Federal Housing Finance Agency
Office of Inspector General

Management Advisory: Freddie Mac's Reimbursement of Certain Employees' Commuting Expenses

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OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency
400 7th Street SW, Washington, DC 20219

September 6, 2018

TO: Melvin L. Watt, Director

FROM: Marla A. Freedman, Deputy Inspector General for Audits /s/

SUBJECT: Management Advisory: Freddie Mac's Reimbursement of Certain Employees' Commuting Expenses

The Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG) received an anonymous Hotline Complaint (H-17-2612) alleging, among other things, that a Senior Vice President (SVP) of a Freddie Mac business unit engaged in wasteful spending by reimbursing the travel expenses of individuals who were hired by the SVP; live hundreds of miles from Freddie Mac headquarters in McLean, Virginia; and have commuted on a weekly basis to that headquarters for the past few years.[1] According to FHFA and Freddie Mac information, this allegation involved 19 individuals in the SVP's business unit. The commuting expenses reimbursed to these 19 out-of-area employees by Freddie Mac totaled $1,656,664 from 2015 to 2017.[2]

Freddie Mac's Travel and Business Expenses Policy, Policy Number 9-112 (Travel Policy), effective August 3, 2016, states, in pertinent part:

> Freddie Mac will not reimburse an Employee for commuting expenses for travel between an Employee's family home and tax home[3]… An Employee

[1] This hotline complaint raised other allegations for which our administrative inquiry determined no further action by OIG was warranted.

[2] The 19 impacted employees joined the Freddie Mac business unit over the course of 2015 to 2017. All 19 impacted employees were reimbursed commuting expenses in 2017 ($887,324), 12 were reimbursed commuting expenses in 2016 ($523,395), and 6 in 2015 ($245,946). The six employees who were reimbursed in 2015 were also reimbursed in 2016 and 2017, and the average reimbursement of commuting expenses for each of these six employees over the three years was nearly $176,000.

[3] As Freddie Mac also explains in the Travel Policy, "The IRS [Internal Revenue Service] considers an Employee's 'tax home' to be the entire city or general area where the Employee's main place of business or work is located, regardless of where the Employee maintains his or her family home (e.g., the location of one of the Freddie Mac regional offices)." This explanation is consistent with IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, page 3 (online at https://www.irs.gov/publications/p463).

> who erroneously requests and obtains reimbursement for these personal commuting expenses should report the reimbursed amount as income on their personal tax return subject to withholding.

We initially referred this complaint to FHFA, as conservator for Freddie Mac, and asked it to provide us with factual responses to this claim. Freddie Mac reported that its review of the reimbursement practices at issue in the hotline complaint "did not reveal" any violations of its Travel Policy and ethics guidance and found "no merit" to the claim. FHFA undertook its own review and determined that Freddie Mac's reimbursement practices conflicted with its Travel Policy.

Freddie Mac subsequently acknowledged that its reimbursement of commuting expenses was in conflict with its established Travel Policy. Because these 19 employees were advised, at the time that they were hired as employees by this SVP, that Freddie Mac would reimburse their commuting expenses, Freddie Mac reported that these 19 employees viewed continuing reimbursement as part of their compensation.

We asked why these 19 employees were hired by Freddie Mac. Freddie Mac explained that:

> [The SVP] was brought in to oversee a vast business technological transformation at high cost and high risk to the Company… As [the SVP] built his organizational structure, he used his network to ensure that the necessary skills were brought in. These individuals were largely invited to apply for positions on that basis; they had previous work experience with [the SVP] or others on his leadership team and were hired based on their demonstrated expertise and success with similar major undertakings at other firms.

Freddie Mac proposed two corrective actions to address the violation of its Travel Policy.

First, it proposed a three-year "transition plan" to phase out reimbursement of commuting expenses for the 19 impacted employees,[4] during which its reimbursement of commuting expenses for each employee would be based on a written agreement with the employee and capped at $6,500 a month. FHFA explained to Freddie Mac that it does not support reimbursement of expenses associated with commuting from outside the Washington, D.C. metropolitan area to Freddie Mac's headquarters and questioned the need for a three-year transition plan. FHFA's analysis found that "the hiring manager [SVP] did not explain the travel policy to the new employees as he himself did not understand it." It credited Freddie Mac's claim that the reimbursement was viewed by the 19 employees as part of their compensation and that a three-year transition plan was needed to retain these employees while keeping their direct compensation in line with peers, and did not object to the proposed transition plan. Reimbursements during the three-year transition period are to be based on actual receipts, and

[4] According to Freddie Mac, this transition plan will only affect the impacted employees, and it will not be offered to any other current employees or new hires.

Freddie Mac will report the commuting expenses as taxable income. At the conclusion of the transition period, each employee will either relocate, pay his/her commuting expenses out of pocket, or resign from Freddie Mac. In technical comments provided to us on a draft of this memorandum, FHFA informed us that, due to personnel changes, Freddie Mac ultimately has entered into written agreements with 17 employees for the reimbursement of commuting expenses for a maximum of three years, with reimbursement not to exceed $6,000[5] a month. The potential cost for reimbursement of commuting expenses for this three-year transition plan is $2.9 million.[6]

While the FHFA and Freddie Mac materials we reviewed discussed how the taxable income impact of the reimbursement of commuting expenses would be handled going forward, the materials did not discuss how the tax impact was handled for commuting expenses reimbursed by Freddie Mac during the period 2015 to 2017, and we asked Freddie Mac for an explanation. In response, Freddie Mac stated:

> [b]ecause it was determined that these travels are considered commuting, Freddie Mac retroactively adjusted the impacted employees' taxable income from their hire dates (2015, 2016, and 2017) and W-2[c]s[7] were issued. Senior management decided that the impacted employees will be made whole and therefore, the additional reported taxable income was grossed up. Additionally, Freddie Mac will pay for and gross up any additional tax liabilities, shortages in tax refunds, interests, penalties, and applicable refiling fees. The impacted employees have been given a deadline of September 30, 2018 to submit requests for reimbursement and provide any necessary supporting documentation.

Second, Freddie Mac proposed to revise its Travel Policy to clarify what costs (including commuting costs) are reimbursable. Freddie Mac plans to complete its revisions by September 1, 2018.

Freddie Mac has been in the conservatorship of FHFA since September 2008 and FHFA acknowledges that its statutory responsibilities are to "preserve and conserve" the assets and property of Freddie Mac while operating it in a manner consonant with the public interest. We

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[5] Freddie Mac stated that they, with input from FHFA, lowered the initially proposed $6,500 maximum monthly cap to $6,000. The actual reimbursement agreements for individual employees ranged from $3,000 a month to $6,000 a month.

[6] According to Freddie Mac, due to personnel changes, 3 of the originally identified 19 impacted employees did not enter into written agreements with Freddie Mac. Written agreements were entered into with the 16 remaining impacted employees and one employee who began working for Freddie Mac mid-2017 and was not one of the originally identified 19 impacted employees. Another impacted employee who entered into a written agreement subsequently left Freddie Mac. Considering the reimbursement cap of each employee's agreement, the potential cost to Freddie Mac over the three-year transition period currently stands at $2.9 million.

[7] IRS Form W-2c, *Corrected Wage and Tax Statement*, corrects a previously issued Form W-2. If an income tax return has been filed for a given year and a Form W-2c is issued, the employee may have to file an amended income tax return for that year.

recognize that FHFA, as conservator, has delegated authority to Freddie Mac for its day-to-day operations and risk controls. With respect to employee expenses, Freddie Mac senior management appears to recognize the obligations attendant to an entity in conservatorship. Its Travel Policy directs:

> Employees must be particularly mindful that the company operates in conservatorship and has been entrusted as a steward of taxpayer funds. As such, Employees must ensure that they are prudent in their expenditures and that expenses are generally modest. Employees must avoid incurring expenses that are, or have the appearance of being, excessive or inappropriate for a company in conservatorship.

Notwithstanding the clear direction in Freddie Mac's Travel Policy that Freddie Mac "will not reimburse an Employee for commuting expenses for travel between an Employee's family home and tax home," Freddie Mac's Compliance Division initially found no violation of this policy caused by reimbursement of travel expenses of the 19 impacted employees and "no merit" to the claim. However, that initial finding was overturned by FHFA, and Freddie Mac has now acknowledged that payment of these travel expenses "is in conflict" with its Travel Policy. This unauthorized reimbursement may run about $4.6 million,[8] before the additional reported tax liabilities, shortages in tax refunds, interests, penalties, and applicable refiling fees are paid by Freddie Mac, which according to FHFA was caused by an SVP who "did not explain the travel policy to the new employees as he himself did not understand it."[9]

Because FHFA has determined that this improper reimbursement of travel expenses was limited to these 19 employees and Freddie Mac is revising its Travel Policy and causing income taxes to be paid on the reimbursed travel expenses, we make no formal recommendations. Prudence counsels that FHFA should review Freddie Mac's revised Travel Policy for clarity; ensure that Freddie Mac properly trains current and new employees and its Compliance Division on the revised Travel Policy; and monitor Freddie Mac's completion of actions addressing the tax issues related to the reimbursement of commuting expenses to the 19 employees for 2015, 2016, and 2017 and implementation of Freddie Mac's transition plan.

FHFA states in its management response that as conservator, FHFA will review Freddie Mac's revised Travel Policy to confirm that it addresses the issues raised by FHFA during its review of the hotline complaint. FHFA also plans, as part of its supervisory and regulatory functions, to monitor Freddie Mac's implementation of its revised Travel Policy, handling of tax issues related to the reimbursement of commuting expenses to the impacted employees from 2015 to 2017, and execution of its three-year transition plan for the employees who have signed agreements and are

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[8] This includes commuting expenses already reimbursed to the impacted employees by Freddie Mac ($1.656 million from 2015 to 2017) and the potential cost to Freddie Mac over the three-year transition period ($2.9 million).

[9] In technical comments to a draft of this management advisory provided to FHFA, Freddie Mac asserted that, "[t]he language 'caused by an SVP' is not truly reflective of what occurred. The SVP oversaw the employees whose commuting costs were expensed in contravention of Freddie Mac's corporate policy, but there were other employees both in Single Family and in other departments whose errors or misunderstandings also contributed to the problem."

participating in the plan. FHFA’s management response is included in the appendix to this memorandum.

Appendix: FHFA's Response to OIG's Advisory

Federal Housing Finance Agency

MEMORANDUM

TO: Marla A. Freedman, Deputy Inspector General, Audits

BR

FROM: Bob Ryan, Acting Deputy Director, Division of Conservatorship

SUBJECT: Draft Management Advisory: *Freddie Mac's Reimbursement of Certain Employees' Commuting Expenses*

DATE: August 21, 2018

This Memorandum transmits the management response of the Federal Housing Finance Agency (FHFA) to the FHFA Office of Inspector General's (OIG) draft management advisory referenced above (Advisory). FHFA reviewed the draft Advisory, shared a copy with Freddie Mac, and provided technical comments to the OIG.

Freddie Mac is in process of revising and updating its travel policy and remote worker agreement for clarity. FHFA as conservator will review the revised Travel Policy to confirm that it addresses the issues raised by FHFA during its review of the hotline complaint. The Division of Enterprise Regulation, as part of FHFA's supervisory and regulatory functions, will monitor Freddie Mac's: (i) implementation of its revised Travel Policy, (ii) handling of tax issues related to the reimbursement of commuting expenses to the affected employees for 2015-2017, and (iii) execution of its three-year transition plan for the employees who have signed agreements and are participating in the plan.

cc: John Major, Internal Controls and Audit Follow-up Manager
Larry Stauffer, Acting Chief Operating Officer