

September 2010

SOCIAL SECURITY ADMINISTRATION

Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees



GAO

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Why GAO Did This Study

In 2007, 73 percent of state and local government employees were covered by Social Security. Unlike the private sector where most employees are covered by Social Security, federal law generally permits each public employer to decide which employees to cover. The Social Security Administration (SSA) is responsible for facilitating Social Security coverage for these employers through agreements with states. SSA is also responsible for maintaining accurate earnings records, while IRS is responsible for ensuring Social Security taxes are paid. Because of the need to ensure Social Security coverage is administered accurately, GAO was asked to review (1) how SSA works with states to approve Social Security coverage and ensure accurate coverage of public employees, and (2) how IRS identifies incorrect Social Security taxes for public employees. GAO reviewed procedures of federal agencies and selected states; surveyed all state administrators; and reviewed IRS case files.

What GAO Recommends

GAO recommends that SSA work with IRS, state administrators, and public employers to improve management oversight and monitoring of public employer reporting of Social Security wages and that SSA clarify its guidance on state administrator responsibilities. GAO also recommends that IRS track errors found through compliance efforts and share results with SSA to the extent permitted by law. SSA and IRS reviewed the report and agreed with the recommendations.

View [GAO-10-938](#) or [key components](#). For more information, contact Daniel Bertoni at (202) 512-7215 or bertonid@gao.gov.

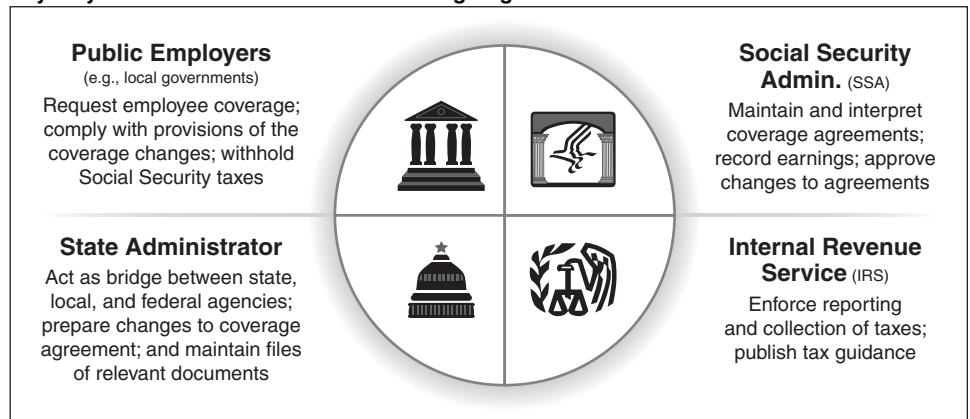
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What GAO Found

Although SSA approves Social Security coverage on behalf of state and local government employers, it faces challenges in ensuring accurate reporting of Social Security earnings. SSA works with states to establish and amend Social Security coverage agreements, but public employers do not always know that SSA's approval is required. For example, a small fire district in one state reported Social Security wages for more than a decade without approved coverage to do so, not realizing a coverage agreement between SSA and the state was required. While state administrators are responsible for managing the approved coverage agreements for public employers, SSA's guidance does not specify how states should go about fulfilling this responsibility, leading to variation in the extent to which states meet their responsibility. SSA lacks basic data on which public employers have approved coverage and relies on public employers to comply with coverage agreements voluntarily. SSA officials told us that the agency does not use existing information, such as lessons learned from prior coverage errors, to assess the risks that these errors pose to the accuracy of public employer wage reporting.

Key Players in the Administration of Coverage Agreements



Source: GAO analysis of agency documents.

IRS conducts compliance checks and examinations of public employers; however, examining Social Security coverage for employees is challenging due to limited data and the difficulties of determining whether employees are covered. To obtain needed data, one IRS field office sent its examiners to the SSA regional office to make copies of Social Security coverage agreements. Some other IRS field offices do not have copies of all their respective agreements. IRS tracks the results of its examinations to identify the number of public employers that need tax adjustments; however, IRS does not track whether the tax adjustments relate to Social Security coverage agreement errors even though this information is available during examinations. SSA could benefit from such information so that it could help public employers identify and correct errors. As a result, IRS's and SSA's ability to fully understand problems related to Social Security coverage is limited.

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Abbreviations

FICA	Federal Insurance Contributions Act
FSLG	Federal, State and Local Governments Office
IRS	Internal Revenue Service
MOU	Memorandum of Understanding
NCSSSA	National Conference of State Social Security Administrators
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration

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United States Government Accountability Office
Washington, DC 20548

September 29, 2010

The Honorable John Lewis
Chairman
The Honorable Charles Boustany, Jr.
Ranking Member
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

The Honorable Earl Pomeroy
Acting Chairman
The Honorable Sam Johnson
Ranking Member
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives

The Honorable John S. Tanner
House of Representatives

Before certain amendments to the Social Security Act were made in 1950, public employees were not covered by Social Security. After 1950, public employers increasingly provided Social Security coverage for their employees, and by 2007, about 73 percent of public employees were covered. Currently, state and local governments, in conjunction with the Social Security Administration (SSA), generally decide whether or not to provide Social Security coverage to their employees who are members of a public retirement system.¹ Every state has an agreement, called a section 218 agreement, with SSA that details which public employees are covered by Social Security. According to SSA and state officials, these agreements ensure that granting Social Security coverage complies with state and federal law, since certain states have laws that prohibit Social Security coverage for certain employees. Great variation exists between states and local governments in terms of which positions are covered by Social Security and which are not. For example, although in the same state,

¹Section 218 of the Social Security Act authorizes coverage for groups of positions of a state or local government employer. The groups can include those positions outside or inside the public employer's retirement system. Thus, a public employer may have coverage for some but not all of its employees.

police in one city may be covered, while police in another city may not be covered. SSA is responsible for maintaining accurate records of Social Security-covered wages, and relies on the state administrators and the Internal Revenue Service (IRS) to help in this responsibility. IRS audits in 2007 found that potentially hundreds of school districts in the state of Missouri had not accurately reported the coverage status of certain part-time teachers and other school staff, resulting in confusion over the Social Security coverage status of these employees, and uncertainty for affected employees.

Because of the need to ensure that Social Security coverage is administered consistent with the requirements of the Social Security Act, we reviewed SSA's procedures for overseeing public employer wage reporting. Specifically, this report addresses (1) how SSA works with states to approve Social Security coverage and ensure accurate coverage of public employees, and (2) how IRS identifies incorrect Social Security taxes for public employees.

To answer these questions, we used a variety of methods to review the procedures of SSA, states, and IRS. To address how SSA works with states to approve Social Security coverage and ensure accurate coverage of public employees, we reviewed relevant federal laws and regulations and conducted interviews with SSA officials in headquarters and all 10 regional offices. We also reviewed the Memorandum of Understanding between SSA and IRS, as well as data from SSA, such as the percent of covered state and local government employees. We administered a Web-based survey and received responses from all state Social Security administrators of the 50 states, Puerto Rico, and Virgin Islands between January and February 2010; interviewed state officials in selected states regarding coverage agreements; and reviewed relevant documents, such as policies and procedures of state administrators.² To address how IRS identifies incorrect Social Security taxes for public employees, we reviewed relevant federal laws and regulations, agency policies, and documents on Social Security and Medicare taxes for public employers. We also conducted interviews with IRS officials in the Federal, State and Local Governments office (FSLG) within the Tax Exempt and Government Entities Division. We also obtained IRS data on examinations and compliance checks completed between fiscal years 2007 and 2009. Finally,

²For purposes of this report, we use the term "states" to include the 50 states, Puerto Rico, and the Virgin Islands.

we reviewed a judgmental sample of FSLG audit files for 10 examinations and 20 compliance checks completed in fiscal year 2009. We did not review state laws or verify information pertaining to state laws that were given to us in the course of our work.

We conducted this performance audit from July 2009 through September 2010 in accordance with generally accepted government auditing standards. Those standards require that 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. See appendix I for additional information about our methodology.

Background

When the Social Security Act was passed in 1935, state and local government employees were excluded from Social Security. As a result, some state and local government workers who were not covered by a retirement system were left without benefits when they retired. To help these employees, in 1950, Congress added section 218 to the Social Security Act allowing states to enter into voluntary agreements to provide Social Security coverage to certain state and local government employees.³ Section 218 authorizes the 50 states, Puerto Rico, and the Virgin Islands to enter into these agreements.⁴ Although under section 218 of the Act, the District of Columbia, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa are excluded from the definition of “state,” employees within these territories can have Social Security coverage under other provisions of the Act. Within a year of this amendment, about 30 states had executed section 218 agreements with the Social Security Administration.

Subsequently, additional amendments to the Social Security Act changed Social Security and Medicare coverage for state and local government

³Pub. L. No. 81-734, § 106 (1950); codified at 42 U.S.C. § 418.

⁴Section 218 also allows interstate instrumentalities to enter into these agreements. An interstate instrumentality is an independent legal entity that is organized by two or more states to carry out one or more functions. For purposes of a section 218 agreement, an interstate instrumentality is governed (to the extent practicable) by the provisions applicable to agreements with states. According to SSA, there are approximately 60 interstate instrumentalities, such as the Port Authority of New York and New Jersey, with a section 218 agreement.

workers. Starting in 1991, the Social Security Act required all state and local government employees to be covered by Social Security if they were not covered by a qualifying state or local retirement system. Table 1 describes some of these amendments relating to the coverage of state and local government workers.

More recently, Social Security has projected future financial shortfalls in its programs. According to Social Security's Board of Trustees, the program's annual surpluses of tax income over expenditures are expected to turn to cash flow deficits this year before turning positive again in 2012.⁵ In addition, all of the accumulated Treasury obligations held by the trust funds are expected to be exhausted by 2037. Once exhausted, annual program revenue will be sufficient to pay only about 78 percent of scheduled benefits in 2037 (and gradually declining to 75 percent by 2084), according to the Social Security trustees' 2010 intermediate assumptions.

Many options have been proposed to help assure the financial stability of Social Security, among them requiring all newly hired public employees to participate in the program. Although this approach could improve Social Security's finances at least temporarily and would simplify Social Security as it pertains to public employees, we have previously reported that such a change could also result in increased costs for the affected governments and their employees.⁶

⁵The Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (Aug. 2010).

⁶GAO, *Social Security: Issues Regarding the Coverage of Public Employees*, [GAO-08-248T](#) (Washington, D.C.: Nov. 6, 2007) and *Social Security: Implications of Extending Mandatory Coverage to State and Local Employees*, [GAO/HEHS-98-196](#) (Washington, D.C., Aug. 18, 1998).

Table 1: Selected Legislative Changes Impacting Social Security Benefits for Public Employees

Law	Description of relevant portion of legislation
Social Security Act Amendments of 1950 ^a	Section 218 was added, which gave states the option of providing Social Security coverage to certain state and local government employees.
Social Security Amendments of 1954 ^b	At state option, state and local government employees covered under a retirement system were allowed coverage under Social Security, if a vote is held.
Social Security Amendments of 1983 ^c	A provision was repealed that had allowed states to terminate the agreement with respect to any coverage group. In effect, states could no longer terminate coverage for covered employees. ^d
Consolidated Omnibus Budget Reconciliation Act of 1985 ^e	Employees hired after March 31, 1986, are mandatorily covered by Medicare Hospital Insurance only, unless specifically excluded by law. For state and local government employees hired before April 1, 1986, Medicare coverage may be elected under an agreement between SSA and states.
Omnibus Budget Reconciliation Act of 1986 ^f	Public employers were required to pay their Social Security payments directly to the IRS rather than to the State Social Security Administrator.
Omnibus Budget Reconciliation Act of 1990 ^g	Starting on July 2, 1991, state and local government employees who were not members of a qualifying state or local retirement system were generally required to have Social Security coverage. ^h

Source: GAO analysis.

^aPub. L. No. 81-734, § 106 (1950).

^bPub. L. No. 83-761, § 101(h)(2) (1954).

^cPub. L. No. 98-21, § 103 (1983).

^dThe state of California challenged the law, arguing it had a contractual right to terminate its agreement and that Congress had violated the takings clause of the Fifth Amendment by denying the state its contractual right without just compensation. The Supreme Court rejected California's argument that the contract had established a property right within the meaning of the Fifth Amendment. *Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapments*, 477 U.S. 41 (1986).

^ePub. L. No. 99-272, § 13205 (1986).

^fPub. L. No. 99-509, § 9002 (1986).

^gPub. L. No. 101-508, § 11332 (1990).

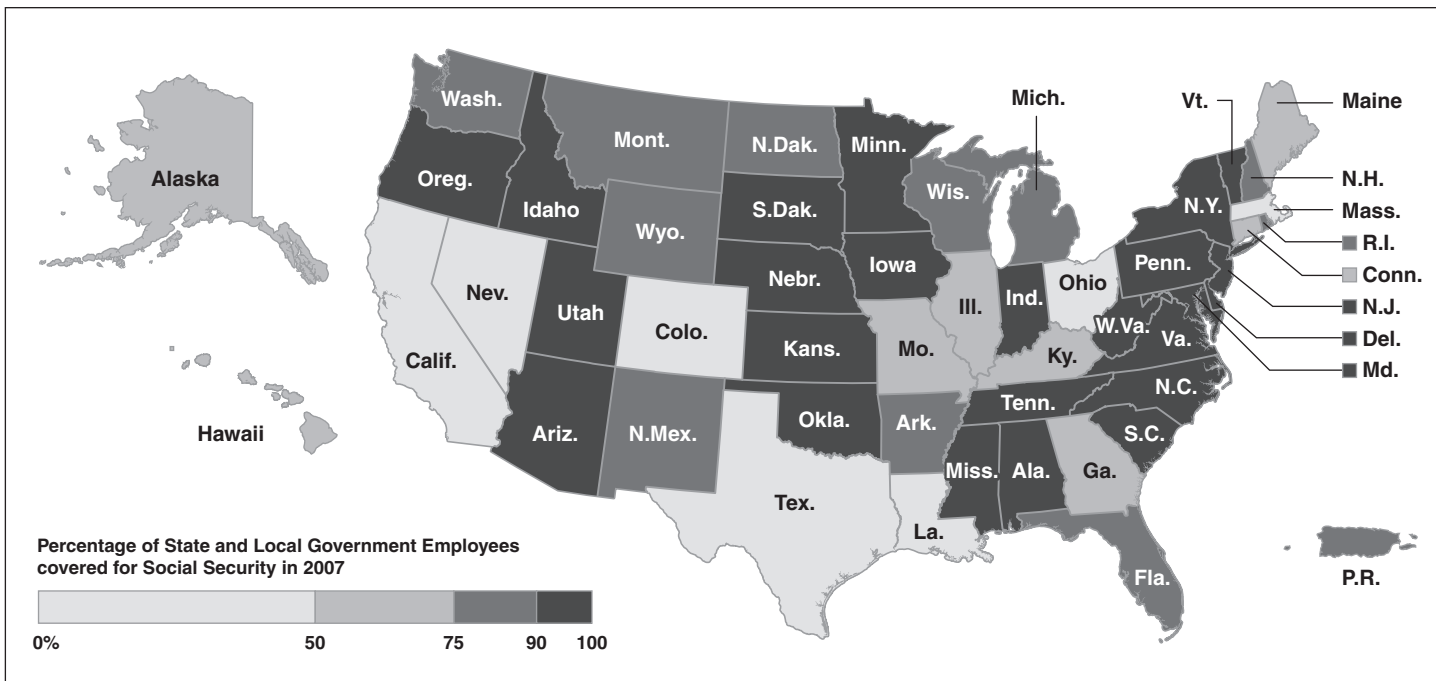
^hIRS rules generally treat an employee as a member of a retirement system if he or she participates in a system that provides retirement benefits, and has an accrued benefit or receives an allocation under the system that is comparable to the benefits he or she would have or receive under Social Security. 26 C.F.R. § 31.3121(b)(7)-2(b).

Social Security Coverage Agreements with States

The extent to which public employees are covered by Social Security varies greatly from state to state. For example, according to SSA data, in Vermont, 98 percent of public employees are covered, but in Ohio, only about 3 percent are covered. Figure 1 shows the variation in Social Security coverage of public employees among states, and appendix II provides the amount of covered and noncovered earnings by employees in each state. Within states, there is also variation in Social Security coverage among public employees working for the same employer. Some public

employers provide a retirement system for some of their employees who meet certain criteria. If employees do not meet these criteria and are ineligible for the retirement system such as a pension system, they are covered by Social Security. In other instances, public employers may choose to provide only Medicare coverage rather than both Social Security and Medicare.

Figure 1: Percentage of State and Local Government Employees Covered in 2007 for Social Security by State



Source: GAO analysis of SSA data; National Atlas of the United States (map).

Note: SSA data did not provide the percentage of covered public employees specifically in the Virgin Islands.

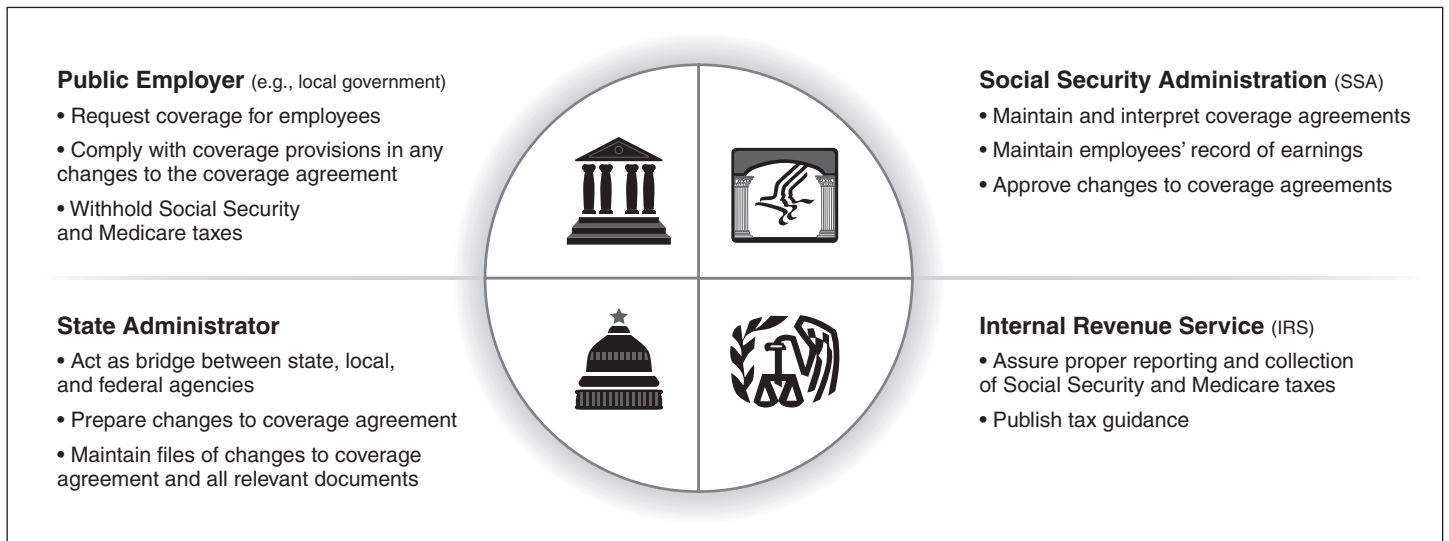
All states have a section 218 agreement with the SSA that allows them to extend Social Security and/or Medicare coverage to designated public employees. With an agreement in force, SSA and the state can coordinate and ensure that granting coverage to public employees complies with applicable state and federal laws, since according to SSA and state officials, state laws can restrict certain employees who are members of other retirement plans from receiving Social Security coverage. SSA requires states to designate a state employee as a state Social Security administrator and establishes the basic roles and responsibilities for these administrators. For example, the guidance outlines that state

administrators should serve as a bridge between state and local public employers and federal agencies, as well as administer and maintain the Social Security coverage agreement.

If public employers within the states wish to extend Social Security coverage to their employees, their state administrator files a draft amendment to the coverage agreement—known as a modification—with their SSA regional office. After the state process is completed and the SSA Regional Office approves the modification, the public employer should begin withholding Social Security and Medicare taxes for the employee positions that are covered and send information on earnings to SSA. SSA is required by law to maintain accurate earnings records for all workers. SSA uses an employee’s earnings record to calculate the amount of Social Security benefits—retirement, disability, or survivor benefits—for an individual or their dependents. Covered earnings, which are posted to the earning record, are subject to Social Security and Medicare taxes paid by employers and employees. IRS is responsible for assuring state and local government employers are properly paying Social Security and Medicare taxes (also known as FICA taxes).⁷ Figure 2 shows the major responsibilities for these government partners.

⁷Federal Insurance Contributions Act (FICA) is a tax on both employers and employees to fund the Social Security and Medicare trust funds. The Social Security tax is 6.2 percent each for employers and employees on earnings up to a maximum amount, which typically increases each year. In 2010, the maximum amount was \$106,800. The Medicare tax is 1.45 percent each for employers and employees on all earnings. 26 U.S.C. §§ 3101, 3111.

Figure 2: Shared Responsibilities for Administering Section 218 Agreements



Source: GAO analysis of agency documents.

How Errors Can Happen: A Synopsis of the Social Security Coverage Errors in Missouri

In 2007, IRS conducted audits in the state of Missouri that identified vulnerabilities to providing Social Security coverage to public employees. In 2003, a retired Missouri teacher, who was not covered for Social Security as a teacher, returned to work as a bus driver. The employee raised questions at a local SSA field office about why she was not covered for Social Security as a bus driver, and this inquiry eventually led to a broad review of the coverage in Missouri's school districts, including a few IRS audits in 2007 to 2008. Missouri's school districts have two separate retirement systems—one pension plan that includes full-time teachers and another that includes full-time nonteachers. According to federal and state officials, each of these pension plans operates under different rules, namely the full-time teachers do not generally have Social Security coverage while full-time nonteachers do. State and federal officials found that, over decades, several changes in state law altered the membership rules of these two pensions, especially the eligibility for part-time employees. The effects of these changes on Social Security coverage were not well understood and contributed to widespread coverage errors in hundreds of districts, according to state and federal documents. For example, some teachers were incorrectly paying Social Security taxes when they were not eligible to receive Social Security coverage. Others were not paying Social Security taxes although they were covered by Social Security. To resolve the coverage errors and determine which positions in school districts had approved coverage, a task force of SSA, IRS, and state officials met several times from December 2008 to February 2009 and issued a report in March 2009.⁸ From 2009 to 2010, SSA and state officials on the task force took steps in Missouri, including educational outreach to school districts, to help these public employers understand the correct Social Security coverage of their employees and to report covered wages accurately starting July 2010. While it is still unknown how many employees were affected, the task force estimated that potentially hundreds of school districts have employees whose earnings records may need to be corrected so that they can receive the benefits to which they are entitled. Since IRS did not collect any back taxes from audited school districts, SSA and IRS officials told us that the U.S. Treasury and Social Security Trust Funds would effectively bear the cost of any long-standing coverage errors and FICA taxes that school districts and employees did not pay.⁹ To date, eight Missouri school districts have already gone through the process with SSA and the state for correcting their coverage under the state's agreement.

⁸Report: *Federal Section 218 Task Force for Missouri School Districts* (Mar. 31, 2009), available at <http://oa.mo.gov/acct/schooldistricts.htm>.

⁹IRS generally has a 3-year statute of limitations for assessing taxes. In the case of Missouri, IRS decided to not pursue back-taxes on audited school districts, partly due to the ongoing research needed to determine which positions were covered and who would be responsible for paying any back-taxes. Instead, IRS focused its resources on correcting the issues prospectively.

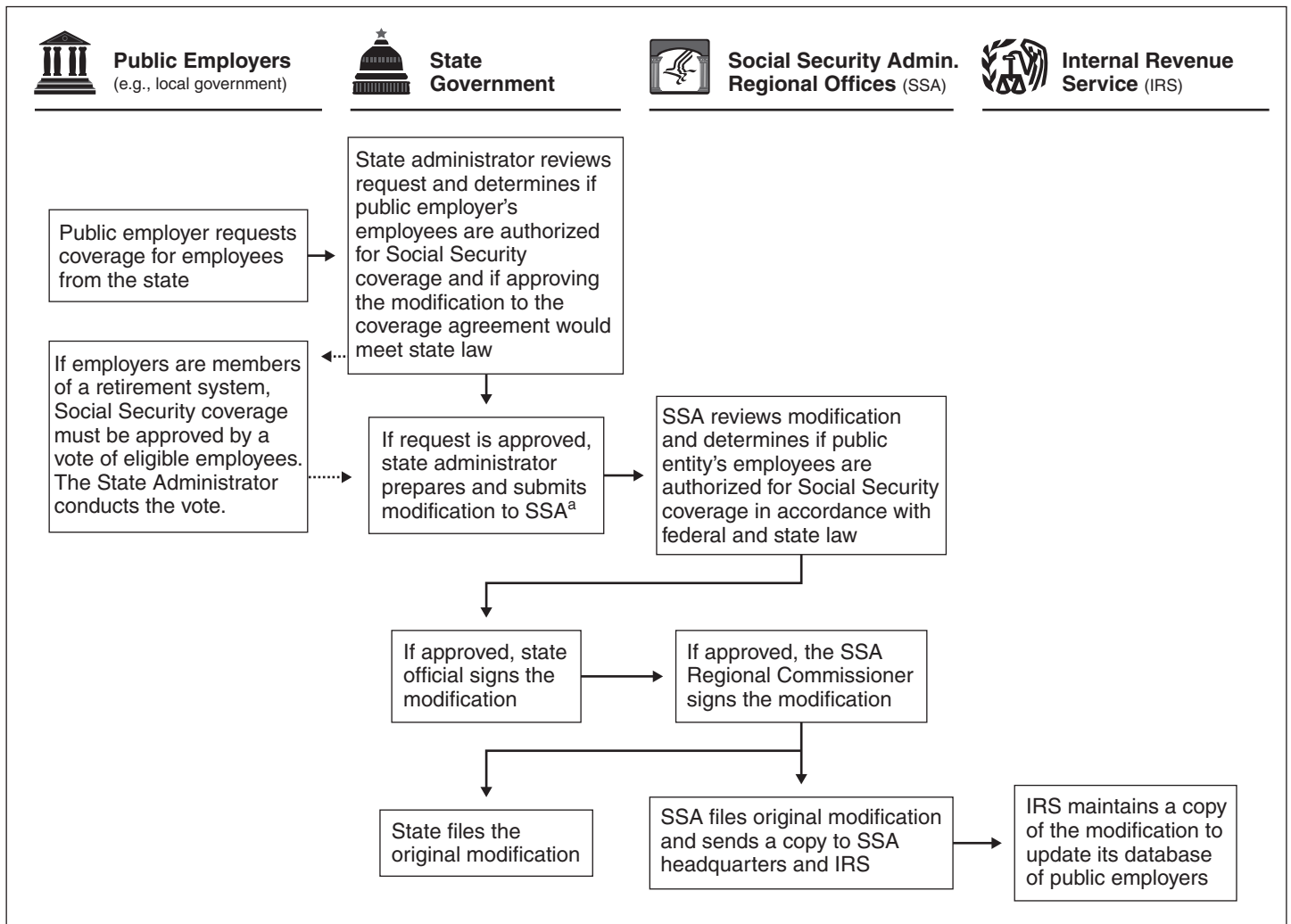
SSA Has a Process to Approve Coverage, but Faces Challenges in Ensuring Accurate Coverage

SSA Works with States to Approve Social Security Coverage, but It Is Unclear If Public Employers Always Know When to Seek Approval

SSA has an established process for working with states to approve coverage. This approval process is intended to ensure that public employers follow applicable state and federal laws regarding Social Security coverage, as some state laws exclude certain types of employees from receiving Social Security coverage, according to SSA and state officials. For example, current New Hampshire law prohibits Social Security coverage for police and fire fighters, who belong to a distinct, more generous pension plan than other public employees in New Hampshire, according to state officials. To obtain Social Security coverage, public employers first contact their state Social Security administrator who files an amendment—known as a modification—to the state’s coverage agreement with SSA.¹⁰ Because all states already have an approved agreement with SSA, any changes to include additional public employers are modifications to the agreement. If the coverage is proposed for employees who are members of a retirement system, then a favorable vote of eligible employees is required. The SSA regional office reviews the modification to ensure that it complies with all relevant laws and procedures. If it is determined these public employees are authorized for coverage, the regional office approves the modification and transmits it back to the state. After coverage has been approved, the public employer begins withholding Social Security and Medicare taxes for the employees in covered positions. Under certain circumstances, SSA may approve retroactive coverage, which is effective prior to the date that SSA approves the modification. Figure 3 shows the modification approval process.

¹⁰According to SSA officials, in some regions, the modification may undergo an initial review at an SSA field office, known as the Parallel Social Security Office, which is usually located in the state’s capital. SSA regional offices should send copies of approved modifications to the Parallel Social Security Office.

Figure 3: Modification Approval Process



Source: GAO analysis of agency documents.

^aA state administrator may send a signed modification to SSA for review.

States may file modifications to their coverage agreement on behalf of public employers under a variety of circumstances. For example, SSA guidance specifies that a state is to amend its agreement to (1) extend coverage to new groups of employees, (2) identify new public employers joining a public retirement system, (3) correct errors in coverage, (4) implement changes in federal or state law, and (5) in very limited circumstances, make certain exclusions to previously covered services or positions. According to our survey of state Social Security administrators,¹¹ we found that administrators in 36 states had approved a modification in the last 5 years. Of these 36 states, the most commonly cited reasons for approving a modification were to include additional coverage groups (23 states), followed by correcting coverage errors (20 states), and notifying SSA of new public employers joining a retirement system that SSA has already approved for coverage on a statewide basis (19 states).¹²

States do not always notify SSA of changes to covered public employers, which can lead to errors in the accuracy of SSA records. Under SSA guidance, state administrators are to provide notice and evidence to SSA when a public employer legally ceases to exist, or dissolves.¹³ Our survey of state administrators showed that SSA does not consistently receive information from states about dissolutions. Only 9 states reported collecting information on all dissolutions among their public employers, while 16 states reported collecting little or none of this information. For example, in one state we visited, over 100 school employees were granted retroactive coverage a decade after their school district had been formed. The new school district was formed by consolidating two school districts that had dissolved, but an amendment to the state's coverage agreement had not been approved at the time of the consolidation to reflect the change. Also, when existing employers legally consolidate, another modification may be necessary to provide coverage for the new consolidated employer. While 11 states responded that they collect

¹¹We sent the survey to the 52 states and territories authorized to enter into coverage agreements with SSA: the 50 states, Puerto Rico, and the Virgin Islands.

¹²This survey question asked state administrators to rank the top three reasons for modifications in the last 5 years. Since respondents could provide more than one reason, the sum of the reasons may exceed the number of respondents (52 states and territories).

¹³A state or local government employer that legally dissolves ends its coverage. This is the only situation that can end coverage approved by SSA. Otherwise, consistent with a 1983 statutory change to section 218, a public employer's coverage cannot terminate.

information on all consolidations that occur among their public employers, 14 states responded that they collect little to none of this information. Another 7 states reported that they did not know how much information they collect on dissolutions or consolidations. If states do not collect information on dissolutions or consolidations, they do not know about these changes to public employers and are unable to work with SSA to approve coverage and prevent errors.

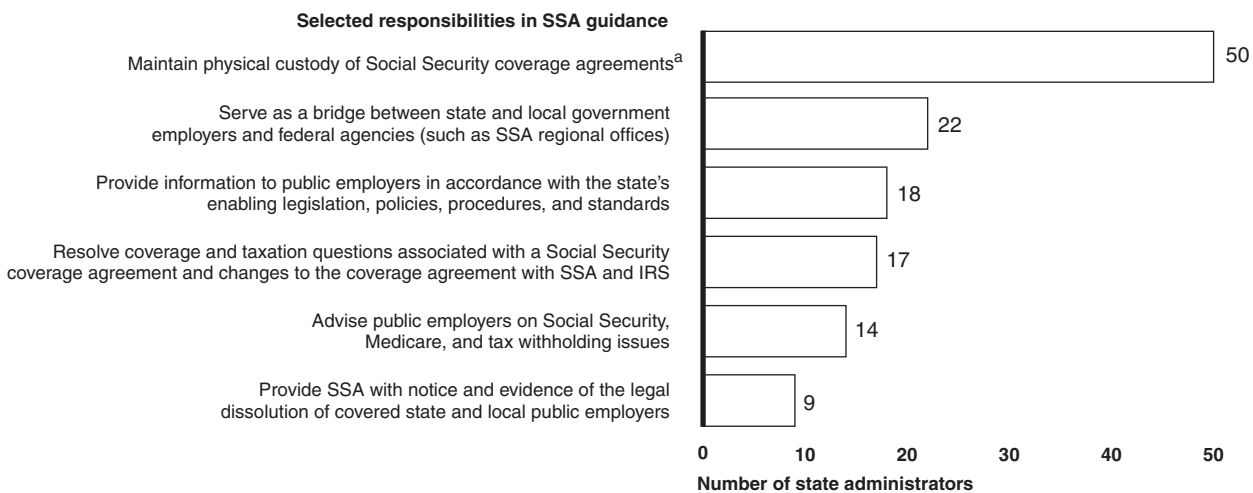
Depending on the circumstances in a particular state, several SSA and state officials told us that states lacking recent modifications may signal that the state or its public employers do not understand the established process for obtaining Social Security coverage approval, or may not be actively overseeing coverage agreements. Our analysis of January 2010 SSA data showed that several states had no modifications approved since the 1990s, while over 20 states received approval as recently as last year. (See app. III for the number and year of the last modification that SSA approved as of January 1, 2010.) In New York, where SSA last approved a modification in 1994, SSA records show that a prior state administrator mistakenly thought that modifications were no longer necessary and did not submit any, despite state actions to consolidate public employers. Similarly, in Missouri, whose last modification had been approved in 1997, several SSA and state officials told us that the state administrator had been inactive until becoming involved to address the widespread coverage errors in many school districts (see text box on page 9). According to officials who resolved the coverage errors in Missouri, the state and school districts did not understand or communicate certain aspects of their coverage agreement. For example, the terms of existing modifications continued to apply to covered positions, even though subsequent state laws expanded the membership of retirement systems for the school districts. Instead of continuing to provide coverage based on the modifications, school districts based their coverage on the subsequent laws, and as a result, the state experienced coverage errors that were found decades after the laws passed.

States Vary in Their Efforts to Implement SSA Guidelines

All states have a state Social Security administrator who is responsible for managing Social Security coverage for both state and local public employers, but state administrators vary in their efforts to implement SSA guidelines. SSA has established the basic roles and responsibilities for these administrators by providing guidance on administering the provisions of the state Social Security agreement (see app. IV). However, SSA's guidance is broad and does not specify how a state administrator should fulfill these responsibilities. As a result, state administrators vary in

the extent to which they meet their responsibilities. For example, while SSA’s guidance notes that state administrators are to administer and maintain the coverage agreement, the guidance does not provide detail on the types of activities that are necessary for meeting this responsibility—such as the frequency with which modifications should be reviewed to determine whether changes to public employers have occurred. For example, as noted above, both New York and Missouri were unclear on their administrative responsibility, resulting in both states being at risk for coverage errors. Additionally, SSA’s guidance notes that state administrators should advise public employers on Social Security, Medicare, and tax withholding issues; and according to our survey, only 14 states reported doing this to a very great or great extent. Likewise, only 18 states reported following SSA’s guidance on providing information to public employers on policies, procedures, and standards to a very great or great extent (see fig. 4).

Figure 4: SSA Guidance Undertaken by State Administrators to a Very Great or Great Extent to Manage Coverage Agreements



Source: GAO analysis of survey results.

^aNumber of state administrators who responded yes to our survey question asking whether they maintain physical custody of the section 218 agreement.

In the absence of more detailed SSA or other guidance on how states should manage Social Security coverage for state and local public employers, the National Conference of State Social Security Administrators (NCSSSA)¹⁴ in 2003 developed a list of recommended practices for use by state administrators. These recommended practices help state administrators to carry out SSA’s guidance. For example, one NCSSSA practice recommends that state administrators maintain an electronic database so that they can meet the SSA guidance on maintaining physical custody of Social Security coverage agreements. While 37 states reported maintaining an electronic database of state and local public employers with Social Security coverage, we found that only 28 of these states’ databases include more detailed coverage information such as the date of each employer’s modifications (see table 2). Moreover, 14 states could not provide the total number of public employers with approved coverage for their employees in their state. We also found differences in the extent to which states review these databases to check for accuracy and completeness. Of the 37 states with an electronic database, 5 states reported not updating their information and 1 state did not know how often they updated their database information. Further, only 7 states reported taking all of the following steps to ensure the information was reliable: conducting routine monitoring of the data, using edit checks to identify out-of-range entries, and verifying the data for accuracy.

Table 2: Number of State Databases That Include Certain Types of Information

Type of information included in state databases	Number of state databases that contain this information
List of all noncovered public employers	6
List of all covered public employers ^a	32
More detailed data on all covered public employers (e.g., date of modification, groups covered, etc.)	28

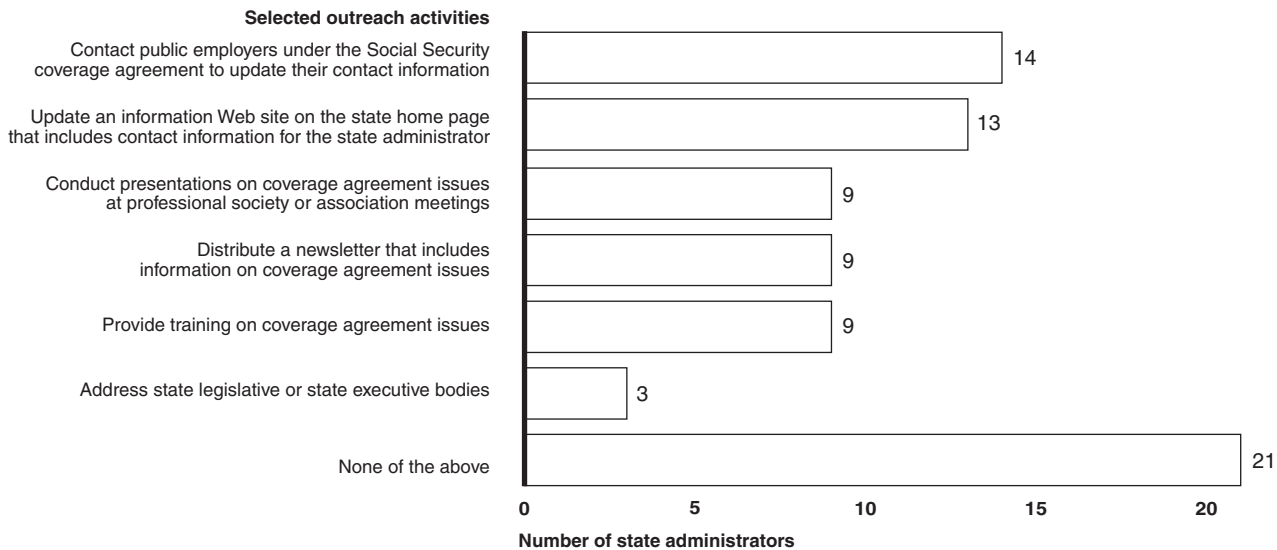
Source: GAO analysis of survey results.

^aFor the purposes of our survey and this report, we defined “covered public employer” as a state or local government employer that is subject to a coverage agreement for at least some of the employer’s positions.

¹⁴The National Conference of State Social Security Administrators (NCSSSA), an association of state administrators, was formed in 1952 to provide leadership to state and local public employers on Social Security, Medicare, and employment tax issues.

SSA's guidance also sets forth that state administrators are to provide certain information or advice to public employers, but falls short in denoting specific ways such outreach activities can be carried out, such as the format for distributing information and time frames for carrying out such activities. For example, one state administrator told us that he regularly attended local public employer association conferences so that he could identify new public employers and provide advice to them. However, officials in another state told us that they did not have any formal outreach practices and updated their information on new public employers when they read about them in the newspaper. As a result, the state administrator could not ensure that its list of public employers was current. While SSA's guidance is limited, NCSSEA has developed recommended practices for conducting outreach efforts to public employers, such as presenting at local association meetings, providing information via a Web site or newsletters, or pursuing other means of outreach. Such efforts can help states educate and respond to questions about coverage agreements. According to our survey, nine states reported regularly (i.e., at least annually) distributing a newsletter or providing training, while just over one-quarter of states contact public employers included in coverage agreements to update their information (see fig. 5). In contrast, 21 states reported that they do not conduct any of these outreach activities. Ten of these states have nearly universal Social Security coverage for their public employees and four states had less than half of their public employees covered by Social Security.

Figure 5: Types of Outreach Activities Conducted by State Administrators at Least Annually to Assist Public Employers



Source: GAO analysis of survey results.

The variation in how states implement the activities outlined in SSA guidance can also be explained in part by the training, experience, and staffing of state administrators. Some state administrators reported they were initially unfamiliar with coverage agreements and noted there was little or no transfer of knowledge to help them learn about coverage issues. Twenty-seven administrators reported receiving little or no training from their predecessor. Of those administrators who had not received training, 93 percent had never worked on Social Security coverage issues at all prior to becoming the administrator. Administrators cited several reasons for the lack of training or knowledge-sharing by predecessors, including classification of these positions (e.g., political appointees), turnover among staff, and lack of funding.

To address this training gap, NCSSSA developed a training module which they recently began providing to state administrators. As of July 2010, 11 state administrators have received this training, according to NCSSSA officials we interviewed. Additionally, in our survey, the availability of staff with expertise in coverage agreements was identified as a great or very great challenge by 19 states. Differences in the amount of time dedicated to the position of state administrator also varied among states. Most state administrators view the role as an ancillary responsibility, and not as their primary duty. Over half of those working as state

administrators reported spending 10 percent or less of their time on state administrator responsibilities.

SSA Has Limited Management Oversight of Public Employee Wage Reporting

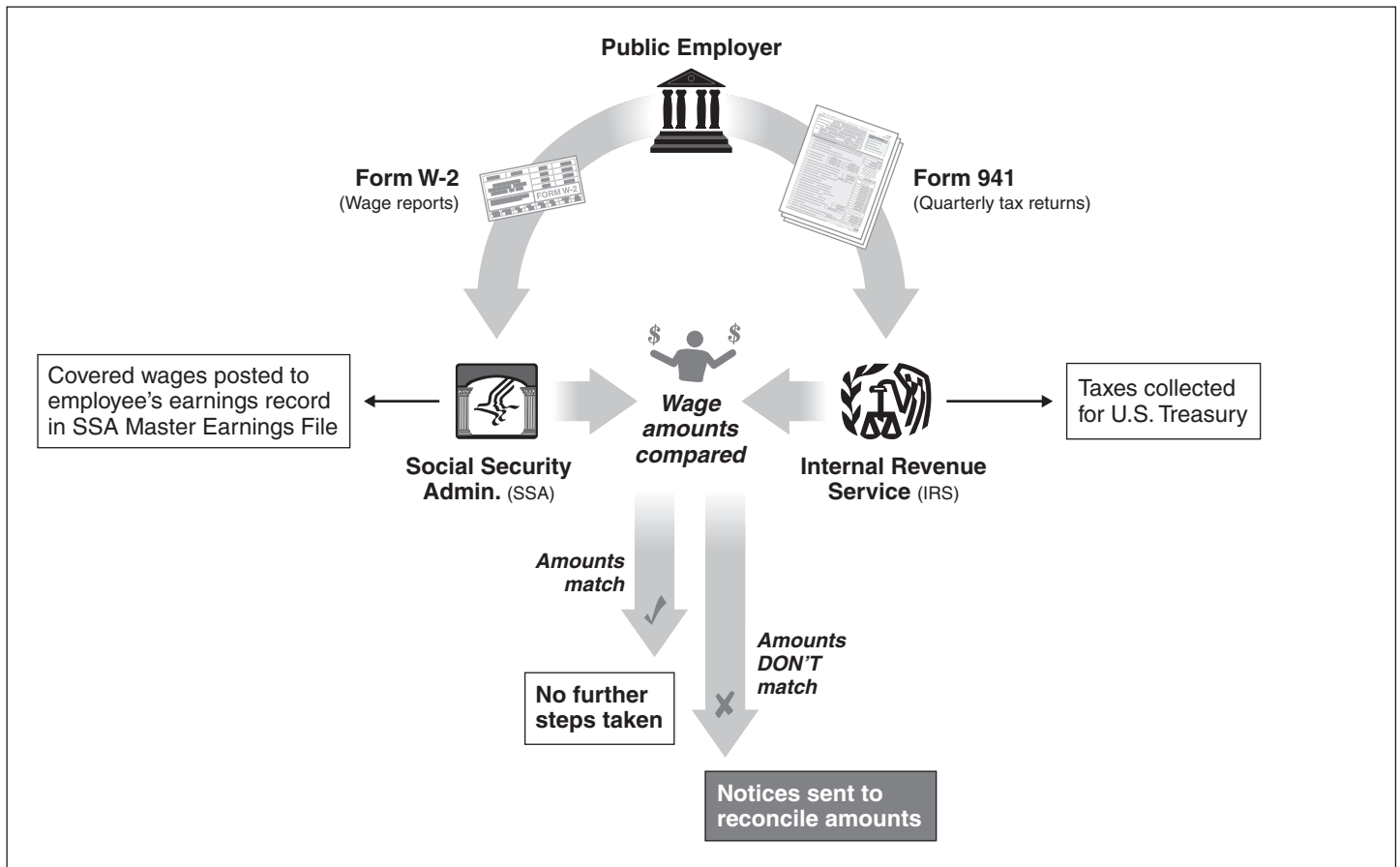
SSA relies primarily on public employers to correctly interpret their coverage and accurately report covered wages of public employees, according to SSA officials. However, some public employers do not understand that a modification to the state's agreement with SSA is required before amending coverage under section 218 and reporting Social Security wages. For example, a small fire district in one state reported Social Security wages for more than a decade without approved coverage to do so, not realizing coverage under an agreement between SSA and the state was required. Several SSA officials told us that they also rely on IRS to review the compliance of public employers.

The Social Security Act requires SSA to ensure that all workers have accurate earnings records. SSA requires employers—public and private—to use SSA's process of wage reporting (see fig. 6) to report Social Security covered wages. In 2007, private and public employers reported nearly \$5 trillion in covered wages, with public employers representing \$528 billion of that amount. (See app. II on covered and estimated noncovered wages for state and local government employment in 2007.) The Form W-2 is the annual report of a worker's wages, including wages covered for Social Security and for Medicare. SSA posts the wages to the employee's earnings record on its Master Earnings File and provides IRS with the W-2 information so IRS can monitor accurate payment of Social Security taxes. SSA and IRS annually match the amounts on Form W-2 with wages that employers report to IRS on a quarterly basis.¹⁵ When the amounts match, no further steps are taken. When the amounts do not match, SSA and IRS have processes to reconcile the amounts, including letters to contact the employer.¹⁶

¹⁵The quarterly tax return for employers is generally the Form 941.

¹⁶For more information on the annual reconciliation process, see SSA, Office of the Inspector General, *The Social Security Administration's Wage Reconciliation Process With the Internal Revenue Service*, A-03-08-18069 (June 16, 2009).

Figure 6: Wage-Reporting and Tax Payment Process of SSA and IRS



Source: GAO analysis of SSA and IRS documents.

SSA does not have a process to ensure that public employers only report wages for covered employees and that such wages are associated with valid coverage under the state’s coverage agreement. As long as the wage amounts on the Forms W-2 and 941 match, SSA does not follow up to ensure that reported wages actually reflect public employees who are covered by their state’s agreement. SSA officials told us the agency does not compare the reported wages with coverage modifications applicable to the employer. While wage reports identify employees by their name and Social Security number, procedures and data do not exist to verify that employees are in positions that are covered by their state’s agreement. SSA regional officials told us they answer questions by public employers about whether employees are covered based on their interpretation of

coverage agreements. However, SSA officials are not able to check if the public employers correctly report covered earnings.

While SSA does not currently monitor the accuracy of public employee coverage, prior to 1987, SSA conducted regular oversight activities to ensure more accurate reporting. Prior to 1987, state administrators gathered Social Security payments in lieu of FICA taxes from public employers with approved coverage. States were therefore accountable for payments from public employers and employees in their state. SSA was responsible for ensuring that state and local government employers made the correct payments for the Social Security Trust Funds. Given its responsibility, SSA conducted compliance reviews and collected data on public employers, such as lists of which public employers were part of the coverage agreement. In 1987, a legislative change took effect requiring the IRS to collect Social Security taxes from public employers and employees directly.¹⁷ As a result, public employers were required to withhold Social Security taxes from their employees and pay taxes to the Treasury using the same procedures as private sector employers. SSA and the states reduced staffing, management attention, and oversight of coverage agreements. SSA also reduced its oversight of public employers, including discontinuing compliance reviews and ending certain data collection. In 1996, SSA's Inspector General found that many public employers were at risk of not complying with their states' coverage agreements, partly due to SSA's reduced focus on administration after this statutory change.¹⁸ The Inspector General recommended that SSA pursue regular compliance reviews; develop a Memorandum of Understanding (MOU) with IRS; and study the possibility of universal coverage of public employers to eliminate the inherent complexity of their coverage. In 2002, SSA and IRS signed an MOU regarding the compliance of state and local government employers that specified each agency's role, including IRS's responsibility to conduct compliance reviews of public employers. Among other things, the MOU established a joint SSA-IRS committee to share information on policies, procedures, and compliance issues.

SSA continues to lack basic data on the public employers for which it has approved coverage, preventing the agency from monitoring potential errors. According to *Standards for Internal Control in the Federal*

¹⁷Pub. L. No. 99-509, §9002 (1986).

¹⁸SSA, Office of the Inspector General, *Social Security Coverage of State and Local Government Employees*, A-04-95-06013 (Dec. 13, 1996).

Government, data are important for an agency to manage its operations and measure its activities.¹⁹ However, SSA does not track the number of public employers that are under a state’s approved coverage agreement or various activities that could expose public employers to greater risk of committing coverage errors. From data given to us by all 10 SSA regions, we estimated that since 1951 when coverage agreements began, SSA has approved as many as 28,798 modifications extending Social Security coverage for public employers. (See app. III for information on the number and year of the last modification approved by SSA for each state as of January 1, 2010.) However, 6 of 10 SSA regional offices no longer collect any information on which public employers have approved coverage, and SSA officials told us they have not required regional offices to update their data, partly due to resource constraints. SSA has also not provided the regional offices with guidelines for what should be collected and how. As a result, six regions currently collect no data at all, while the four regions still collecting data varied in the data formats and level of detail of the information collected. For example, based on data we reviewed from regional officials, one region had a database with details on public employers and their coverage, while another region had a list with little information other than the names of public employers and the date that SSA approved coverage.

Without comprehensive and uniform data, SSA may miss opportunities to prevent or more quickly correct errors related to public employee wages. For example, if all regions tracked information such as recent approved modifications, SSA could better identify which states had less activity, and could follow up to ensure that those states and public employers were aware of the circumstances that would warrant filing a modification. In addition, SSA is unable to fully support IRS in its efforts to ensure compliance. For example, SSA does not validate IRS’s database of public employers—including covered employers—which may not always contain correct data. Moreover, the lack of current or consistently tracked data can limit the efficiency with which regions research or answer questions about a particular employer. For example, one SSA regional office official said that in order to identify a modification with information relevant to a particular employer, it takes up to an hour to manually search paper files for any modification made after 1987.

¹⁹GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

Officials in nearly all 10 SSA regions told us their oversight efforts to ensure accurate reporting of public employers generally involve reacting to errors or questions brought to their attention. When a concern is identified, SSA regional officials respond to address the coverage of a particular employer based on specific facts and circumstances. For example, IRS conducted an audit of a public port and worked with SSA to determine whether the employer had covered employees, according to SSA officials and documents. SSA determined that the employer's predecessor had a modification for coverage, but the new employer did not have coverage for its full-time employees. SSA assisted the state and the employer to file a modification that would retroactively grant coverage to these employees. Had SSA actively worked with the state and used data to observe trends with modifications, the state and SSA may have prevented this error or caught it sooner.

SSA has also been asked to resolve errors involving public employers that are subject to a modification, but these employers and their employees have not paid Social Security taxes. If SSA was notified of the error and evidence of employees' earnings was produced by employers or employees, SSA officials told us that the agency would correct their earnings records. IRS is authorized to collect back-taxes subject to its statute of limitations, which is generally 3 years.²⁰ Unfortunately, some of the coverage errors in Missouri school districts involved public employers and employees who stopped paying Social Security taxes in the 1980s. Thus, the U.S. Treasury and Social Security Trust Funds effectively bear the cost of any taxes employers or employees did not pay beyond the 3-year statute of limitations, according to SSA and IRS officials. Similarly, if an error goes undetected or uncorrected, then public employees may not have Social Security earnings posted to their record. This could result in employees who should be covered by Social Security not becoming eligible or not receiving the appropriate amount of Social Security benefits in the event of retirement, disability, or survivorship.

SSA officials told us that the agency does not use existing information to assess the extent to which coverage errors are occurring and the risk that these errors pose to the accuracy of public employer wage reporting. According to *Standards for Internal Control in the Federal Government*, risk assessment is the identification and analysis of relevant risks

²⁰IRS generally has a 3-year statute of limitations for assessing additional taxes.

associated with achieving the agency's objectives.²¹ SSA has many internal and external sources of information it could use to assess the risks of inaccurate coverage of public employees. However, SSA headquarter officials told us that SSA may not be aware of all errors or related factors that regional offices address, unless they are elevated to headquarters for assistance. SSA officials in headquarters and regional offices generally told us that SSA in recent years has not routinely shared experiences across regions, including lessons learned from coverage errors and factors that contribute to them. For example, one SSA regional office helped resolve a coverage problem that involved a consolidation of a state's capital city and the county in which it was located. Because the public safety officers of the city were not covered while the public safety officers of the county were covered, the consolidation had the potential to change the Social Security coverage of some public safety positions. Under current budgetary pressures, some states are considering or pursuing similar consolidations to reduce costs; however, SSA headquarters did not share lessons learned from this example with other regions so that they could be better prepared to address similar issues in the future. SSA headquarters also does not routinely review internal legal opinions—known as coverage determinations—or modifications that SSA regional offices have approved to correct coverage errors. SSA officials told us that they have not analyzed such information in a systematic approach to identify any patterns or common issues. Also, SSA officials in 8 of 10 regions told us that IRS does not typically share the results of its enforcement activities, and IRS officials agreed. As a result, SSA is not always aware of the coverage errors that IRS finds during examinations and compliance checks.

SSA hosted a conference in April 2010 with IRS and state administrators to explore options for improving how coverage agreements are administered. Based on this conference, SSA identified possible proposals to reduce the complexity of public employees' coverage, including the potential for universal coverage. It also formed 11 committees consisting of SSA and state or IRS officials. Each week, at least one committee is supposed to meet, and quarterly conference calls are planned for all participants to discuss their progress starting in September 2010. According to SSA, two committees are of the highest priority: the committee to improve training

²¹According to *Standards for Internal Control in the Federal Government*, risk assessment may include qualitative and quantitative approaches, such as ranking risks, conducting planning sessions, or other methods.

of federal, state, and local governments, as well as the committee on policies and procedures. A list of the 11 committees and their objectives is in appendix V.

IRS's Compliance Efforts Are Limited by a Lack of Social Security Coverage Information

IRS Is Responsible For Ensuring Public Employers Pay Social Security Taxes but Determining Coverage Is Challenging

Since 1987, IRS has been the primary agency responsible for ensuring that public employers are accurately paying Social Security and Medicare taxes, and its level of enforcement has increased over the years. According to IRS officials, IRS performed limited enforcement work during the first 10 years after they became responsible for receiving public employer Social Security taxes. In 1997, IRS started a state and local government compliance initiative to provide outreach to public employers. In fiscal year 2000, IRS created the Federal, State and Local Governments office (FSLG) to facilitate more accurate reporting and collection of Social Security and Medicare taxes by public employers, among other activities. Initially, FSLG allocated most of its time to educational activities, but in fiscal year 2004 began to focus more on enforcement activities.

IRS's enforcement program consists of compliance checks and examinations. IRS reviews selected employers each year, based partly on its workload and staff availability. A compliance check is a method of reaching out to public employers, and is intended to be educational. Compliance checks review public employer tax returns and are typically less detailed than an examination. Generally, compliance checks are performed on smaller public employers, partly to allocate IRS enforcement resources. By conducting compliance checks on smaller employers, IRS can review and educate a greater number of public employers, while still allocating staff time and resources to conduct more time-consuming examinations on larger, more complex public employers. For compliance checks, IRS completes a checklist of selected employment tax areas. Our review of the checklist found that it includes four questions about Social Security coverage agreements: (1) Does the taxpayer have an agreement? (2) Does the taxpayer have a copy of the agreement? (3) What are the number, date, and description of the modification to the

agreement? (4) What categories of workers are excluded from Social Security coverage? If issues are found during the compliance check, IRS provides the employer with a discrepancy letter identifying problems to be resolved. We reviewed a nongeneralizable sample of 20 compliance checks completed in fiscal year 2009 that IRS identified as having issues related to Social Security coverage agreements. In 11 of these cases, the public employer was not covered under the state's Social Security coverage agreement. In 6 of the other cases in which the state or local government employer was actually covered under the state's coverage agreement, IRS found that the employer did not have a copy of its modification and in one of these cases, the employer did not know one was in effect. In another case, a school district that was covered under its state agreement dissolved, and then combined with another school district that also was subject to a modification. The school district being reviewed was not certain if the coverage agreement was still in effect and planned to contact the state Social Security administrator to determine if a new modification was necessary.

IRS also has the authority to conduct examinations of public employers' records to determine the correct tax liability. Unlike compliance checks, examinations are in-depth, formal audits that may result in a tax assessment. Examinations review many areas, including proper Social Security withholding, fringe benefits, and public retirement systems. For each examination, the IRS examiner is supposed to obtain information about the applicable Social Security coverage agreement and determine the employees that are covered. In making its coverage determination, IRS examiners have to review employer records and may informally contact the state administrators and SSA. Figure 7 shows the basic procedures IRS uses to determine if public employees are covered by Social Security or Medicare. Generally, examinations are performed on larger public employers, and took an average of almost 9 months in fiscal year 2009 to complete. If errors are found, IRS can either make a tax assessment for the amount owed by the employer or, among other things, refund an overpayment.²² Generally, IRS does not provide information about its enforcement activities to SSA or state administrators. IRS is subject to statutory provisions that generally prevent it from disclosing taxpayer information unless there is an exception authorizing disclosure in the

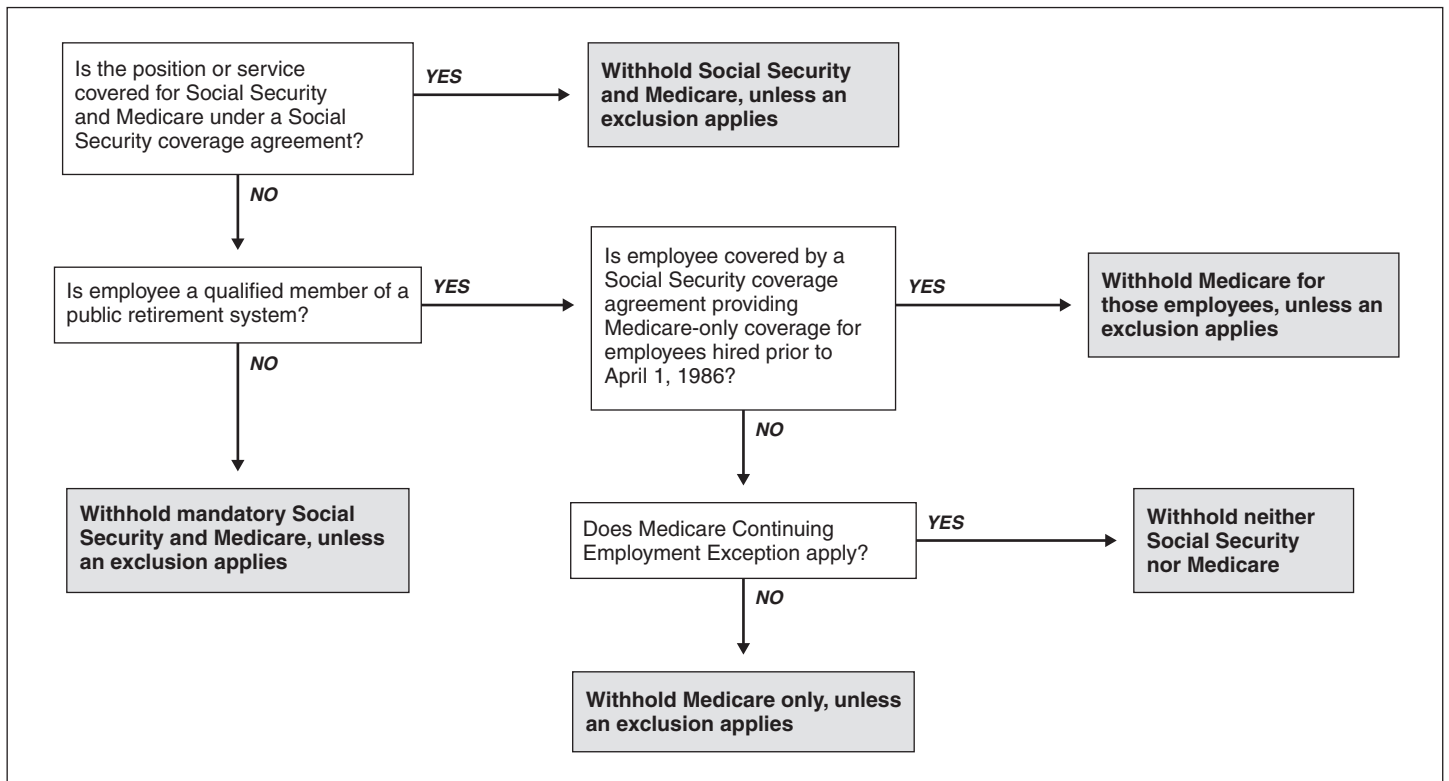
²²IRS generally has a 3-year statute of limitations for assessing taxes. In addition, when a taxpayer files for a tax refund, generally only the taxes paid in the preceding 3 years can be refunded.

law.²³ One such exception is for purposes of administering certain portions of the Social Security Act, in which case the information can be disclosed to SSA upon a written request.²⁴ The MOU between IRS and SSA states that it serves as such a request, but IRS still does not generally tell SSA about its examinations and compliance checks because, according to IRS officials, many of its examiners are not aware of the MOU. According to IRS officials, state administrators do not have an exception to the disclosure requirements so the agency is prevented from providing information to them.

²³26 U.S.C. § 6103.

²⁴26 U.S.C. § 6103(I)(1)(A).

Figure 7: Determining Social Security or Medicare Coverage of State and Local Government Employees



Source: IRS Publication 963, Federal-State Reference Guide.

Note: The Medicare Continuing Employment Exception provides that state and local government employees hired prior to April 1, 1986, are exempt from mandatory Medicare taxes, if they meet certain requirements.

IRS Has Limited Information about Public Employers' Social Security Coverage but Is Working to Obtain Additional Information

IRS receives limited information about public employers' Social Security coverage. Employers are generally required to submit quarterly tax returns to IRS providing information on wages and Social Security and Medicare taxes paid.²⁵ According to an IRS official, IRS started to receive copies of coverage modifications from SSA around fiscal year 2000, but IRS generally does not distribute copies of the modifications to all field offices. To obtain a complete set of modifications, IRS officials in one field office told us they went to the SSA regional office and duplicated them. Although some IRS offices lack a complete set of modifications, the agency maintains a database of public employers and over half of these employers are designated as being covered under a Social Security coverage agreement.

To increase its knowledge about state and local government employers' Social Security coverage, in 2009, IRS developed an assessment document designed to identify states with potential coverage problems. The assessment document is filled out by IRS officials and the state administrator and is intended to capture general information such as the name of the state administrator and staff, and the applicable SSA and IRS officials responsible for that state. The assessment also requests the number of modifications and if the state maintains a list of employers covered under its coverage agreement. Ultimately, IRS plans to use the information obtained to identify states needing outreach and education. By October 2009, IRS had developed a draft document and later obtained and incorporated input from SSA and NCSSSA officials. IRS pilot tested it in January 2010 and, according to an IRS official, started using the document in all states in July 2010. IRS officials noted that they intend to use the document as the basis for continued communication, outreach, and enforcement.

In addition, from 2008 to 2010, an advisory committee to IRS developed a detailed self-evaluation document for public employers to assess their own compliance. The self-evaluation document expands on the IRS checklist used in compliance checks to include understandable information on employment tax requirements, including Social Security and Medicare taxes. IRS plans to refine and post the document on its Web site by the end

²⁵ According to IRS officials, some public employers are not required to submit quarterly tax returns. Some employers do not pay wages either due to staff volunteering their time or the use of contracted workers. Others may file a consolidated quarterly return rather than separately for each quarter.

of 2010 in an attempt to enhance voluntary compliance by public employers.

IRS Is Evaluating Its Case Selection Process and Results of Its Compliance Checks and Examinations

In 2006, the Treasury Inspector General for Tax Administration (TIGTA) issued a report that reviewed IRS's FSLG workload selection process and identified issues related to tracking the effectiveness of the indicators used to select cases for review and to analyzing the results of compliance checks.²⁶ IRS utilizes 14 indicators to select cases for review from over 103,000 state and local government employers. One indicator is used to identify issues related to Social Security coverage by computing the ratio of Social Security wages to total wages paid.²⁷ Under this computation, a lower ratio of Social Security wages to total wages increases the chances that an employer is selected for review. However, a low ratio may not always indicate noncompliance with the state's Social Security coverage agreement. For example, a Social Security coverage agreement may not include some employees and would result in a lower ratio of Social Security wages to total wages paid. TIGTA found that IRS was not systematically analyzing the effectiveness of its selection process. The TIGTA report said that, with this information, IRS could identify more productive indicators and provide baseline measures of the levels of noncompliance identified. IRS officials told us that they are currently conducting a special analysis of the indicators used for its examinations and compliance checks conducted in 2006, 2007, and 2008, and hope to complete this analysis by 2011.

In 2006, TIGTA also found that IRS was not analyzing the results of completed compliance checks to identify common issues found during reviews, and our recent work found that IRS still does not routinely conduct such analysis. For compliance checks, IRS tracks the number of employers that were issued a discrepancy letter, but not the number that had issues related to Social Security coverage. In fiscal years 2007 to 2009, IRS issued discrepancy letters to over 79 percent of the public employers that had a compliance check. However, IRS does not know what percent of the employers did not comply with their state's Social Security coverage agreement. In 2009, IRS performed a special analysis of its 2008

²⁶Treasury Inspector General for Tax Administration, *The Federal, State, and Local Governments Office Can Improve the Workload Selection Process to Increase Effectiveness*, 2006-10-073 (Apr. 28, 2006).

²⁷Another indicator involves Medicare wages.

compliance checks to determine the issues found during the year. IRS found that 4.1 percent of all of its closed compliance checks had Social Security coverage issues. In 2006, TIGTA concluded that by analyzing the results of its compliance checks, IRS could identify common issues and focus its work for future compliance checks. IRS is currently conducting a special analysis of the results of its compliance checks, as well as its examinations conducted in 2006, 2007, and 2008. It plans to use this information and information from other special projects to identify the most common areas of noncompliance. IRS will then provide focused outreach to state and local government employers to address these areas. This outreach could include publishing articles in the IRS newsletter or other industry journals. IRS officials told us that they anticipate completing this analysis by 2011.

Table 3 provides information on the number of compliance checks completed and discrepancy letters issued in fiscal years 2007 to 2009.

Table 3: Fiscal Year 2007 to 2009 Compliance Checks Completed and Discrepancy Letters Issued for Employment Tax Issues

Fiscal year	Closed cases for employers covered under Social Security coverage agreements^a	Cases with discrepancy letters for all employment tax issues^b	Percentage
2007 compliance checks	563	499	88.6
2008 compliance checks	409	364	89.0
2009 compliance checks	355	281	79.2

Source: FSLG data.

^aThese data do not include the number of examinations on public employers who are not covered under a coverage agreement.

^bEmployment tax issues include many issues, one of which is Social Security coverage.

For examinations, FSLG tracks the number of cases that resulted in an adjustment to the employers' taxes, but does not know if such tax adjustments are due to errors with Social Security coverage agreements. FSLG officials told us they do not yet know the prevalence of coverage problems and have not done enough audits to fully understand the extent of the problems. We requested the closed examinations for fiscal year 2009 that had issues related to Social Security coverage agreements. FSLG officials stated that due to constraints in their information system, they

could not identify all of these cases and, at best, could provide a list of examinations that might indicate Social Security coverage agreement issues using the amount of wage adjustments. We selected and reviewed a sample of 10 closed examinations provided by IRS that had large wage changes. In 5 of these examinations, the public employer did not have an error related to its coverage agreement. In 3 of the other 5 cases in which errors were found with coverage agreements, the public employer misclassified the employees for whom it was not paying Social Security taxes. For example, some Social Security coverage agreements exclude certain categories of employees, such as student workers. In one of these cases, IRS conducted an examination of a public employer with student workers and determined that some of the employees classified as students were not actually taking classes at the time. As a result, IRS found that the employer was responsible for paying Social Security and Medicare taxes for these employees. The following table provides information on the number of completed examinations and the number of cases with errors in fiscal years 2007 through 2009.

Table 4: Fiscal Year 2007 to 2009 Examinations Completed and Number with Tax Adjustments for Employment Tax Issues

Fiscal year	Closed cases for employers covered under Social Security coverage agreements^a	Number of cases with tax adjustments for all employment tax issues^b	Percentage
2007 examinations	269	245	91.1
2008 examinations	391	349	89.3
2009 examinations	259	233	90.0

Source: FSLG data.

^aThese data do not include the number of examinations on public employers who are not covered under a coverage agreement.

^bEmployment tax issues include many issues, one of which is Social Security coverage.

In fiscal years 2007 to 2009, over 89 percent of employers examined had tax adjustments, but the reasons for those tax adjustments are not tracked. In 2009, IRS issued a report on community colleges that provides an indication of how well some state and local government employers were following their state’s coverage agreements. The primary objective of the report was to measure the compliance level of community colleges and identify specific issues of noncompliance. IRS selected a random sample of 88 community colleges for examination. Although the community college special project results cannot be applied to all public employers, IRS found that 10 percent of the 88 employers reviewed incorrectly

excluded workers who should have been covered by their state's Social Security coverage agreements.

Conclusions

SSA and IRS do not currently have the information needed and procedures in place to effectively and efficiently provide oversight of Social Security coverage for public employees. When IRS began collecting and overseeing the accuracy of the taxes collected in 1987, SSA ceased key monitoring activities that could help ensure states and public employers are following the states' agreements for Social Security coverage. Ensuring the accuracy of the Social Security records for public employees is still a requirement for SSA, and should be a priority for the managers of SSA and IRS. At present, SSA and IRS managers do not know the extent to which wages are reported accurately or to which Social Security taxes are paid in accordance with program rules. States can also play a vital role in the oversight structure of Social Security coverage for public employees, but lack clear guidelines with specific responsibilities to ensure state participation. Absent additional management attention and a system to monitor the accuracy of public employer wage reporting, Social Security benefits and tax payments may be inaccurately reported. Without a coordinated monitoring process between SSA and IRS to make sure that public employers are complying with state coverage agreements, opportunities to identify and correct errors will be lost. Given the projected fiscal challenges of the Social Security program in the coming decades, every attempt should be made to assure coverage is correctly applied so that employers and employees are reporting earnings and paying taxes when required to do so.

Recommendations for Executive Action

To improve SSA's management oversight of retirement benefits for public employees, we recommend that the Commissioner of Social Security, in consultation with IRS, state administrators, and public employers, develop procedures for monitoring the accuracy of Social Security earnings records. This could include (1) improving data collected on public employers, (2) identifying risk factors using existing SSA information and IRS audit findings, and (3) targeting public employers with those risk factors for follow-up reviews on an ongoing basis.

To improve the states' administration of public employer wage reporting, we recommend that the Commissioner of Social Security, in consultation with the National Conference of State Social Security Administrators, modify SSA's policy guidance to clarify state responsibilities governing

their oversight of public employers and set clear expectations for the steps state administrators should take in implementing these responsibilities.

To improve the process for identifying and correcting errors, we recommend that the Commissioner of Internal Revenue track errors found through its compliance efforts on Social Security and Medicare taxes and share results with SSA, to the extent permitted by federal law.

Agency Comments and Our Evaluation

We provided a draft of this report to the Social Security Administration and the Internal Revenue Service. In its written response, reproduced in appendix VI, SSA stated that our report fairly represented the key players involved in the administration of Social Security coverage agreements and provided a balanced representation of the issues. SSA generally agreed with all of our recommendations, but suggested that we reword our first recommendation to clarify the duties of the respective agencies. SSA also stated that IRS should collect data on employees covered under Section 218 agreements. We changed the language in the recommendation to clarify that SSA should monitor the accuracy of Social Security earnings records and highlighted that existing Social Security information as well as IRS audit findings may be useful in developing risk factors. While we believe that any monitoring effort should be coordinated with IRS and other stakeholders, our recommendation is intended for SSA to take the leadership role in such an effort. As we note in the conclusion above, SSA holds the primary responsibility of ensuring accurate Social Security records for public employees. SSA also provided technical comments that were incorporated into this report as appropriate.

In its written response, reproduced in appendix VII, IRS stated that our report made an important contribution to the concept of ensuring compliance with coverage agreements. IRS agreed with our recommendation that it should track errors found through its compliance efforts on Social Security and Medicare taxes and stated that it has begun identifying and tracking such errors. IRS also stated that it will ensure that information applicable to these errors is shared with SSA to the extent allowable by the Internal Revenue Code.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to relevant congressional committees. In addition, this report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-7215 or bertonid@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made key contributions to this report are listed in appendix VIII.



Daniel Bertoni
Director, Education, Workforce,
and Income Security Issues

Appendix I: Scope and Methodology

SSA Process for Ensuring Accurate Coverage

To obtain information on how the Social Security Administration (SSA) ensures accurate coverage of public employees, we interviewed SSA officials in Headquarters and in all 10 Regional Offices. We asked officials about the roles and interactions of SSA, state administrators, public employers, and the Internal Revenue Service (IRS). We asked about SSA's data, educational outreach, and oversight, as well as how coverage errors are detected and corrected. We reviewed relevant federal laws and regulations. We also reviewed documentation from SSA, such as policies and procedures, training, Inspector General reports, the Memorandum of Understanding (MOU) between SSA and IRS, and meeting minutes since fiscal year 2004 of the joint SSA-IRS committee. To understand the coverage agreement process, we reviewed selected original agreements, modifications (i.e., amendments) that provide coverage to public employees, internal legal opinions known as coverage determinations, and documents on specific coverage errors such as the report of the Federal Section 218 Task Force for Missouri School Districts.

To provide background information on the number of covered state and local government employees and the amount of covered earnings, we requested data from SSA on covered state and local government employment from 2007—the most recent year for which data were available. Specifically, we requested the number and percent of state and local government workers with and without Social Security coverage in each state. We also requested the amount of earnings (i.e., wages) of state and local government workers that were covered and not covered in each state. SSA's Office of Research, Evaluation and Statistics used its 1 percent sample of Social Security numbers, which is generalizable to the universe of workers. The sample contains earnings data that employers report to SSA on Form W-2. The data do not specify the source of coverage, such as coverage agreements under section 218 or the provisions under section 210 of the Social Security Act.¹ For the purposes of our tables, the data assume that state and local government workers do not have other, nonpublic employment. To assess the reliability of the data, we reviewed relevant documents and interviewed knowledgeable SSA officials. On the

¹Although most Social Security coverage of state and local government employees is obtained through coverage agreements under section 218, additional Social Security provisions affect the coverage of other state and local government employees. For example, section 210 of the Social Security Act extends mandatory coverage for Social Security and Medicare to state and local government employees who are not members of a qualifying retirement system, subject to certain exceptions.

basis of this information, we determined that the data for 2007 were sufficiently reliable for the purposes of our review.

To provide information on how many modifications to the coverage agreement SSA has approved by state, we requested the number and year of the most recently approved modification for each state.² From SSA, we requested that the 10 regional offices provide the number and date of the amendment (i.e., modification) most recently approved by SSA as of January 1, 2010. From states, we requested the same information through our Web-based survey. We then compared the results and performed follow-up work, where needed. We also reviewed relevant documents and interviewed knowledgeable SSA and state officials about the process to approve modifications for coverage. Based on these steps, we determined that the data we specially requested on the number and year of the last approved modification were sufficiently reliable for the purposes of our review.

State Roles in Social Security Coverage Process

To understand the role of states in ensuring accurate coverage, we visited four states—California, Colorado, New Hampshire, and Rhode Island. We selected these states to provide a variety of experiences, based on the percent of covered employees, geographic dispersion, and indicators or referrals from SSA or the National Conference of State Social Security Administrators (NCSSSA) of how active the state administrator is. During our site visits, we interviewed the state officials who administer the state's coverage agreement with SSA. We asked about the role of the state administrator, the practices to administer the coverage agreement, as well as staffing and funding to do so. We also asked about interactions with SSA and IRS. We reviewed documents from states, such as policies and procedures, and select parts of the coverage agreement. We did not review state laws or verify information pertaining to state laws that were given to us in the course of our work. We also conducted interviews and obtained documents from officials of the NCSSSA.

²Each state has only one agreement with SSA, comprised of an original agreement along with any amendments (known as modifications). For the purpose of this report, we generally refer to a state's original agreement along with the modifications as a "coverage agreement." However, for the table in appendix III on the number of the last approved modification, we explicitly noted that we excluded the original agreement from the data in accordance with SSA and states' numbering sequence.

To obtain further information on states administering Social Security coverage agreements, we conducted a Web-based survey that was sent to state administrators in all 50 states, Puerto Rico, and the Virgin Islands.³ The survey was conducted between January and February 2010 and had a response rate of 100 percent. The survey included questions about the characteristics of states' coverage agreements, the extent to which state administrators conduct activities to manage these agreements, as well as the challenges state administrators face in administering these agreements.

Because this was not a sample survey, there are no sampling errors. However, the practical difficulties of conducting any survey may introduce nonsampling errors, such as variations in how respondents interpret questions and their willingness to offer accurate responses. We took a number of steps to minimize nonsampling errors. For example, a social science survey specialist designed the questionnaire in collaboration with GAO staff with subject matter expertise. As part of survey development, we received feedback from NCSSSA. The questionnaire also underwent a peer review by a second GAO survey specialist. We also pretested the questionnaire with appropriate officials in four states—Colorado, Florida, Indiana, and Nevada—to ensure that the questions and information provided to respondents were appropriate, concise, and clearly stated. We selected pretest states based on variation in the percentage of covered public employees, geographic dispersion, and the level of state administrator involvement identified by NCSSSA officials. The pretesting took place during November and December 2009 by telephone. Since these were Web-based surveys, respondents entered their answers directly into electronic questionnaires. This eliminated the need to have data keyed into databases, thus removing an additional source of error. Finally, to further minimize errors, computer programs used to analyze the survey data were independently verified by a second GAO data analyst to ensure the accuracy of this work.

While we did not validate specific information that administrators reported through our survey, we reviewed their responses and took steps to determine that they were complete, reasonable, and sufficiently reliable for the purposes of this report. For example, during pretesting, we took

³We did not send a state administrator survey to the District of Columbia, Guam, the Commonwealth of the Northern Mariana Islands, or American Samoa because they are not authorized to enter into Social Security coverage agreements.

steps to ensure definitions and terms used in the survey were clear and familiar to the respondents, categories provided in closed-ended questions were complete and exclusive, and the ordering of survey sections and the questions within each section were appropriate. In our review of the data, we also identified and logically fixed skip pattern errors—questions that respondents should have skipped but did not. On the basis of our checks, we believe our survey data are sufficient for the purposes of this report.

IRS Identification of Incorrect Social Security Taxes

To understand how IRS identifies incorrect Social Security taxes for public employees, we held interviews with IRS managers in the Federal, State and Local Governments office (FSLG), which is responsible for the tax compliance of federal, state, and local government employers, including their Social Security coverage. We asked FSLG officials about how IRS selects state and local government employers to review, performs examinations and compliance checks, corrects any errors in coverage and taxes, and interacts with SSA and states. We reviewed relevant federal laws and regulations. In addition, we reviewed relevant documents, including policies and procedures, training materials, criteria to select employers for review, the MOU between SSA and IRS, reports from special projects, and publicly available forms and publications.

We obtained IRS data on enforcement activities it conducted between fiscal years 2007 and 2009, including examinations and compliance checks completed in each state, and the results of these enforcement activities. For examinations, IRS provided information about whether the examination resulted in a tax adjustment. For compliance checks, IRS provided information about number of cases that resulted in a discrepancy letter. We reviewed documents and contacted knowledgeable IRS officials about the data. For the purposes of our review, we determined these data were sufficiently reliable.

To understand how IRS identifies Social Security errors for public employees, we reviewed a judgmental sample of FSLG audit files for 10 examinations and 20 compliance checks of state and local government employers that were completed in fiscal year 2009. Because IRS does not track this information, we asked FSLG to provide lists of examinations and compliance checks with an indication of noncompliance for Social Security coverage. IRS officials told us that the indications of noncompliance, particularly for examinations, are imperfect. For example, IRS examiners may not consistently use the codes to denote noncompliance related to Social Security coverage agreements. Because examinations are in-depth reviews that may result in changes to reported

earnings and taxes, we selected 10 of 34 examinations with larger increases and decreases of Social Security or Medicare earnings. For compliance checks, IRS identified 20 closed compliance checks that found issues with approved Social Security coverage. We selected all of these cases for our review. We reviewed the files to gather information on how IRS detected errors, what the errors were, and how they were resolved. The review of these files is for illustrative purposes and is not generalizable to all state and local government employers.

We conducted this performance audit from July 2009 to September 2010 in accordance with generally accepted government auditing standards. Those standards require that 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Social Security-Covered and Estimated Noncovered Earnings from State and Local Government Employment in 2007

(Dollars in millions, rounded to nearest million)

	Social Security-covered earnings	Percent of state and local government earnings covered for social security	Estimated noncovered earnings	Percent of state and local government earnings not covered for social security	Estimated total of covered and noncovered earnings ^a
Total	\$527,552	71	\$213,534	29	\$741,085
Alabama	10,489	97	372	3	10,860
Alaska	757	42	1,038	58	1,795
Arizona	12,460	92	1,042	8	13,503
Arkansas	4,533	94	264	6	4,797
California	40,281	40	60,506	60	100,787
Colorado	3,625	30	8,631	70	12,256
Connecticut	5,998	55	4,948	45	10,946
Delaware	2,083	92	190	8	2,274
District of Columbia	1,929	64	1,075	36	3,003
Florida	36,344	95	2,062	5	38,407
Georgia	14,971	75	4,900	25	19,870
Hawaii	3,129	83	627	17	3,755
Idaho	3,266	98	75	2	3,341
Illinois	11,498	36	20,322	64	31,819
Indiana	11,415	92	972	8	12,387
Iowa	6,903	96	323	4	7,226
Kansas	6,826	96	262	4	7,088
Kentucky	6,024	67	2,936	33	8,960
Louisiana	1,358	17	6,617	83	7,974
Maine	971	36	1,716	64	2,687
Maryland	14,596	93	1,112	7	15,708
Massachusetts	553	3	15,414	97	15,968
Michigan	22,157	95	1,246	5	23,404
Minnesota	11,793	93	892	7	12,685
Mississippi	6,042	97	161	3	6,203
Missouri	7,733	65	4,087	35	11,820
Montana	1,813	95	92	5	1,904
Nebraska	3,673	91	351	9	4,024
Nevada	252	4	5,640	96	5,891
New Hampshire	2,317	84	453	16	2,769

**Appendix II: Social Security-Covered and
Estimated Noncovered Earnings from State
and Local Government Employment in 2007**

(Dollars in millions, rounded to nearest million)

	Social Security-covered earnings	Percent of state and local government earnings covered for social security	Estimated noncovered earnings	Percent of state and local government earnings not covered for social security	Estimated total of covered and noncovered earnings ^a
New Jersey	25,237	91	2,483	9	27,720
New Mexico	5,322	93	409	7	5,731
New York	65,384	99	898	1	66,282
North Carolina	19,799	98	449	2	20,248
North Dakota	1,393	95	76	5	1,469
Ohio	160	1	25,332	99	25,492
Oklahoma	7,012	92	651	8	7,663
Oregon	8,280	97	224	3	8,505
Pennsylvania	24,040	93	1,757	7	25,797
Puerto Rico	4,676	83	960	17	5,636
Rhode Island	1,938	77	563	23	2,501
South Carolina	9,872	98	151	2	10,023
South Dakota	1,566	98	35	2	1,601
Tennessee	11,984	91	1,122	9	13,106
Texas	23,966	47	26,755	53	50,721
Utah	4,687	94	316	6	5,003
Vermont	1,440	99	13	1	1,453
Virginia	19,742	98	430	2	20,173
Washington	16,734	91	1,582	9	18,316
West Virginia	3,759	95	205	5	3,965
Wisconsin	12,754	96	549	4	13,302
Wyoming	2,003	97	72	3	2,075
Other ^b	15	8	176	92	191

Source: GAO analysis of data from SSA's Office of Research, Evaluation, and Statistics, 1% Continuous Work History Sample-2007 Employee Employer File.

Notes: The data presented in the table are from earnings that were posted to SSA administrative records as of January 2009. Any earnings posted to SSA's Master Earnings File after this January cut-off are not included in the counts. In some years, different state and local governments may be late in submitting acceptable W-2 forms to SSA, and the state and local government employees included in the late submittal would not be included in a given state's total counts for covered or noncovered employment.

^aTo develop this estimate, SSA hypothetically assumed a situation of universal coverage where all state and local government employment was covered in 2007 and taxable up to the annual Social Security taxable maximum of \$97,500 in 2007 for each employer. From the total estimate, we subtracted currently covered earnings to obtain estimated noncovered earnings.

^bOther includes American Samoa, Guam, Northern Mariana Islands, and U.S. Virgin Islands.

**Appendix II: Social Security-Covered and
Estimated Noncovered Earnings from State
and Local Government Employment in 2007**

Although most Social Security coverage of state and local government employees is obtained through coverage agreements, additional Social Security provisions affect the coverage of other state and local government employees. For example, section 210 of the Social Security Act extends mandatory coverage for Social Security and Medicare to state and local government employees who are not members of a qualifying retirement system, subject to certain exceptions.

Appendix III: Number and Year of Last Modification Approved by SSA, as of January 1, 2010

State	Number of last approved modification	Year of last approved modification
Alabama	717	2005
Alaska	183	2001
Arizona	442	2009
Arkansas	845	2009
California	1,543	2009
Colorado	395	2007
Connecticut	447	2008
Delaware	83	2006
Florida	609	2009
Georgia	960	2009
Hawaii	13	2006
Idaho	255	2009
Illinois	934	2009
Indiana	558	2007
Iowa	397	2002
Kansas	765	2005
Kentucky	884	2009
Louisiana	745	2009
Maine	317	2009
Maryland	255	2000
Massachusetts	11	2003
Michigan	988	2008
Minnesota	424	2009
Mississippi	790	2009
Missouri	444	1997
Montana	393	2008
Nebraska	408	1995
Nevada	52	1989
New Hampshire	325	2008
New Jersey	735	2009
New Mexico	267	2009
New York	362	1994
North Carolina	1,134	2006
North Dakota	689	2006

Appendix III: Number and Year of Last Modification Approved by SSA, as of January 1, 2010

State	Number of last approved modification	Year of last approved modification
Ohio	1	1972
Oklahoma	1,161	2009
Oregon	647	2009
Pennsylvania	1,796	2009
Puerto Rico	73	2003
Rhode Island	100	2003
South Carolina	490	2008
South Dakota	380	2009
Tennessee	913	2008
Texas	1,583	2009
Utah	210	2008
Vermont	346	1993
Virgin Islands	11	1996
Virginia	388	2004
Washington	839	2009
West Virginia	430	2009
Wisconsin	778	2009
Wyoming	283	2009

Source: SSA information and GAO's survey of state administrators.

Notes: The number of the last modification approved by SSA is not necessarily the exact number of modifications currently in effect. We could not state the exact number of modifications currently in effect for several reasons. First, the numbers should ascend in sequential order, but occasionally some modifications may skip a number. For example, a state may withdraw a proposed coverage modification before SSA approves or denies it, which could create a skip in the sequence. Second, not all modifications are presently in effect. A modification may provide coverage for a public employer, which later dissolves and no longer exists. A modification may apply to an employer which terminated its coverage prior to 1983—when terminating coverage modifications was permitted.

Consistent with the numbering sequences of SSA and states, the table excludes a state's original agreement. The original agreement is not counted as a modification because it is not an amendment to the agreement.

Appendix IV: SSA's Guidance Related to the Responsibilities of State Social Security Administrators

-
- Serve as a bridge between state and local public employers and federal agencies, including SSA and IRS.
 - Administer and maintain the section 218 agreement that governs voluntary Social Security and Medicare coverage by public employers.
 - Prepare modifications to the section 218 coverage agreement to include additional coverage groups, correct errors in other modifications, identify additional public employers that join a covered retirement system, and obtain Medicare coverage for public employees whose employment relationship with a public employer has been continuous since March 31, 1986.
 - Provide SSA with notice and evidence of the legal dissolution of covered state and local public employers.
 - Conduct referenda for Social Security and Medicare coverage for services performed by employees in positions under a public retirement system.
 - Resolve coverage and tax questions associated with Section 218 agreements and modifications with SSA and IRS.
 - Advise public employers on Social Security, Medicare, and tax withholding matters.
 - Provide information to public employers as appropriate in accordance with the state's enabling legislation, policies, procedures, and standards.
 - Provide advice on Section 218 optional exclusions applicable to the state and/or individual modifications, and advice on state and local laws, rules, regulations and compliance concerns.
 - Maintain physical custody of the state's Section 218 agreement, modifications, dissolutions, and intrastate agreements.
-

Source: SSA's Program Operations Manual System SL 10001.130.

Appendix V: List of Committees Formed by SSA at Its April 2010 Conference

Committee	Objectives
Improving Collaboration	Develop and implement ways to improve interagency relationship and collaboration.
Uniform Workflow Processes	Recommend uniform procedures for the regions and state administrators.
Policy and Procedures ^a	Research policies and recommend improvements.
Database Development	Develop ideas that will improve a centralized database.
State Administrator Position Support	Suggest and develop training materials that will help new state administrators learn the position.
Succession Planning	Improve succession planning procedures.
Training and Education ^a	Improve training in all levels of federal, state, and local government by creating joint training sessions.
Policy Enhancement	Research to identify areas of policy or procedures that may be improved.
Raising Awareness for State Elected Officials	Develop and explore ways to strengthen agency relationships with state-elected officials.
Staffing Resources	Review staffing issues in the regions and states and recommend solutions.
Disclosure Issues	Discuss disclosure limitations.

Source: SSA.

^aSSA identified these committees as the highest priorities.

Appendix VI: Comments from the Social Security Administration



SOCIAL SECURITY

September 17, 2010

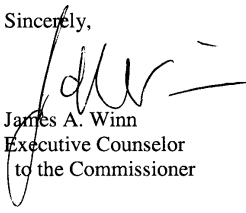
Mr. Daniel Bertoni
Director, Education, Workforce,
and Income Security Issues
441 G. Street, N.W.
Washington, D. C. 20548

Dear Mr. Bertoni:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) Draft Report, "Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees" (GAO-10-938). Our comments on the report are enclosed.

If you have any questions, please contact me or have your staff contact Rebecca Tothoro, Acting Director, Audit Management and Liaison Staff at (410) 966-6975.

Sincerely,



James A. Winn
Executive Counselor
to the Commissioner

Enclosure

SOCIAL SECURITY ADMINISTRATION BALTIMORE, MD 21235-0001

COMMENTS ON THE GOVERNMENT ACCOUNTABILITY OFFICE (GAO) DRAFT REPORT, "SOCIAL SECURITY ADMINISTRATION: MANAGEMENT OVERSIGHT NEEDED TO ENSURE ACCURATE TREATMENT OF STATE AND LOCAL GOVERNMENT EMPLOYEES" (GAO-10-938)

GENERAL COMMENTS

We believe the report fairly represents the key players involved in the administration of Social Security Act, Section 218 coverage agreements, and is a balanced representation of the issues. The report also accurately describes the present Section 218 process that we and the Internal Revenue Service (IRS) use.

We strive to administer all programs and activities in accordance with applicable laws and regulations. To assist state and local government employers on Social Security coverage issues, we work with state administrators at the local level through our ten regional employer services liaison officers. We also have regional office state and local coverage specialists who provide support. In addition, we sponsor an annual meeting of the National Conference of State Social Security Administrators (NCSSSA), and maintain a website solely for state and local government employers. <http://www.ssa.gov/slge/index.htm>.

COMMENTS ON RECOMMENDATIONS

Recommendation 1

To improve SSA's management oversight of retirement benefits for public employees, the Commissioner of Social Security, in consultation with IRS, state administrators, and public employers, should develop a monitoring effort that ensures Social Security earnings are accurately reported for public employees. This could include 1) improving data collected on public employers, 2) identifying risk factors, and 3) targeting public employers with those risk factors for follow-up reviews on an ongoing basis.

Comment

We suggest you reword this recommendation as it is unclear regarding the duties of the respective agencies.

We will work to develop monitoring efforts with IRS, state administrators, and public employers to ensure Social Security earnings are accurately reported for public employers. IRS, however, must collect data on employees covered under Section 218 agreements. With this information from IRS, we can work together to:

- develop a monitoring effort that ensure Social Security earnings are accurately reported for public employees;
- identify risk factors, and target public employers with those risk factors; and
- establish best practices for educating public employers with this information.

Recommendation 2

To improve the states' administration of public employer wage reporting, the Commissioner of Social Security, in consultation with the National Conference of State Social Security Administrators, should modify SSA's policy guidance to clarify state responsibilities governing their oversight of public employers and set clear expectations for the steps state administrators should take in implementing their responsibilities.

Comments:

We agree. Our "Policy and Procedures" committee, with input for other committees, will focus on this task. We will collaborate with the NCSSSA, and revise our policy guidance as you suggest. We will improve the guidance and post it to our Program Operations Manual System (POMS) by March 2011.

POMS is our official repository of program instructions, and it may be accessed by our employees and by state and Federal agencies, including IRS. When we issue the new instructions, state administrators will have a clearer and more detailed source of information to guide them in carrying out their roles and responsibilities under Section 218.

Recommendation 3

To improve the process for identifying and correcting errors, the Commissioner of the Internal Revenue Service should track errors identified through compliance efforts and share the results with SSA to the extent permitted by Federal law.

Comments:

We agree.

Appendix VII: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 17, 2010

Mr. Daniel Bertoni
Director
Education, Workplace, and Income Security Issues
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Bertoni:

I have reviewed your draft Government Accountability Office (GAO) report titled, "Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees" (GAO-10-938).

The report makes an important contribution to the concept that ensuring compliance with Section 218 agreements – the agreements between various state and local governmental entities and the Social Security Administration (SSA) under which certain public employees are covered by Social Security – is challenging and important. As the report demonstrates, the interaction of federal tax, Social Security and state statutes and Section 218 agreements needed to arrive at correct Social Security and Medicare coverage determinations for public employees is complex. It requires the coordination of the SSA, State Social Security Administrators, and the Internal Revenue Service (IRS).

The IRS created its Federal, State and Local Governments (FSLG) function in 2000 to serve as the focal point within the IRS for meeting the IRS's responsibility to ensure that units of state and local government were correctly determining and paying federal employment taxes for their employees. Since it was created 10 years ago, FSLG has provided extensive outreach services and training to units of state and local governments. The goal has been to arm these entities with a robust knowledge of the special withholding and reporting rules that apply to their employees covered by Section 218 agreements. Over the past five years, FSLG has also focused on conducting examinations to evaluate employment tax and information reporting compliance at the state and local levels.

The report notes that we have also undertaken several initiatives to enhance our data gathering and reporting on SSA Section 218 issues. For example, FSLG is at work now on an analysis of the results of its Section 218 examination and compliance check activity. FSLG plans to share its findings from this work with SSA, to the extent permitted by law. (As you indicated, section 6103 of the Internal Revenue Code imposes certain limits on the ability of the IRS to share tax information with other federal agencies.)

2

The report also notes that FSLG is conducting reviews of state-level Section 218 agreements using an IRS Section 218 assessment tool. These reviews are designed to give us a complete picture of the Section 218 agreements and structures that define Social Security coverage of state and local employees in each state. The information FSLG gains from this assessment, combined with the information from its analysis of examination and compliance check activity, will allow us to improve our overall service and compliance efforts at the state and local levels.

We work with the SSA on an ongoing basis on significant issues related to Section 218 compliance. While we do not always share final audit reports with SSA, we typically contact SSA when an examination will result in changing the 218 coverage of an employee or category of employees. In cases where the governmental unit we are examining agrees with the IRS determination, this contact with SSA is normally carried out informally. In cases where the governmental unit disagrees with our determination, we obtain a formal written interpretation from SSA. This practice honors SSA's statutory authority to interpret coverage questions under Section 218 agreements.

This consultation is carried out, in part, pursuant to a Memorandum of Understanding (MOU) between SSA and the IRS. FSLG provided a copy of this MOU, and an accompanying explanatory memorandum from the Director of FSLG, to all FSLG employees in 2007. Further, FSLG specifically addresses Section 218 matters in the Internal Revenue Manual at section 4.90.1.4, to which all FSLG employees have access.

We look forward to continuing our outreach, education and compliance activities with government employers at the state and local levels. We also look forward to continuing collaboration with SSA and the State Social Security Administrators to identify and address Section 218 concerns, including consulting with them on ways to ensure that Social Security earnings are accurately reported for public employees.

A response to your recommendation for the IRS is enclosed. We appreciate your interest in our work with state and local governmental entities on matters related to Social Security and Medicare taxes. If you have any questions or would like to discuss this response in more detail, please contact Sarah H. Ingram, Commissioner, Tax Exempt and Government Entities Division, at (202) 283-2500.

Sincerely,



Steven T. Miller

Enclosure

Enclosure

Recommendation

To improve the process for identifying and correcting errors, we recommend that the Commissioner of Internal Revenue track errors found through its compliance efforts on Social Security and Medicare taxes and share results with SSA, to the extent permitted by federal law.

Response

We have begun identifying and tracking errors concerning Section 218 agreements discovered in our compliance processes. We will ensure that information applicable to these errors is shared with the Social Security Administration to the extent allowable by the disclosure provisions of the Internal Revenue Code.

Appendix VIII: GAO Contact and Staff Acknowledgments

GAO Contact

Daniel Bertoni (202) 512-7215 or bertonid@gao.gov

Staff Acknowledgments

Blake Ainsworth, Assistant Director; Richard Harada, Matthew Saradjian, Anjali Tekchandani, Kris Trueblood, James Bennett, Susannah Compton, Alex Galuten, Stuart Kaufman, Wayne Turowski, and Walter Vance made significant contributions to this report.

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