OFFICE OF
THE INSPECTOR GENERAL

SOCIAL SECURITY ADMINISTRATION

THE SOCIAL SECURITY ADMINISTRATION’S COMPLIANCE WITH EMPLOYEE TAX REQUIREMENTS

April 2007 A-03-06-16062

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: April 6, 2007

To: The Commissioner

From: Inspector General

Subject: The Social Security Administration’s Compliance with Employee Tax Requirements (A-03-06-16062)

OBJECTIVE

Our objective was to determine if the Social Security Administration (SSA) is appropriately paying and reporting employment taxes to the Internal Revenue Service (IRS).

BACKGROUND

In June 2005, the IRS requested that each Federal Office of Inspector General determine whether its parent agency is complying with Federal tax laws. Federal agencies are subject to the same requirements as all other employers. The Internal Revenue Code requires employers to pay employment taxes on wages and to report wages and certain other payments on various IRS forms. Federal employment taxes include withholdings related to Federal income, Social Security, and Medicare taxes. Employers are required to make deposits of employment taxes on a daily, weekly, or semi-weekly schedule depending upon the amount of tax they accumulate for deposits.

Employers are also required to file Forms 941, Employer’s Quarterly Federal Tax Return, reporting liability for withholdings related to Federal income, Social Security, and Medicare taxes on a quarterly basis. In addition, as part of the Annual Wage Reporting (AWR) process, employers are required to file Forms W-3, Transmittal of Wage and Tax Statement, with SSA along with copies of Forms W-2, Wage and Tax Statement, for all

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of their employees. Employees must complete Forms W-4, *Employee’s Withholding Allowance Certificate*, so the employer can withhold the correct Federal income tax from their pay.

**Processing SSA’s Payroll**

Beginning with Tax Year (TY) 1998, the Department of Interior’s (DOI) National Business Center (NBC) started processing SSA’s payroll through its Federal Personnel Payroll System (FPPS). For TY 2004, SSA was among 35 Federal entities receiving personnel and payroll services from NBC. As SSA’s payroll provider, NBC is responsible for calculating applicable Federal, State, and local income tax withholdings as well as Social Security and Medicare taxes based on the information entered into FPPS by SSA staff. NBC is also responsible for preparing the quarterly Forms 941 and annual Forms W-3 and W-2 for all its clients and providing year-end interface files containing wage and tax data to its clients. When reporting tax information to the IRS, NBC combines wage and tax information for its clients and reports it under a single Employment Identification Number (EIN).

**SCOPE AND METHODOLOGY**

Our audit focused on Federal employment taxes paid to the IRS on behalf of SSA employees. We reviewed personnel, payroll, and other financial records related to SSA’s employees for TY 2004 to determine whether the appropriate amount of Federal employment taxes were paid to the IRS. We provide a full description of the scope and methodology and the sampling methodology in Appendices F and G.

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3 Employees can file Forms W-4 at any time to adjust their tax withholdings. See Appendix C for a copy of the Form W-4.

4 FPPS is a mainframe-based, on-line, and real time personnel and payroll system. The system provides personnel and payroll support to numerous Federal entities, servicing over 200,000 accounts.

5 See Appendix D for a listing of the 35 Federal entities.

6 NBC uses the FEDTAX II system, which facilitates the electronic payment of Federal taxes by Federal clients. FEDTAX II also enables Federal entities to transmit the Form 941s to the IRS electronically.

7 A detail description and flowchart of the payroll process is included in Appendix E.
RESULTS OF REVIEW

In general, our review found during TY 2004 DOI appropriately withheld and deposited Federal employment taxes for SSA employees. We found DOI properly deposited approximately $856 million related to withholdings for Federal income, Social Security, and Medicare taxes to the IRS on behalf of SSA employees in TY 2004. Moreover, we reviewed 100 sample employee records to ensure correct amounts of Federal income, Social Security taxes, and Medicare taxes were withheld from the sample employees’ pay. We found DOI withheld the proper amount of Federal employment taxes from employees’ pay.

EMPLOYMENT TAXES ON WAGES

Our review found DOI appropriately deposited approximately $856 million in Federal employment taxes to the IRS on behalf of SSA employees in TY 2004. As stated previously, employers are required to deposit Federal income taxes withheld and the employer and employee portions of the Social Security and Medicare taxes. The deposits should be made on a daily, weekly, or semi-weekly schedule depending on the amount of taxes the employer accumulates for deposits.\(^8\) Our review of deposit confirmations for TY 2004 showed DOI deposited about $2.4 billion in Federal employment taxes to the IRS for 35 Federal entities.\(^9\) In our review of the DOI’s Federal Tax Pay Period Collection Reports and supporting schedules,\(^10\) used by DOI to calculate the deposit amounts, we determined SSA’s portion of the $2.4 billion tax liability totaled about $856 million, or 36 percent.\(^11\) A breakout of the $856 million in Federal employment taxes is shown in the following figure.

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\(^9\) While the IRS is in fact being credited with the amount of the tax payments, funds never actually pass through the banking system. Instead, FEDTAX II creates a debit voucher for each Agency Location Code/EIN having reported Federal tax payments for a given day. A deposit ticket, summarizing the total payments made for a given day is created for the IRS. The debit voucher and deposit ticket information is reported to Treasury through CA$HLINK II, which results in an accounting entry into the central accounting system of the United States.

\(^10\) The Federal Tax Pay Period Collection Report is generated from FPPS and summarizes the Federal tax liability amount for each DOI client. DOI provided us with copies of this report as well as supporting schedules for SSA. DOI did not provide us with copies for the reports and supporting schedules for the other 34 Federal entities because the documents included sensitive tax data.

\(^11\) Our review of SSA records showed DOI initially submitted 205,997 W-2s for 35 entities, of which 70,638 W-2s (34 percent) related to SSA employees.
Federal Employment Tax Deposits for SSA
(TY 2004)

To determine whether the $856 million in employment taxes for SSA appeared reasonable, we reviewed the Forms W-2 data reported to SSA as part of the AWR process. Our comparison showed the tax deposits totaled approximately $855,704,000 in employment taxes while Forms W-2 totaled about $855,748,000, a difference of about $44,000. The $44,000 difference primarily related to credits received from the IRS for prior year adjustments for Social Security and Medicare taxes. As a result, we believe DOI paid the appropriate amount of employment taxes to the IRS for SSA employees later reported through the AWR process.

EMPLOYMENT TAX WITHHOLDINGS

Based on our review of personnel and payroll records for 100 sample SSA employees in TY 2004, we found DOI withheld the proper amount of Federal employment taxes from the employees' pay. We performed this test to ensure DOI accurately computed the employment tax withholdings. Our review of the personnel and payroll records for the 100 sample employees—50 employees who submitted Forms W-412 in TY 2004 and 50 employees who did not request a change to their Federal withholdings—showed the following:13

- **Sample Employees with Forms W-4.** The 50 sample employees submitted a total of 85 Forms W-414 during TY 2004 that were processed by SSA Personnel Offices

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12 The employee completes the Form W-4 so the employer can withhold the correct Federal income tax from their pay. Employees have an option to complete a manual or electronic version of the Form.

13 See Appendix G for a full description of the sampling methodology.

14 The 50 sample employees submitted 1 to 11 Forms W-4 during TY 2004.
or through Employee Express,\textsuperscript{15} which is an automated system that allows Federal employees to make discretionary changes to their payroll records.\textsuperscript{16} Based on our review of the Forms W-4 and the employees’ FPPS records, we found SSA properly processed the 85 requests by entering the correct withholdings data into FPPS. Furthermore, to determine if DOI withheld the proper amount of employment taxes from the sample employees’ pay, we calculated the withholding amounts of Federal income, Social Security, and Medicare taxes\textsuperscript{17} for all 50 employees and compared the calculated amounts to the employment tax withholdings shown in the employees’ FPPS records.\textsuperscript{18} We found in all 50 cases, the amounts agreed.

- **Sample Employees without Forms W-4.** For the 50 sample employees who did not submit Forms W-4 during TY 2004, we calculated the withholding amounts of Federal income, Social Security, and Medicare taxes for the last pay period in TY 2004 and compared the calculated amounts to the amount of employment tax withholdings shown in the employees' payroll record. Again, we found the amounts agreed.

**CONCLUSION**

Our review did not disclose any material discrepancies with the amount of Federal employment taxes withheld and deposited for SSA employees in TY 2004. We found DOI properly deposited approximately $856 million in employment taxes to the IRS for SSA employees during the period reviewed. Furthermore, we found DOI withheld the correct amounts of Federal income, Social Security and Medicare taxes from SSA employees’ wages during the period.

\textsuperscript{15} Employee Express is an on-line self-serve program that allows Federal employees to effect certain changes to their payroll/personnel data. Changes made through Employees Express are electronically transmitted to FPPS to update the employees’ payroll/personnel records.

\textsuperscript{16} Of the 50 sample employees, we found 14 submitted a manual Form W-4, while 36 employees submitted an electronic Form W-4 through Employee Express.

\textsuperscript{17} We used IRS Publication 15, *Circular E, Employers Tax Guide*, to calculate the amount of Federal income, Social Security, and Medicare withholdings. We used the Percentage Method to calculate the Federal income tax withholdings because it can be used for any number of allowances claimed by the employee on the Form W-4 and any amount of wages. To calculate the Social Security and Medicare taxes, we used the employee tax rates of 6.2 percent and 1.45 percent, respectively.

\textsuperscript{18} DOI uses a commercial tax package to compute taxes shown in FPPS. The software is a subprogram that interfaces with most payroll systems to calculate U.S. and Canadian payroll withholding taxes.
AGENCY COMMENTS

SSA did not have any specific comments to the draft report. The full text of the Agency’s memorandum is included in Appendix I.

Patrick P. O’Carroll, Jr.
Appendix A

Acronyms

AWR     Annual Wage Reporting
DOI     Department of Interior
EIN     Employer Identification Number
FPPS    Federal Personnel and Payroll System
HRMIS   Human Resource Management Information System
IRS     Internal Revenue Service
MTAS    Mainframe Time and Attendance System
NBC     National Business Center
OIG     Office of the Inspector General
SSA     Social Security Administration
TY      Tax Year

Forms/Numbers

Form 941  Employer’s Quarterly Federal Tax Return
Form W-2  Wage and Tax Statement
Form W-3  Transmittal of Wage and Tax Statements
Form W-4  Employee’s Withholding Allowance Certificate
SF-50    Notification of Personnel Action
SF-52    A Request for Personnel Action
Appendix B

Form 941 Employer’s Quarterly Federal Tax Return

Employer’s Quarterly Federal Tax Return

[Form 941 Employer’s Quarterly Federal Tax Return]

[Instructions]

1. Enter state code for state in which deposits were made only if different from state in which deposit is made.
2. Enter state code for state in which income tax was withheld from wages.
3. Enter state code for state in which income tax was withheld from tips.
4. Enter state code for state in which income tax was withheld from sick pay.
5. Enter state code for state in which income tax was withheld from sick leave.
6. Enter state code for state in which income tax was withheld from social security tips.
7. Enter state code for state in which income tax was withheld from Medicare wages.
8. Enter state code for state in which income tax was withheld from Medicare taxes.
9. Enter state code for state in which income tax was withheld from social security taxes.
10. Enter state code for state in which income tax was withheld from Medicare taxes.
11. Enter state code for state in which income tax was withheld from social security taxes.
12. Enter state code for state in which income tax was withheld from Medicare taxes.
13. Enter state code for state in which income tax was withheld from social security taxes.
14. Enter state code for state in which income tax was withheld from Medicare taxes.
15. Enter state code for state in which income tax was withheld from social security taxes.
16. Enter state code for state in which income tax was withheld from Medicare taxes.

[Form 941 Employer’s Quarterly Federal Tax Return]

[Instructions]

1. Enter state code for state in which income tax was withheld from wages.
2. Enter state code for state in which income tax was withheld from tips.
3. Enter state code for state in which income tax was withheld from sick pay.
4. Enter state code for state in which income tax was withheld from sick leave.
5. Enter state code for state in which income tax was withheld from social security tips.
6. Enter state code for state in which income tax was withheld from Medicare wages.
7. Enter state code for state in which income tax was withheld from Medicare taxes.
8. Enter state code for state in which income tax was withheld from social security taxes.
9. Enter state code for state in which income tax was withheld from Medicare taxes.
10. Enter state code for state in which income tax was withheld from social security taxes.
11. Enter state code for state in which income tax was withheld from Medicare taxes.
12. Enter state code for state in which income tax was withheld from social security taxes.
13. Enter state code for state in which income tax was withheld from Medicare taxes.
14. Enter state code for state in which income tax was withheld from social security taxes.
15. Enter state code for state in which income tax was withheld from Medicare taxes.

[Form 941 Employer’s Quarterly Federal Tax Return]

[Instructions]

1. Enter state code for state in which income tax was withheld from wages.
2. Enter state code for state in which income tax was withheld from tips.
3. Enter state code for state in which income tax was withheld from sick pay.
4. Enter state code for state in which income tax was withheld from sick leave.
5. Enter state code for state in which income tax was withheld from social security tips.
6. Enter state code for state in which income tax was withheld from Medicare wages.
7. Enter state code for state in which income tax was withheld from Medicare taxes.
8. Enter state code for state in which income tax was withheld from social security taxes.
9. Enter state code for state in which income tax was withheld from Medicare taxes.
10. Enter state code for state in which income tax was withheld from social security taxes.
11. Enter state code for state in which income tax was withheld from Medicare taxes.
12. Enter state code for state in which income tax was withheld from social security taxes.
13. Enter state code for state in which income tax was withheld from Medicare taxes.
14. Enter state code for state in which income tax was withheld from social security taxes.
15. Enter state code for state in which income tax was withheld from Medicare taxes.

[Form 941 Employer’s Quarterly Federal Tax Return]

[Instructions]

1. Enter state code for state in which income tax was withheld from wages.
2. Enter state code for state in which income tax was withheld from tips.
3. Enter state code for state in which income tax was withheld from sick pay.
4. Enter state code for state in which income tax was withheld from sick leave.
5. Enter state code for state in which income tax was withheld from social security tips.
6. Enter state code for state in which income tax was withheld from Medicare wages.
7. Enter state code for state in which income tax was withheld from Medicare taxes.
8. Enter state code for state in which income tax was withheld from social security taxes.
9. Enter state code for state in which income tax was withheld from Medicare taxes.
10. Enter state code for state in which income tax was withheld from social security taxes.
11. Enter state code for state in which income tax was withheld from Medicare taxes.
12. Enter state code for state in which income tax was withheld from social security taxes.
13. Enter state code for state in which income tax was withheld from Medicare taxes.
14. Enter state code for state in which income tax was withheld from social security taxes.
15. Enter state code for state in which income tax was withheld from Medicare taxes.
Form W-4 Employee’s Withholding Allowance Certificate

Form W-4 (2004)

Purpose: Complete Form W-4 so that your employer can withhold the correct Federal income tax from your pay. Because your tax situation may change, you may want to refigure your withholding each year.

Exemptions from withholding: If you are exempt, complete only lines 1, 2, 3, 4, and 5 and sign the form to authorize it. Your exemption for 2004 expires February 16, 2005. See Pub. 505, Tax Withholding and Estimated Tax.

Note: You cannot claim exemption from withholding if all your income exceeds $5000 and includes more than 25% of the income of your spouse (if any, except self-employment) and any other persons who can claim you as a dependent on their tax return.

Basic instructions. If you are not exempt, complete the Personal Allowances Worksheet below. The worksheets on page 2 adjust your withholding allowances based on exempted deductions, certain credits, adjustments to income, or two-earner/two-job situations. Complete all worksheets that apply. However, you may claim fewer (or zero) allowances.

Appendix C

Form W-4 Employee’s Withholding Allowance Certificate
Deductions and Adjustments Worksheet

Note: Use this worksheet only if you plan to itemize deductions, claim certain credits, or claim adjustments to income on your 2004 tax return.

1. Enter an estimate of your 2004 itemized deductions. These include qualifying home mortgage interest, charitable contributions, state and local taxes, medical expenses in excess of 7.5% of your income, and miscellaneous deductions. (For 2004, you may have to reduce your itemized deductions if your income is over $142,700 ($71,350 if married filing separately). See Worksheet 3 in Pub. 919 for details.)

<table>
<thead>
<tr>
<th>Itemized Deductions</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage Interest</td>
<td>$7,150</td>
</tr>
<tr>
<td>State and Local Taxes</td>
<td>$4,850</td>
</tr>
<tr>
<td>Medical Expenses</td>
<td>$3,000</td>
</tr>
<tr>
<td>Miscellaneous Deductions</td>
<td>$2,500</td>
</tr>
</tbody>
</table>

2. Subtract line 2 from line 1. Enter “-0-” if greater than zero. Enter “-0-” if less than zero.

3. Enter an estimate of your 2004 adjustments to income, including alimony, deductible IRA contributions, and student loan interest.

4. Enter an estimate of your 2004 nonrefundable credits such as dividends or interest.

5. Subtract line 3 from line 2. Enter the result. Do not use the rest of this worksheet.

6. Divide the amount on line 7 by $3,000 and enter the result here. Drop any fraction.

7. Enter the number from the Personal Allowances Worksheet, line H, page 1.

8. Enter the number from line 1 of this worksheet.

Two-Earner/Two-Job Worksheet (See two earners/two jobs on page 1.)

Note: Use this worksheet only if the instructions under line 4 on page 1 direct you here.

1. Enter the number from line H, page 1 (or from line 10 above if you used the Deductions and Adjustments Worksheet).

2. If line 1 is less than line 2, enter “-0-” on Form W-4, line 5, page 1. Complete lines 4-9 below to calculate the additional withholding amount necessary to avoid a year-end tax bill.

3. Multiply line 7 by line 6 and enter the result here. This is the additional amount to be withheld from each paycheck.

4. Table 1: Two-Earner/Two-Job Worksheet

5. Table 2: Two-Earner/Two-Job Worksheet

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. The Internal Revenue Code requires the information under sections 6104 and 6109 and is subject to the Privacy Act and Paperwork Reduction Act. Failure to provide a properly completed form will result in your being treated as a single person who claims no withholding allowances.

Providing fraudulent information may also subject you to penalties. Returnable uses of this information include applying for federal and state agencies to enforce federal income tax law.

You are not required to provide the information requested on a form if its subject to the Internal Revenue Service’s rules unless the form displays a valid OMB control number. (i.e., if the form contains an OMB control number, it means that it was reviewed and approved by the Office of Management and Budget.)
Appendix D

Listing of Federal Entities

In Tax Year (TY) 1998, the Department of Interior’s National Business Center (NBC) started processing Social Security Administration’s (SSA) payroll through its Federal Personnel Payroll System. As shown below, SSA was among 35 Federal entities receiving personnel and payroll services from NBC in TY 2004.

1. Advisory Council Historic Preservation
2. African Development Foundation
3. Arctic Research Commission
4. Chemical Safety and Hazard Investigation Board
5. Commission of Fine Arts
6. Consumer Product Safety Commission
7. Department of Education
8. Department of the Interior
9. Department of Transportation
10. Equal Employment Opportunity Commission
11. Executive Residence/White House
12. Federal Labor Relations Authority
13. Federal Trade Commission
14. Harry S. Truman Scholarship Foundation
15. Inter-American Foundation
16. James Madison Memorial Fellowship Foundation
17. Millennium Challenge Corporation
18. National Aeronautics and Space Administration
20. National Labor Relations Board
21. National Science Foundation
22. National Transportation Safety Board
23. Nuclear Regulatory Commission
24. Office of Navajo Hopi Indian Relocation
25. Overseas Private Investment Corporation
26. Pension Benefit Guaranty Corporation
27. Presidio Trust
28. Securities and Exchange Commission
29. Selective Service System
30. Social Security Administration
31. Trade and Development Agency
32. United States Holocaust Memorial Museum
33. United States International Trade Commission
34. Utah Reclamation Mitigation Conservation Commission
35. Valles Caldera Trust
Appendix E

Description of SSA’s Payroll Process

When a new Social Security Administration (SSA) employee is hired, he or she must complete a Form W-4, Employee’s Withholding Allowance Certificate, so the correct amount of Federal income tax can be withheld from the wages. A SSA Human Resource Specialist enters into the Department of Interior’s (DOI) Federal Personnel and Payroll System (FPPS), the complete personnel record for the employee, including the job title, Social Security number, grade and salary, number of allowances (via Form W-4), and full or part-time status. A Standard Form 52, Request for Personnel Action, and Standard Form 50, Notification of Personnel Action, are processed by DOI’s FPPS. DOI in turn sends SSA an electronic file to update SSA’s Human Resources Management Information System (HRMIS).¹

At the end of each pay period, SSA enters the employee’s time and leave data into its Mainframe Time and Attendance System (MTAS).² The data is then electronically transmitted to FPPS to generate the employee’s pay. DOI uses a commercial tax package to calculate the applicable Federal, State and local taxes.³ During this process the FPPS master payroll record is updated and FPPS produces an accounting feeder file for the current pay period for SSA employees as well as a Leave and Earnings Statement for each employee. The payroll data is then transmitted electronically by DOI to the Department of Treasury for disbursement. The Department of Treasury transmits direct deposit data to the Federal Reserve, which in turn transmits direct deposit data to various banks nationwide. This data serves as the basis for the issuance of payroll checks and direct deposit payments to SSA employees.

At the completion of the pay period, DOI uses FEDTAX II to deposit Federal employment taxes withheld from employee wages to the Internal Revenue Service (IRS). The Federal employment taxes include Federal income, Social Security and Medicare taxes. DOI reports this data to the IRS at the aggregate level for 35 Federal entities under a single Employer Identification Number. On a quarterly basis, DOI prepares the Form 941, Employer’s Quarterly Federal Tax Return, to report the liability

¹ HRMIS is a computer-based, multi-file personnel records system designed to meet SSA’s needs for data, statistics, and information on the characteristics of SSA’s workforce. HRMIS serves as the database for SSA staffing, promotion plan operations, personnel research and program evaluation, equal opportunity statistics, management information, planning and budgeting for training, internal and external reporting, and position control.

² MTAS is a computerized system for processing pay and leave data pertaining to SSA employees. MTAS allows timekeepers to record time and attendance information indicating the number of hours an employee has worked each day and the hours the employee has been absent.

³ DOI uses a commercial tax package to compute taxes shown in FPPS. The software is a subprogram that interfaces with most payroll systems to calculate U.S. and Canadian payroll withholding taxes.
for the Federal employment taxes for its 35 Federal clients. The Forms 941 are transmitted electronically to the IRS via FEDTAX II. By January 31\textsuperscript{st} of the following year, DOI generates from FPPS the Forms W-2, \textit{Wage and Tax Statements} and sends copies of the forms to each employee and to SSA as part of the Annual Wage Reporting (AWR) process.

Each year, SSA performs the AWR reconciliation, which is a process that compares the Social Security and Medicare wage information employers report to SSA (via Forms W-2), and the IRS (via the Forms 941) to ensure the amounts balance. When more wages are reported to the IRS than to SSA, SSA is concerned that employees' earnings are not recorded correctly in the Agency’s records. SSA examines these cases and attempts to resolve any difference without contacting the employer. When this effort is unsuccessful, SSA sends a notice to the employer, requesting information to resolve the case. If SSA does not receive a response within 45 days, the employer is sent a second notice. When no response is received after the second notice, the IRS is responsible for contacting the employer and may impose penalties, if necessary. When more wages are reported to SSA than to the IRS, the IRS investigates these cases because they could represent unpaid employment taxes.\footnote{SSA, Program Operations Manual System, RM 02070.001 \textit{SSA/IRS Reconciliation Process}.} A flowchart of the payroll process follows:
Start

Employee Completes IRS Form W-4

Transmit Pay to Treasury Department

End

Paycheck to Employee

Transmit Pay to Treasury Department

End

DOI's FPPS

IRS Employment Taxes & Form 941 via FEDTAX II

PAYE Reconciliation

AWR Reconciliation

Form W-2 Employee & SSA

End

SSA's HRMIS

SSA's MTAS
Appendix F

Scope and Methodology

To accomplish our objective, we:


- Reviewed applicable Internal Revenue Service (IRS) regulations and circulars.

- We limited the scope of our review based on prior audit work conducted by independent auditors:
  - SSA’s independent auditors performed internal control testing during Fiscal Year 2005 to determine whether: (1) procedures related to payroll, specifically new hires, were in place and operating effectively; and (2) SSA new hire information in the Human Resource Management Information System was reconciled to the Department of Interior’s (DOI) Federal Personnel and Payroll System (FPPS).

  - DOI’s independent auditors performed internal control testing to evaluate the reliability of the employee withholdings and employer contributions reported in DOI and SSA’s Reports of Withholdings and Contributions for Retirement, Health Benefits, and Life Insurance for 3 pay periods in Tax Year (TY) 2004.

  - DOI’s independent auditors tested controls and operational effectiveness of DOI’s FPPS. The scope of the review covered October 1, 2004 to July 31, 2005.

- Met with staff at SSA and DOI to gain an understanding of the payroll process.

- Reviewed copies of the TY 2004 Forms 941, Employer’s Quarterly Federal Tax Return, DOI submitted to the IRS.

- Reviewed the Federal Tax Pay Period Collection Reports generated from FPPS and supporting schedules for SSA employees.¹

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¹ The Federal Tax Pay Period Collection report is generated from FPPS and summarizes the Federal tax liability amount for each DOI client.
• Reviewed copies of the TY 2004 deposit confirmations generated from the FEDTAX II system.2

• Reviewed the results from the TY 2004 Annual Wage Reporting reconciliation. As part of the reconciliation process, SSA compares Social Security and Medicare wage information employers report to SSA and the IRS via the Forms W-2, Wage and Tax Statements, and the Forms 941.3

• Obtained a listing from DOI’s FPPS of SSA employees who were in pay status during TY 2004.

• Obtained from DOI, a listing of SSA employees who submitted either paper or electronic Forms W-4, Employee’s Withholding Allowance Certificate, during TY 2004. We requested and reviewed leave and earnings statements from FPPS for 100 sample employees and compared this information to the actual Forms W-4. The Forms W-4 were provided by the relevant SSA Servicing Personnel Office. See Appendix G for our sample methodology.

We determined the data used in our audit work was sufficiently reliable to meet the audit objectives. We conducted our audit work from April 2006 to January 2007 in Philadelphia, Pennsylvania. The SSA entity reviewed was the Center for Personnel Management Information Systems and Payroll within the office of the Deputy Commissioner for Human Resources. We conducted our audit in accordance with generally accepted government auditing standards.

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2 NBC uses the FEDTAX II system, which facilitates the electronic payment of Federal taxes by Federal clients. FEDTAX II also enables federal entities to electronically sign and transmit to the IRS the Form 941, Employer’s Quarterly Federal Tax Return.

Sampling Methodology

For Tax Year (TY) 2004, we obtained a listing of Social Security Administration (SSA) employees from the Department of Interior’s Federal Personnel Payroll System (FFPS). The listing included 70,537 SSA employees who were in active status anytime during TY 2004. To focus our analysis better, we divided the population into two groups:

- The first group consisted of 12,709 employees who submitted Internal Revenue Service (IRS) Forms W-4, Employee’s Withholding Allowance Certificate, during TY 2004. We randomly selected 50 employees from this group. We reviewed their FFPS records for the pay period prior to the effective date of the Form W-4 and the pay period immediately following to determine if SSA correctly processed the Forms W-4. Further, we calculated the withholding amounts of Federal income, Social Security, and Medicare taxes for the applicable pay periods to determine whether the correct amounts of Federal employment taxes were withheld from their pay.

- The second group consisted of 57,828 employees who did not submit Forms W-4 during TY 2004. We randomly selected 50 sample employees from this group and reviewed their first and last payroll records during TY 2004 to determine if there were any changes in the amount of Federal income taxes withheld. Further, we calculated the withholding amounts of Federal income, Social Security, and Medicare taxes for the last pay period in TY 2004 to determine whether the correct amounts of Federal employment taxes were withheld from their pay.

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1 FPPS is a mainframe-based, on-line, and real time personnel and payroll system. The system provides personnel and payroll support to numerous Federal entities, servicing over 200,000 accounts.

2 The employee completes the Form W-4 so the employer can withhold the correct Federal income tax from their pay. Employees can file Forms W-4 at any time to adjust their tax withholdings. Federal employees have an option to complete manual or electronic versions of Form W-4. Employees access the electronic version of Form W-4 through Employee Express, an automated system that Federal employees can use to make changes to their personnel and payroll records.

3 Of the 50 sample employees, we found 14 submitted manual Forms W-4 while 36 employees submitted electronic Forms W-4 through Employee Express.

4 We used IRS Publication 15, Circular E, Employers Tax Guide, to calculate the amount of Federal income, Social Security, and Medicare withholdings. We used the Percentage Method to calculate the Federal income withholdings because it can be used for any number of allowances claimed by the employee on the Form W-4 and any amount of wages. To calculate the Social Security and Medicare taxes, we used the employee tax rates of 6.2 percent and 1.45 percent, respectively.
Appendix H

Annual Wage Reporting Reconciliation

In our review of the Social Security Administration’s (SSA) Tax Year (TY) 2004 Annual Wage Reporting (AWR) reconciliation, we found the Department of Interior (DOI) may have underreported Social Security and Medicare wages totaling $230,000 on the Form 941, *Employer’s Quarterly Tax Return*. While the $230,000 represents a relatively small percentage (.001 percent) of the reported Social Security and Medicare wages reported during TY 2004 for all 35 Federal entities, we believe it is incumbent upon DOI to ensure that it accurately reports wage and tax information to both SSA and the Internal Revenue Service (IRS). Under the current AWR reconciliation process, this wage difference is a matter to be resolved between DOI and the IRS.

**RECONCILIATION PROCESS**

As part of the AWR reconciliation process, SSA compares the Social Security and Medicare wages employers report to SSA and the IRS to ensure the amounts balance. This process can identify instances where employers may have under/over-reported the amount of Social Security and Medicare wages, which could result in an under/over-reporting of employment taxes. As of January 2007, the TY 2004 reconciliation showed DOI may have underreported about $230,000 in Social Security and Medicare wages to the IRS (see table below). We determined the underreported wages could potentially represent approximately $22,500 in unpaid employment taxes. We were not able to conclude whether the underreported wages related to SSA because the amounts were reported at the aggregate level for 35 Federal entities and we did not have access to records for the other 34 entities.¹

<table>
<thead>
<tr>
<th>Agency</th>
<th>Social Security Wages</th>
<th>Medicare Wages</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRS</td>
<td>$6,098,775,621.19</td>
<td>$10,297,557,229.51</td>
<td>$16,396,332,850.70</td>
</tr>
<tr>
<td>SSA</td>
<td>$6,098,942,040.93</td>
<td>$10,297,621,193.71</td>
<td>$16,396,563,234.64</td>
</tr>
<tr>
<td>Difference</td>
<td>($166,419.74)</td>
<td>($63,964.20)</td>
<td>($230,383.94)</td>
</tr>
<tr>
<td>Taxes</td>
<td>($20,636.05)</td>
<td>($1,854.96)</td>
<td>($22,491.01)</td>
</tr>
</tbody>
</table>

¹ This difference of approximately $230,000 is not the same as the $44,000 difference cited in the body of the report related to SSA’s employee tax deposits. This earlier difference was simply an adjustment to earlier tax years and did not relate to TY 2004 tax liabilities.
The IRS investigates the discrepancy when higher Social Security and Medicare wages are reported to SSA than to the IRS. According to DOI staff, they made attempts to resolve the discrepancies by submitting three corrected Forms 941 to the IRS from June 2005 to October 2006. Furthermore, we found as of August 2006, DOI submitted numerous corrected Forms W-2 to SSA that adjusted the wage amounts.

2 When more wages are reported to the IRS than to SSA, SSA is concerned that employees’ earnings are not recorded correctly in the Agency’s records. SSA examines these cases and attempts to resolve any difference without contacting the employer. When this effort is unsuccessful, SSA sends notices to the employer, requesting information to resolve the case. If SSA does not receive a response to the notices, the case is referred to the IRS and they may impose penalties, if necessary.
Agency Comments
MEMORANDUM

Date: March 30, 2007

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

From: Larry W. Dye /s/


We appreciate OIG’s efforts in conducting this review. We are pleased that this review found our Agency to be within full compliance with regulations regarding employee tax requirements and payroll procedures. In addition, the review did not disclose any material discrepancies with the amount of taxes deposited with the Internal Revenue Service for SSA employees during the review periods and found the Department of Interior is properly withholding Federal employment taxes for Agency employees.

Please let me know if we can be of further assistance. Staff inquiries may be directed to Candace Skurnik, Director, Audit Management and Liaison Staff, on extension 54636.
Appendix J

OIG Contacts and Staff Acknowledgments

OIG Contacts

Walter Bayer, Director, Philadelphia Audit Division, (215) 597-4080

Cylinda McCloud-Keal, Audit Manager, (215) 597-0572

Acknowledgments

In addition to those named above:

Frank Trzaska, Auditor-in-Charge

Damon Mahoner, Auditor

Mildred Soto, Auditor

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Office of Audit

OA conducts and/or supervises 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 and program evaluations and projects on issues of concern to SSA, Congress, and the general public.

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Office of the Chief Counsel to the Inspector General

OCCIG provides independent legal advice and counsel to the IG on various matters, including statutes, regulations, legislation, and policy directives. OCCIG 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. Finally, OCCIG administers the Civil Monetary Penalty program.

Office of Resource Management

ORM supports OIG by providing information resource management and systems security. ORM also coordinates OIG’s budget, procurement, telecommunications, facilities, and human resources. In addition, ORM is the focal point for OIG’s strategic planning function and the development and implementation of performance measures required by the Government Performance and Results Act of 1993.