

## *Financial Reporting Operations*

---

### **Introduction**

Financial statements such as the balance sheet, income statement and cash flow statement provide information about an entity's financial position, performance, and changes in financial position. Financial statements contain information used to evaluate and monitor the FHLBank's performance, goals, and compliance with established policies, procedures, accounting standards and regulatory requirements.

The Office of Finance relies on financial information provided by each of the FHLBanks to prepare the quarterly and annual combined financial reports of the twelve FHLBanks. Finance Board regulations require FHLBanks to provide to the Office of Finance all the necessary information to prepare the combined financial reports.

Financial statement users need reliable information to evaluate the FHLBank's financial condition and performance and in making economic decisions. Of key importance is the proper presentation of assets, liabilities and equity and the proper recognition of income and expenses. Also important is the information presented regarding the FHLBank's risk profile, including on-and off-balance-sheet items, capital adequacy, the capacity to withstand short-term problems, and the ability to generate additional capital. Users may also need information to understand the special characteristics of the FHLBank's operations such as liquidity and the relative degree of risk involved in various aspects of the FHLBank's business.

An FHLBank's board of directors and senior management have the ultimate responsibility for the design, implementation, and monitoring of the FHLBank's risk management and internal controls over financial reporting. Specific controls should be established to:

- 1) Provide reasonable assurance that assets are safeguarded and financial and operational information is timely and reliable;
- 2) Detect and correct errors and irregularities in a timely manner;
- 3) Ensure compliance with Generally Accepted Accounting Principles (GAAP), FHLBank's policies and procedures, and applicable laws and regulations; and
- 4) Promote the economical and efficient use of resources.

An FHLBank's financial reporting operations function is responsible for compiling and distributing financial information to executive/line management, and the board of directors. This function is also responsible for generating required quarterly and annual financial reports to be publicly issued, reporting to the Office of Finance for System combined reporting purposes, and for reporting financial and risk information to regulators. The institution's internal controls governing financial reporting should ensure that its financial information possesses the following characteristics:

## *Financial Reporting Operations*

---

- 1) **Relevance** – To be relevant, information should be presented timely in order to be of use in decision-making, and should be helpful to decision-makers in evaluating past, present and future events or in confirming or correcting past assessments.
- 2) **Reliability** - Information should be free from material errors and bias. The key aspects of reliability are accurate representation, priority of substance over form, neutrality and completeness.
- 3) **Comparability** - Information should be presented consistently over time in accordance with applicable accounting principles and standards so that it may be readily compared with that of other entities. In accounting, “comparability” exists when different companies apply the same accounting standards and principles in their reporting of information
- 4) **Understandability** - Information should be easily comprehensible for users with reasonable knowledge of business, economics and accounting.

Both the internal and external (independent) audit functions of an FHLBank play key roles in the maintenance of strong financial reporting controls. External auditors are primarily concerned with the financial institution’s ability to record, process, summarize and report financial data consistent with assertions in the financial statements. Internal auditors are also concerned with controls over the effectiveness, economy, and efficiency of management decision-making processes that may not relate to a financial statement audit but which nevertheless affect an FHLBank’s financial reporting. In this sense, the responsibility of the internal audit function extends beyond that of the external audit function with respect to the reliability and integrity of an FHLBank’s financial information.

### **Regulatory Environment**

The primary rules, regulations and references of the Federal Housing Finance Board that pertain to financial reporting operations are set forth below. The discussion does not address the application of authorities other than the FHLBank Act and the regulations, interpretations and issuances of the Finance Board to the FHLBanks. The examiner should ensure that the application of such authorities to an FHLBank

- 1) ***Rules and Regulations of the Federal Housing Finance Board, which include the following parts and sections relevant to financial reporting operations:***

Part 917 of the Finance Board regulations addresses powers and responsibilities of FHLBank boards of directors and senior management. In particular, Section 917.3, Risk Management and Section 917.6, Internal Control System, are pertinent.

Section 917.9, requires that an FHLBank’s board of directors declare and pay a

## *Financial Reporting Operations*

---

dividend only from previously retained earnings or current net earnings and only if such payment will not result in a projected impairment of the par value of the institution's capital stock.

Section 989.3, addresses the preparation and completion of an FHLBank's financial statements and the distribution of financial information and other information to the Finance Board and the Office of Finance.

- 2) ***Advisory Bulletins of the Federal Housing Finance Board*** that provide supervisory guidance relating to financial reporting operations are the following:

Advisory Bulletin 03-02, dated February 10, 2003, and Advisory Bulletin 02-3, dated February 13, 2002, which offer guidance on specific attributes to be considered by FHLBanks in the formulation of their business continuity plans and the establishment of bilateral agreements with other FHLBanks.

Advisory Bulletin 05-05, dated May 18, 2005, which provides guidance on the risk management responsibilities of an FHLBank's board of directors, senior management and risk management.

Advisory Bulletin 06-03, dated July 18, 2006, which provides guidance on disclosure in SEC filings of unpublished information as defined in Part 911 of the Finance Board Rules and Regulations.

- 3) ***Resolutions of the Federal Housing Finance Board***, which include the following:

Resolution 2005-14, dated July 13, 2005, Data Reporting Requirements: Call Report System, underscores the importance of filing accurate and timely Call Reports. The resolution references Call Report instructions which require an FHLBank to promptly amend previously filed Call Reports, within three business days, of any adjustments the FHLBank makes to its monthly or quarterly financial statements.

- 4) ***Statements of Financial Accounting Standards (SFAS) promulgated by the Financial Accounting Standards Board (FASB)***, which include the following:

- a) SFAS 5, Accounting for Contingencies, establishes standards of financial accounting for loss contingencies. It requires accrual by a charge to income (and disclosure) for an estimated loss from a loss contingency if two conditions are met (1) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and (2) the amount of loss can be reasonably estimated.

## *Financial Reporting Operations*

---

- b) SFAS 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, establishes the requirement to recognize a loan's origination fees and origination costs over its life as an adjustment to yield. The level-yield interest income/cost recognition requirement for all loan fees, inclusive of origination costs and purchase premiums/discounts, is applicable to AMA, Investment Securities, and Advances. Discounts, premiums, and costs of issuing debt (COs for FHLBanks) are accounted for under Accounting Principles Board Opinion 21, which requires that these items be treated as adjustments to yield, similar to comparable items under SFAS 91.
- c) SFAS 107, Disclosures about Fair Value of Financial Instruments, requires certain fair value disclosures for all financial instruments, both assets and liabilities.
- d) SFAS 114, as amended by SFAS 118, Accounting by Creditors for Impairment of a Loan, requires a creditor to recognize loan impairment through the creation of a credit loss reserve and a charge to bad debt expense. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. This statement is applicable to Advances and to AMA.
- e) SFAS 115, Accounting for Certain Investments in Debt and Equity Securities, addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. Those investments are to be classified and accounted for as follows:
  - (1) Debt securities that the institution has the positive intent and ability to hold to maturity are classified as *held-to-maturity* securities and recorded at amortized cost.
  - (2) Debt and equity securities that are bought and held principally for the purpose of selling in the near term are classified as *trading securities* and reported at fair value, with unrealized gains and losses included in earnings.
  - (3) Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and recorded at fair value, with unrealized gains and losses excluded from earnings and recorded in a separate component of shareholders' equity.
- f) SFAS 133, Accounting for Derivatives and Hedging Activities, as amended by SFAS 138, 149 and 155, requires derivatives to be recorded at fair value on the balance sheet and periodically marked-to-market. Where derivatives are acquired

## *Financial Reporting Operations*

---

to hedge specific assets or liabilities, and the hedge relationships qualifies for hedge accounting, the earnings volatility from recognizing the derivative's gain/loss can be offset by changes, due to the hedged risk, in the fair value of the hedged item which is also recognized in earnings.

Specifically, for a "fair value" hedge, the derivative's gain/loss from a change in fair value that is recorded in earning would be offset by a similar fair value mark to the hedged item, which would also be recorded in earnings. For a "cash flow" hedge, the derivative's gain/loss is not recorded directly into earnings, but instead is recognized in equity as a component of other comprehensive income. To qualify for hedge accounting, entities must meet stringent documentation and effectiveness testing requirements. SFAS 149 clarifies that certain loan commitments should be accounted as derivatives. SFAS 155 permits institutions to elect fair value accounting for certain hybrid instruments, for which embedded derivatives are otherwise required to be bifurcated from the host instruments under SFAS 133, and establishes a requirement to analyze securitized financial instruments for the existence of free-standing or embedded derivatives..

- g) SFAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. For example, SFAS 150 requires that under most circumstances mandatorily redeemable capital stock must be classified as a liability and requires classification of dividends on mandatorily redeemable stock as interest expense, which reduces GAAP net earnings.
- h) SFAS 157, Fair Value Measurements, establishes a framework for measuring fair value according to GAAP. This statement further expands disclosures on fair value measurements. The successful application of this statement requires an entity to use exit prices based on observable market information, when available. This statement becomes effective for fiscal years beginning November 15, 2007, but may be adopted early.

### **5) *Sarbanes-Oxley Act and Registration with the Securities and Exchange Commission***

The Sarbanes-Oxley Act (SARBOX) was enacted in 2002 will be applicable to each FHLBank as a registrant of a class of equity securities with the Securities and Exchange Commission (SEC) pursuant to Section 12(g)(1) of the Securities Exchange Act of 1934 (1934 Act). In June 2004, in Part 998 of its regulations, the Finance Board directed each FHLBank to file a registration statement covering a class of equity securities with the SEC by June 30 2005 and thereafter ensure that the registration statement became effective under Section 12 of the 1934 Act by August 29, 2005. As of August 2006, all 12 FHLBanks are effective SEC registrants.

## *Financial Reporting Operations*

---

Major SARBOX provisions include the following:

- a) Creation of the Public Company Accounting Oversight Board (PCAOB);
- b) A requirement that public companies evaluate and disclose the effectiveness of their internal controls over financial reporting, and that independent auditors attest to such disclosure (As non-accelerated filers, the management disclosure is currently required beginning in 2007, with the auditor's attestation scheduled to be effective for FHLBanks beginning in 2008);
- c) Certification of quarterly and annual financial reports by chief executive and chief financial officers;
- d) Auditor independence, including bans on certain types of work for audit clients and pre-certification by the company's Audit Committee of all other non-audit work;
- e) A ban on most personal loans to executive officers or directors;
- f) Accelerated reporting of insider trading;
- g) Additional disclosures;
- h) Enhanced criminal and civil penalties for violations of securities law;
- i) Longer maximum jail sentences and larger fines for executives who knowingly and willfully misstate financial statements; and
- j) Whistleblower protection.

As a registrant of a class of equity securities with the SEC pursuant to Section 12(g)(1) of the 1934 Act, each FHLBank is subject to the reporting requirements of the SEC, including periodic preparation and filing of public disclosures relating to an institution's financial condition, results of operations, trends, or uncertainties affecting its business, and management's assessment of its business and financial condition, including supporting financial information and certifications. Moreover, each FHLBank is subject to the enforcement authority of the SEC.

### **FHLBank Environment**

An FHLBank's financial reporting operations function is responsible for ensuring that the institution's activities are accurately recorded in its financial statements and disclosed in its financial reports. Financial statements are published quarterly and annually. The Office of Finance issues quarterly and annual combined financial statements on behalf of the FHLBank System.

In addition, an FHLBank's financial reporting operations function is responsible for timely and accurately filing monthly and quarterly call reports with the Federal Housing Finance Board. To the extent that an FHLBank makes adjustments to previously issued financial statements, it is required to file appropriate Call Report amendments within three business days.

## *Financial Reporting Operations*

---

The financial reporting operations function is charged with implementing increasingly complex accounting standards and financial disclosure requirements including determining accounting treatments applicable to new products and services. Other responsibilities include providing financial information to various users including the FHLBank's board of directors and senior/line management, the Office of Finance, the Finance Board and other governmental authorities. Finally, at some FHLBanks, accounting department staff are involved in the yearly budget process, and in processing and paying invoices received by the FHLBank.

### **Risks Associated with Financial Reporting Operations**

#### ***1) Lack of Sound Corporate Governance (Board of Directors and Senior Management Oversight)***

- a) Key accounting risks and controls are not adequately identified, assessed, and monitored.
- b) Accounting and valuation systems are incapable of properly capturing the FHLBank's complex transactions, and are poorly integrated with each other or other data systems, and may represent information technology that is not aligned with the FHLBank's goals and strategies.
- c) Duties and responsibilities, including segregation of operational and control functions, are not adequately defined.
- d) Financial reporting operations personnel lacks either the staffing size or expertise to properly implement what are increasingly complex accounting standards, resulting in misstatements of the FHLBank's financial position or results of operations.
- e) The FHLBank's financial performance and compliance with established goals, policies, procedures, accounting and regulatory requirements are not properly reviewed and monitored due to inadequate, inaccurate and/or untimely reporting to the board of directors and senior/line management.
- f) Financial statement errors and misstatements are not detected and corrected in a timely manner.
- g) A business continuity plan for financial reporting operations is not in place and regularly tested.
- h) Independent audit coverage and testing is limited. For example; auditors may be inexperienced or lack the technical experience to adequately test the control environment.

#### ***2) Operational Risk***

- a) Accounting, valuation and other key information systems do not meet financial reporting needs, resulting in the introduction of various manual processes such as, user-developed applications and workarounds which can result in errors and misstated financial results.

## ***Financial Reporting Operations***

---

- b) Implementation of new products and services may be delayed due to the lack of expertise of accounting personnel.
- c) Errors, misstatements and losses may not be detected in a timely manner.
- d) Inaccurate or untimely financial statements and other information may be filed with the Office of Finance, Finance Board and other governmental authorities.
- e) Where outside vendors' services have material effects on financial statement, SAS 70 reviews are not obtained, or alternative assessments not performed, to assure that the outside service provider's internal control environment is sound.
- f) Data cannot be readily recreated and/or required tasks readily performed in the event of a disaster or personnel turnover.
- g) Procedures that pertain to the destruction and retention of records have not been established or followed.

### **Specific Risk Controls Relating to Financial Reporting Operations**

An FHLBank's controls relating to financial reporting operations are set forth below.

#### **1) Corporate Governance**

The board of directors and senior management have the ultimate responsibility for the design, implementation, and monitoring of the FHLBank's internal control environment. Specific elements of the internal control environment include identification of key risks, implementation of controls, organizational structure, departmental policies and procedures, managerial review and exception reporting, rigorous hiring and screening practices designed to protect the integrity of the institution's financial reporting processes, business contingency planning, and training and retention of staff possessing the necessary technical expertise. FHLBank management will be required to evaluate and disclose the effectiveness of their internal controls over financial reporting along with their financial statements beginning in 2007, and the FHLBanks' independent auditors will be required to make an internal control attestation beginning in 2008.

#### **2) Federal Home Loan Bank System**

- a) The controllers of the FHLBanks meet periodically to discuss new regulations and accounting pronouncements, implementation issues and methodologies.
- b) The internal audit directors of the FHLBanks meet periodically to discuss new and proposed accounting pronouncements and their potential effects on the System.
- c) The Office of Finance and FHLBank presidents (or their designee) participate in an accounting and disclosure committee to discuss system accounting, reporting and disclosure issues arising in connection with the issuance of combined financial reports for the System.



## *Financial Reporting Operations*

---

### 3) *External (Independent) Audit*

An FHLBank should have ongoing communication and coordination with its external auditors on emerging accounting issues. When a proposed accounting treatment is particularly complex, or if there exist a range of potential interpretations, the proposed treatment should be reviewed with the institution's external auditors.

### 4) *Internal Audit and/or Outsourced Independent Testing*

Internal Audit is an independent appraisal function that contributes to the improvement of risk management, control, and governance systems. The primary objective of internal auditing is to provide evaluations of the adequacy and effectiveness of the internal control structure.

Internal auditors evaluate financial reporting risks and related controls, including the risk of non-compliance with accounting standards. The frequency and scope of internal audit reviews should reflect the internal auditor's independent risk assessment, should be incorporated into an annual audit plan, and should be regularly reviewed with the FHLBank's audit committee. If the internal audit function does not have adequate technical expertise to address certain issues, audit work on those issues may be outsourced to external auditing firms (generally not the auditor of the FHLBank's financial statements) or to other consultants.

### 5) *Financial Reporting Operations*

An FHLBank should have in place the following controls pertaining to the accuracy and integrity of its financial information:

- a) The general ledger is the "official set of accounting records" and primary source of data for financial reporting. The integrity of the general ledger data is verified by the different users of the system and controlled by accounting operations personnel through periodic verifications, reconciliations, and validations.
- b) Accounting procedures are in place for the FHLBank's various transactions. Procedures should cover the preparation and input of general ledger entries, and the preparation of financial statements and reports.
- c) Processes are in place for reviewing upcoming or new accounting pronouncements; to determine their effects on existing activities; and to create new or revise existing accounting policies and procedures as needed.
- d) Processes also are in place to review new products and activities and determine the appropriate accounting requirements.
- e) Internal and external financial reports are reviewed by management and the Audit Committee, and required certifications are made by authorized FHLBank personnel before they are released.

## *Financial Reporting Operations*

---

- f) Procedures are in place to address manual processes and/or workarounds such as restricting access to user-developed applications and the back-up of data.

### **6) Business Continuity and Recovery**

The FHLBank should have written procedures for operations at its designated hot-site. Back-up tapes should be stored off-site and be easily retrievable. Bilateral agreements with one or more FHLBanks must be in place to ensure the continuity of the FHLBank's operations, including financial reporting operations. Each FHLBank should test its business continuity plans and systems regularly to verify their reliability.

### **7) Risk Self-Assessments**

An FHLBank's *Annual Risk Assessment* should include a risk self-assessment by Financial Reporting Operations in which it rates all key inherent risks in its processes before internal controls are considered and residual risk remaining after considering internal controls. Residual risks, if deemed unacceptable, would require Financial Reporting Operations to mitigate the risk exposures by implementing more effective controls or developing new processes.

## **Examination Guidance**

A work program for Financial Reporting Operations accompanies this narrative. What follows below are examples of attributes that examiners should consider in completing the analyses required in the work program. In determining the extent of review and testing to be conducted in completing each analysis, the examiner should take into account his or her assessment of the quality and effectiveness of corporate governance, risk management, internal controls and audit coverage relating to Financial Reporting Operations.

However, the evaluation and testing of the FHLBank's operating procedures to ensure the accuracy and timeliness of Call Report System (CRS) filings must be performed on every examination.

### **1) *Organizational Structure***

- a) Review the functional organization and reporting structure of Financial Reporting Operations.
- b) Identify key personnel and their primary duties, job responsibilities and technical expertise. Assess whether duties are properly segregated and personnel are cross-trained.

## *Financial Reporting Operations*

---

c) Assess the information flow to and from other areas such as Treasury Operations, Advance Operations, Acquired Member Asset (AMA) Operations, Market Risk Valuations and Modeling to determine what affects financial reporting results and how those results affect decision making.

d) Review any significant changes since the last examination.

**2) *Development of key policies and oversight by the board of directors. Adequacy of senior management oversight and the risk management function for financial reporting.***

The FHLBank's financial reporting requirements are complex given their extensive hedging activities and reliance on hedge accounting. In addition, the FHLBank's financial reporting environment is increasingly more challenging as the SEC continually strives for more transparent and market-based financial statement presentations, and the FASB responds with more frequent and complex accounting standards pronouncements.

a) Review the FHLBank's accounting policies to determine if they represent a comprehensive set of accounting guidelines and procedures covering all the FHLBank's financial activities.

b) Determine if the FHLBank has a process in place to assess upcoming or new Financial Accounting Standards, and to ensure that its accounting practices stay current and relevant.

c) Review the FHLBank's process for establishing accounting treatments for new business activities. Does the FHLBank consider accounting risk before deciding to offer new business activities? For example, an FHLBank that considers offering modifications of fixed-rate convertible/putable advances should consider whether such transactions should be recorded as new advances or continuations of existing advances, and how to treat swaps or options hedging the original advances.

d) Assess the FHLBank's process for generating and reviewing its SEC filings. Most of the FHLBanks have formed Disclosure Committees, consisting of senior managers that meet periodically to review and oversee financial reporting and SEC filing requirements. Review the structure, member composition, and minutes of these committees.

## *Financial Reporting Operations*

---

### **3) *Key FHLBank Policies and Procedures***

- a) Accounting policies and procedures should cover the application of SFAS 133, SFAS 91, and other relevant accounting standards. These policies and procedures should include detailed descriptions of the Bank's methodologies. For example, as part of its SFAS 133 procedures, the FHLBank should have detailed descriptions of its hedging strategies, its methodologies for documenting a hedging relationship and assessing hedge effectiveness, and its methods for measuring hedge ineffectiveness.
- b) Risk Management Policy and procedures for assessing inherent and residual risks in Financial Reporting Operations;
- c) Call reporting procedures; and
- d) General Ledger to subsidiary ledger reconciliation procedures.

### **4) *Risk Assessment under Part 917 and internal control evaluation under SARBOX***

- a) Review Financial Reporting Operations' annual self-risk assessment to determine whether the inventory of accounting and reporting processes is comprehensive, whether inherent risks and internal controls are sufficiently identified and evaluated, and whether residual risks are reasonably quantified. To the extent that residual risks are unacceptably high, has management committed to timely remediation that will reasonably mitigate and reduce the risk exposure? What is the current status of those mitigation efforts?
- b) SARBOX requires effective internal controls to support financial statement reporting processes. Where is the FHLBank in its implementation process, and is it on track to be fully compliant with SARBOX by the implementation deadline, currently year-end 2007 for management's internal control disclosure certification, and 2008 for the auditor's attestation on internal controls over financial reporting.

### **5) *Testing performed by external and internal auditors and outside consultants***

- a) Evaluate the adequacy of audit scope and testing performed by internal auditors.
  - (1) Coordinate with the examiner reviewing Internal Audit. Assess whether audit plans provide adequate coverage of accounting operations. Review relevant completed internal audit work to determine if the testing performed fairly captures the accounting risks posed by more complex activities, including complex hedging strategies. Strategies for hedging pooled whole mortgage loans (for which the borrower holds a prepayment option) are more complex,

## *Financial Reporting Operations*

---

and measuring hedge ineffectiveness is more difficult, than for simpler hedging strategies, such as those for consolidated obligations or advances wherein options in hedged items can be offset with matched critical terms in hedging instruments.

- (2) Determine whether the Internal Auditor and staff have the knowledge and expertise to audit areas that pose high financial reporting risks. If not, do they out-source or co-source such auditing work and is such work adequately reviewed?
- b) Evaluate the adequacy of the scope and testing performed by external auditors.
- (1) External auditors determine its scope and testing based on the materiality of current activities to the FHLBank's financial reporting. Consequently, the external auditor may not review certain activities that are presently infrequent or immaterial, but that are emerging as significant.
  - (2) Review external auditor's most recent management letter to determine the nature and severity of findings and recommendations therein.
  - (3) Consult with the Accounting Department to identify if any issues arose from their review of the external auditors' workpapers that may require follow-up.
  - (4) Meet with the external auditors to discuss their audits and gain insight into the focus of their reviews.
- c) Evaluate the adequacy of the scope and testing performed by outside consultants.

FHLBanks frequently engage outside consultants to test key processes that are complex and for which internal staffing lack the needed expertise. Examiners should review the work performed, to ensure that key risks, processes and controls are sufficiently tested. In addition, the examiner should review the FHLBank's process of reviewing and accepting the consultants' work.

### **6) *Information technology and controls***

- a) Review the flow of financial information and how activities are captured and recorded in the accounting system. Review controls implemented by Financial Reporting Operations to verify that the terms of financial instruments are accurately recorded in accounting systems.
- b) Assess the capabilities of the main (General Ledger) accounting system and its reliance on other supplemental systems for accruals, valuation, and other accounting input for different financial instruments.
  - (1) Determine whether these systems capture sufficient data and can perform calculations needed to comply with current financial accounting standards, such as the level-yield amortization requirements of SFAS 91.

## *Financial Reporting Operations*

---

- (2) Assess how well the systems interface with each other and to what extent manual intervention is required. If manual processes are needed, review the controls over those processes to determine their effectiveness in detecting and correcting errors.
  - (3) Assess the extent to which the FHLBank relies on user-developed applications. Assess the process implemented to inventory and control these applications.
- c) Assess the FHLBank's plans for financial reporting continuity and financial data recovery. What type of accounting systems will be relied upon during disaster recovery? Evaluate the adequacy of periodic testing of these systems.
- 7) *Identification and evaluation of controls and significant changes to the activity or function***
- a) Evaluate the process that captures, account and report financial transactions, focusing on controls, the level and direction of risk and the quality of risk management; and
  - b) Evaluate any significant changes that have been implemented since the last examination or are being considered that may affect the FHLBank's risk profile such as management, systems, key personnel, new products, new regulatory requirements, and changes in transaction processing.

**8) *Testing***

Conduct testing as appropriate. The scope of testing should be based on the preliminary review of governance, risk management, internal controls and audit coverage.

a) **Compliance with Accounting Standards**

Select samples of certain transactions and test for compliance with relevant accounting standards. Consider testing compliance with the following key standards:

- (1) SFAS 5, Accounting for Contingencies;
- (2) SFAS 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Costs of Leases;
- (3) SFAS 107, Disclosures about Fair Value of Financial Instruments;
- (4) SFAS 114, as amended by SFAS 118, Accounting by Creditors of Impairment of a Loan;
- (5) SFAS 115, Accounting for Certain Investments in Debt and Equity Securities;

## *Financial Reporting Operations*

---

- (6) SFAS 133, as amended by SFAS 138, 149 and 155, Accounting for Derivatives and Hedging Activities;
- (7) SFAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity; and
- (8) SFAS 157, Fair Value Measurements.

### b) Compliance with Call Reporting Requirements

Each FHLBank must file a Call Report as of the end of each month and each calendar quarter. Under the new CRS.net, monthly Call Reports are due on the 15<sup>th</sup> calendar day of the month. Quarterly call reports are due on the 20<sup>th</sup> calendar day of the month except the fourth quarter of 2006 is not due until February 15, 2007. By regulation, Capital Compliance report deadline remains 15 business days after the end of the month.

Each Call Report, including any amended Call Report, is required to be submitted by a senior officer, or by an FHLBank employee to whom authority has been delegated by a senior officer. Monthly and quarterly Call Reports and schedules are included on the Intranet under CRS Reporting. Call Reports include a cover page that shows the date/time the report was submitted. The financial information provided by each of the FHLBanks is critical to the Finance Board for its analysis of the FHLBanks financial and operating performance.

Users of CRS must follow Finance Board procedures. Finance Board CRS administrators may grant access privileges ranging from read-only to data entry, validate, submit, and revoke. FHLBank CRS administrators cannot grant any privileges under CRS.net. Their only role is to be the central contact point and process requests to add or deactivate FHLBank users or request to have passwords reset. Each FHLBank is permitted to have a maximum of two CRS Administrators and up to five CRS users who may submit Call Report data to the Finance Board. Submit rights are normally limited to the CFO, Controller and other Vice President or higher officers.

In assessing the adequacy of the call reporting process, the examiner should consider performing the following:

- (1) Determine if there were any revocations or rejections since the last examination by accessing the CRS system and reviewing a history of CRS filings.
- (2) Select a sample of month-ends, including a month near the examination as-of date, since the last examination. Obtain the Bank's general ledger trial balances for the months selected. Select a sample of account balances included on the trial balance and agree the account balances to CRS schedules for the months selected.

## ***Financial Reporting Operations***

---

- (3) Obtain and review source documents for account balances selected. The source documents should include the source from which the account balances are derived. Source information usually comes from various sub-ledger systems of the FHLBanks.
- (4) Review and analyze the controls surrounding reconciliations between the sub-ledger systems and the general ledger. Assess the adequacy of segregation of duties and the establishment of a review/approval/reporting process for general ledger balances.
- (5) Coordinate the review of sub-ledger balances with examiners reviewing other areas of the FHLBank.

### ***9) Assessment of Risks***

Summarize the results of the activity or function examined in a separate memorandum. The memorandum must articulate the risks and the management of those risks. It should also clearly and specifically describe the basis and analysis for the assessment. The memorandum should discuss the type(s) of risk (market, credit, operational); the level of the risk (low, moderate, high); the direction of the risk (stable, decreasing, increasing); and the quality of risk management (strong, adequate, weak). A memorandum must be prepared irrespective of whether the examiner's assessment is positive or negative.

### ***10) Items requiring follow-up at the next on-site visitation***

Identify key issues that have been communicated to management (written or oral) that require follow-up during the next on-site visitation.