



***Federal Housing Finance Board
Office of Supervision***

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To: Federal Home Loan Bank Presidents, Office of Finance Managing Director, Chief Financial Officers, Controllers, and Directors of Internal Audit

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Subject: Service Organizations

Background

Over the past several years, the Federal Home Loan Banks (“FHLBanks”) have increased their engagement of service organizations to perform critical activities for the FHLBanks’ operations. For example, and in particular, under the Acquired Member Assets (“AMA”) programs, participating financial institutions often service the mortgage loans they sell to the FHLBanks. In addition, the FHLBanks engage master servicers to provide loan accounting and servicing oversight. FHLBanks also commonly use service organizations as securities safekeeping agents and to provide information technology, custodial, and financial services.

Guidance

When an FHLBank engages a service organization, certain transactions that affect the FHLBank’s financial statements become subject to controls that are, at least in part, physically and operationally separate from that FHLBank. As part of the risk assessment of its operations and activities, each FHLBank should gain an understanding of its service organizations’ controls and the effectiveness of those controls in carrying out activities for, and protecting the interest of, the FHLBank. The understanding should be sufficient to allow the FHLBank to evaluate all material risks, and that understanding should be documented. FHLBank management should also document and evaluate all controls that are deemed significant to the financial reporting process. If an FHLBank uses a service provider to process transactions, host data, or perform other significant services, the FHLBank’s management should satisfy itself and external auditors that the service organization’s controls are well-designed and operating effectively.

The most robust attestation generally available for an FHLBank to assess a service organization’s internal controls is a Service Auditor’s report, prepared in accordance with Statement of Auditing Standards No. 70 (“SAS 70”). A SAS 70 Type II report includes testing of internal controls, while a Type I report documents the existence of adequate control policies and procedures as of a date certain. Other means may be employed to gain confidence in the



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service organization's internal controls, including sending FHLBank auditors to the service organization to perform auditing procedures, agreed-upon procedures (including testing of controls) performed by a third party, or other forms of control attestation.

In evaluating an FHLBank's risk assessments, examiners will review the methodologies and practices in place to evaluate service organizations' controls. The examiner's review will assess whether such controls are adequate to support current financial statement assertions as well as planned future operations of the FHLBank for which the service organization is engaged. Examiners will also review the form of the attestation regarding the service organization's internal controls and the reliability of the attestation based on the quality of the auditor, the scope and nature of the testing performed, and the materiality of the service organization's activities to the FHLBank's current and planned future operations.

An Office of Supervision advisory bulletin presents guidance to the Federal Home Loan Banks on the application of legal requirements through the supervisory process. It is not a supervisory determination. Any supervisory determination implementing such guidance is subject to review pursuant to the Procedures for Review of Disputed Supervisory Determinations.