 2013, 8 of 22 OQA recommendations (or 36%)—made before 2013 that relate to FHFA's examination and examination support functions—remained open, as shown in Figure 2. (See Appendix D for more details on all eight open recommendations.) Six of the eight recommendations (or 75%) had been open for 520 or more days as of March 31, 2013. These six recommendations were the result of two October 2011 OQA reports that relate to FHFA examinations.[6]

FIGURE 2. STATUS OF IN-SCOPE OQA RECOMMENDATIONS

Issuance Date	2011	2012	Total
Open	6	2	8
Closed	5	9	14
Total	11	11	22
% Open	55%	18%	36%

For example, OQA identified concerns about examination work papers used to support findings and documentation of the supervisory review. In some cases, mandatory examination

[6] OQA stated it was aware that FHFA had potentially taken corrective actions in response to its recommendations. However, OQA had not performed follow up activities to confirm that corrective actions were completed.

documents missed required information or contained inexact information. OQA also reported that examination products and processes were not subject to a comprehensive quality control review process. A lack of quality control review could result in FHFA directing the GSEs to take action that is not supported by its examinations or may result in unmitigated risk if examination findings are not completely and accurately reported. OQA therefore recommended that FHFA establish a comprehensive quality control review process for examination reports, work papers, and other examination work products.

OQA also recommended that FHFA assess examination resource needs and priorities as warranted, and that examination supervisors monitor the completion and filing of assignments. Regarding the open recommendation about assessing resource needs, inadequate staffing can result in insufficient coverage of the risks identified in the examiners' assessments and planning. As such, FHFA may not have comprehensive supervision concerning the GSEs' safety and soundness. GSE processes and functions posing the highest risk should receive the highest examination priority to ensure that the agency highlights areas requiring action to mitigate risk to an acceptable level.

Standards for internal control state that there should be policies and procedures governing prompt resolution of findings. Further, OMB Circular A-123 states, "Agency managers are responsible for taking timely and effective action to correct deficiencies. Correcting deficiencies is an integral part of management responsibility and must be considered a priority by the agency."

OQA Closed Recommendations Without FHFA Management Fully Addressing Them

Of the 14 recommendations OQA closed, 7 (or 50%) were closed without FHFA management completing actions to address the recommendations. For example, five recommendations were closed even though DER's management stated that it only partially addressed the recommendations or was working on actions that would address them. These recommendations to DER included:

- Coordinating with DEPS (now DSPS) on the preparation of FHFA's new examiner guidance manual and related material;
- Monitoring the frequency and number of instances in which findings are removed from draft examination reports when an enterprise objects to the findings, to identify trends that may indicate undue influence; and
- Encouraging examiners in meetings with the enterprises to prepare minutes and have at least two employees in attendance at interviews to avoid the appearance that the enterprises have too much influence over the contents of the examination reports.

OQA closed the seven recommendations without evaluating whether corrective actions had been implemented or whether the actions had adequately addressed the recommendations. Instead, OQA relied on management's assertion that it would make the recommended corrections.

In addition to accepting management's assertion as the basis for closing certain recommendations, OQA closed two recommendations based on its judgment—but again without validation—that management had taken responsive action to address the reported findings. OQA closed these two recommendations based on an organizational change FHFA made, rather than its management directly addressing the recommendation. When OIG inquired about the rationale for closing these two recommendations, OQA management acknowledged that it should have characterized the recommendations' status as "postponed to be re-addressed."

Standards for internal control state:

> The resolution process begins when audit or other review results are reported to management, and is completed only after action has been taken that (1) corrects identified deficiencies, (2) produces improvements, or (3) demonstrates the findings and recommendations do not warrant management attention.

OQA Does Not Require Written Responses to Recommendations

The primary reason that OQA recommendations remained open beyond a year or were prematurely closed is that OQA policy allows reports to be issued without written management responses, including a commitment to and specific timelines for corrective action. OQA management stated that either verbal or written management responses are acceptable.

The lack of written responses means that OQA has neither specific timelines for anticipated closure of recommendations nor agreed-upon corrective action as a basis for judging whether a recommendation has been adequately addressed. Specifically, four of eight OQA reports within OIG's audit scope did not have a written management response that was obtained before the final report was issued. Further, although none of the four reports had evidence of management disagreements at the time of report issuance, in two cases FHFA business units identified points of disagreement with the findings and recommendations in writing after the final reports were issued.

Management's written responses to OQA's findings and recommendations can memorialize management's commitment to take corrective actions, or document the justification for not

taking them. OIG believes written responses serve to hold management accountable for implementing agreed-upon actions and facilitate tracking of management commitments.

Tracking commitments is particularly important in times of management changes. For example, the lack of written management responses appears to have resulted in disagreements and delays in correcting findings, such as the appearance of the enterprises' undue influence on the agency's ROEs, and not having comprehensive quality control review processes for examination work products. Specifically, the DER ROE review was completed in October 2011, and although OQA says the former DER deputy director agreed with its findings and recommendations, FHFA management did not respond in writing. Thus, management corrective actions and timeframes for addressing the recommendations were not memorialized. A new DER deputy director was appointed in November 2011. OQA followed up with the new DER deputy director on DER's progress in addressing OQA's recommendations. In September 2012 (almost one year after the report was issued), DER responded that OQA's report lacked critical details or views of key staff. DER also stated that it had partially addressed some of the recommendations or was taking actions to address them, such as coordinating with DEPS (now DSPS) on the preparation of FHFA's new examiner manual and related guidance. Nevertheless, some recommendations remained open as of the end of audit fieldwork.

OQA findings and recommendations that are not resolved timely or addressed adequately can reduce OQA's effectiveness and result in quality issues in FHFA examinations. For example, examiners could have had clearer guidance in performing examinations if the recommendation to coordinate with DEPS (now DSPS) on the preparation of FHFA's new examiner manual and related guidance had been promptly addressed. Likewise, FHFA examinations could have been enhanced with prompt resolution of the recommendation for FHFA management to remind examiners of the requirements for examination documentation. OQA found that there were several instances where examiners did not include required information or documentation in the examination work papers, which could raise questions as to the sufficiency and validity of evidence supporting the findings.

2. OQA Does Not Cover Other Critical FHFA Functions

Although OQA assesses risk for four of FHFA's supervision and housing mission divisions (i.e., DBR, DER, DSPS, and DHMG), it does not routinely perform risk assessments or quality assurance reviews for other important offices. Instead, offices outside of the examination and examination support functions may be subject to ad hoc OQA reviews,

according to the office's policies and procedures. As such, during the audit period, OQA issued only one report covering other offices.[7]

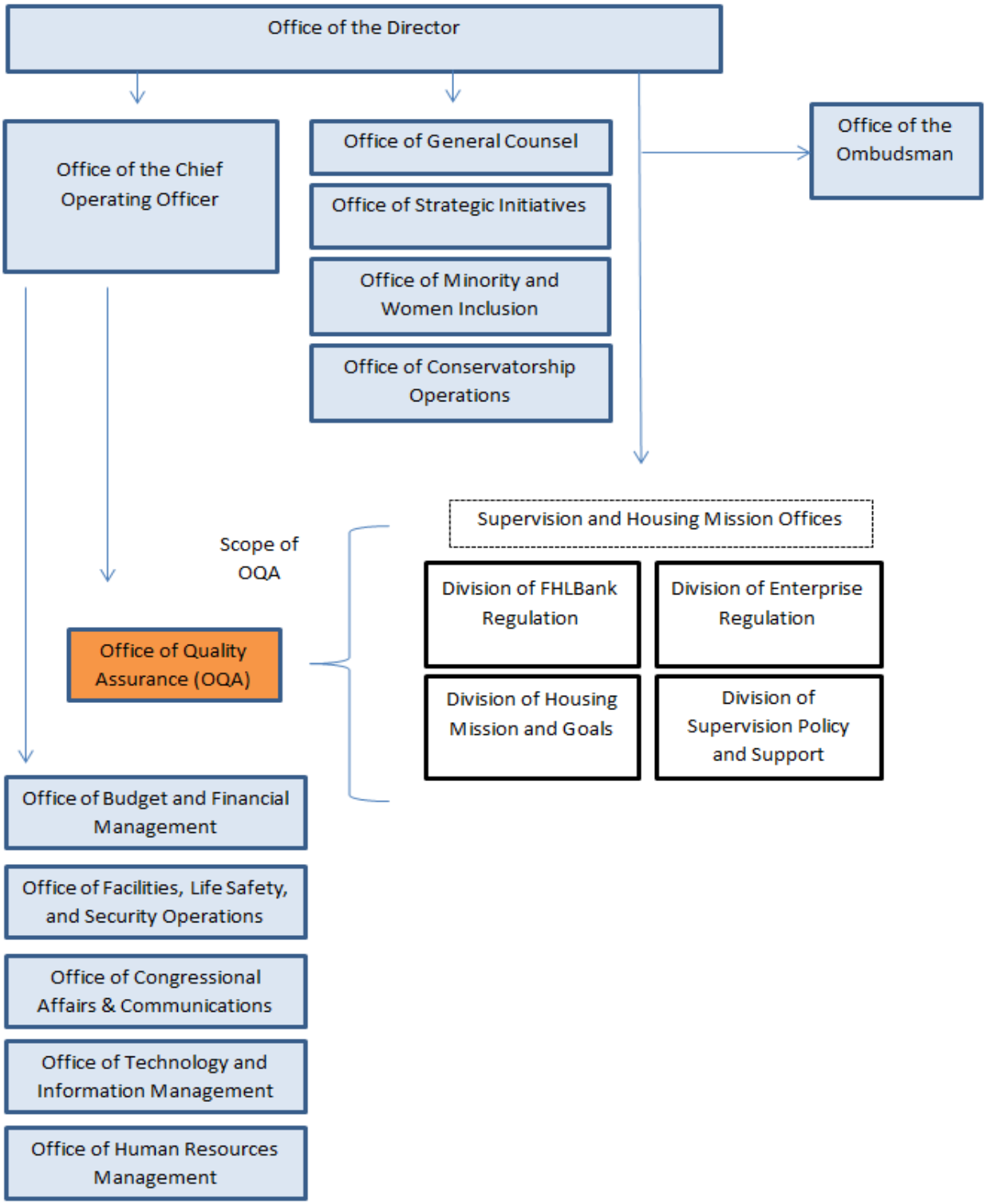
Without OQA oversight, FHFA's other offices are not reviewed by any internal, independent entity to identify comprehensively and assess internal and external risk across the agency. Rather, these offices—some of which provide critical agency functions[8]—are reviewed by their own managers, who perform self-assessments in response to OMB Circular A-123 review requirements. The self-assessments performed to fulfill OMB Circular A-123 requirements are not a substitute for independent reviews.

The areas highlighted in blue in Figure 3 are outside of OQA's coverage.

[7] OQA reviewed FHFA's complaint processing at the request of the COO.

[8] OCO, for example, has authority to approve enterprise actions, ranging from those related to the Senior Preferred Stock Purchase Agreements with the Department of the Treasury to material actions in connection with legal or regulatory settlements exceeding $50 million. In fact, OCO received from the enterprises 611 conservatorship action requests as of May 17, 2012.

FIGURE 3. OQA'S ROLE IN FHFA'S ORGANIZATIONAL CHART



Source: OIG analysis based on FHFA organizational chart as of January 2, 2013, and OQA September 2011 Charter.

Three key criteria support more comprehensive OQA coverage of the risks within the various agency divisions and offices: FHFA's *Annual Performance Plan for Fiscal Year 2013*,[9] GAO's *Standards for Internal Control in the Federal Government*, and OMB Circular A-123.

First, FHFA's *Annual Performance Plan* states:

> Program evaluation is an important feedback tool to ensure that FHFA's activities are meaningful and effective. FHFA regularly evaluates its progress towards achieving its goals in an ongoing manner throughout the year. The agency uses its quarterly management meetings to communicate and discuss organizational goals and objectives, and the status of activities which further their achievement. FHFA's Executive Committee on Internal Controls meets quarterly to review the results of internal and external program evaluations. The committee evaluates the findings and establishes appropriate remediation activities for FHFA. **The Quality Assurance internal review process likewise informs on results to help determine a program's relevance**. (Emphasis added.)

Second, applicable internal control standards identify risk assessment as one of the five standards of internal control. Risk assessment is the identification and analysis of relevant risks associated with achieving program objectives and forming a basis for determining how risks should be managed. According to the internal control standards, management needs to comprehensively identify risks, including all significant interactions between the entity and other parties, and internal factors at both the entity-wide and activity level. Once risks have been identified, management should analyze their possible effect.

Third, OMB Circular A-123 identifies program evaluations as an important component of an agency's assessment of internal control.

OQA serves as one of FHFA's management monitoring tools, although FHFA has not assessed OQA's role in complementing the internal control and related A-123 activities performed across the agency. Specifically, the framework for OQA was envisioned by the former acting COO to encompass only the supervision, regulation, and housing mission areas of FHFA's mission. As a result, OQA's charter, dated September 2011, states its mission as follows:

> The Office of Quality Assurance is an organizationally independent and objective advisory office established within FHFA to evaluate the quality of

[9] FHFA, *Annual Performance Plan for Fiscal Year 2013*, at 36 (October 24, 2012); accessed September 24, 2013, at http://www.fhfa.gov/webfiles/24624/FinalFHFAFY2013APP102412.pdf.

work of the Division of Enterprise Regulation (DER), Division of Federal Home Loan Bank Regulation (DBR), Division of Examination Programs and Support (DEPS), and the Division of Housing Mission and Goals (DHMG), collectively, "the supervision and housing mission offices."

Assessing the scope of OQA's coverage to include agency offices that pose significant risk can give FHFA greater assurance that its management direction is being successfully implemented across the entire agency. For example, since September 2008 FHFA has overseen the Fannie Mae and Freddie Mac conservatorships, which FHFA describes as the "largest, most complex conservatorships in history;" and the enterprises have received over $187 billion from the federal government. It is OCO's role and duty to support the conservator, FHFA's Acting Director, who issues conservatorship directives, and DER examiners assess the enterprises' compliance with those directives. Yet, whereas DER's efforts to ensure compliance with conservatorship directives are subject to OQA review, OCO's creation and implementation of such directives is beyond the scope of OQA's charter.

Similarly, OSI supports FHFA's fourth strategic plan goal of "prepar[ing] for the future of housing finance in the United States." It was established in May 2012 to lead, coordinate, and clarify as needed all agency and enterprise activities related to FHFA's *A Strategic Plan for the Enterprise Conservatorships*.[10] OSI supports three broad goals that will define the conservatorships for the next few years: (1) building a new infrastructure for the secondary mortgage market, (2) contracting enterprise operations, and (3) maintaining foreclosure prevention efforts and credit availability. In spite of these vital responsibilities, OSI is not subject to OQA reviews. Without independent review of OSI's activities, there is a risk that the enterprises and FHFA could inaccurately assess the enterprises' progress toward those goals.

Likewise, OMWI fulfills a critical requirement for the agency. In January 2011, FHFA established OMWI pursuant to section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. OMWI's statutory mission is to ensure that minorities, women, service-disabled veterans, and individuals with disabilities are fully included in any and all job and business opportunities created as a part of the federal government's efforts to reform and strengthen the banking system and the financial services industry. Except pursuant to an ad hoc request, OQA will not assess the quality of OMWI's efforts.

FHFA can have greater assurance that its objectives are achieved and risks are managed if there is comprehensive OQA coverage of all agency functions in its risk assessments. OIG

[10] FHFA, *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending* (February 21, 2012); accessed August 27, 2013, at http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf.

recognizes that resource constraints do not allow every division or office to be reviewed by OQA or FHFA, but reviews can and should be performed based on FHFA's assessment of its highest risks.[11] Nevertheless, without a comprehensive, risk-based approach to monitoring, FHFA may have unmitigated risk residing in offices that are either not covered by OQA or not monitored in an effective manner.

[11] Both the OIG and GAO perform external reviews, audits, or separate evaluations of FHFA on specific subjects and at specific points in time. Such external reviews, audits, or separate evaluations should be considered in FHFA's risk assessment process.

CONCLUSIONS

Within the last couple of years, OQA has established processes, policies, and procedures to perform internal reviews primarily of FHFA's examination and examination support divisions. OQA provides an important internal monitoring mechanism for FHFA, but it is still evolving and can make improvements in its processes, policies, and procedures to ensure its effectiveness. For example, it should implement procedures to follow up proactively on its recommendations and validate management's corrective actions. Moreover, there are gaps in FHFA's internal review coverage that may pose significant risks to FHFA and merit consideration in OQA's risk assessments and review coverage.

RECOMMENDATIONS

To enhance OQA's policies and procedures for reporting and follow up, FHFA should:

1. Update OQA's policy to require management to provide written responses and corrective action timelines to OQA findings;

2. Track the corrective action timelines provided by management and follow up on corrective actions based on those timelines;

3. Implement a policy to escalate to the appropriate level of management when corrective action is not implemented by the reported deadline; and

4. Evaluate management corrective actions and document evidence supporting closure of its recommendations.

To enhance the comprehensiveness of the agency's internal risk assessments, FHFA should:

5. Evaluate the roles and responsibilities of OQA across the agency and revise OQA's charter accordingly;

6. Assess risks across all agency operations for purposes of planning OQA review coverage; and

7. Direct performance of reviews of those areas that pose the most significant risk to FHFA.

OBJECTIVE, SCOPE, AND METHODOLOGY .....

The objective of this performance audit is to assess the effectiveness of FHFA's OQA. The audit scope is OQA reviews—completed between March 2011 and March 2013—of FHFA's examination and examination support divisions: DBR, DER, and DSPS. (OIG did not include DHMG in the audit scope because it does not perform enterprise examination and examination support functions which were the focus of the audit.) In addition, while completing the audit work, OIG assessed the significance of a broader issue and adjusted the scope to include the extent of OQA's coverage of FHFA's other functions that may pose significant risks.

To accomplish its objectives, OIG interviewed senior officials in FHFA's DBR, DER, and DSPS, as well as the COO, OQA managers, and OQA staff. OIG reviewed relevant regulations, laws, and other federal guidance. OIG also reviewed OQA's policies and procedures, risk assessments, planning documents, and other work products. OIG judgmentally selected four of eight OQA reports specific to the examination and examination support functions and conducted a detailed review of the work papers, reported findings, recommendations, and OQA's recommendation tracking and associated support. OIG reviewed recommendations that were issued between March 2011 and December 2012 and that were open as of March 31, 2013. OIG conducted this audit at FHFA's office in Washington, D.C.

OIG also assessed the internal controls related to its audit objective. Internal controls are an integral component of an organization's management and provide reasonable assurance that the following objectives are achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives, and include the processes and procedures for planning, organizing, directing, and controlling program operations, as well as the systems for measuring, reporting, and monitoring program performance. Based on the work completed on this performance audit, OIG considers weaknesses in FHFA's OQA reviews to be significant in the context of the audit's objectives.

OIG conducted this performance audit from December 2012 through August 2013 in accordance with generally accepted government auditing standards. Those standards require that audits be planned and performed to obtain sufficient, appropriate evidence to provide a

reasonable basis for the report's findings and conclusions based on the audit objective. OIG believes that the evidence obtained provides a reasonable basis for its findings and conclusions, based on the audit objectives.

APPENDIX A .....

FHFA's Comments on OIG's Findings and Recommendations

Federal Housing Finance Agency

MEMORANDUM

TO: Russell A. Rau, Deputy Inspector General for Audits

FROM: Richard Hornsby, Chief Operating Officer

SUBJECT: Response to the Office of Inspector General Draft Audit Report, *FHFA Can Strengthen Controls Over Its Office of Quality Assurance* (Assignment AUD-2013-007)

DATE: September 20, 2013

Thank you for the opportunity to review the OIG Report titled *FHFA Can Strengthen Controls Over Its Office of Quality Assurance*. We appreciate the opportunity to provide feedback on this draft report and the FHFA-OIG findings.

The objective of the audit was to assess the effectiveness of the Office of Quality Assurance (OQA) and covered OQA reviews completed between March 2011 and March 2013. As discussed in the report, these OQA reviews included assessment of annual examination activities completed in 2010 and 2011. FHFA has been actively working to strengthen its supervision capabilities and has made several enhancements to the environment. OQA follow-up processes must be designed to account for both the timing of examination activities and enhancements made to the supervision environment.

The report discusses the coverage of OQA in a broader context of overall FHFA functions. OQA was established, designed, and executed with a specific focus and developed the charter accordingly. However, given the recommendations within the report, it may be appropriate to consider the OQA coverage and how it fits into a broader context of an agency framework such as quality control within operating units, risk assessment and planning, reviews, external oversight activities, and completion of corrective actions.

Specific responses to the report's recommendations are discussed below.

To enhance OQA's policies and procedures for reporting and follow-up and the comprehensiveness of the agency's internal risk assessment, FHFA should:

1. **Update OQA's policy to require management to provide written responses and corrective action timelines to OQA findings;**

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2. **Track the corrective actions timelines provided by management and follow up on corrective actions based on those timelines;**

3. **Implement a policy to escalate to the appropriate level of management when corrective action is not implemented by the reported deadline;**

4. **Evaluate management corrective actions and document evidence supporting closure of its recommendation;**

FHFA Response:

FHFA agrees with the recommendations to enhance OQA policies and procedures to improve the effectiveness of follow-up and reporting activities. We will review current OQA policies and procedures and make appropriate enhancements by April 30, 2014.

5. **Evaluate the roles and responsibilities of OQA across the agency and revise OQA's charter accordingly;**

6. **Assess risks across all agency operations for purposes of planning OQA review coverage; and**

7. **Direct performance of reviews of those areas that pose the most significant risk to FHFA.**

FHFA Response:

FHFA believes that the scope of OQA's functions as described in its charter, focusing on conducting internal reviews of FHFA's divisions that directly meet the agency's statutory supervisory and regulatory mission, enhance the effectiveness of FHFA's supervision of the housing GSE's. However, FHFA will evaluate the current roles, responsibilities, risk assessment, planning, and coverage of OQA in the broader agency context and framework. If necessary, FHFA will modify the OQA coverage and charter during fiscal year 2014.

APPENDIX B.....

OIG's Response to FHFA's Comments

On September 20, 2013, FHFA provided comments to a draft of this report, agreeing with OIG's recommendations and identifying specific actions it would take to address the recommendations. FHFA agreed to enhance OQA policies and procedures to improve the effectiveness of follow up and reporting activities by April 30, 2014. With respect to the recommendations to enhance the comprehensiveness of FHFA's risk assessment and coverage of areas representing the most significant risk, FHFA stated that it will evaluate the current roles, responsibilities, risk assessment, planning, and coverage of OQA in the broader agency context and framework and, if necessary, FHFA will modify the OQA charter and coverage during fiscal year 2014. FHFA officials clarified that the completion date related to these actions is September 30, 2014.

OIG considers the planned actions sufficient to resolve the recommendations, which will remain open until OIG determines that the agreed-upon corrective actions are completed and responsive to the recommendations. OIG considered the agency's full response (attached as Appendix A), along with technical comments, in finalizing this report. Appendix C provides a summary of management's comments on the recommendations and the status of agreed-upon corrective actions.

APPENDIX C.....

Summary of Management's Comments on the Recommendations

This table presents management's responses to the recommendations in OIG's report and the status of their resolution as of the date when the report was issued.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved[a] Yes or No	Open or Closed[b]
1 through 4	FHFA will review current OQA policies and procedures and make appropriate enhancements to improve the effectiveness of follow up and reporting activities.	4/30/2014	$0	Yes	Open
5 through 7	FHFA will evaluate the current roles and responsibilities, risk assessment, planning, and coverage of OQA in the broader agency context and framework. If necessary, FHFA will modify the OQA charter and coverage.	9/30/2014	$0	Yes	Open

(a) Resolved means: (1) management agrees with the recommendation, and the planned, ongoing, or completed corrective action is consistent with the recommendation; (2) management does not agree with the recommendation, but alternative action meets the intent of the recommendation; or (3) management agrees to the OIG monetary benefits, a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

(b) Once OIG determines that the agreed-upon corrective actions have been completed and are responsive to the recommendations, the recommendations can be closed.

APPENDIX D .....

Open Recommendations Aging Status as of March 31, 2013, for Recommendations Issued in 2011 and 2012

	Report Date	Subject FHFA Division	Recommendation Description	Days Open
1	October 7, 2011	DER	Establish a comprehensive quality control review process for examination reports, work papers, and other examination work products.	541
2	October 28, 2011	DBR	Work programs should include a reference or link to supporting work papers, and DBR's quality control processes should check to ensure work programs include such references or links.	520
3	October 28, 2011	DBR	Examiners should include their names and the name of the FHLBank under examination on all work papers they prepare.	520
4	October 28, 2011	DBR	The basis section of examination findings explicitly includes, when possible, the cause of the problem and the effect of not correcting the problem or of following the recommended or required course of action. FHFA should expand the guidance for the basis section to better explain expectations for describing the cause and effect; including examples may help provide clarity. In addition, FHFA should consider clarifying the guidance since, as currently written, an examiner would need to identify the cause in all cases.	520
5	October 28, 2011	DBR	DBR management should remind examiners of its work paper requirements. Recommend that work papers memorialize exceptions to the requirements by including a brief summary/ statement or memo to file that discusses the reason for noncompliance. Further, the Examiner-In-Charge, or an assigned member of the examination team, finalizes the findings tracker document for the specific examination at that designated point in time to ensure that all of the vetted findings included in the ROE appear on the findings tracker for that particular time period.	520

	Report Date	Subject FHFA Division	Recommendation Description	Days Open
6	October 28, 2011	DBR	Examination management should review resource needs and priorities as warranted. In addition, examination supervisors should monitor the completion and filing of assignments.	520
7	April 12, 2012	DBR	Enhance the Office of Bank Analysis' supervisory oversight procedures to include a process that memorializes the supervisory and peer review efforts.*	353
8	December 28, 2012	DBR	Develop formal written policies and procedures for DBR's fatal flaw review process.*	93

Source: OIG analysis of OQA recommendations.

* OQA closed recommendations #7 and #8 as of September 6, 2013.

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