SOCIAL SECURITY

MEMORANDUM

Date: June 18, 2012 Refer To:

To: The Commissioner

From: Inspector General

Subject: The Social Security Administration Cost Allocation Methodology (A-15-10-20152)

We contracted with Grant Thornton LLP (Grant Thornton) to conduct four reviews related to the Social Security Administration's (SSA) Cost Analysis System (CAS) and Cost Allocation Methodology. SSA has responsibility for the stewardship of the four Trust Funds: the Retirement and Survivors Insurance Trust, Disability Insurance Trust, Hospital Insurance Trust, and Supplementary Medical Insurance Trust. As part of this stewardship objective, the Commissioner of Social Security established a cost allocation process in July 1973. This cost allocation process was based on the policy that administrative costs for all Trust and general fund programs, as well as reimbursable work performed by SSA for outside organizations, would be allocated based on cost-sharing principles. A central part of SSA's cost allocation process is its CAS.

Grant Thornton's objectives were to:

1. Determine whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate.
2. Determine whether SSA's cost allocation process was efficient.
3. Review and test internal controls surrounding the transfer and payment between the Social Security and Medicare Trust Funds.

This is the last in a series of four reports related to SSA's CAS, cost allocation process, and cost allocation methodology. The first report, A-15-10-20149, *Cost Analysis System Background Report and Viability Assessment,* documents a historical background of CAS and a system viability assessment. The second report, A-15-10-20150, *Office of Disability Adjudication and Review Cost Allocation Process* discusses ODAR's cost allocation process. The third report, A-15-10-20151, *Social Security Administration Cost Allocation Process,* discusses SSA's overall cost allocation process. The reader is encouraged to review these reports for background and context.

Please provide within 60 days a corrective action plan that addresses each recommendation. If you wish to discuss the final report, please call me or have your staff contact Steven L. Schaeffer, Assistant Inspector General for Audit, at (410) 965-9700.

Patrick P. O'Carroll, Jr.

Attachment

OFFICE OF THE INSPECTOR GENERAL

SOCIAL SECURITY ADMINISTRATION

THE SOCIAL SECURITY ADMINISTRATION COST ALLOCATION METHODOLOGY

June 2012 **A-15-10-20152**

AUDIT REPORT

Mission

By conducting independent and objective audits, evaluations and investigations, we inspire public confidence in the integrity and security of SSA's programs and operations and protect them against fraud, waste and abuse. We provide timely, useful and reliable information and advice to Administration officials, Congress and the public.

Authority

The Inspector General Act created independent audit and investigative units, called the Office of Inspector General (OIG). The mission of the OIG, as spelled out in the Act, is to:

- **Conduct and supervise independent and objective audits and investigations relating to agency programs and operations.**
- **Promote economy, effectiveness, and efficiency within the agency.**
- **Prevent and detect fraud, waste, and abuse in agency programs and operations.**
- **Review and make recommendations regarding existing and proposed legislation and regulations relating to agency programs and operations.**
- **Keep the agency head and the Congress fully and currently informed of problems in agency programs and operations.**

To ensure objectivity, the IG Act empowers the IG with:

- **Independence to determine what reviews to perform.**
- **Access to all information necessary for the reviews.**
- **Authority to publish findings and recommendations based on the reviews.**

Vision

We strive for continual improvement in SSA's programs, operations and management by proactively seeking new ways to prevent and deter fraud, waste and abuse. We commit to integrity and excellence by supporting an environment that provides a valuable public service while encouraging employee development and retention and fostering diversity and innovation.

MEMORANDUM

Date: December 28, 2011

To: SSA Office of the Inspector General

From: Grant Thornton, LLP

Subject: Audit of the Social Security Administration's Cost Allocation Methodology (A-15-10-20152)

We are pleased to report the results of our audit of the Social Security Administration (SSA) Cost Analysis System (CAS) methodology. The objectives were to:

1. Determine whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate.
2. Determine whether SSA's cost allocation process was efficient.
3. Review and test internal controls surrounding the transfer and payment between the Social Security and Medicare Trust Funds.

We appreciate the support provided to us in completing this review.

John Short
Partner

Executive Summary

The Social Security Administration (SSA) has responsibility for the stewardship of the four Trust Funds for which it provides administrative support: the Retirement and Survivors Insurance Trust, Disability Insurance Trust, Hospital Insurance Trust, and Supplementary Medical Insurance Trust. As part of this stewardship, the Commissioner of Social Security established a cost allocation process in July 1973. This cost allocation process was based on the policy that administrative costs for the Trust and general fund programs, as well as for reimbursable work performed by SSA for outside organizations, would be allocated based on cost-sharing principles. A central part of SSA's cost allocation process is its Cost Analysis System (CAS).

OBJECTIVES

The objectives of the SSA Cost Allocation Methodology audit were to:

1. Determine whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate.
2. Determine whether SSA's cost allocation process was efficient.
3. Review and test internal controls surrounding the transfer and payment between the Social Security and Medicare Trust Funds.

This report is the last in a series of four related to SSA's CAS, cost allocation process, and cost allocation methodology. The first report, A-15-10-20149, *Cost Analysis Background Report and Viability Assessment* documents a historical background of CAS and a system viability assessment. The second report, A-15-10-20150, *Office of Disability Adjudication and Review Cost Allocation Process* discusses ODAR's cost allocation process. The third report, A-15-10-20151, *Social Security Administration Cost Allocation Process,* discusses SSA's overall cost allocation process. We encourage you to review these reports for background and context.

BACKGROUND

SSA uses a cost allocation methodology to allocate administrative costs to Trust and general fund programs to which SSA provides administrative support and for reimbursable work performed by SSA for outside organizations. The *Social Security Act*[1] authorizes SSA to allocate administrative costs to the four Trust Funds. The cost allocation methodology determines actual administrative costs chargeable to Trust Fund activities, general fund programs, and other reimbursable programs. In Fiscal Year (FY) 2010, SSA's total cost of administering these and other smaller programs was approximately $12 billion.

[1] *Social Security Act* § 201(g)(1), 42 U.S.C. § 401(g)(1).

SSA's policy for allocating administrative costs[2] was initially established by a 1973 Commissioner's Decision,[3] which states that costs related solely to one program will be assigned exclusively to that program. Further, it specifies that costs benefitting multiple programs will be equitably distributed among those programs, based on the proportionate value of those shared costs to each benefiting program. The current cost allocation methodology has been in use for about 35 years.

RESULTS OF REVIEW

We found the equitableness and accuracy of SSA's cost allocation methodology could be improved in allocating administrative costs between the Social Security and Medicare Trust Funds as follows.

- The basis for allocating shared workload costs, representing 56 percent of FY 2010 total administrative costs, to Trust Funds did not reflect a cause-and-effect relationship between resources and outputs.
- Critical work measurement data were unreliable.
- Non-personnel costs, representing approximately 27 percent of FY 2010 total administrative costs,[4] were allocated to workloads and program activities based on workyears rather than a direct trace or a cause-and-effect basis.
- The use of accrued expenditures, commitments, and obligations in lieu of actual operating expenses may have significantly altered Trust Fund cost allocations.
- The cost allocation methodology did not fully comply with Federal cost accounting standards.

In addition, we found the following inefficiencies in SSA's cost allocation process.

- To determine the final Trust Fund charges, SSA needed to perform additional spreadsheet calculations outside the official cost allocation system, CAS.
- Substantial manual intervention was required for data collection and validation.

CONCLUSIONS AND RECOMMENDATIONS

SSA's cost allocation methodology for allocating administrative costs between the Social Security and Medicare Trust Funds could become more equitable, accurate, and efficient.

[2] SSA, AIMS, Financial Management Manual (FMM) 04.02 (November 2, 2009).

[3] SSA, *Face Sheet for Acting Commissioner's Action Meeting* (July 16, 1973).

[4] This calculation assumes disability determination services' costs as personnel-related.

We were unable to conclude whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate because of underlying data concerns and the non-compliance issues related to Statement of Federal Financial Accounting Standards (SFFAS) No. 4.

We recommend SSA:

1. Implement an annual process for reviewing the method of allocating costs to ensure the current allocation is effective, accurate, and efficient in light of current year changes.
2. Assign non-personnel costs to appropriate workloads or program activities or where direct tracing is not possible or feasible, assign based on cause-and-effect.
3. Incorporate into the official cost allocation system, CAS, the external calculations of the final distribution of costs to the Trust Funds.
4. Reduce manual intervention using CAS' existing technological capability to the extent practical.

SSA determined that because of the interrelationship of all four CAS reviews, it was premature to comment or respond to Grant Thornton's recommendations before it received the fourth report. There is total of 14 recommendations for all 4 CAS reports.

AGENCY COMMENTS

In response to our draft reports, SSA agreed with 7 of our 14 recommendations. See Appendix D for Agency comments.

GRANT THORNTON RESPONSE

Although SSA had made improvements in some areas after our fieldwork, the Agency continues to lack a formal review process for reviewing and updating its cost allocation methodology as well as its CAS documentation in light of new accounting standards and information technologies. The Agency has not provided an adequate staffing succession plan that mitigates the risk of CAS subject matter expert departures. Our conclusion remains unchanged that the use of benefit outlays is an inappropriate means of allocating shared costs and does not comply with SFFAS No. 4. Lastly, the inclusion of unliquidated obligations in the costing methodology is inappropriate for managerial cost accounting purposes and may incorrectly alter how administrative costs are assigned to programs.

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Introduction

The Social Security Administration (SSA) has responsibility for stewardship of the four Trust Funds for which it provides administrative support: the Retirement and Survivors Insurance (RSI) Trust, Disability Insurance (DI) Trust, Hospital Insurance (HI) Trust, and Supplementary Medical Insurance (SMI) Trust. As part of this stewardship, the Commissioner of Social Security established a cost allocation process in July 1973. This cost allocation process was based on the policy that administrative costs for the Trust and general fund programs, as well as for reimbursable work performed by SSA for outside organizations, would be allocated based on cost-sharing principles. A central part of SSA's cost allocation process is its Cost Analysis System (CAS).

OBJECTIVES

Our objectives were to:

1. Determine whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate.
2. Determine whether SSA's cost allocation process was efficient.
3. Review and test internal controls surrounding the transfer and payment between the Social Security and Medicare Trust Funds.

BACKGROUND

In addition to managing its own programs, SSA provides administrative services to the Medicare and Medicaid programs administered by the Centers for Medicare and Medicaid Services (CMS). For these two programs, SSA performs customer service functions, including enrolling eligible individuals, maintaining beneficiary information, and collecting premiums. As such, the *Social Security Act* establishes SSA's authority to seek reimbursement from the Social Security and Medicare Trust Funds for administrative costs. SSA's total cost of administering these and other smaller programs was approximately $12 billion in FY 2010.

SSA's policy for allocating administrative costs[1] was initially established by a 1973 Commissioner's Decision,[2] which states costs related solely to one program will be assigned exclusively to that program. Further, it specifies that costs benefitting multiple programs will be equitably distributed among those programs, based on the proportionate value of those shared costs to each benefiting program.

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[1] SSA, AIMS, FMM 04.02 (May 7, 2011).

[2] SSA, *Face Sheet for Acting Commissioner's Action Meeting* (July 16, 1973).

In the early 1970s, SSA developed a cost allocation methodology to assign its administrative costs to the programs it supported and determine the respective amount of reimbursement due from each Trust Fund. SSA continues to apply this cost allocation methodology to assign administrative costs to the programs it serves. The SSA CAS was designed to automate this cost allocation methodology. CAS became operational in 1976[3] and has been in service for about 35 years.

SSA's cost allocation methodology integrates data from payroll, Agency work measurement systems, and the core financial accounting system and assigns costs to specific program activities and workloads. SSA allocates a majority of its direct and indirect costs based on work measurement. Costs related to one program exclusively are directly assigned to that program, while costs related to multiple programs are shared by those programs.

SSA's cost allocation methodology distinguishes shared workloads as either sequential or concurrent. A sequential workload is initially performed for one program but may later apply to other programs as well. For example, for many beneficiaries, RSI entitlement is established during initial DI determination since a portion of DI benefits is converted to RSI benefits at full retirement age. That is, entitlement for disability becomes entitlement for retirement benefits upon conversion from DI to RSI. Thus, the RSI and DI Trust Funds should share these sequential workload costs.

A concurrent workload supports more than one program simultaneously. Costs of certain workloads incurred during claims taking and maintenance, which CAS assigns to the RSI Trust Fund, also benefit the HI and SMI Trust Funds. Furthermore, certain workload costs that CAS assigns to the DI Trust Fund also benefit the RSI, HI, and SMI Trust Funds. The HI and SMI programs benefit from work performed on the RSI and DI programs and therefore per SSA policy should share the cost. For example the, *RSI Nondisabled Claims* workload captures the activity associated with a claimant's initial filing for Social Security benefits. This initial filing process establishes claimant identity, age, insured status, and other basic information. Initially, through CAS, the costs for this workload are allocated to the RSI and SSI program activities. However, since this information will also be used to establish the claimant's entitlement to Medicare, SSA re-allocates a portion of these initial costs to the HI and SMI Trust Funds through the Inter-Trust Fund Adjustment (ITFA).

CAS performs the initial cost allocation to workloads and program activities. After this initial allocation, the SSA cost allocation methodology distributes costs associated with sequential and concurrent benefits to each Trust Fund through the ITFA. This final adjustment weights the cost of shared workloads in proportion to the current value of benefit outlays. A more detailed description of the ITFA is in Appendix D.

[3] SSA, Cost Analysis Manual, 2-00-10.

SSA's cost allocation methodology uses a budgetary accounting basis (that is, accrued expenditures, obligations, and commitments) rather than an accrual accounting basis (that is, actual expenses) for its administrative cost allocations to workloads and program activities. However, final Trust Fund charges need to be based on actual expenses.[4] Therefore, after the ITFA, final allocation percentages calculated using budgetary accounting are applied to actual expenses to obtain the final charges to the Trust Funds.

SSA's cost allocation methodology is applied through a cost allocation process. The cost allocation process consists of five steps.

1. **SSA collects work measurement, payroll, and financial accounting data**. SSA uses multiple methods for work measurement. The field offices (FO), disability determination services (DDS), and program service centers (PSC) use point-in-time random work sampling techniques already in place before CAS implementation. Each employee is sampled once during the applicable period for a specific point in time. For example, the survey would determine the activity the employee was performing at 1:30 p.m. This method covers the largest portion of SSA's workforce. Other SSA components use alternative methods for collecting level-of-effort data, including standard time values, 100-percent work capture, and mirroring another organization's level-of-effort proportions.

   SSA operates multiple work sampling systems, each of which covers a major segment of SSA operations. Work sampling data are entered into tally sheets that are subsequently transcribed into an automated feeder system for use by CAS.

   Payroll data are collected from the Payroll Operational Data Store. Financial accounting data come from the Social Security Online Accounting and Reporting System.

2. **SSA organizes and loads these data into CAS**. SSA provides workyear, personnel leave, personnel and non-personnel costs, and other data to the Office of Cost Analysis and System Support (OCASS) and the components. These data are manually entered into Excel workbooks and passed between OCASS and the components to ensure correctness and consistency with historical trends. Once the monthly Excel workbooks are completed, their data, along with data from automated feeder systems are loaded into CAS.

3. **SSA uses CAS to allocate costs to workloads and program activities.** CAS assigns direct and indirect administrative costs to workloads and program activities primarily in proportion to direct labor. As discussed earlier, some of the workloads are sequential or concurrent and therefore need to be reallocated using the ITFA in the next step.

[4] *Social Security Act* § 201(g)(1)(B), 42 U.S.C. § 401(g)(1)(B).

4. **SSA applies the ITFA using spreadsheets**. The ITFA is performed outside CAS in an Excel workbook, which requires transcription of CAS results into the workbook. The ITFA pre-dates CAS. Originally, CAS was an outgrowth of a legacy budgeting process and followed existing workload structures. CAS was built around that process and workload structure. As the ITFA was performed outside the legacy process, in a spreadsheet, when the cost allocation process was automated with CAS, these calculations were not built into CAS.

5. **SSA applies the resulting allocation percentages to actual administrative expenses, again using spreadsheets, to determine the final charges to the Trust Funds**. Allocation percentages are provided to the Office of Finance (OF), which applies them to the given period's actual administrative expenses. This establishes how much each Trust and general fund account will contribute to the administrative operating revenues for SSA, for that period.

Grant Thornton

Results of Review

AUDIT OBJECTIVE 1: Determine Whether SSA's Methodology for Allocating Administrative Costs Between the Social Security and Medicare Trust Funds Was Equitable and Accurate

We reviewed SSA's cost allocation methodology to determine whether its assignment of administrative costs to the Social Security and Medicare Trust Funds was equitable and accurate. For this review, we defined an equitable and accurate cost allocation methodology as one that (1) is in accordance with current cost accounting standards, (2) is based on reliable input data, (3) fairly associates cost to level-of-effort, and (4) includes full cost of resources consumed within a given draw down period.

We found the equitableness and accuracy of SSA's cost allocation methodology in allocating administrative costs between the Social Security and Medicare Trust Funds could be improved.

- The allocation basis for shared workload costs, representing 56 percent of FY 2010 total administrative costs, to Trust Funds did not reflect a cause-and-effect relationship between resources and outputs.
- Critical work measurement data were unreliable.
- Non-personnel costs, representing approximately 27 percent of FY 2010 total administrative costs,[5] were allocated to workloads and program activities based on workyears rather than on a direct trace or a cause-and-effect basis.
- The use of accrued expenditures, commitments, and obligations in lieu of actual operating expenses may have significantly altered Trust Fund cost allocations.
- The cost allocation methodology did not fully comply with Federal cost accounting standards.

<u>The Allocation Basis for Shared Workload Costs, Representing 56 Percent of FY 2010 Total Administrative Expenses, Did Not Reflect a Cause-and-Effect Relationship Between Resources and Outputs.</u>

As discussed in our review of the *Social Security Administration Cost Allocation Process* (A-15-10-20151), the use of relative benefit outlays as a basis for assigning shared workload costs to the Trust Funds may be inequitable because it assigns a greater portion of costs to programs with higher dollar benefit outlays even though SSA's costs may not increase correspondingly with the higher outlay amounts. SSA's cost allocation methodology, through the ITFA, allocates a portion of shared costs, which represents 56 percent FY 2010 total allocated costs, based on the Trust Fund's total benefit

[5] This calculation assumes disability determination services costs as personnel-related.

outlays. The use of benefit outlays to assign shared costs does not manifest a suitable causal relationship between resources and outputs.

We understand workload costs related to multiple programs should be shared. However, we do not believe benefit outlays represent an equitable cost assignment basis, as cost allocation is then driven by benefit amounts rather than the work performed. To illustrate, an RSI beneficiary receiving $1,000 a month does not consume more administrative costs than a DI beneficiary receiving $500 a month. A DI claimant must complete an extensive medical questionnaire at the FO and a determination of disability at a DDS. However, using benefit outlays as the basis would assign more shared costs to the RSI program.

Alternatively, if Congress changes a program's benefit entitlement amounts, the cost allocation would change even though the required work would remain the same. For example, if the DI monthly benefit were raised by 10 percent, the cost allocation methodology would shift more cost to the DI Trust Fund even though the cost to administer the DI program would remain the same. Therefore, the use of benefit outlays to assign shared costs unfairly assigns a greater portion of costs to programs with higher dollar benefit outlays although SSA's cost may not increase as a result of the higher outlays. As recommended in our report on *The Social Security Administration Cost Allocation Process*, A-15-10-20151, SSA should discontinue using benefit outlays for allocating shared costs to program activities.

SSA management maintains that its cost allocation methodology cannot be changed because it is prescribed by the *Social Security Act*. However, the *Social Security Act* specifies administrative cost allocations to the Trust Funds, ". . . shall be made in accordance with the cost allocation methodology in existence on the date of the enactment of the Social Security Independence and Program Improvements Act of 1994 until such time as the methodology . . . is revised by agreement of the Commissioner and the Secretary. . . ."[6] This clause implies the cost allocation methodology is not permanent but can be revised as needed to ensure an equitable cost allocation.

In 1997, at the Government Accountability Office's request, Price Waterhouse LLP[7] reviewed the cost allocation methodology used to charge costs to the Medicare Trust Funds. Price Waterhouse concluded the use of benefit outlays as a cost assignment basis for shared workload cost did not result in equitable cost assignment and recommended its use be discontinued in favor of cause-and-effect cost assignment.[8] In response to the review, SSA indicated it looked ". . . forward to the challenge . . . to again pioneer the Federal effort to successfully implement new, expanded cost accounting practices, improvements to management information systems and

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[6] *Social Security Act* § 201(g)(1)(D), 42 U.S.C. § 401(g)(1)(D).

[7] Now PricewaterhouseCoopers LLP.

[8] Government Accountability Office, *Social Security Administration Cost Assignment Methodology Review*, (Price Waterhouse LLP), pages 2 and 3, September 29, 1997.

procedures recently promulgated as Federal Accounting Standards Advisory Board standards." [9] To date, SSA has not implemented Price Waterhouse's recommendations for improving the cost allocation methodology.

Critical Work Measurement Input Data Were Unreliable

As discussed in our review of the *Social Security Administration Cost Allocation Process*,[10] we found work measurement data based on work sampling was unreliable. During our visits to 15 FOs, we checked District Office Work Sampling (DOWS) tally sheets against the data transcribed into the system. At seven of these FOs, sampling records were maintained; however, the records did not match what was entered into the automated collections system. Thus, workloads assigned costs using the data collected by the DOWS method could not receive their appropriate share of Limitation on Administrative Expenses costs.

As recommended in report on *The Social Security Administration Cost Allocation Process*, A-15-10-20151, SSA should institute a procedure to evaluate the transcription error rate of the DOWS sample taking process. Once known, SSA should perform a sensitivity analysis of the sample transcription process to establish an acceptable rate of transcription error and regularly sample the process to ensure the organization remains within acceptable limits.

Non-Personnel Costs, Representing 27 Percent of FY 2010 Total Administrative Costs, Were Allocated to Workloads and Program Activities Based on Workyears Rather Than on a Direct Trace or a Cause-and-Effect Basis.

Non-personnel costs represented 27 percent of FY 2010 total administrative costs.[11] They were allocated to workloads and program activities in proportion to workyears. While some non-personnel costs can and should be allocated based on labor distribution, non-personnel costs are significant enough that they should not all be subject to arbitrary, across-the-board allocation. This can lead to under- or over-costing programs and thus result in an inequitable and inaccurate Trust Fund allocation. SSA should periodically evaluate non-personnel costs to achieve more equitable and accurate cost assignments based on direct-tracing or cause-and-effect methods.

[9] Id. at 98.

[10] SSA OIG, *The Social Security Administration Cost Allocation Process* (A-15-10-20151), June 2011.

[11] This calculation assumes disability determination services costs as personnel-related.

The Use of Accrued Expenditures, Commitments, and Obligations, in Lieu of Actual Operating Expenses, May Significantly Alter Trust Fund Cost Allocations.

The SSA cost allocation methodology relies on budgetary accounts that include accrued expenditures, commitments, and unliquidated obligations, rather than actual operating expenses. The inclusion of unliquidated obligations in the costing methodology is appropriate for determining cash draw downs from the Trust Funds to meet program funding requirements. However, actual expenses should be used for managerial cost accounting purposes to calculate the true cost of work performed on SSA programs. For instance, to calculate the true cost per claim, the use of obligations would not be accurate because of cost recognition timing differences between accrual and budgetary accounting. The inclusion of these accrued expenditures, commitments, and unliquidated obligations allows non-period transactions to impact period results and may incorrectly alter how administrative costs are allocated to the Trust and general funds.

SSA would improve accuracy by using accrual accounting rather than budgetary accounting for cost assignments because accrual accounting recognizes actual expenses for the period in which they are incurred.

The Cost Allocation Methodology Did Not Fully Comply with Current Federal Cost Accounting Standards.

SSA's cost allocation methodology meets the requirements of SSA's AIMS,[12] which lists the governing policy and principles and the general methods for allocating administrative costs in SSA. However, since the inception of CAS in 1976, there have been significant changes in Federal accounting standards that should have been reflected and updated in the methodology.

As documented in our report on the *Social Security Administration Cost Allocation Process*, A-15-10-20151,[13] SSA's cost allocation methodology did not fully comply with the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.*[14] SSA's cost allocation methodology was established in the early 1970s, before the Federal Accounting Standards Advisory Board (FASAB) issued SFFAS No. 4 in 1995.

[12] SSA, AIMS, FMM, 04.02.02 and 04.02.05 (November 2, 2009).

[13] SSA OIG, *The Social Security Administration Cost Allocation Process* (A-15-10-20151), June 2011.

[14] FASAB, SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, July 31, 1995.

SSA's cost allocation methodology complies with many of the requirements established by SSFAS No. 4. For instance, it

- uses direct tracing to a large extent in allocating costs to program activities;
- links costs to organizational performance;
- is performed regularly and consistently;
- has defined responsibility segments;
- accumulates cost and quantitative units of resources consumed; and
- includes the cost for social insurance programs.

However, our overall assessment of SSA's cost allocation methodology's compliance with SSFAS No. 4 is "partially compliant" because it does not adhere to some of the critical requirements outlined in SFFAS No. 4.

- SSA's cost allocation methodology did not assign certain shared workload costs through (a) direct trace; (b) cause-and-effect; or (c) reasonable and consistent allocation of costs to accurately reflect the work effort involved. That is, the use of benefit outlays as the basis of assigning shared costs does not manifest a suitable causal relationship between resources and outputs.
- CAS work sampling input data were often inaccurate.
- SSA's cost allocation methodology did not reconcile budgetary to proprietary methods of allocation at a detailed level.
- The SSA cost allocation methodology did not use actual expenses in assigning costs to reporting periods and outputs.
- SSA did not always adequately document cost allocation methodology and processes.
- There were no procedures for periodically revisiting, updating, and documenting significant changes to the cost allocation methodology.

We were unable to conclude whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate because of underlying data concerns and the noncompliance issues related to SFFAS No. 4.

AUDIT OBJECTIVE 2: Determine Whether SSA's Cost Allocation Process Was Efficient

We reviewed SSA's cost allocation process from work measurement to final calculation of the charges to each of the four Trust Funds to determine whether it was efficient. For this review, we defined an "efficient" cost allocation process as one that minimizes manual intervention, rework, and duplicative activities or systems.

We found inefficiencies in SSA's cost allocation process because

- to determine the final Trust Fund charges, SSA needed to perform additional spreadsheet calculations outside CAS and
- substantial manual intervention was required for data collection and validation.

To Determine the Final Trust Fund Charges, SSA Needed to Perform Additional Spreadsheet Calculations Outside CAS.

CAS calculates initial allocation of administrative costs to program activities based on data it extracts from financial, personnel, and work measurement systems. The ITFA is then performed by transcribing CAS calculation results to an Excel workbook to produce a set of percentages associated with each of the Social Security and Medicare Trust Funds and the SSI general fund account. Since these results must be applied to SSA operating expenses, and CAS uses commitment and obligation data, OCASS must pass these calculated percentages to OF, which, again using spreadsheets, applies them to period operating expenses, and charges the funds the amounts derived from these final calculations.

Given the capabilities of available CAS software features (that is, Oracle[15]), we question why CAS cannot perform these steps and provide OF amounts to charge the Trust Funds.

Substantial Manual Intervention Was Required for Data Collection and Validation.

Considering the level to which automated systems are involved in SSA's cost allocation process, we were concerned about the extent of manual data processing. Most component workyear data are loaded into CAS from Excel workbooks. SSA personnel manually populate and validate those workbooks. This can require that the workbook be passed between the OCASS analyst and responsibility segment personnel multiple times to ensure the base workyear data were transcribed into the workbook correctly and workyear distribution is historically consistent. Once OCASS and the component are satisfied the data are correct, the workbook data are put in a form that can be read by CAS and the data uploaded into the system.

Automated validation routines are not present in CAS. SSA personnel manually validate calculated results. This consists primarily of comparing monthly CAS results with historical trends to identify any outliers. Once these outliers are identified, research is performed to determine whether the result is because of errors in the base data or if the result is, in fact, correct.

[15] See SSA OIG, *Cost Analysis System Background Report and Viability Assessment (A-15-10-20149)*, April 2011, for a discussion of CAS' technical evolution and capabilities.

This type of research and analysis is performed manually. However, considering the sophistication of the automated process surrounding CAS, we question why the initial outlier identification is not performed automatically by CAS with exceptions simply reported so the necessary research and analysis can be performed.

AUDIT OBJECTIVE 3: Review and Test Internal Controls Surrounding the Transfer and Payment Between the Social Security and Medicare Trust Funds

SSA performs cash transfers to CMS each month. The majority of these cash transfers relate to the collection and subsequent transfer of SMI premiums that SSA performs on behalf of CMS. SSA maintains numerous internal controls surrounding its monthly submissions to CMS. They include

- daily and monthly reconciliations of expenditures and transfers,
- monthly reconciliations of Treasury submissions to supporting documentation, and
- timely reconciliations of differences noted on Treasury's monthly Statement of Difference.

During the FY 2010 financial statement audit, we

- obtained documentation of each month in FY 2010 and determined that the CMS Intra-governmental Payment and Collection system reports agreed with SSA payment vouchers and other supporting documentation; and
- examined Treasury submissions for 3 months and tested to ensure amounts were properly supported; differences were identified and corrected timely; and transfer amounts were correctly received by Treasury.

We noted no exceptions. Internal controls surrounding the transfer and payment between SSA and CMS Trust funds operated effectively.

Grant Thornton

Conclusions and Recommendations

CONCLUSIONS

AUDIT OBJECTIVE 1: Determine Whether SSA's Methodology for Allocating Administrative Costs Between the Social Security and Medicare Trust Funds Was Equitable and Accurate

We concluded that SSA's cost allocation methodology could be more equitable and accurate.

- The allocation basis for shared workload costs, representing 56 percent of FY 2010 total administrative costs, to Trust Funds did not reflect a cause-and-effect relationship between resources and outputs.
- Critical work measurement data were unreliable.
- Non-personnel costs, representing approximately 27 percent of FY 2010 total administrative costs,[16] were allocated to workloads and program activities based on workyears rather than on a direct trace or a cause-and-effect basis.
- The use of accrued expenditures, commitments, and obligations in lieu of actual operating expenses may have significantly altered Trust Fund cost allocations.
- The cost allocation methodology did not fully comply with current Federal cost accounting standards.

We were unable to conclude whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate because of underlying data concerns and the noncompliance issues related to SFFAS No. 4.

AUDIT OBJECTIVE 2: Determine Whether SSA's Cost Allocation Process Was Efficient

We found inefficiencies in SSA's cost allocation process.

- To determine the final Trust Fund charges, SSA needed to perform additional spreadsheet calculations outside the CAS.
- Substantial manual intervention was required for data collection and validation.

[16] This calculation assumes disability determination services costs as personnel-related.

AUDIT OBJECTIVE 3: Review and Test Internal Controls Surrounding the Transfer and Payment Between the Social Security and Medicare Trust Funds

Based on our analysis, SMI transfers to the Medicare Trust Fund were consistent throughout FY 2010. In addition, internal controls over transfer payments were operating effectively.

RECOMMENDATIONS

To address the risks cited in this report, we recommend SSA:

1. Implement an annual process for reviewing the method of allocating costs to ensure the current allocation is effective, accurate, and efficient in light of current year changes.
2. Assign non-personnel costs to appropriate workloads or program activities or where direct tracing is not possible or feasible, assign based on cause-and-effect.
3. Incorporate into the official cost allocation system, CAS, the external calculations of the final distribution of costs to the Trust Funds.
4. Reduce manual intervention using CAS' existing technological capability to the extent practical.

SSA determined that because of the interrelationship of all four CAS reviews, it was premature to comment or respond to Grant Thornton's recommendations before receipt of the fourth report. Below, for the reader's benefit, we have outlined the recommendations from the first three CAS reviews, with the report number and corresponding recommendation number listed in parenthesis. The reader is encouraged to refer to the previous reports for discussions of the associated findings.

5. Review and update the CAS methodology as needed, in light of current statutes, regulations, and Federal accounting standards, as well as current SSA business processes and system technology. (A-15-10-20149, Recommendation #1 and A-15-10-20151, Recommendation #6)
6. Review, update, and enhance the AIMS documents, Cost Analysis Manual, and other policies and procedures on an annual basis, and when major changes are implemented. The CAS methodology should be clearly documented, especially the rationale, methodology, and calculations of the ITFA. The CAS strategic plan should be updated annually, to reflect any changes in priorities, timelines, and funding requirements. (A-15-10-20149, Recommendation 2 and A-15-10-20151, Recommendation 7)
7. Establish and periodically update a staffing succession plan, encompassing the OCASS and the Office of Earnings, Enumeration and Administrative Systems staff, to ensure continuity of operations and to mitigate the risk of CAS institutional knowledge loss through attrition. (A-15-10-20149, Recommendation 3)

8. Formalize a scheduled, periodic review of the Office of Disability Adjudication and Review's (ODAR) standard time values, to help ensure future CAS results reflect the current status of operations. (A-15-10-20150, Recommendation 1)
9. Develop a formalized monthly review process of ODAR's CAS submission as part of its control structure. This formalized review process should be consistent and documented. (A-15-10-20150, Recommendation 2)
10. Enforce and enhance policies and procedures, such as secondary reviews or reconciliations of tally sheets to CAS submissions to ensure that workload sampling inputs are transcribed into automated systems accurately. (A-15-10-20151, Recommendation 1)
11. Discontinue the use of benefit outlays as the means of allocating shared costs to program activities. Instead, SSA should review existing data sets to identify cost assignment methods that manifest suitable causal relationships between the work SSA performs and the programs that are charged for that work. (A-15-10-20151, Recommendation 2)
12. Update policies and procedures to ensure the data collection process is consistently performed and reviews are conducted timely. (A-15-10-20151, Recommendation 3)
13. Reconcile the budgetary accounting basis used for cost allocation with the proprietary, or accrual, basis of accounting at a detailed level. (A-15-10-20151, Recommendation 4)
14. Use actual operating expenses to determine the distribution and allocation of costs to outputs and program activities. (A-15-10-20151, Recommendation 5)

AGENCY COMMENTS

In response to our draft reports, SSA agreed with 7 of our 14 recommendations. SSA disagreed with Recommendations 1, 2, 5, 6, 7, 11, and 14.

- Recommendation 1 suggested SSA implement an annual process for reviewing SSA's method of allocating costs. SSA noted that the Agency already conducts an annual review and modifies CAS to make necessary changes.
- Recommendation 2 suggested SSA assign non-personnel costs to appropriation workloads or programs. SSA stated the Agency already assigns non-personnel costs using cause-and-effect principles. When cause-and-effect principles are not practical, costs are allocated on a reasonable and consistent basis.
- Recommendation 5 suggested SSA review and update CAS methodologies, business process and system technology as needed. SSA noted the Agency routinely reviews CAS and updates it as necessary.
- Recommendation 6 proposed SSA review, update and enhance policies and procedures on an annual basis. SSA stated policies and procedures are currently updated annually.

- Recommendation 7 suggested SSA establish and update a staffing succession plan regarding CAS. SSA stated it has adequate succession planning in place.
- Recommendation 11 stated that SSA should discontinue the use of benefit outlays as the means of allocating shared costs to program activities since there is not causal relationship between benefit outlays and program costs. SSA noted that the Social Security Act prevents the Agency from changing its cost accounting methodology without consent from the Department of Health and Human Services.
- Recommendation 14 proposed using actual operating expenses to determine the allocation of workload activities. SSA stated that the Agency already uses certain operating expenses as part of its overall cost allocation process.

The full context of the Agency's comments can be found in Appendix D.

GRANT THORNTON RESPONSE

We have reviewed SSA's responses and continue to have concerns with the following policies.

<u>Recommendation 1</u> - In report *A-15-10-20152*, we identified why SSA needs a formal process to review and adjust the cost allocation methodology. Management provided no evidence to support its assertion that a formal process to review the cost allocation methodology exists.

<u>Recommendation 2</u> - SFFAS No. 4 *Managerial Cost Accounting Concepts and Standards* states, ". . . cost assignments should be performed by the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis." As non-personnel costs at SSA represented 27 percent of FY 2010 total administrative costs, they are significant enough that they should not all be subject to arbitrary, across-the-board allocation. As we indicate in this report, this can lead to under- or over-costing programs and thus result in an inequitable and inaccurate Trust Fund allocation.

We understand that at CAS' inception in 1976 direct trace or cause-and-effect cost assignments may not have been economically feasible. However, economic feasibility can change over time, allowing for the introduction of new accounting standards and information technologies. No evidence was provided to demonstrate that evaluation has been completed by management to determine the practicality of determining cause and effect relationships.

<u>Recommendation 5</u> – Management provided no evidence to support its assertion that there is a formal process to review the cost allocation methodology. As noted in our first report, *A-15-10-20149*, Price Waterhouse LLP reviewed the SSA cost allocation methodology in 1997 and recommended significant changes to the cost allocation methodology that, to date, have not been implemented.

Grant Thornton

Recommendation 6 - SSA has considerably improved the documentation of CAS policies and procedures. For instance, flowcharts and high-level systems architecture documents have been updated based on issues noted during the audit. However, we found no evidence that SSA developed and implemented a formal procedure to review and update CAS documentation on a periodic basis subsequent to our audit.

Recommendation 7 - During and after our fieldwork, we found no evidence of a formal, documented staffing succession plan that mitigated the risk of CAS subject matter expert departures.

Recommendation 11 - During and after our fieldwork, we found no evidence to indicate that SSA is not in compliance with the Act with respect to cost accounting methodology. However, the pertinent audit objectives were to "Determine whether the cost allocation methodology SSA management used complied with the *Statement of Federal Financial Accounting Standards No. 4*, *Managerial Cost Accounting Concepts and Standards for the Federal Government*" (report *A-15-10-20151*) and "Determine whether SSA's methodology for allocating administrative costs between the Social Security and Medicare Trust Funds was equitable and accurate." (Report *A-15-10-20152*).

The use of benefit outlays is an inappropriate means of allocating shared costs to program activities based on modern cost accounting principles as espoused in SFFAS No. 4. As stated in our third report, *A-15-10-20151*, benefit outlays do not manifest a suitable causal relationship between resources and outputs. For instance, an OASI claimant receiving $1,000 per month does not incur more shared costs than a DI or SSI claimant receiving $500 per month. Under SSA's methodology, this is exactly how shared costs are allocated. We realize that in the past, this method may have been appropriate. However, in light of changes to Federal accounting standards as well improvements in information technologies, the use of benefit outlays as the means of allocating shared costs to program activities is inappropriate.

We agree that benefit outlays are one of many factors that affect shared cost computations. However, benefit outlays is used as the allocation basis for 56 percent of FY 2010 total administrative costs and is therefore, quite significant.

Recommendation 14 - We agree that the inclusion of unliquidated obligations in the costing methodology is appropriate for determining cash drawdowns from the Trust Funds to meet program funding requirements. However, SSA also claims to be using CAS for managerial cost accounting purposes to calculate the true cost on a monthly basis. Although the difference between budgetary and accrual accounting may be negligible over an extended (annual or longer) basis, the differences in cost recognition timing differences are more pronounced on a monthly basis. The effect of non-period transactions may incorrectly alter how administrative costs are assigned to programs. For instance, the total contract amount of a new data center would have a substantial impact to the cost allocation in the period SSA enters into the contract. However, under accrual accounting, expenses are recognized in the period in which they occur. We feel the use of actual operating expenses and accrual accounting is more accurate than budgetary expenditure data for allocating costs between programs because it recognizes actual expenses in the period in which they are incurred.

We realize that SSA has allocated its administrative costs in the same manner for the last 40 years. However, with updates to Federal accounting principles as well as changes in information technology, we feel that SSA should revisit its allocation methodology on a periodic basis. We believe that updates to the methodology will provide a more accurate allocation of costs between programs as well as reduce the amount of time and resources SSA incurs to allocate those costs.

Appendices

APPENDIX A – Acronyms

APPENDIX B – Scope and Methodology

APPENDIX C – Inter-Trust Fund Adjustment Overview

APPENDIX D – Agency Comments

APPENDIX E – Communication with the Department of Health and Human Services

Acronyms

AIMS	Administrative Instructions Manual System
CAS	Cost Analysis System
CMS	Centers for Medicare and Medicaid Services
DBCA	Division of Benefit Certification & Accounting
DDS	Disability Determination Services
DI	Disability Insurance
DOWS	District Office Work Sampling
FASAB	Federal Accounting Standards Advisory Board
FO	Field Office
FY	Fiscal Year
HI	Hospital Insurance
ITFA	Inter-Trust Fund Adjustment
OCASS	Office of Cost Analysis and Systems Support
ODAR	Office of Disability Adjudication and Review
OF	Office of Finance
OIG	Office of Inspector General
OPSOS	Office of Public Service and Operations Support
PSC	Program Service Center
RSI	Retirement & Survivors Insurance
SFFAS	Statement of Federal Financial Accounting Standards
SMI	Supplementary Medical Insurance
SOBER	Separate Operation for Billing Entitlement and Remittances
SSA	Social Security Administration
SSI	Supplemental Security Income

Scope and Methodology

We assessed the equitableness and accuracy of SSA's cost allocation methodology and the efficiency of SSA's cost allocation process as it relates to the assignment of administrative costs to the Social Security and Medicare Trust Funds. We relied on evidence we gathered and presented in Reports A-15-10-20149, 20150, and 20151. Additionally, we interviewed Agency subject matter experts from the Offices of Cost Analysis and Systems Support (OCASS); Research, Evaluation, and Statistics (ORES); and Public Service and Operations Support (OPSOS) for information on system operations, work sampling results, and output and data reports.

We based our assessment on the cost allocation principles and requirements promulgated in the *Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government.*[1]

In Fiscal Year (FY) 2010, Grant Thornton performed Agreed-Upon Procedures for the Department of Health and Human Services' Office of Inspector General of the audit of certain specified components of the Centers for Medicare and Medicaid Services (CMS) FY 2010 financial statements. These components were Federal Hospital Insurance (HI or Medicare Part A) employment tax revenues, Federal Supplementary Medical Insurance (SMI or Medicare Part B) premium revenues, Medicare Parts A and B benefits, and Medicare Part D Prescription Drug Plans. This Agreed-Upon Procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and Government Auditing Standards, issued by the Comptroller General of the United States. Many of these procedures relate to the internal controls surrounding transfers to/from the various Social Security and Medicare Trust Funds. These procedures were as follows.

- Tested monthly Trust Fund transfers.
- Obtained current year (all months) documentation from SSA's Payment & Accounting Branch of the Division of Benefit Certification & Accounting (DBCA) and performed the following steps related to the accumulation and transfer of SMI premiums to the SMI Trust Fund:
    - Compared the Monthly Trust Fund Transfer Totals (National Totals) to the monthly premium amounts listed in the Regular Transcript File Report.
    - Compared the monthly premium amounts listed in the Regular Transcript File Report to monthly premium amounts listed in the SMI Trust Fund CMS Transfer.
    - Compared the Separate Operation for Billing Entitlement and Remittances (SOBER) run reports (system report) to SOBER Spreadsheet.

[1] FASAB, SFFAS No. 4, supra.

- Compared the SOBER Spreadsheet to the SMI Trust Fund CMS Transfer.
- Compared the final System Integrity Fiscal Tools to the Final SMI Trust Fund CMS Transfer.
- Compared the SMI Trust Fund CMS Transfer to the Standard Form 1081.
- Compared the SF 1081 to the Intra-Governmental Payment and Collection System Reports (Bill prepared by CMS).

- Tested SF-2049 Retirement and Survivors Insurance (RSI)/Disability Insurance (DI) disbursements.
- Obtained the monthly SF-2049s (SSA Monthly Summary report) from selected SSA payment service centers (PSCs) for 3 months in FY 2010. We then compared the monthly totals on the SF-2049s for RSI and DI disbursements to the sum of the daily totals on the SF-2049s. Next, we obtained the summary monthly SF-2049s from the selected PSCs and performed the following:
    - Compared the totals from the SF-2049s to the amounts listed on Section 1 of the SF-224s.
    - Compared the totals from the SF-2049s to the Federal Agencies Centralized Trial Balance System transmission.
    - Compared the total of all of the monthly SF-2049s that each PSC submitted for the months selected for RSI and DI to the Department of the Treasury payment file total for the months selected to ensure DBCA certified what Treasury paid out in aggregate.

We determined the computerized data used during our audit were sufficiently reliable given our objectives, and the intended use of the data should not lead to incorrect or unintentional conclusions.

We requested and received data on total obligations and expenditures for FY 2010, pre- and post-Inter-Trust Fund Adjustment (ITFA), and allocations to the trust funds and general fund accounts. We were also provided data on shared workload costs, and costs not subject to the ITFA. This information was used to evaluate potential impacts of using different bases of accounting (that is, obligations versus expenditures), analysis of the ITFA, and its impact on the trust fund and general fund accounts, and to facilitate our discussion of the SSA concepts of concurrent and sequential benefit. We determined that the data provided were sufficiently reliable, given the use to which they were put.

The entities reviewed were DBCA, OCASS, OPSOS, ORES, and the Office of Finance. Our work was conducted at SSA Headquarters in Baltimore, Maryland, from May 2010 through January 2011. We determined the data used in this report were sufficiently reliable given the review objective and their intended use. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Inter-Trust Fund Adjustment Overview

The purpose of the Inter-Trust Fund Adjustment (ITFA) is to ensure the Trust Funds are equitably charged for concurrent and sequential shared workload costs. Adjustments are made to account for the following.

1. Sequential shared workload for Retirement and Survivors Insurance (RSI) and Disability Insurance (DI): Entitlement for RSI is established initially for some people through DI determination, and a portion of DI benefits will later be converted to RSI benefits. Thus, the two Trust Funds should share these sequential workload costs. The rationale being entitlement for disability becomes entitlement for retirement benefits upon conversion from DI to RSI upon attainment of full retirement age.
2. Work not required by Hospital Insurance (HI) and Supplementary Medical Insurance (SMI): Certain work performed to establish RSI and DI entitlement is not required by Medicare. For example, the retirement test is a factor in determining whether an applicant is eligible for RSI benefits; it has no bearing, however, on entitlement to HI and SMI.
3. Concurrent shared workload also benefitting HI and SMI: Costs of certain workloads incurred during claims taking and maintenance assigned to the RSI program activity through the Cost Analysis System (CAS) also benefit the HI and SMI trust funds, and certain workloads assigned to the DI trust fund through CAS also benefit RSI, HI, and SMI. The HI and SMI programs benefit from work done on the RSI and DI programs and therefore, per SSA policy, should share the cost. For example, costs for the workload, *RSI Nondisabled Claims*, are initially charged almost 100 percent to the RSI program activity through CAS, with a smaller portion charged to SSI. This workload captures the activity of a claimant's initial filing for social security benefits. This initial filing process requires SSA to establish the person's identity, age, insured status, and other basic information. Since this information will also be used to establish the person's entitlement to Medicare, SSA allocates a portion of these initial costs to the HI and SMI trust funds. A portion of RSI workload cost is assigned to HI and SMI, and a portion of DI workload cost is assigned to RSI, HI, and SMI because assumptions related to the HI/SMI benefit of these particular workloads are not programmed into CAS.
4. Allocation equity: This adjustment weights the cost of shared workloads in proportion to benefit outlays. In SSA's view, this shifts costs to the larger funds and thus, increases allocation equity.

It is important to note the ITFA process does not affect the SSI program. The activities SSA performs for SSI are so specific to that program, that there is little overlap in activities performed. The SSI program does not have to be adjusted because charges for proofs of age, disability and income determinations and the like are measured either independently or broken out from other programs using formulas based on special studies or similar empirical data. It is therefore not necessary to transfer any dollars to or from SSI based on Treasury outlays. However, a small portion of costs related to RSI and DI Enrollment workloads are shared with SSI. Similar to the process by which SSA assigns the costs of these workloads to the trust funds, the SSI cost assignment is based on relative benefit outlays. Shared workload cost assignment to SSI is performed through CAS based on formulas reflecting relative benefit outlays.

The ITFA pre-dates CAS. Originally, CAS was an outgrowth of a legacy budgeting process and followed existing workload structures. CAS was built around that process and workload structure. As the ITFA was performed outside the legacy process in a spreadsheet, when the process was automated, these calculations were not built into CAS.

The ITFA works as follows.

Step 1: Modify benefit outlays using benefit ratios to account for sequential workload sharing

Benefit outlays for RSI and DI are modified by actuarial "benefit ratios" to take into account that entitlement for RSI is established initially for some people through DI determination and a portion of DI benefits will later be converted to RSI benefits. Benefit ratios adjust workload costs which currently benefit DI but in the future will benefit RSI as disability claimants leave the rolls or transfer to the RSI rolls upon attainment of full retirement age.

The ratio adjusts RSI benefits as they apply to RSI recipients who originally became entitled under DI. Since the RSI program did not incur enrollment costs for these beneficiaries, any benefits paid to them must be removed from the RSI benefit base when apportioning RSI enrollment costs.

The benefit bases used for apportioning DI initial enrollment and appeals costs, including costs incurred by State Agencies, must be modified to take into consideration the lifetime RSI benefits that will be received by persons who were originally enrolled under the DI program. The rationale being entitlement for disability becomes entitlement for retirement benefits upon conversion from DI to RSI upon attainment of full retirement age. Thus, the two Trust Funds should share these costs.

The actuarial benefit ratios are obtained from SSA's Office of the Actuary. Actuarial ratios do not require monthly updates. Generally, the ratios are only updated once per year and the weights are updated every few years or when major procedural changes are made or new programs are started.[1]

Benefit outlays for each trust fund are obtained from the US Treasury report "Outlays of the US Government."

Step 2: Modify benefit outlays again using benefit weights to account for work not required by Medicare.

The second step is intended to modify current benefit outlays for certain work performed to establish RSI and DI entitlement that is not required by Medicare. This is done through the application of "benefit weights." Benefit outlays for all trust funds are reduced by "benefit weights," which take into account that certain sub-activities of RSI and DI workloads should not be assigned to all trust funds. A benefit weight represents the portion and value of the shared workload relative to each program.

In computing these weights, general assumptions are made regarding the relative values to HI and SMI of specific aspects of the RSI and DI initial enrollment, appeals, maintenance and continuing eligibility processes. For example, the retirement test is a factor in determining whether an applicant is eligible for RSI benefits; it has no bearing, however, on entitlement to HI and SMI. Therefore, the "benefit weights" are applied to HI and SMI totals of benefits outlays to reduce them by an appropriate percentage intended to compensate for these costs. Similar assumptions have been made for other factors such as family relationship, insured status, other benefits received, and amount of benefits.

Benefit weights are updated based on special studies performed every 3 to 5 years or when major procedural changes are made or new programs are started.

Step 3: Application of cost allocation ratios to shared workloads to account for concurrent RSI and DI work benefitting SMI and HI.

Cost adjustment ratios are used for the 12 workloads containing elements benefitting multiple programs.

- RSI initial enrollment
- RSI appeals
- RSI maintenance of beneficiary records
- RSI continuity eligibility
- DI initial enrollment
- DI appeals

[1] SSA, CAM 10-10-30.

- DI maintenance of beneficiary records
- DI continuity eligibility
- DI state agency initial enrollment
- DI state agency appeals
- DI state agency continuity eligibility
- Annual wage reporting

This step primarily accounts for RSI and DI work also benefitting HI and SMI.

Step 4: Application of cost allocation ratios to modified benefit outlays to increase allocation cost equity.

The final step is the application of "cost allocation adjustment ratios" to the totals of the administrative costs as originally allocated to each trust fund. These cost allocation adjustment ratios are intended to redistribute administrative costs to trust funds in proportion to their respective benefit outlays as modified by the "benefit ratios" and "benefit weights."

Cost allocation ratios are calculated based on the proportion of each trust fund's adjusted benefits to total adjusted benefits.

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Agency Comments

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SOCIAL SECURITY

MEMORANDUM

Date: March 30, 2012 Refer To: S1J-3

To: Patrick P. O'Carroll, Jr.
Inspector General

From: Dean S. Landis /s/
Deputy Chief of Staff

Subject: Office of the Inspector General Draft Report, "The Social Security Administration Cost Allocation Methodology" (A-15-10-20152) -- INFORMATION

Thank you for the opportunity to review this draft report. Please see our attached comments.

Please let me know if we can be of further assistance. You may direct staff inquiries to Teresa Rojas at (410) 966-7284.

Attachment

COMMENTS ON THE OFFICE OF THE INSPECTOR GENERAL DRAFT REPORT, "THE SOCIAL SECURITY ADMINISTRATION COST ALLOCATION METHODOLOGY" (A-15-10-20152)

Your report is the last in a series of four on our Cost Analysis System (CAS). When you issued the first report in April 2011, we opted to defer our comments until you completed all four interrelated audits. This response provides our consolidated comments.

You state in the first report that "[t]he primary purpose of CAS is to determine the amount of reimbursement due from each Trust or general fund to which SSA provides administrative support, including the Medicare Trust Funds." You listed several objectives in performing your audits, but your main objective, as stated in your fourth report, was to assess whether CAS fulfills its "primary purpose." In our view, it does. After reading each of the reports, there is no information supporting a contrary view. You imply that CAS may be ineffective and claim that "equitable and appropriate allocation of administrative costs to the Trust Funds could be at risk" and that certain workload activity "could possibly not be accounted for in the cost allocation methodology." These statements, and others like it, do not demonstrate that CAS is ineffective.

The work we do supports several Federal programs. We directly administer the Old Age and Survivors and Disability Insurance (OASDI), and the Supplemental Security Income (SSI) programs. We also help the Centers for Medicare and Medicaid Services administer Health Insurance (HI) and Supplemental Medical Insurance (SMI). Congress recognized that our work was intertwined when it enacted § 201(g) of the Social Security Act (Act). Pursuant to the authority provided in that section, we finance our administrative costs by drawing funds from the OASDI, HI, and SMI trust funds, and from general tax revenues for our SSI work. Because it is difficult to attribute a specific worker's actions to a specific product, we use various cost accounting techniques and the CAS to determine how much to draw from the various funding sources. For example, if we determine that we are devoting 24 percent of our efforts to DI workloads, we draw 24 percent of our cash needs for our administrative expenses from the DI trust fund. We use CAS processes to approximate which actions benefit which programs, but we do not, nor should we, under cost accounting standards, expect absolute precision.

The Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) Number 4 states that "cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause and effect basis, or (c) allocating costs on a reasonable and consistent basis." We follow the SFFAS Number 4's prescribed order. In fact, your third audit recognizes that we generally use direct tracing in allocating cost to program activities. We strive for accuracy while complying with SFFAS Number 4 guidance, which states, "unnecessary precision and refinement of data should be avoided." Therefore, there are times when we must allocate costs on a reasonable and consistent basis.

RESPONSES TO RECOMMENDATIONS

Recommendation 1

Implement an annual process for reviewing the method of allocating costs to ensure the current allocation is effective, accurate, and efficient in light of current year changes.

Response

We disagree. We already conduct an annual review and modify CAS to make necessary changes. We consider this recommendation closed for tracking purposes.

Recommendation 2

Assign non-personnel costs to appropriate workloads or program activities or where direct tracing is not possible or feasible, assign based on cause-and-effect.

Response

We disagree. Where practical, we already assign non-personnel costs using cause-and-effect principles. Where this principle is not possible, we use other methods. For example, we use work time measurement data to allocate field office rental costs among the various programs. This method is an acceptable statistical practice and complies with Office of Management and Budget accounting standards. SFFAS Number 4 provides that cost may be assigned using cause-and-effect methods. Where those methods are not "feasible and economically practicable," it is proper to allocate "costs on a reasonable and consistent basis." Id. We follow this approach. As you state in your first report, "[t]he CAS methodology has remained consistent and stable since its inception in 1976." We consider this recommendation closed for tracking purposes.

Recommendation 3

Incorporate into the official cost allocation system, CAS, the external calculations of the final distribution of costs to the Trust Funds.

Response

We agree. We are currently making modifications to CAS and will incorporate those changes by the beginning of fiscal year (FY) 2013.

Recommendation 4

Reduce manual intervention using CAS' existing technological capability to the extent practical.

Response

We agree. As always, and to the extent practical and economical, we pursue opportunities for automation. However, our few manual processes are effective. We consider this recommendation closed for tracking purposes.

Recommendation 5

Review and update CAS methodology as needed, in light of current statutes, regulations, and Federal accounting standards, as well as current SSA business processes and system technology.

Response

We disagree. We routinely review CAS and update it as necessary. For example, we modified CAS processes to accommodate additional workloads brought on by the Medicare Modernization Act of 2003. Our routine reviews also examine our current business processes and systems technology. For example, if a technological improvement lowers processing times for a specific workload, random sampling will account for that fact. The time spent on that workload will drop and the CAS will reflect that change. We consider this recommendation closed for tracking purposes.

Recommendation 6

Review, update, and enhance the AIMS documents, Cost Analysis Manual, and other policies and procedures on an annual basis, and when major changes are implemented. The CAS methodology should be clearly documented, especially the rationale, methodology, and calculations of the Inter-Trust Fund Adjustment. The CAS strategic plan should be updated annually, to reflect any changes in priorities, timelines, and funding requirements.

Response

We disagree. We currently update the Administrative Instruction Manual System and document our procedures annually. This year, we began posting this information to an internal website to maintain our documentation in a single location. We consider this recommendation closed for tracking purposes.

Recommendation 7

Establish and periodically update a staffing succession plan, encompassing the OCASS and the Office of Earnings Enumeration and Administrative Systems staff, to ensure continuity of operations and to mitigate the risk of CAS institutional knowledge loss through attrition.

Response

We disagree. We have adequate succession planning already in place. Our Office of Cost Analysis and Systems Support, has two GS-15s on staff with detailed knowledge of CAS. In addition, we have trained nine additional employees in the intricacies of the system and our processes.

The Office of Earnings Enumeration and Administrative Systems (OEEAS) has several employees, as well as contractors, who are knowledgeable about CAS. OEEAS mitigates potential institutional knowledge loss by documenting the requirements and design of automated systems supporting CAS. In addition, we maintain a separation of duties between requirements, development, and testing to eliminate any single points of failure. We consider this recommendation closed for tracking purposes.

Recommendation 8

Formalize a scheduled, periodic review of the Office of Disability Adjudication and Review's (ODAR) standard time values, to help ensure future CAS results reflect the current status of operations.

Response

We agree. We have created a schedule to conduct a standard time value study every three years. We have incorporated this schedule into our cost reporting Standard Operating Procedures (SOP). We will conduct the next standard time value study in the first quarter of FY 2013. We consider this recommendation closed for tracking purposes.

Recommendation 9

Develop a formalized monthly review process of ODAR's CAS submission as part of its control structure. This formalized review process should be consistent and documented.

Response

We agree. We created a monthly review process that includes a formal examination within ODAR by a Division of Management Information and Analysis analyst, two budget analysts, and the budget formulation branch chief, prior to release to OCASS. Our SOPs mandate the use of this review process, which we document on the final consolidation tab of ODAR's CAS submission. We consider this recommendation closed for tracking purposes.

Recommendation 10

Enforce and enhance policies and procedures, such as secondary reviews or reconciliations of tally sheets to CAS submissions to ensure that workload sampling inputs are transcribed into automated systems accurately.

Response

We agree. On September 14, 2011, we informed our Regional Offices that we had simplified sampling procedures. For example, we combined and reduced cost categories. We sent reminders about our current policies and included requirements for a secondary review of tally sheets. In addition, we rewrote the Management Information Manual to identify changes and reinforce required procedures, and we created Work Sampling Guidance for managers. We consider this recommendation closed for tracking purposes.

Recommendation 11

Discontinue the use of benefit outlays as the means of allocating shared costs to program activities. Instead, SSA should review existing data sets to identify cost assignment methods that manifest suitable causal relationships between the work SSA performs and the programs that are charged for that work.

Response

We disagree. First, the Act prevents us from changing our cost accounting methodology without consent from the Department of Health and Human Services (HHS), as any changes may affect the HI and SMI trust funds. Second, benefit outlays are only one of many factors that affect shared cost computations.

We sent a letter with your audit report to the Kathleen Sebelius, Secretary of HHS, to request her opinion about your recommendation. On March 1, 2012, Secretary Sebelius replied that "[a]t this time, we do not believe changes to the cost allocation methodology are necessary." (Attached) We consider this recommendation closed for tracking purposes.

Recommendation 12

Update policies and procedures to ensure the data collection process is consistently performed and reviews are conducted timely.

Response

We agree. See response to Recommendation 10.

Recommendation 13

Reconcile the budgetary accounting basis used for cost allocation with the proprietary, or accrual, basis of accounting at a detailed level.

Response

We agree.

Recommendation 14

Use actual operating expenses to determine the distribution and allocation of costs to workloads and program activities.

Response

We disagree. We already use certain operating expenses (e.g., depreciation expenses) as part of our overall cost allocation process. We also use budgetary data, including unliquidated obligations, in our computations. Over two-thirds of our obligations are for payroll expenses; therefore, the difference between budgetary data and operating expenses is negligible. Our analysis confirms that expense-based and obligation-based methods yield comparable results. We will perform annual analyses to determine if our method remains comparable. We will not modify the CAS itself, because it would be too costly. We consider this recommendation closed for tracking purposes.

Communication with the Department of Health and Human Services

Grant Thornton

SOCIAL SECURITY
The Commissioner

January 24, 2012

The Honorable Kathleen Sebelius
Secretary of Health and Human Services
Washington, D.C. 20220

Dear Madam Secretary:

I write concerning an issue that our Inspector General (IG) raised in the enclosed audit report. Our IG recommended that we revisit the methodology used to allocate shared administrative costs among Social Security Trust Funds, the Hospital Insurance Trust Fund, and the Supplementary Medical Insurance Trust Fund (Trust Funds) to consider introducing new accounting standards, changes in business processes, or technology. Any changes in the methodology would affect future charges to both the Social Security and Medicare Trust Funds.

The Social Security Act requires that we jointly agree to any changes in the methodology for allocating these shared administrative costs, and I welcome your suggestions about what changes, if any, should be considered. As trustees, we must carefully consider whether to undertake changes to the existing cost allocation methodology during this difficult fiscal and economic climate. If you believe an interagency workgroup to study alternatives would be appropriate, we will be glad to coordinate that effort.

Thank you for your attention to this matter. If you would like to discuss it further, please do not hesitate to contact me. If your staff would like more information, they should contact Michael Gallagher, Deputy Commissioner for Budget, Finance and Management, at (410) 965-3148.

Sincerely,

Michael J. Astrue

Enclosure

cc:
Timothy Geithner

SOCIAL SECURITY ADMINISTRATION BALTIMORE, MD 21235-0001

THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

March 1, 2012

OFFICE OF PUBLIC INQUIRIES
MAILROOM
2012 MAR -8 AM 9:57

The Honorable Michael J. Astrue
Commissioner
Social Security Administration
Baltimore, MD 21235

Dear Commissioner Astrue:

Thank you for your letter regarding the consideration of changes to the allocation methodology for shared administrative costs related to the Social Security Trust Funds, the Hospital Insurance Trust Fund, and the Supplementary Medical Insurance Trust Fund (Trust Funds).

At the Department of Health and Human Services, we strive to be careful stewards of taxpayer funds. As such, we are committed to ensuring that costs related to the joint administration of our Trust Funds are consistent with the requirements posed and the benefits received by each Trust Fund. At this time, we do not believe changes to the cost allocation methodology are necessary. However, if you feel that our agencies should undertake a joint effort to review and evaluate the cost allocation methodology to ensure that the accounting standards and external factors are considered and applied appropriately, we are happy to participate.

Please do not hesitate to contact me if you have any further thoughts or concerns. If your staff would like more information, Ms. Sheila Conley, Deputy Assistant Secretary for Finance, has the lead on this for the Department. She can be reached at (202) 690-7084.

Sincerely,

Kathleen Sebelius

DISTRIBUTION SCHEDULE

Commissioner of Social Security

Chairman and Ranking Member, Committee on Ways and Means

Chief of Staff, Committee on Ways and Means

Chairman and Ranking Minority Member, Subcommittee on Social Security

Majority and Minority Staff Director, Subcommittee on Social Security

Chairman and Ranking Minority Member, Committee on the Budget, House of Representatives

Chairman and Ranking Minority Member, Committee on Oversight and Government Reform

Chairman and Ranking Minority Member, Committee on Appropriations, House of Representatives

Chairman and Ranking Minority, Subcommittee on Labor, Health and Human Services, Education and Related Agencies, Committee on Appropriations, House of Representatives

Chairman and Ranking Minority Member, Committee on Appropriations, U.S. Senate

Chairman and Ranking Minority Member, Subcommittee on Labor, Health and Human Services, Education and Related Agencies, Committee on Appropriations, U.S. Senate

Chairman and Ranking Minority Member, Committee on Finance

Chairman and Ranking Minority Member, Subcommittee on Social Security Pensions and Family Policy

Chairman and Ranking Minority Member, Senate Special Committee on Aging

Social Security Advisory Board

Overview of the Office of the Inspector General

The Office of the Inspector General (OIG) is comprised of an Office of Audit (OA), Office of Investigations (OI), Office of the Counsel to the Inspector General (OCIG), Office of External Relations (OER), and Office of Technology and Resource Management (OTRM). To ensure compliance with policies and procedures, internal controls, and professional standards, the OIG also has a comprehensive Professional Responsibility and Quality Assurance program.

Office of Audit

OA conducts financial and performance audits of the Social Security Administration's (SSA) programs and operations and makes recommendations to ensure program objectives are achieved effectively and efficiently. Financial audits assess whether SSA's financial statements fairly present SSA's financial position, results of operations, and cash flow. Performance audits review the economy, efficiency, and effectiveness of SSA's programs and operations. OA also conducts short-term management reviews and program evaluations on issues of concern to SSA, Congress, and the general public.

Office of Investigations

OI conducts investigations related to fraud, waste, abuse, and mismanagement in SSA programs and operations. This includes wrongdoing by applicants, beneficiaries, contractors, third parties, or SSA employees performing their official duties. This office serves as liaison to the Department of Justice on all matters relating to the investigation of SSA programs and personnel. OI also conducts joint investigations with other Federal, State, and local law enforcement agencies.

Office of the Counsel to the Inspector General

OCIG provides independent legal advice and counsel to the IG on various matters, including statutes, regulations, legislation, and policy directives. OCIG also advises the IG on investigative procedures and techniques, as well as on legal implications and conclusions to be drawn from audit and investigative material. Also, OCIG administers the Civil Monetary Penalty program.

Office of External Relations

OER manages OIG's external and public affairs programs, and serves as the principal advisor on news releases and in providing information to the various news reporting services. OER develops OIG's media and public information policies, directs OIG's external and public affairs programs, and serves as the primary contact for those seeking information about OIG. OER prepares OIG publications, speeches, and presentations to internal and external organizations, and responds to Congressional correspondence.

Office of Technology and Resource Management

OTRM supports OIG by providing information management and systems security. OTRM also coordinates OIG's budget, procurement, telecommunications, facilities, and human resources. In addition, OTRM is the focal point for OIG's strategic planning function, and the development and monitoring of performance measures. In addition, OTRM receives and assigns for action allegations of criminal and administrative violations of Social Security laws, identifies fugitives receiving benefit payments from SSA, and provides technological assistance to investigations.