

Office of Inspector General



March 30, 2001
Audit Report No. 01-015

**Audit of FDIC's Compliance with
26 CFR 1.6050 M-1**



DATE: March 30, 2001

MEMORANDUM TO: Arleas Upton Kea, Director
Division of Administration

FROM: 
David H. Loewenstein
Assistant Inspector General

SUBJECT: *Audit of the FDIC's Compliance with 26 CFR 1.6050 M-1*
(Audit Report No. 01- 015)

This report presents the results of the Office of Inspector General's (OIG) audit of the Federal Deposit Insurance Corporation's (FDIC) compliance with 26 Code of Federal Regulations (CFR) 1.6050 M-1. This regulation requires federal executive agencies to file information returns with the Internal Revenue Service (IRS) for certain contracts entered into by the agency.

BACKGROUND

Our review resulted from a telephone call made by an FDIC employee to the OIG alleging that the FDIC may not be in compliance with 26 CFR 1.6050 M-1, which became effective January 1, 1989. The regulation requires the heads of federal executive agencies¹ to file quarterly information returns with the IRS for certain contracts exceeding \$25,000 entered into by that agency. The regulation also requires that the quarterly returns contain information on individual contract actions that increase the amount obligated on the contract by more than \$25,000 (contract increases).

The returns are used as a source of information to assist with the collection of delinquent federal tax liabilities. A return includes information on the contractor's name, address, taxpayer identification number, date of contract action, expected date of completion of the contract, and the total amount obligated under the contract action. IRS Form 8596, "Information Return for Federal Contracts," and IRS Form 8596-A, "Quarterly Transmittal of Information Returns for Federal Contracts," are to be filed with the IRS Center, Kansas City, Missouri, by the end of the month following each quarter.

¹ The regulation cites section 5 USC 105 which defines "Executive agency" to mean an executive department, a government corporation, and an independent establishment. This definition applies to the FDIC as a government corporation.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether the FDIC is required to comply with 26 CFR 1.6050 M-1 and whether it has been complying.

To assess the applicability of 26 CFR 1.6050 M-1 to the FDIC, we reviewed and analyzed the original statute, final regulations, and IRS reporting forms. We interviewed representatives of the FDIC's Division of Administration (DOA), Division of Finance, the FDIC Legal Division (Legal Division), and the Counsel to the Inspector General (Counsel to the IG). After our inquiries, the Legal Division and the Counsel to the IG worked cooperatively to assess the applicability of 26 CFR 1.6050 M-1 to the FDIC. We reviewed the advisory memoranda issued by the Legal Division and Counsel to the IG related to the applicability of the statute. These memoranda held that 26 CFR 1.6050 M-1 required the FDIC to report contracts over \$25,000 that used appropriated funds.

To assess the FDIC's use of appropriated funds, we reviewed the U.S. General Accounting Office's (GAO) reports on the FDIC's 1998 and 1999 financial statements, the 43rd Quarterly Outlay Report of the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF), and a February 4, 2001 listing of OIG contracts issued with appropriated funds. We performed audit fieldwork at the FDIC's offices in Washington, D.C. We conducted the audit from September 1, 2000 through February 4, 2001 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

We concluded that the provisions of 26 CFR 1.6050 M-1 apply to FDIC contracts and contract increases over \$25,000 that were awarded using appropriated funds. We determined that the FDIC has not been filing the required quarterly information returns with the IRS.

THE FDIC NEEDS TO COMPLY WITH 26 CFR 1.6050 M-1

We determined that regulation 26 CFR 1.6050 M-1 applies to the FDIC's contracts and contract increases over \$25,000 that were awarded using appropriated funds. The FDIC uses appropriated funds for OIG contracts and possibly for contracts awarded with funds from the FRF. However, DOA has not been complying with the regulation because management officials believed that the regulation did not apply to the FDIC.

We met with representatives of DOA at the beginning of our audit regarding the applicability of the regulation to the FDIC and inquired whether the FDIC was reporting any of its contracts to the IRS. DOA representatives informed us that they believed that the FDIC was not complying with the regulation because it was not required to do so.

DOA's Acquisition and Corporate Services Branch (ACSB) is the organizational entity responsible for awarding contracts. Based upon our inquiries, the Assistant Director, Acquisition Section, ACSB,

requested that the Contracting Law Unit, Legal Division, review the regulation for applicability to the FDIC's contracting activities. The Contracting Law Unit issued an advisory memorandum dated September 11, 2000, stating that the FDIC is not required to file information returns relating to contracts entered into using non-appropriated funds.² We asked the Counsel to the IG to review the advisory memorandum and she concurred with the Contracting Law Unit's advice. The FDIC's operations are funded from two deposit insurance funds with revenue generated through premiums assessed from insured financial institutions. Therefore, since the monies are not appropriated from U.S. taxpayers, the regulation does not generally apply to the FDIC's contracting activities.

However, the Contracting Law Unit's advisory memorandum also stated that the FDIC is required to file information returns relating to contracts entered into using appropriated funds and that only the OIG uses appropriated funds for its contracts. The Counsel to the IG agreed that the OIG contracts are subject to the regulation because the OIG's annual budget request is reviewed and approved by the Congress during the appropriations process. While the OIG has contracting authority granted by the Inspector General Act of 1989, as amended, DOA awards contracts on behalf of the OIG. Therefore, DOA is responsible for reporting any of the OIG's contracts and contract increases over \$25,000 to the IRS. As of February 4, 2001, the OIG had 6 open contracts, each of which exceeded \$25,000.

The FDIC also manages a third fund, called the FRF, to fulfill the obligations of the former FSLIC. On January 1, 1996, the FRF assumed responsibility for the assets and obligations of the Resolution Trust Corporation. We reviewed GAO's reports on the FDIC's 1998 and 1999 financial statements and the 43rd Quarterly Outlay Report for the FRF to assess whether the FRF uses appropriated funds. We found that the FRF is currently self-sustaining, but in the past it has relied on infusions of appropriated funds from the U.S. Treasury to fund prior year operations. We asked the Counsel to the IG whether contracts awarded using FRF funds might be covered by the regulation. The Counsel to the IG advised us that contracts paid from the FRF might also be subject to the regulation. We provided this advice to the Associate Director, ACSB, who subsequently asked for the Legal Division's opinion on this matter. The Legal Division is developing an opinion on whether the historical infusions of funds from the U.S. Treasury into the FRF render its contracts subject to the regulation, and whether FDIC contracts use any other appropriated funds. The Legal Division is planning to coordinate with the Counsel to the IG in developing its opinion on this matter. Due to the uncertainty of whether the FRF-funded contracts need to be reported to the IRS, we did not research the number of the FRF-funded contracts and contract increases exceeding \$25,000 as a part of our review.

During the audit the Assistant Director, Acquisition Section, ACSB, agreed to begin filing the quarterly information returns with the IRS in accordance with the regulation. At the request of the Assistant Director, we provided information on how to comply with the regulation including which forms to file and where to send the information. The intent of 26 CFR 1.6050 M-1 is to provide information to assist the IRS in its collection of delinquent federal tax liabilities from monies owed contractors. If contracts are no longer open, the IRS has no means to collect. Therefore, for

² The regulation contains a "reserved" provision for applicability of contracts entered into using non-appropriated funds. The *Federal Register* states "When an appropriate effective date for treating such contracts as contracts for the purposes of section 6050M has been determined, the regulations will be amended prospectively to remove the reservation and to provide appropriate rules for such contracts." As of January 29, 2001, this provision of the regulation had not been amended.

contracts awarded prior to 2001, we believe it is reasonable for the ACSB to report only the open contracts and contract increases that were originally awarded for over \$25,000 using appropriated funds.

RECOMMENDATIONS

We recommend that the Director, DOA:

- (1) Begin filing the quarterly information returns with the IRS in accordance with 26 CFR 1.6050 M-1. The first return should be filed by April 30, 2001 and include information on:
 - (a) the OIG's contracts and contract increases exceeding \$25,000 awarded from January 1, 2001 through March 31, 2001 and
 - (b) the OIG's contracts open at March 31, 2001 awarded prior to 2001 where the initial contract or contract increase exceeded \$25,000. Subsequent quarterly returns should include information on contracts and contract increases newly awarded during the respective calendar quarter.
- (2) Obtain an opinion from the Legal Division on the applicability of 26 CFR 1.6050 M-1 to other FDIC contracts, including those funded by the FRF. Additional covered contracts as determined by the Legal Division should be reported for new contracts and previously issued contracts in a manner similar to that outlined in recommendation (1).

CORPORATION COMMENTS AND OIG EVALUATION

On March 27, 2001, the Director, DOA, provided a written response to the draft report. The response is presented in Appendix I of this report.

DOA management agreed with both the OIG conclusions and recommendations. DOA management also certified that it had completed necessary corrective action for recommendation (1). Regarding recommendation (2), DOA indicated that it had requested the opinion from the Legal Division and anticipates that the opinion will be forthcoming in time to meet the April 30 reporting requirement.

The Corporation's response to the draft report provided the elements necessary for management decisions on the report's recommendations. Therefore, no further response to this report is necessary. Appendix II presents management's proposed or completed actions on our recommendations and shows that there is a management decision for each recommendation in this report.



FDIC

Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

APPENDIX I

Division of Administration

March 27, 2001

TO: David H. Loewenstein
Assistant Inspector General

FROM: Arleas Upton Kea *Arleas Upton Kea*
Director, Division of Administration

SUBJECT: Management Response to OIG Draft Report entitled
Audit of FDIC Compliance with 26 CFR 1.6050 M-1

The Division of Administration (DOA) has completed its review of the Office of Inspector General (OIG) Draft Report entitled “*Audit of FDIC Compliance with 26 CFR 1.6050 M-1.*” The OIG reported one audit finding and made two recommendations.

We agree with both the OIG conclusions and recommendations. The first recommendation involves the filing of quarterly information returns to the Internal Revenue Service (IRS) for OIG contracts and contract increases greater than \$25,000 awarded after January 1, 2001. The second recommendation involves obtaining a legal opinion on whether the FDIC must also report on contracts funded by the FSLIC Resolution Fund (FRF). This response includes the actions planned, our expected completion dates, and the documentation that will confirm the actions taken. **This Management Response also serves as a statement of certification that DOA has completed necessary corrective action for recommendation number 1.**

MANAGEMENT DECISION

Finding #1: The FDIC is not in compliance with 26 Code of Federal Regulations (CFR) 1.6050 M-1 that requires federal executive agencies to file information returns with the IRS for certain contracts entered into by the agency.

Recommendation #1: The Director, DOA should begin filing quarterly information returns with the IRS in accordance with 26 CFR 1.6050 M-1. The first return should be filed by April 30, 2001, and include information on (a) the OIG’s contracts and contract increases exceeding \$25,000 awarded from January 1, 2001 through March 31, 2001 and (b) the OIG’s contracts open at March 31, 2001 awarded prior to 2001 where the initial contract or contract increase exceeded \$25,000. Subsequent quarterly returns should include information on contract increases newly awarded during the respective calendar quarter.

Management Response: We agree with this recommendation. The Assistant Director, Acquisitions Section (AS), has issued a procedural memorandum that requires the Chief, AS Headquarters Operations Unit to file a quarterly report with the IRS (IRS Standard Forms 8596 and 8596A). This report will cover all OIG contracts entered into that obligate an aggregate of \$25,000 or more in appropriated funds, and will be filed within 30 days following the end of each calendar quarter. **This response serves as a statement of certification that DOA has completed the necessary corrective action for this recommendation.**

Recommendation #2: The Director, DOA should obtain an opinion from the Legal Division on the applicability of 26 CFR 1.6050 M-1 to other FDIC contracts, including those funded by the FRF. Additional covered contracts determined by the Legal Division should be reported for new contracts and previously issued contracts in a manner similar to that outlined in recommendation (1).

Management Response: We agree with the recommendation. DOA has requested an opinion from the Legal Division on the FDIC reporting requirements for other FDIC contracts funded by the FRF. We anticipate that legal opinion will be forthcoming in time to meet the April 30 reporting requirement.

If you have any questions regarding this response, you may contact Andrew O. Nickle, Audit Liaison for the Division of Administration, at (202) 942-3190.

cc: Mike Rubino
Deborah Reilly
Steve Hanas
Paul Sherman
Harry Baker
Richard Johnson
Andrew Nickle
Ken Jones, OICM

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC’s responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management’s response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management’s descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management’s written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Corporation has issued a procedural memorandum requiring the Chief, AS Headquarters Operations Unit to file a quarterly report with the IRS.	Completed	Procedural memorandum, Quarterly information returns	None	Yes
2	The Corporation requested the opinion from the Legal Division and expects that the opinion will be forthcoming in time to meet the April 30, 2001 reporting requirement	April 30, 2001	Legal opinion, quarterly information returns	None	Yes