

Office of the Inspector General

March 25, 1999

Kenneth S. Apfel
Commissioner of Social Security

Acting Inspector General

The Social Security Administration's Estimation of Excess Federal Insurance Contribution Act Taxes

The attached final management advisory report presents the results of the Social Security Administration's (SSA) estimation of excess Federal Insurance Contribution Act (FICA) taxes (A-13-97-51015). The objectives of this review were to: (1) determine the differences between the actuarial and final estimates of excess FICA wages; (2) assess the accuracy of SSA's estimates of excess FICA wages; and (3) determine the related impact on the Social Security trust funds.

You may want to comment on any further action taken or contemplated. If you choose to offer comments, please provide them within the next 60 days. If you wish to discuss the final report, please call me or have your staff contact Daniel R. Devlin, Acting Assistant Inspector General for Audit, at (410) 965-9700.

James G. Huse, Jr.

Attachment

**OFFICE OF
THE INSPECTOR GENERAL**

SOCIAL SECURITY ADMINISTRATION

**THE SOCIAL SECURITY
ADMINISTRATION'S ESTIMATION
OF EXCESS FEDERAL
INSURANCE CONTRIBUTION
ACT TAXES**

March 1999 A-13-97-51015

**MANAGEMENT
ADVISORY REPORT**



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The Social Security Administration's Estimation of Excess Federal Insurance Contribution Act Taxes

OBJECTIVE

This management advisory report presents the results of our review of the Social Security Administration's (SSA) estimation of excess Federal Insurance Contribution Act (FICA) taxes. The objectives of our review were to: (1) determine the differences between the actuarial and final estimates of excess FICA wages; (2) assess the accuracy of SSA's estimates of excess FICA wages; and (3) determine the related impact on the Social Security trust funds.

BACKGROUND

Generally, all workers' wages are subject to FICA tax up to a ceiling cut off which was \$68,400 for Calendar Year (CY) 1998. When the ceiling has been met, no further FICA taxes are owed. In some cases, employers err and continue to withhold FICA taxes from their employees (known as single employer [SE] excess FICA). Overpayments of this type, which are refundable to the employees, may be claimed from the Internal Revenue Service (IRS) through their employers. In other cases, employees may work two or more jobs and their combined wages exceed the wage ceiling (known as multiple employer [ME] excess FICA). The ME overpayments may be claimed from IRS on the employees' Federal income tax return. The SE who pays a matching contribution in error can seek a refund for employer tax by adjustment to tax reports filed with IRS, but no provision for refund exists for the ME.

Annually, the trust funds reimburse the general fund for refunds made to taxpayers and employers for overpaid and incorrectly paid FICA taxes. Sections 201(g)(2) and 201(g)(3) of the Social Security Act (the Act), 42 United States Code §§ 401(g)(2) and 401(g)(3), prescribe general criteria for computing the FICA reimbursement amount

transferred from the trust funds to the general fund. SSA estimates the amount of wages with excess FICA taxes and the Department of the Treasury (Treasury) makes the actual transfer of funds.

SSA's estimating process for each Tax Year (TY) covers a 5-year span before it is considered final. For example, the estimating process for TY 1991 spans from CYs 1992 to 1996. The first 4 CYs of the estimating process consist of actuarial estimates that are based on current economic trends and historical data. In July of each CY, SSA prepares actuarial estimates on the amount of SE and ME wages that are in excess of the FICA tax wage ceiling. These actuarial estimates are forwarded to Treasury via a certification letter, and the estimates are used as the basis for computing the FICA tax reimbursement transfer to the general fund. Within these first 4 CYs, the actuarial estimates are reviewed and adjusted, if necessary.

In the fifth CY, SSA completes its analysis of a 1 percent sample of workers' records with earnings in excess of the FICA ceiling. The results of this sample are used to prepare SE and ME final estimates which are forwarded to Treasury. These final estimates are used to adjust FICA tax transfers that were based on earlier actuarial estimates.

In July 1997, the TY 1992 final estimates of SE and ME excess Old-Age, Survivors and Disability Insurance wages were \$183 million and \$13 billion, respectively. Their respective FICA taxes were \$22.7 million and \$806 million. In each CY, SSA includes 5 TYS of estimates for both SE and ME in a certification letter to Treasury.

The review covered CYs 1987 through 1998 for TYS 1983 through 1993. Since the final estimate for any TY takes 5 years, the latest year finalized was TY 1993.

The work was performed at SSA Headquarters in Baltimore, Maryland. The field work was conducted from June 1997 through September 1998.

RESULTS OF REVIEW

Using data from SSA's Office of the Actuary and Office of Research, Evaluation and Statistics, we determined the differences between SSA's actuarial and final estimates of excess FICA wages. We could not meet our objectives of assessing the accuracy of SSA's estimation process and determining the related impact on the SSA trust funds because we identified two conditions that raise concern about SSA's current process for estimating excess FICA tax. First, the current estimation process results in trends of overestimating and underestimating amounts to be transferred to the general fund. Secondly, SSA and IRS do not share information on actual excess FICA refunds. When comparing SSA and IRS excess FICA data, we noted significant differences

between the SSA estimates and amounts IRS indicated it had refunded. These two issues raise questions about the accuracy of the amounts transferred to the general fund for excess FICA tax.

As previously indicated, the process is as follows: (1) SSA prepares actuarial estimates of excess FICA; (2) Treasury transfers money to the general fund based on the actuarial estimates; and (3) Treasury adjusts the related trust fund transfers based on final estimates derived from a sample of SSA wage records. The final estimates are used as the control figure for ensuring that the correct amounts have been transferred to the general fund. When we compared SSA's final estimates to its actuarial estimates for TYs 1983 through 1991, we found that SSA's actuarial estimates were overstated. As a result, SSA had transferred excess funds to the general fund. Beginning in TY 1992, SSA changed its actuarial estimation methods to bring its actuarial estimates more in line with its final estimates. We recognize that fluctuations are inherent in any estimation process.

However, because SSA's estimation process does not include steps to reconcile its final estimates to actual excess FICA refunds, we question whether or not the estimates are representative of the actual FICA taxes refunded. Specifically, there is no exchange of actual excess FICA refund data between SSA and IRS. This lack of communication is viewed as a hindrance to determining an accurate amount to transfer to the general fund for excess FICA refunds.

During our review, we requested actual refund data from IRS to compare against SSA's final estimates. Data on actual excess FICA refunds were unavailable. We found that the best available IRS data on excess FICA refunds are derived from IRS statistical samples of tax returns.¹ We did not test IRS' process for estimating the amount of excess FICA refunds, nor did we assess the accuracy of the IRS data. However, we believe that IRS should provide its refund data to SSA for comparison.

To demonstrate the usefulness of exchanging data, we obtained IRS statistics on excess FICA refunds. We compared the IRS statistics to SSA's estimates for ME excess FICA and determined there were significant differences. As the following chart indicates, SSA's final estimate for TY 1993 differed from the IRS estimates by about \$125.5 million or 13.6 percent. SSA's actuarial estimates for TYs 1994 and 1995 differed from IRS estimates by \$17.5 million (1.9 percent) and \$65.6 million (6.1 percent), respectively. Although we have not verified the accuracy of the IRS data, our comparison of excess FICA data from IRS and SSA suggests that SSA may be transferring incorrect amounts to the general fund for excess FICA refunds. These differences raise the question of whether SSA's estimates are representative of actual FICA overpayments. There may be explanations for these differences. However, the

¹ The IRS estimates of FICA taxes withheld are published quarterly in The Statistics of Income (SOI) Bulletin.

differences cannot be resolved as long as the two agencies continue to unilaterally establish estimates and statistics without sharing data.

Comparison of IRS' Estimated Excess FICA Refunds to SSA's Estimated Transfers of Excess FICA to the General Fund					
Tax Year	IRS Estimates	SSA Estimates	Difference	SSA Estimates	Shortfall
1993	\$ 925,295,000	\$ 799,800,000	\$ 125,495,000	Lower	General Fund
1994	935,083,000	917,600,000	17,483,000	Lower	General Fund
1995	1,081,454,000	1,147,000,000	(65,546,000)	Higher	Trust Funds

The American Institute of Certified Public Accountants' Statements on Auditing Standards (number 57) suggests that management should incorporate internal controls to minimize the likelihood of material misstatement of an estimate. One of the suggested control techniques is a comparison of estimates with subsequent events to assess the reliability of the process used to arrive at the estimates. We believe a concerted effort by both IRS and SSA to reconcile their excess FICA data will improve the estimation process, provide additional data to SSA and ultimately improve the accuracy of amounts transferred to the general fund for excess FICA refunds.

Under section 201(g)(2) of the Act, the amount of excess FICA transferred to the general fund is based on wages established and maintained by SSA and certified to Treasury by the Commissioner of Social Security. Based on the Comptroller General of the United States Decision B-261522 issued on September 29, 1995, in reviewing section 201(a)(3) of the Act, SSA may consider both individual employee wages, as reported annually by employers to SSA, and wage information reported quarterly by employers to IRS on Form 941, in certifying wages to Treasury. Since both sections 201(g)(2) and 201(a)(3) of the Act refer to certifications based on records established and maintained by SSA, we believe that SSA would likewise have the latitude of using IRS data for establishing the amount of excess FICA wages.

CONCLUSION AND RECOMMENDATION

Treasury makes transfers from the trust funds to the general fund based on SSA's certified excess FICA estimates. Neither SSA nor IRS reconciles actual IRS refunds to the excess FICA amounts transferred from the SSA trust funds to the general fund.

Due to the disparity between IRS and SSA estimates, we could not fully assess the accuracy of SSA's estimates and the related impact on SSA's trust funds. Treasury may be transferring an incorrect amount from the trust funds to the general fund. To prevent losses to either the trust fund or general fund because of an inaccurate estimate, we believe that the final certification should be based upon the actual repayments of overpaid FICA taxes. SSA and IRS should consider, when appropriate,

using actual IRS refund data in making a final certification. We recommended that SSA establish a task force with IRS to initiate a formal Memorandum of Understanding on the protocol for: (1) sharing excess FICA wage data and (2) resolving/reconciling any differences between agencies.

AGENCY COMMENTS

SSA disagreed with our conclusion that the final certification be based on actual repayments of FICA taxes. SSA relies on the explicit language of the Act to use the Agency's records for estimating the amount of wages with excess FICA taxes. However, SSA will share our report with IRS and follow up with them to determine whether improvements of the type we have suggested, or any other improvements, are possible. Appendix A includes a copy of the complete text of SSA's comments.

OIG RESPONSE

We acknowledge that SSA relies on the explicit language of the Act. However, we believe the Comptroller General's decision pertaining to the Act supports our position that SSA could use IRS data for establishing actual repayments of overpaid FICA taxes.

Our concern is the accuracy of SSA's estimation process. Under the current estimation process, amounts of excess FICA transferred to the general fund could be substantially lower or higher than necessary. We believe that SSA should base, when appropriate, its final certification upon the actual repayments of overpaid FICA taxes. SSA should continue to make its estimates. However, SSA should compare its estimates to the actual IRS reported excess FICA refunds to ascertain the difference, and if necessary, resolve/reconcile the difference. This comparison would lessen the chance of material misstatement of an estimate. Nonetheless, SSA plans to share our concern with IRS to determine if any improvements can be made.

James G. Huse, Jr.

APPENDICES

APPENDIX A

SSA COMMENTS

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For additional copies of this report, please contact the Office of the Inspector General's External Affairs Office at (410) 966-9158. Refer to Common Identification Number A-13-97-51015.

APPENDIX C

SSA ORGANIZATIONAL CHART
