
**OFFICE OF
THE INSPECTOR GENERAL**

SOCIAL SECURITY ADMINISTRATION

**ADMINISTRATIVE COSTS
CLAIMED BY THE NORTH CAROLINA
DISABILITY DETERMINATION
SERVICES**

March 2006

A-04-05-15040

AUDIT REPORT



Mission

We improve SSA programs and operations and protect them against fraud, waste, and abuse by conducting independent and objective audits, evaluations, and investigations. We provide timely, useful, and reliable information and advice to Administration officials, the Congress, and the public.

Authority

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

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

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

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

Vision

By conducting independent and objective audits, investigations, and evaluations, we are agents of positive change striving for continuous improvement in the Social Security Administration's programs, operations, and management and in our own office.



SOCIAL SECURITY

MEMORANDUM

Date: March 13, 2006

Refer To:

To: Paul D. Barnes
Regional Commissioner
Atlanta

From: Inspector General

Subject: Administrative Costs Claimed by the North Carolina Disability Determination Services
(A-04-05-15040)

OBJECTIVE

Our objectives were to evaluate the North Carolina Disability Determination Services' (NC-DDS) internal controls over the accounting and reporting of administrative costs and determine whether costs claimed were allowable and properly allocated and funds were properly drawn.

BACKGROUND

Disability determinations under the Social Security Administration's (SSA) Disability Insurance and Supplemental Security Income programs are performed by Disability Determination Services (DDS) in each State or other responsible jurisdiction, according to Federal regulations.¹ Each DDS is responsible for determining claimants' disabilities and ensuring adequate evidence is available to support its determinations. To make proper disability determinations, each State agency is authorized to purchase consultative examinations (CE) and medical evidence of record from the claimants' physicians or other treating sources. SSA pays the State agency 100 percent of allowable expenditures using Form SSA-4513, *State Agency Report of Obligations for SSA Disability Programs*. The DDS withdraws Federal funds through the Department of the Treasury's (Treasury) Automated Standard Application for Payments (ASAP) system to pay for program expenditures. (For additional background, scope and methodology, see Appendix B.)

¹ 20 C.F.R. §§ 404.1601 *et seq.* and 416.1001 *et seq.*

RESULTS OF REVIEW

NC-DDS did not always have adequate controls in place to ensure it properly accounted for and reported administrative costs it billed to SSA. Additionally, NC-DDS did not always comply with guiding regulations and policies regarding allowable claims and draws. For example, during our audit period, NC-DDS claimed \$1,845,432 in office space costs above the amount allowed by SSA policy. Also, NC-DDS transferred significant funds between Treasury accounts that were established for costs expended during specific fiscal years (FY). These fund transfers contributed to a \$410,693 discrepancy between cash draws and disbursements reported on Forms SSA-4513. NC-DDS also had \$689,211 remaining in Treasury fund balances for FYs 2001 through 2003 that should have been returned to SSA. Finally, during our audit period, NC-DDS claimed \$18,705 in excess CE fees and \$2,338 in excess payroll charges and did not inventory 719 SSA-provided computers.

We also noted that NC-DDS noncompetitively awarded contracts totaling about \$1.1 million for work related to its move to new office space. Although these costs may have been reasonable, we were unable to determine the appropriateness of these charges because the DDS did not seek competition during the bid process. This contract award may be contrary to State law and is being reviewed by North Carolina State Auditors.

EXCESSIVE OFFICE SPACE

During our audit period, NC-DDS leased more office space than allowed by SSA policy. SSA policy allows reimbursement to DDSs for a maximum of 150 square feet per full-time equivalent position (FTE),² yet the NC-DDS leased approximately 235 square feet per FTE. NC-DDS passed on to SSA an additional \$1,845,432 in rent for the 3-year audit period.

In August 1999, NC-DDS began relocating its operations to a privately owned building in Raleigh, North Carolina. NC-DDS entered into a 7-year lease agreement to occupy 150,000 square feet at an average annual cost of \$1,704,000. Before its relocation, NC-DDS occupied 104,406 square feet of office space at an annual cost of \$913,729.

In planning its relocation, NC-DDS developed an estimate of future space needs based on 639 FTEs. Given this estimate and SSA's maximum allowable square footage of 150 square feet per FTE, the NC-DDS should have leased about 95,850 square feet of space. Instead, NC-DDS leased 150,000 square feet, which is

- 54,150 square feet more than allowed by policy,
- 235 square feet per FTE, and
- 44 percent more than it previously occupied.

² An FTE represents one full-time employee.

NC-DDS did not experience staffing increases that would justify the additional space. From the lease's inception in August 1999 through September 2004, NC-DDS' FTEs remained relatively constant (see Table 1).

Table 1: Number of FTE's for FYs 1999 Through 2004

| Fiscal Year | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|-------------|------|------|------|------|------|------|
| FTE | 642 | 642 | 642 | 642 | 639 | 659 |

SSA approved a relocation plan that included 142,625 square feet of space. The State ultimately acquired 150,000 square feet of office space, 7,375 square feet more than SSA approved. By approving the relocation plan, SSA did not follow its own policy, which would have limited NC-DDS office space to about 96,000 square feet. Based on the average lease cost of \$11.36 per square foot, NC-DDS office space costs charged to SSA would have been \$615,144 less per year, and \$1,845,432 less during our 3-year audit period.

While at NC-DDS, we observed multiple conference rooms, expansive storage areas, and two unoccupied case processing units. The two unoccupied case processing units comprised approximately 6,000 square feet. At an average of \$11.36 per square foot, we estimate NC-DDS paid \$204,480 for this unoccupied space during our audit period. Even if NC-DDS had grown as it anticipated, we believe this unoccupied space was unnecessarily leased because the lessor agreed to provide additional office space for future DDS expansion on an as needed basis.

The current NC-DDS lease expires in July 2006. According to the NC-DDS Administrator, the DDS has no plans to relocate at the end of the lease and will most likely renew its present lease at that time. If the lease is renewed with the same square footage, SSA will continue to reimburse the NC-DDS for office space costs in excess of SSA policy.

NONCOMPETITIVE CONTRACT AWARDS

NC-DDS noncompetitively awarded about \$1.1 million in contracts to one contractor. The DDS awarded these contracts in 1999 to prepare its new office space for occupancy. The contractor, a company affiliated with the lessor, was paid \$856,000 for data cabling and electrical wiring and about \$214,000 for other site preparation.

According to North Carolina State law, it appears construction contracts exceeding \$300,000 are to be competitively bid to the public. NC-DDS claimed that, in accordance with a North Carolina Department of Health and Human Services' (NC-DHHS) policy, renovations to a leased property may be done by the lessor. However, we believe the departmental policy should not supersede State law. Further, because the State had not signed the lease when the contract was awarded, the departmental policy did not appear to be applicable.

Because the work was not competitively bid, we could not determine whether the cost of the work was reasonable. Further, neither the agreement nor the contractor's invoices provided detail on the amount, type of cable or hardware installed. As a result, we had no basis to assess the reasonableness of these charges.

Telephone System Inappropriately Funded

NC-DDS charged SSA \$650,427 to install a telephone system at its new building. Most of the telephone system was installed in December 1999. However, NC-DDS inappropriately used funds authorized for a previous FY to pay the FY 2000 telephone system installation expense. According to Federal regulations, Federal funds specifically authorized for a FY are to reimburse expenditures that occur in that period.³ Yet, we found no evidence that SSA authorized NC-DDS to expend prior year Federal funds for this expenditure. SSA authorized \$470,000 in FY 1997 funds to upgrade the telephone system at its old building. Also, NC-DDS submitted a FY 1998 budget to SSA that indicated an additional \$170,000 was needed to complete the telephone system upgrade at the old location. We believe NC-DDS should not have used prior year Federal funds to pay for the telephone system at its new location. Rather, it should have returned funds not used for FY 1997, 1998, and 1999 expenditures and requested additional funds in FY 2000 for the new telephone system expense. Table 2 details the Federal funds NC-DDS used to pay for its new telephone system.

Table 2: Federal FY Funds Used for the Telephone System

| Fiscal Year | Funds Used |
|--------------|------------------|
| 1997 | \$470,000 |
| 1998 | 170,988 |
| 1999 | 9,439 |
| Total | \$650,427 |

Overlapping Rent Payments

NC-DDS paid \$518,000 in rent from August 1 to November 30, 1999 to lease a new building. NC-DDS also extended its lease and paid rent on its existing building from August 1 through December 31, 1999. Despite paying rent at both locations, NC-DDS did not move its staff into the new building until December 1999.

An official from the State Property Office explained the new building may not have been ready for the August 1, 1999 occupancy date because of additional SSA data wiring requirements. However, it is our understanding SSA provided the State with detailed electrical and data wiring specifications early in the planning process and

³ 31 U.S.C. § 1502.

before the State advertised its request for proposals. We could not determine the specific SSA wiring requirements that may have caused delays in the build-out.

SSA approved the overlapping rent payments through December 1999—as long as the new building was ready for occupancy. In August 1999, an official from the State Property office determined that “85 percent of the facility was substantially complete.” However, at that time, the required data cabling and wiring was not complete and the telephone system had not been installed. Further, the State Property Office instructed NC-DDS that it should not occupy the building until it obtained the proper Certificate of Occupancy. Unfortunately, NC-DDS did not obtain a Certificate of Occupancy until we initiated our audit—over 5 years later. We believe NC-DDS should not have paid rent on the new building until December 1, 1999, when the building was substantially complete.

CASH MANAGEMENT

Funds to recover NC-DDS expenditures are drawn from Treasury’s ASAP system. Cash draws made from ASAP are to reimburse NC-DDS for expenditures incurred during the same period as the account’s FY reporting period.⁴ For each FY, NC-DDS is assigned a separate account in ASAP.

For each of the three ASAP accounts in our audit period, total cash draws did not equal total disbursements reported by the NC-DDS on the corresponding Forms SSA-4513. Additionally, each of the three accounts had available balances that exceeded unliquidated obligations reported on the Forms SSA-4513. Table 3 details the ASAP variances and the remaining balances for each of the three FYs in our audit period.

Table 3 : ASAP Variances and Balances

| FY | ASAP Cash Draws | Funds Disbursed Per SSA- 4513 | SSA Authorized Funding | ASAP Draws Exceed Funds Disbursed | Unliquidated Obligations Per Forms SSA-4513 | ASAP Available Balance |
|-----------|------------------------|--------------------------------------|-------------------------------|--|--|-------------------------------|
| 2001 | \$42,065,267 | \$40,729,061 | \$40,729,061 | \$1,336,206 | 0 | \$9,441 |
| 2002 | 45,606,938 | 47,086,396 | 47,086,396 | (1,479,458) | 0 | 12,810 |
| 2003 | 46,322,547 | 45,768,602 | 46,489,507 | 553,945 | \$59,645 | 666,960 |
| Totals | | | | \$410,693 | \$59,645 | \$689,211 |

During our 3-year audit period, it appeared NC-DDS’ cash draws exceeded reported disbursements by \$410,693. However, NC-DDS transferred funds between ASAP accounts. As a result, the FY ASAP cash disbursements did not equal the expenditures reported on the respective years’ Forms SSA-4513, and the FY ASAP available balances did not agree with the reported unliquidated obligations. Because the ASAP accounts contained transfers from ASAP accounts outside of our audit

⁴ Id.

period, we could not conclude that the NC-DDS' draws exceeded its reported disbursements. To do so would require a reconstruction of cash draws from prior and future years to determine whether cash draws were appropriate. We determined that ASAP funds were transferred between ASAP accounts during FYs 1999 through 2004; and fund transfers likely occurred before FY 1999—according to an NC-DDS official. Because this practice occurred over an extended period of time, we believe NC-DDS should reconcile ASAP cash disbursements to reported expenditures (by FY) to ensure the ASAP disbursements were appropriate. The funds transferred between Federal FY ASAP accounts are detailed in Table 4.

Table 4: Funds Transferred Between Federal FY ASAP Accounts

| Transfer Date | FY 1999 | FY 2000 | FY 2001 | FY 2002 | FY 2003 | FY 2004 |
|------------------|-----------|-----------|-------------|---------------|-----------|-----------|
| March 7, 2001 | -- | \$194,000 | (\$194,082) | -- | -- | -- |
| January 28, 2002 | \$573,828 | 1,410,517 | (258,762) | (\$1,740,674) | -- | -- |
| June 7, 2002 | -- | -- | 1,568,004 | (1,568,004) | -- | -- |
| May 23, 2003 | -- | -- | (111,184) | 111,184 | -- | -- |
| March 30, 2004 | -- | (568,159) | (117,620) | 162,911 | \$300,000 | \$222,868 |

LEGEND:
 Numbers in **RED** indicate a transfer of funds TO another FY ASAP account.
 Numbers in **BLACK** indicate a transfer of funds FROM another FY ASAP account.

An official with the NC-DHHS Controller's Office explained that, in the past, NC-DDS had overdrawn ASAP funds in some FYs and under-drawn in others. The official further explained funds are transferred between ASAP accounts to reconcile each funding year, but the net effect of the transfers on the overall funding is zero. The official also added that current cash management procedures allow the NC-DDS to more timely monitor ASAP draws.

The Atlanta Regional Office does not know when a DDS transfers cash between ASAP accounts because it does not require that DDSs obtain prior approval to transfer funds. Furthermore, the Regional Office does not have access to the ASAP system, which would allow for better monitoring of DDS cash management activities. Improved oversight of DDS cash management activities would reduce the risk of mismanagement of Federal funds.

The transfer of funds between accounts allows for an inappropriate use of one FY's appropriation to pay the expenses of another FY. Federal statute states, "The balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title."⁵ As of May 31, 2005, the ASAP accounts for FYs 2001 and 2002 still had available balances of \$9,441 and \$12,810, respectively. However, NC-DDS submitted its final Form SSA-4513 for these years and reported that no

⁵ 31 U.S.C. § 1502(a).

unliquidated obligations remained. Additionally, the ASAP account for FY 2003 had an available balance of \$666,960, but NC-DDS' most recent Form SSA-4513 reports that only \$59,645 in unliquidated obligations remain.

An official with the NC-DHHS' Controller's Office stated the \$22,251 remaining in the FY 2001 and 2002 ASAP accounts will not be needed and should be returned. Regarding the \$666,960 FY 2003 ASAP account balance, the NC-DHHS official acknowledged that the available ASAP balance exceeds NC-DDS' FY 2003 unliquidated obligations. The official further explained that NC-DDS is evaluating the ASAP balance; however, it is very probable that NC-DDS will not use the \$666,960 and it will need to be returned.

CONSULTATIVE EXAMINATION COSTS

The DDS obtains medical information necessary to determine whether an applicant meets the eligibility criteria for Disability Insurance or Supplemental Security Income benefit payments. When existing medical evidence is insufficient, not available, or cannot be obtained, the DDS is authorized to purchase a CE. The DDS establishes fee schedules for the CE procedures it purchases. Each procedure in the fee schedule is identified by a Current Procedural Terminology (CPT) code.⁶ NC-DDS developed a standardized fee schedule that generally adopted the Medicare fee schedule.

Generally, the DDS paid CE fees in accordance with its established fee schedule. However, during our audit period, NC-DDS paid \$18,705 in CE fees in excess of its fee schedule. SSA's Program Operations Manual System (POMS) states:

The State will determine the rates of payment for medical or other services that are necessary to make a disability determination. The DDS will consider its fee schedule as a maximum payment schedule. Authorized payments will represent the lower of either:

- the providers usual and customary charge, or
- the maximum allowable charge under the fee schedule.⁷

⁶ CPT codes, defined by the American Medical Association, provide a uniform language that accurately describes medical, surgical, and diagnostic procedures in the fee schedule.

⁷ POMS, DI 39545.210 1.a. and b.

The NC-DHHS Controller's office added employment tax⁸ (7.65 percent) to CE fees paid to medical providers that are employed by the State but perform services outside their State employment. The State deemed these employees to have dual employment status. Payments to CE providers with dual employment status pass through the employing State agency. Therefore, NC-DHHS considered it appropriate to add the tax, not realizing the mark up caused the fees to exceed the NC-DDS CE fee schedule. NC-DDS did not question this practice, and these excess CE costs were charged to SSA.

Officials from both NC-DDS and NC-DHHS' Controller's Office agreed the addition of employment taxes caused NC-DDS to exceed its CE fee schedule. As a result of our audit, NC-DDS and NC-DHHS have revised their procedures to ensure CE payments to dual employment CE providers do not exceed the NC-DDS fee schedule.

PAYROLL COSTS

In FY 2003, NC-DDS claimed reimbursement for \$2,338 in excess payroll costs. In January 2003, a DDS employee transferred from a position that was fully chargeable to SSA to one that was only partially chargeable because the new position was not 100 percent dedicated to SSA-related work. In January 2003, a manual payroll action was made to properly allocate the employee's salary expense for that month. However, because of a payroll processing error, a portion of the employee's wages was incorrectly charged to SSA from February through June 2003.

In July 2003, the NC-DHHS Controller's Office identified the error and took corrective action to ensure it did not charge the employee's future payroll expense to SSA. However, the Controller's Office did not retroactively adjust the payroll expense and, as a result, its unallowable wages and benefits of \$2,338 were charged to SSA. We discussed this matter with officials from NC-DDS and the NC-DHHS Controller's Office. The officials agreed the payroll expense was incorrectly charged to SSA.

INVENTORY CONTROLS

NC-DDS' inventory list was incomplete because it did not reflect 719 computers SSA purchased for the DDS. According to SSA instructions, ". . . (t)he State is responsible for maintenance and inventory of all equipment acquired -- whether purchased through SSA or the State."⁹ The State did not include the computers on the NC-DDS inventory because the equipment was known to be SSA's property. Failure to maintain a current and accurate inventory list reduces the DDS' ability to properly safeguard its assets.

⁸ Employment tax is also known as Social Security Tax, defined under the Federal Insurance Contribution Act as a Federal tax levied equally on employers and employees, used to pay for Social Security programs. See 26 U.S.C. § 3101 *et seq.*

⁹ POMS, DI 39530.020(A)(1).

CONCLUSION AND RECOMMENDATIONS

NC-DDS claimed unallowable office space costs of \$1,845,432 for October 1, 2001 through September 31, 2003. Also, NC-DDS transferred significant funds between ASAP accounts. We believe the fund transfers contributed to variances between ASAP cash draws and disbursements reported on the Form SSA-4513. NC-DDS claimed \$18,705 in excess CE fees and \$2,338 in unallowable payroll expenses. Finally, the DDS did not inventory 719 SSA-provided computers.

We recommend that SSA:

1. Determine the appropriateness of the \$1,845,432 in office space costs above the amount allowed by SSA policy and seek reimbursement for any inappropriate charges.
2. Instruct NC-DDS to return the \$518,000 resulting from overlapping rent payments.
3. Determine whether the nearly \$1.1 million NC-DDS paid for electrical wiring, data cabling and other build-out services was reasonable and seek reimbursement for any charges determined to be inappropriate.
4. Determine whether the \$650,427 NC-DDS paid for its new telephone system was appropriate and seek reimbursement for any charges determined to be inappropriate.
5. Instruct NC-DDS to return the \$689,211 that remains unused in its FYs 2001 through 2003 ASAP accounts.
6. Require that DDSs in the Atlanta Region obtain approval to transfer funds between ASAP accounts.
7. Consider whether a reconciliation of ASAP cash draws to expenditures reported on the Form SSA-4513 is needed to assure ASAP cash disbursements were appropriate.
8. Instruct NC-DDS to refund \$18,705 in unallowable CE fees resulting from the addition of employment taxes.
9. Instruct NC-DDS to refund \$2,338 to SSA for unallowable payroll expenses.
10. Instruct NC-DDS to inventory all SSA-provided computers.
11. Increase its oversight of the NC-DDS cash management activities and ensure that major capital procurements comply with Federal, State and SSA policies, procedures and regulations.

AGENCY COMMENTS

SSA generally agreed with our recommendations except for Recommendation 2. SSA acknowledged that a Certificate of Occupancy was not obtained from the City of Raleigh before the DDS occupied the facility in December 1999. However, SSA stated that rent was payable beginning in August 1999 because the State determined the building was 85 percent complete at that time. Also, SSA stated that it had approved overlapping rent payments; therefore, it will not require that the NC-DDS return the rent paid before its December 1999 occupancy of the facility. See Appendix C for the full text of SSA's comments.

NC-DHHS COMMENTS

Overall, NC-DHHS did not agree with our recommendations. For example, the NC-DHHS disagreed with our recommendation related to costs associated with excess office space. It stated that SSA's policy regarding acquisition of office space was only a suggested guideline. Additionally, NC-DHHS disagreed with our finding that the acquisition of \$1.1 million in electrical and wiring/cabling may not have been appropriate. NC-DHHS acknowledged that the invoices for this work lacked sufficient detail describing the amount and type of work performed. However, NC-DHHS stated that according to DHHS policy, it was not required to competitively bid the acquisition of these build-out services because the improvements were made to a leased property. See Appendix D for the full text of NC-DHHS' comments.

OIG RESPONSE

As recommended, the Atlanta Region evaluated the appropriateness of the NC-DDS charges we outlined in the report. Regarding Recommendation 2, SSA responded that it relied on the State property officer's determination that the building was substantially complete when the overlapping rent payments began. Accordingly, SSA deemed the rent payments appropriate. However, in our opinion, without evidence of the required inspection and a corresponding Certificate of Occupancy, we are concerned the Region did not have complete information regarding the readiness of the building when it approved the overlapping rent payments.



Patrick P. O'Carroll, Jr.

Appendices

[**APPENDIX A**](#) – Acronyms

[**APPENDIX B**](#) – Background, Scope and Methodology

[**APPENDIX C**](#) – Agency Comments

[**APPENDIX D**](#) – North Carolina Department of Health and Human Services’ Comments

[**APPENDIX E**](#) – OIG Contacts and Staff Acknowledgments

Appendix A

Acronyms

| | |
|----------|--|
| Act | <i>Social Security Act</i> |
| ASAP | Automated Standard Application for Payments |
| CE | Consultative Examination |
| C.F.R. | Code of Federal Regulations |
| CPT | Current Procedural Terminology |
| DI | Disability Insurance |
| DDS | Disability Determination Services |
| FTE | Full-time Equivalent |
| FY | Fiscal Year |
| POMS | Program Operations Manual System |
| NC-DDS | North Carolina Disability Determination Services |
| NC-DHHS | North Carolina Department of Health and Human Services |
| SSA | Social Security Administration |
| SSI | Supplemental Security Income |
| Treasury | Department of the Treasury |
| U.S.C. | United States Code |

Background, Scope and Methodology

BACKGROUND

The Disability Insurance (DI) program, established under Title II of the *Social Security Act* (Act),¹ provides benefits to wage earners and their families in the event the wage earner becomes disabled.² The Supplemental Security Income (SSI) program, established under Title XVI of the Act, provides benefits to financially needy individuals who are aged, blind, or disabled.³

The Social Security Administration (SSA) is responsible for implementing policies for the development of disability claims under the DI and SSI programs. Disability determinations under both the DI and SSI programs are performed by Disability Determination Services (DDS) in each State, Puerto Rico and the District of Columbia, in accordance with Federal regulations.⁴ In carrying out its obligation, each DDS is responsible for determining claimants' disabilities and ensuring adequate evidence is obtained to support its determinations.⁵ Each DDS is also authorized by SSA to purchase consultative medical examinations, such as x-rays and laboratory tests, to supplement evidence obtained from the claimants' physicians or other treating sources.⁶

SSA reimburses the DDS for 100 percent of allowable expenditures up to its approved annual funding authorization. The DDS withdraws Federal funds through the Department of the Treasury's (Treasury) Automated Standard Application for Payments system to pay for program expenditures. Funds drawn must comply with Federal regulations and intergovernmental agreements entered into by Treasury and States under the *Cash Management Improvement Act of 1990*.⁷ An advance or reimbursement for costs under the program must comply with Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*. At the end of each fiscal quarter, each State agency submits to SSA a

¹ Social Security Amendments of 1954, Pub. L. No. 83-761, 68 Stat. 1089.

² Id.

³ Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1465.

⁴ 20 C.F.R. §§ 404.1601 et seq. and 416.1001 et seq.

⁵ Id.

⁶ Program Operations Manual System, DI 39545.001(B)(4).

⁷ *Cash Management Improvement Act of 1990*, Pub. L. No. 101-453, 104 Stat. 1058 (amending 31 U.S.C. §§ 6501 and 6503).

State Agency Report of Obligations for SSA Disability Programs (Form SSA-4513) to account for program disbursements, obligations and unliquidated obligations.

The North Carolina Disability Determination Services (NC-DDS) is a component of the North Carolina Division of Vocational Rehabilitation in the North Carolina Department of Health and Human Services (NC-DHHS). The NC-DHHS Controller's Office accounts for NC-DDS disbursements, completes and submits the Form SSA-4513, and prepares requests to transfer cash from Treasury to the State Treasurer. The State's indirect costs for the DDS are determined based on a cost allocation plan negotiated and approved by the Department of Health and Human Services.

SCOPE

We reviewed the administrative costs submitted by the State for NC-DDS and reported to SSA on Form SSA-4513 for the period October 1, 2000 through September 30, 2003 (Fiscal Years 2001 through 2003). For the audit period, we tested the reliability of the State's computerized data by comparing disbursements—by category and in total—with amounts reported on Form SSA-4513. We then obtained sufficient evidence to evaluate administrative costs in terms of their allowability under the Office of Management and Budget's Circular A-87 and appropriateness, as defined by SSA's Program Operations Manual System (POMS).

We also

- reviewed applicable Federal regulations; pertinent parts of POMS, DI 39501; *DDS Fiscal and Administrative Management*; and other instructions pertaining to administrative costs incurred by the DDS and requests for Federal funds covered by the *Cash Management Improvement Act* agreement;
- evaluated and tested internal controls regarding accounting, financial reporting, and cash management activities;
- interviewed NC-DDS, NC-DHHS, and SSA personnel;
- examined the administrative expenditures (personnel, medical services, and all other non-personnel costs) claimed by the DDS for the period October 1, 2000 through September 30, 2003;
- recomputed indirect costs for Fiscal Years (FY) 2001 through 2003 based on the approved indirect cost allocation plan;
- compared the amount of SSA funds requested and received for program operations to the allowable expenditures reported on Form SSA-4513;
- reviewed work performed by the North Carolina State auditors as part of the North Carolina Single Audit for FY 2002; and

- conducted a physical inventory of equipment items and selected computer hardware items SSA provided to the NC-DDS.

We conducted our audit from October 2004 through August 2005 at the NC-DDS and the NC-DHHS in Raleigh, North Carolina, and at SSA's Regional Office in Atlanta, Georgia. We conducted our audit in accordance with generally accepted government auditing standards.

METHODOLOGY

Our sampling methodology encompassed three general areas of costs, as reported on Form SSA-4513: (1) personnel, (2) medical, and (3) all other non-personnel costs. We obtained computerized data from the NC-DDS for FYs 2001 through 2003 for use in statistical sampling. After selecting and reviewing randomly selected samples, we did not identify errors we felt warranted audit projection.

Personnel Costs

We reviewed 50 personnel transactions from 1 pay period in FY 2003. The sample included five employees the NC-DDS hired as medical consultants. We tested North Carolina Vocational Rehabilitation Department payroll records to ensure it correctly paid employees and adequately documented these payments.

Medical Costs

We sampled 150 medical cost items (50 items from each FY) using a stratified random sample. We distributed the sample items between medical evidence of record and consultative examinations based on the proportional distribution of the total medical costs for each year.

All Other Non-personnel Costs

We selected a stratified random sample of 150 items (50 items from each FY) from all other non-personnel costs. Before selecting the sample items, we sorted the transactions into the following categories: (1) Occupancy, (2) Contracted Costs, (3) Electronic Data Processing Maintenance, (4) New Electronic Data Processing Equipment (5) Equipment Purchases, (6) Equipment Rental, (7) Communication, (8) Applicant Travel, (9) DDS Travel, (10) Supplies, and (11) Miscellaneous. We then distributed the 50 sample items for each year between categories based on the proportional distribution of the costs.

Consultative Exam Costs

We judgmentally selected and tested 100 percent of the fees paid for 21 Current Procedural Terminology (CPT) codes related to the purchase of consultative examinations. These 21 CPT codes represented about 90 percent of the DDS' FY 2001, 2002, and 2003 consultative examination expenditures. In FYs 2001 through 2003, the DDS' consultative exam expenditures totaled \$31,059,541, of which \$28,055,236 (90 percent) was charged to these 21 CPT codes.

Appendix C

Agency Comments



SOCIAL SECURITY

Refer To: K. Killam 2-5727

MEMORANDUM

Date: February 3, 2006

To: Inspector General

From: Regional Commissioner
Atlanta

Subject: Administrative Costs Claimed by the North Carolina Disability Determination Services (NC DDS) – A 04-05-1540

Thank you for the opportunity to comment on the validity of the facts presented in your draft audit report on the NC DDS' internal controls. We believe that the OIG Audit, regarding the accounting and reporting of administrative costs and whether costs claimed were allowable and properly allocated and funds properly drawn, was detailed and thorough.

Our response to the eleven recommendations is as follows:

1. Recommendation: Determine the appropriateness of the \$1,845,432 in office space costs above the amount allowed by Social Security Administration (SSA) policy and seek reimbursement for any inappropriate charges.

The OIG audit states that the NC DDS leased more space than allowed by SSA Policy. SSA's Program Operations Manual System (POMS) reference cited by OIG provides guidelines as to the amount of space to be allocated to each authorized employee. The NC DDS's request to expend funds to relocate and to secure approximately 142,625 square feet of office space was approved in August 1998. The State subsequently advertised for 142,624 square feet of space. In August 1999, the NC DDS began moving into their new location, a privately owned building with 150,000 square feet. The approval for 142,625 square feet of space was based in large part upon anticipated increases in staffing and workload that has not materialized due to budgetary constraints. A cost/benefit analysis of relocating the NC DDS to a different office building that is more in line with space allocation guidelines is underway. The Regional Office (RO) will closely monitor the review and analysis and proceed accordingly. Preliminary results indicate that the cost of relocating the NC DDS to a different facility of reduced size will result in increased expenditures far in excess of what is currently being paid. Additionally, relocation

would create a significant disruption to effective case management and customer service. Because the RO approved the actions of the NC DDS when they occurred, we have determined that the NC DDS acted in good faith at the time the contract was let and we will not seek reimbursement for any charges related to this finding. We will, however, continue to seek an optimum resolution to the space issue.

2. Recommendation: Determine whether the nearly \$1.1 million NC DDS paid for electrical wiring, data cabling and other build-out services was reasonable and seek reimbursement for any charges determined to be inappropriate.

We have reviewed the history of the contracting process for the renovation project done by the NC DDS. We concur with the auditor that the billing/invoicing process for this work lacked specificity. As a result of this finding, the NC DDS has re-written its purchasing policy and has instructed its staff that this revised policy must be followed. This change should ensure that sufficient detail is available regarding any future procurement. However, we find that all parties involved in the renovation project, including the RO, the State Property and Construction Division (SORG), the electrical contractor and MATCO (the building owner), concurred in the renovation decisions. After reviewing the available information regarding this finding, we believe the cost paid for the electrical wiring, data cabling and other services, was reasonable and will not require reimbursement of these costs. No further action connected to this finding is necessary.

3. Recommendation: Determine whether the \$650,427 NC DDS paid for its new telephone system was appropriate and seek reimbursement for any charges determined to be inappropriate.

We have reviewed the history of the telephone system installation in the NC DDS. We concur with the auditor that inappropriate procedures were used to expend funds beyond the authorized fiscal year in which funds were appropriated. The NC DDS acknowledges that the audit findings are technically correct and that internal policy and procedures have been revised and implemented to prevent a repetition. We will be working with the NC DDS to review the regulations, policies and procedures concerning the proper use and accountability of fiscal year appropriations. Since the actual purpose for which the funds were spent was the original basis for authorization of the funds and the use of funds was appropriate, we are not seeking reimbursement of the \$650,427. No further action connected to this finding is necessary.

4. Recommendation: Instruct the North Carolina Disability Determination Services (NC DDS) to return the \$518,000 resulting from overlapping rent payments.

The NC DDS paid \$518,000 in rent from August 1, 1999 to November 1999 to lease a new building. At the same time, the NC DDS also extended the lease and paid rent on its existing building from August 1, 1999 through December 31, 1999. The State Property Office issued a letter dated

August 9, 1999, that stated 85% of the property to be leased was available for occupancy by the NC DDS. The City of Raleigh, the inspections authority for this project, should have issued a certificate for partial occupancy for the part of the building that could be occupied and should have followed up with a full certificate of occupancy when the entire building was ready for occupancy. Although the City did not issue the full certificate of occupancy until August 2005, there was no indication by the city as to the actual date of the original occupancy inspection. Once the facility was determined to be 85% substantially complete and available for the NC DDS to begin installation of its equipment, rent payments were properly due and payable. The overlapping payments for the two locations were approved by RO and were justified. Therefore, we will not seek a return of the \$518,000 in overlapping rent payments. No further action connected to this finding is necessary.

5. Recommendation: SSA should instruct the NC DDS to return the \$689,211 that remains unused in its FYs 2001 through 2003 Automated Standard Application for Payments (ASAP) accounts.

FYs 2001 and 2002 have been closed and will have no further expenditures or draws. The expenditures and draws have been reconciled for both of these years. The balance remaining in the ASAP accounts for FY 2001 is due to refunds of expenditures, mainly sale of surplus property and refund of dual employment expenses. The balance remaining in the ASAP accounts for FY 2002 is due to refunds of expenditures from the sale of surplus property. The RO requested that the NC DDS submit amended SSA-4513 (State Agency Report of Obligations for SSA Disability Programs) reports for these two years that reflect a reduction in expenditures. This SSA-4513 has been received. No further action connected to this finding is necessary.

The balance remaining in the ASAP for FY 2003 that was identified by the OIG auditor has been adjusted in accordance with SSA guidelines. FY 2003 is now closed and will have no further expenditures or draws. A final SSA-4513 report for FY 2003 has been received that reflects a reduction in the expenditures. No further action connected to this finding is necessary.

6. Recommendation: SSA should require that DDSs in the Atlanta Region obtain approval to transfer funds between ASAP accounts.

DDSs are prohibited from transferring funds between ASAP accounts because this would mean transferring funds between fiscal years. However, in the event that such a transaction should occur within a DDS, we will most definitely require that approval be obtained from SSA. No further action connected to this finding is necessary.

7. Recommendation: SSA should consider whether a reconciliation of ASAP cash draws to expenditures reported on the Form SSA-4513 is needed to assure ASAP cash disbursement were appropriate.

We concur with this recommendation. The RO staff does not currently have access to DDS ASAP accounts. The RO budget staff has already begun discussions with the financial staff in Central Office (who does have access) to work towards gaining access to ASAP. Once such access is obtained, the RO budget staff will be in a position to monitor DDS ASAP accounts on a quarterly basis to reconcile ASAP cash draws to expenditures reported on the Form SSA-4513. Action will be on-going.

8. Recommendation: SSA should increase its oversight of the NC DDS cash management activities and ensure that major capital procurements comply with Federal, State and SSA policies, procedures and regulations.

We concur with this recommendation. The DHHS Controller's Office has already strengthened its cash management controls. The office has more access to the data reported on the ASAP system than during the years covered by this audit. The draws are timelier between the Federal Fiscal Years. An additional position has added another layer to these controls. One responsibility of this position is to determine that draws are properly reported by their Federal Funds section, which completes these draws and that they are in agreement with the fund balances by year at all times. Additional Excel spreadsheets have been created since 2004 that also assist in this process. The RO staff will continue to work closely with the NC DDS to ensure that all major capital procurements comply with all appropriate procedures and regulations. Action will be on-going.

9. Recommendation: SSA should instruct NC DDS to refund \$18,705 in unallowable CE fees resulting from the addition of employment taxes.

We concur with this recommendation and note that, due to the audit review, the NC DDS has already revised it's procedures to ensure that CE payments to "dual employment" CE providers do not exceed the NC DDS fee schedule. The NC DDS has asked that the overpayment caused by administrative oversight be waived. We are currently considering this request.

10. Recommendation: SSA should instruct the NC DDS to refund \$2,338 for unallowable payroll expenses.

The RO agrees with this recommendation and action has been taken to resolve it. The State DHHS Controller's Office strengthened its internal control procedures to prevent recurrence. Adjusting entries have been posted with an effective date of May 31, 2005 to reclassify the \$2,338 payroll expense incorrectly charged to SSA. This adjustment was included in the FY 2005 expenditures on the SSA-4513 report for the quarter ending June 30, 2005. No further action connected to this finding is necessary.

11. Recommendation: SSA should instruct the NC DDS to inventory all SSA provided computers.

We agree that all SSA-provided computers should be inventoried. However, an instruction to the NC DDS to inventory such computers is not necessary. The NC DDS does maintain an inventory listing of SSA-purchased computers and the Information Technology Manager maintains the inventory. Throughout the year, as items are purchased, the NC DDS submits documentation to the DHHS Controller's Office to update the Fixed Asset System (FAS). A physical inventory is conducted annually and FAS reports are reconciled to the actual inventory counts for each agency. However, during the time of the audit, the NC DDS was not providing a copy of the SSA-funded inventory listing to the DHHS Controller's Office to maintain in their files. The DHHS Controller's Office has revised its procedures to require the NC DDS to submit a copy of its SSA inventory along with the FAS reports when the annual inventory is completed. No further action connected to this finding is necessary.

Please contact me if I can be of further assistance. Staff questions should be referred to Karen Killam at (404) 562-5727 or Sarah Henderson at (404) 562-1397.

Paul D. Barnes

cc: Linda Harrington
Rhonda Currie
Sarah Henderson



SOCIAL SECURITY

Refer To: K. Killam 2-5727

MEMORANDUM

Date: March 10, 2006

To: Inspector General

From: Regional Commissioner
Atlanta

Subject: Administrative Costs Claimed by the North Carolina Disability
Determination Services (NC DDS) – A 04-05-1540 - UPDATE

We responded to the above draft audit report on February 3, 2006. Our response to the 1st recommendation regarding the appropriateness of space costs indicated that we would continue to seek an optimum resolution to the space issue. In the interim, we have reviewed the space issues with the NC DDS and determined that the renewal of their lease with current the lessor is appropriate.

Our updated response to the space cost recommendation is as follows:

10. Recommendation: Determine the appropriateness of the \$1,845,432 in office space costs above the amount allowed by Social Security Administration (SSA) policy and seek reimbursement for any inappropriate charges.

The OIG audit states that the NCDDS leased more space than allowed by SSA Policy. SSA's Program Operations Manual System (POMS) reference cited by OIG provides guidelines as to the amount of space to be allocated to each authorized employee. The NCDDS's request to expend funds to relocate and to secure approximately 142,625 square feet of office space was approved in August 1998. The State subsequently advertised for 142,624 square feet of space. In August 1999, the NCDDS began moving into their new location, a privately owned building with 150,000 square feet. The approval for 142,625 square feet of space was based in large part upon anticipated increases in staffing and workload that has not materialized due to budgetary constraints. A cost/benefit analysis of relocating the NCDDS to a different office building that is more in line with space allocation guidelines has been done. For example, when we recently moved the Tennessee DDS, which is slightly smaller than the North Carolina DDS, the moving cost was approximately \$3.4 million. In addition to moving costs, we are also concerned about the significant disruption of service and the loss of productivity during the period of the move.

The results of our analysis show that the cost of relocating the NCDDS to a different facility of reduced size will result in increased expenditures far in excess of what is currently being paid. The NCDDS is located in Raleigh, NC which is part of an area known as the "Research Triangle". The three cities that make up the Research Triangle are Durham, Chapel Hill and Raleigh. This area is a very desirable location on the east coast and real estate prices correspondingly reflect this. The NCDDS is currently paying \$11.36 per square foot of space. However, the Social Security Office (SSA) located in Raleigh is currently paying \$23.06 per square foot. The Office of Hearings and Appeals Office in Raleigh is currently paying \$21.81 per square foot and the SSA Office in Durham is currently paying \$25.66 per square foot of space. Based on these prices, a new lease would undoubtedly almost double the cost per square foot. Therefore, not only would relocating to new space create a disruption to effective case management and customer service, but also would not be cost effective. Accordingly, the Regional Office has granted approval to the NCDDS to sign a 3-year renewal of their lease (to begin July 2006) for the same 150,000 square feet of space that the NCDDS currently occupies. The cost of the new lease renewal will be as follows:

- a. The annual cost for the first year will be \$1,826,258.42, or \$12.17 per square foot.
- b. The annual cost for the second year will be \$1,871,914.88, or \$12.48 per square foot
- c. The annual cost for the third year will be \$1,918,712.75 or 12.79 per square foot

The NCDDS cannot renegotiate the lease for fewer square feet (142,625) because the lessor would treat this action as a new lease and then the significant price increases would apply.

As stated in our earlier response, we determined that the NCDDS acted in good faith at the time the original contract was let and we will not seek reimbursement for any charges related to this finding.

Please contact me if I can be of further assistance. Staff questions should be referred to Karen Killam at (404) 562-5727 or Sarah Henderson at (404) 562-1397.

Paul D. Barnes

cc: Linda Harrington
Rhonda Currie
Sarah Henderson

Appendix D

North Carolina Department of Health and Human Services' Comments



North Carolina Department of Health and Human Services

2001 Mail Service Center • Raleigh, North Carolina 27699-2001

Tel 919-733-4534 • Fax 919-715-4645

Michael F. Easley, Governor

Carmen Hocker Odom, Secretary

January 19, 2006

Mr. Patrick P. O'Carroll, Jr.
Inspector General
Office of the Inspector General – Social Security Administration

Dear Mr. O'Carroll:

The NC Department of Health and Human Resources (DHHS) and the Division of Vocational Rehabilitation - Disability Determination Services (NC-DDS) appreciates the opportunity to comment on the draft report titled "Administrative Costs Claimed by the North Carolina Disability Determination Services" (A-04-05-15040). Our response to the draft report includes a brief summary of the finding and the related response to each of the recommendations.

OIG Finding: Excessive Office Space

NC-DDS leased more office space than allowed by SSA policy. SSA policy allows reimbursement to DDSs for a maximum of 150 square feet per full-time equivalent position (FTE).... NC-DDS passed on to SSA an additional \$1,845,432 in rent for the 3-year period.

In August 1999, NC-DDS began relocating its entire operations to a privately owned building in Raleigh, North Carolina. NC-DDS entered into a 7-year lease agreement to occupy 150,000 square feet at an average cost of \$1,704,000... In planning its relocation, NC-DDS developed an estimate of future space needs based on 639 FTEs. Given this estimate and SSA's maximum allowable square footage of 150 square feet per FTE, the NC-DDS should have leased about 95,850 square feet of space....

SSA approved a relocation plan that included 142,625 square feet of space. The state ultimately acquired 150,000 square feet of office space, 7,375 square feet more than SSA approved. By approving the relocation plan, SSA did not follow its own policy....

While at NC-DDS, we observed multiple conference rooms, expansive storage areas, and two unoccupied case processing units. The two unoccupied case processing units occupied approximately 6,000 square feet. At an average of \$11.36 per square foot, we estimate NC-DDS paid \$204,480 for this unoccupied space during our audit period. Even if NC-DDS had grown as it anticipated, we believe this unoccupied space was unnecessarily leased because the lessor agreed to reserve additional office space for future DDS expansion—at no cost.

OIG Recommendation

SSA should determine the appropriateness of the \$1,845,432 in office space costs above the amount allowed by SSA policy and seek reimbursement for any inappropriate charges.



Location: 101 Blair Drive • Adams Building • Dorothea Dix Hospital Campus • Raleigh, N.C. 27603

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NC-DDS Response

We respectfully disagree with the audit finding that the NC-DDS passed on to SSA an additional \$1,845,432 in rent for the 3-year audit period. The OIG audit states that NC-DDS leased more space than allowed by SSA Policy. The audit is ignoring the fact that the Program Operations Manual System (POMS) DI 39527.050 DDS Office Space Allocation Guide, Part B, I is a guideline and clearly states that:

"This section contains the suggested amount of space to be allocated to each authorized employee, according to position."

Suggested is the operative word in the above quote. Thus, the guidelines are for suggested space allocation based on a justification and approval process. This is further documented in a letter from the NC-DDS Administrator to the SSA State Director in which the NC-DDS Administrator states the obvious:

"The POMS and past practice have always been flexible enough to permit actual needs to take precedence over the guidelines if there was an actual need for variance."

As to 142,625 square feet versus 150,000 square feet, the State advertised for approximately 142,624 square feet based on an ideal floor plan. This is another factor as to why the POMS guidelines are just that – a set of guidelines. The reality is that when you publicly advertise for leased space, configuration of the building and other factors offered by lessors in their bids require latitude in the final amount of space leased. There may be ideal floor plans, but existing buildings are not ideal, and rarely conform to ideal floor plans. The October 12, 1998 Request For Proposals (RFP) referenced approximately the amount of space required, taking the above considerations into account.

In an e-mail communication dated 8/21/98, the NC-DDS's request to expend funds to relocate the NC-DDS and to secure approximately 142,625 square feet of office space was approved. (See Exhibit 1) This approval takes into account that the final amount of space would allow for necessary variances. A variation of 142,625 +/- 7,375 (5%) cannot be viewed as unreasonable for a lease of this magnitude. Although the anticipated increased hiring over the term of the lease has not occurred, the justification for space was made with the best information available at the time.

Although irrelevant, NC DHHS would also like to make the point that there was nothing to indicate that the lessor would reserve additional space for NC-DDS at "no cost". The DDS Site Proposal document that the OIG auditor referenced actually states:

"Additional space will be provided to the tenant on an as-needed basis."

We also respectfully disagree with the auditor's position regarding unoccupied space. In order to receive shipments of paper, envelopes and other high volume/use items sent to us on palettes (including deliveries from SSA such as, forms, computers and other equipment), the NC-DDS requires floor space to accommodate these deliveries.

NC-DDS has two small conference rooms in the building for small unit, management team or section meetings and one main conference room for large group meetings. This latter conference room is large enough for all-staff meetings, training sessions and regional office meetings. NC-DDS requires a space where the majority of staff can assemble for meetings as well as training sessions.

The unoccupied case processing units include one unit vacated due to the inability of the landlord to control the temperature of the unit (causing some health concerns for the Unit Supervisor) and one unit which is currently being used to store furniture needing repair. This space will be utilized as the NC-DDS expands. Therefore, we do not agree with the conclusions by the Auditor that the unoccupied space was unnecessary.

OIG Finding: Non-competitive Contract Award

NC-DDS noncompetitively awarded about \$1.1 million in contracts to one contractor. The DDS awarded these contracts in 1999 to prepare its new office space for occupancy. The contractor, a company affiliated with the lessor, was paid \$856,000 for data cabling and electrical wiring and about \$214,000 for other site preparation.

According to North Carolina State law, it appears construction contracts exceeding \$300,000 are to be competitively bid to the public. NC-DDS claimed that, in accordance with a North Carolina Department of Health and Human Services (NC-DHHS) policy, renovations to a leased property may be done by the lessor. However, we believe the departmental policy should not supersede State law. Further, because the State had not signed the lease when the contract was awarded, the departmental policy did not appear to be applicable.

Because the work was not competitively bid, we could not determine whether the cost of the work was reasonable. Further, neither the agreement nor the contractor's invoices provided detail on the amount, type of cable or hardware installed. As a result, we had no basis to assess the reasonableness of these charges.

OIG Recommendation

SSA should determine whether the nearly \$1.1 million NC-DDS paid for electrical wiring, data cabling and other build-out services was reasonable and seek reimbursement for any charges determined to be inappropriate.

NC-DDS Response

The OIG audit comments in this section are without factual standing. The Request For Proposals (RFP) bidding process for leasing space from a private entity contemplates that the RFP will include any items desired by the tenant so that bids received from lessors competing to provide the space will be all inclusive in their offers. The reality is that for buildings and systems of this complexity, this rarely happens. The provision of the building space and building systems for the term of the lease were included in the original bids in response to the RFP. It has also been clearly established that all of the necessary work to meet the SSA's cabling and electrical requirements were not included in the RFP. However,

this was the bid that was approved by the Council of State, the governing body of the state responsible for approving the winning bid, on January 5, 1999.

The State, without the owner's permission does not generally have authority to do work in a private, non-state building. The RFP did not provide a mechanism other than for telecommunications cabling, for the State to do work in the lessor's building. Upon execution of the lease, work can only be performed by the State with the "lessor's prior consent". Work on a private building is not contemplated in State public works statutes without a contractual process with the owner that allows the State to perform work in the owner's building. Even with the lessor's permission, after the fact, it is not practical or technically feasible to separate out the additional electrical requirements previously omitted that become integral to the electrical system to be provided by the lessor in their approved bid.

State public works statutes are applicable to work on State owned buildings and facilities, and do not specifically address work in leased facilities. DHHS' policy recognizes that leased buildings are non-state owned, but follows the same policy as provided in the statutes for State public works projects, i.e., a project legally awarded by the authorized State authority can be change ordered without re-bid of the entire NC-DDS leasing project. The change order process allows the normal flow of work by the building owner to continue during the construction of the leased space with a mutually negotiated price for changes requested by the tenant to the owner's building. This policy is applicable to the entire \$1.1 million in change order requests by the tenant.

The reasonableness of the cost charged by the lessor for the cabling and electrical work required by SSA guidelines was agreed to by all parties. An e-mail from the Assistant to the SSA State Director dated February 26, 1999 (copy provided to the OIG on June 21, 2005), references a meeting with all parties to the contract for the additional cabling and electrical work that included the SSA Regional Office Liaison. The e-mail stated that the SSA Regional Office Liaison "has GSA and SSA electrical engineers on standby to reach via cell phone." In an e-mail dated March 10, 1999 the SSA Regional Office Liaison also stated the following concerning the cabling and electrical work (MATCO proposal):

"This covers the 1A and electrical work. This is over 1000 drops and this new building is almost 45% larger than the current building. In addition, we designed this site for expansion. I recommend that we move ahead unless you have another issue. I have worked with SORG {electrical contractor} and MATCO {lessor} on this site design. ...we have the AIF money to cover this \$856,000."

In addition to all of the other documentation referencing the process for the negotiated price for the work, the above quotes make it clear that the government had ample opportunity to object if the price by the lessor was not viewed as reasonable.

The DHHS Property and Construction Division (and its registered engineers and architects) also reviewed the contract price and considers it to be a reasonable price based on costs for

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this type of work in North Carolina. Property and Construction professional engineers also reviewed the 1999 Means Estimating Guide and found that the lower range cost per square foot for the equivalent to this type of work was \$5.45 per square foot which compares well to the lessor's price of \$5.71 per square foot.

Although not a factor as to the reasonableness of the cost of the electrical work by the contractor, NC-DDS admits that the billing/invoicing process for this work lacked specificity. As a result of this finding in the OIG audit, NC-DDS has re-written its purchasing policy and has verbally informed staff that this revised policy must be followed. This change should ensure that sufficient detail is available about any future procurement.

As far as DHHS and NC-DDS are concerned, this is not a valid finding. Therefore, we do not agree that any repayment of these funds is warranted.

OIG Finding: Telephone System Inappropriately Funded

NC-DDS charged SSA \$650,427 to install a telephone system at its new building. Most of the telephone system was installed in December 1999. However, NC-DDS inappropriately used funds authorized for a previous FY to pay the FY 2000 telephone system installation expense. According to Federal regulations, Federal funds specifically authorized for a FY are to reimburse expenditures that occur in that period. Yet we found no evidence that SSA authorized the NC-DDS to expend prior year Federal funds for this expenditure. SSA authorized \$470,000 in FY 1997 funds to upgrade the telephone system at its old building. Also, the NC-DDS submitted a FY 1998 budget to SSA that indicated an additional \$170,000 was needed to complete the telephone system upgrade at the old location. We believe NC-DDS should not have used prior year Federal funds to pay for the telephone system at its new location. Rather, it should have returned funds not used for FY 1997, 1998, and 1999 expenditures and requested additional funds in FY 2000 for the new telephone system expense. Table 2 details the Federal funds NC-DDS used to pay for its new telephone system.

Table 2: Federal FY funds Used for the Telephone System

| <u>Fiscal Year</u> | <u>Funds Used</u> |
|--------------------|-------------------|
| 1997 | \$470,000 |
| 1998 | 170,988 |
| 1999 | 9,439 |
| Total | <u>\$650,427</u> |

OIG Recommendation

SSA should determine whether the \$650,427 NC-DDS paid for its new telephone system was appropriate and seek reimbursement for any charges determined to be inappropriate.

NC-DDS Response

We respectfully disagree with the auditor's position that NC-DDS inappropriately used funds authorized for a previous FY to pay the FY 2000 telephone system installation expense. NC-

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DDS received authorization from SSA to obligate FY 1997 and FY 1998 funds for the installation/upgrade of a NC-DDS telephone system. NC-DDS also received authorization from SSA for expenditure of FY 1999 AIF funds for furniture and site preparation expenses.

The installation/upgrade of the NC-DDS telephone system was delayed when NC-DDS became aware that they were going to move to a new location. Logic dictated that NC-DDS wait to have the new telephone system installed at its new location rather than incurring the additional expense of having to move the new telephone system once it was installed at the old location.

Since SSA had approved funds for phone system work in FFY 1997, FFY 1998 and FFY 1999, the NC-DDS Budget Office used the prior years' obligated/authorized funds in FFY 2000 for the installation of the new phone system in the new building. Therefore, we do not believe these funds should be returned to SSA as the expenditure was necessary and were used for the purpose they were originally intended, installation of a telephone system for the NC-DDS.

OIG Finding: Overlapping Rent Payment

NC-DDS paid \$518,000 in rent from August 1 to November 30, 1999 to lease a new building. NC-DDS also extended its lease and paid rent on its existing building from August 1 through December 31, 1999. Despite paying rent at both locations, NC-DDS did not move its staff into the new building until December 1999.

SSA approved the overlapping rent payments through December 1999—as long as the new building was ready for occupancy. In August 1999, an official from the State Property Office determined that “85 percent of the facility was substantially complete.” However, at that time, the required data cabling and wiring was not complete and the telephone system had not been installed. Further, the State Property Office instructed NC-DDS that it should not occupy the building until it obtained the proper Certificate of Occupancy. Unfortunately, NC-DDS did not obtain a Certificate of Occupancy until we initiated our audit—over 5 years later. We believe NC-DDS should not have paid rent on the new building until December 1, 1999 when the building was substantially complete.

OIG Recommendation

SSA should instruct NC-DDS to return the \$518,000 resulting from overlapping rent payments.

NC-DDS Response

We respectfully disagree with the auditor's position regarding overlapping rent payments. The State of North Carolina signed a lease in May, 1999 stating that rent payments would begin in August 1999. NC-DDS also received notification from the SSA Regional Office that they had approved the payment of double rent during the period August 1, 1999 through December 31, 1999.

The State Property Office in a letter dated August 9, 1999, stated that 85% of the property to be leased was available for beneficial occupancy by NC-DDS. The City of Raleigh, the inspections authority for this project, should have issued a certificate for partial occupancy for that part of the building that could be occupied, and should have also followed up with a full certificate of occupancy when the entire building was ready for occupancy. Although the certificate of occupancy was not issued by the City until August 2005, there was no indication by the city as to the actual date of the original occupancy inspection. Since the City is required by State Building Code to perform inspections throughout the various stages of building renovation during the actual construction, there is a high degree of certainty that all required building trade compliance inspections required before full occupancy, were conducted by the City during the period before NC-DDS took possession of the building. No definitive conclusion by the OIG or anyone else can be made about the exact date that all required inspections were made without more information. Rent payments should have begun, and did, when the property was available for NC-DDS to begin installation of equipment, whether or not the data equipment or telecommunications system was ready. The inadvertent failure of the City of Raleigh to timely issue an official certificate of occupancy is a moot point.

As to the issue of the availability of the SSA data wiring specifications, it has already been recognized that the RFP bid process did not include the extensive requirements by SSA. Since this work was done as a change order to the original RFP, this work, much of which becomes integral to the entire electrical system of the building would require additional time, which normally is granted to the lessor to prepare the building.

The overlapping payments for the two locations were clearly approved by all responsible parties and were clearly justified. Therefore, we do not agree that repayment of these funds is warranted.

OIG Finding: Cash Management

Funds to recover NC-DDS expenditures are drawn from Treasury's ASAP system. Cash draws made from ASAP are to reimburse NC-DDS for expenditures incurred during the same period as the account's FY reporting period. For each FY, NC-DDS is assigned a separate account in ASAP.

For each of the three ASAP accounts in our audit period, total cash draws did not equal total disbursements reported by the NC-DDS on the corresponding Forms SSA-4513. Additionally, each of the three accounts had available balances that exceeded unliquidated obligations reported on the Forms SSA-4513....

| <u>ASAP Available Balance</u> | |
|-------------------------------|------------------|
| FY 2001 | \$9,441 |
| FY 2002 | 12,810 |
| FY 2003 | 666,960 |
| Total | <u>\$689,211</u> |

OIG Recommendations

SSA should:

1. instruct NC-DDS to return the \$689,211 that remains unused in its FYs 2001 through 2003 ASAP accounts.
2. require that DDSs in the Atlanta Region obtain approval to transfer funds between ASAP accounts.
3. consider whether a reconciliation of ASAP cash draws to expenditures reported on the Form SSA-4513 is needed to assure ASAP cash disbursement were appropriate.
4. increase its oversight of the NC-DDS cash management activities and ensure that major capital procurements comply with Federal, State and SSA policies, procedures and regulations.

NC-DDS Response to Recommendation #1

Federal Fiscal Years 2001 and 2002 have been closed and will have no further expenditures or draws as of December, 2004. The SSA-4513 for the quarter ending December 31, 2004 indicated that there were no unliquidated obligations remaining. The expenditures and draws have been reconciled for both of these years. Until such time as an 872 Grant Award is received to officially decrease the award amount, the remaining balance will exceed the unliquidated obligations. When a grant year is closed, the SSA-4513 reports zero unliquidated obligations to indicate that all obligations have been met. The SSA- 4513 is the documentation used by the Regional Office to determine if a decrease in the grant award is necessary.

The \$9,441 balance remaining in the ASAP accounts for FY 2001 is due to refunds of expenditures, mainly sale of surplus property totaling \$7,288 and refund of dual employment expenses totaling \$2,153. The \$12,810 balance remaining in the ASAP accounts for FY 2002 is due to refunds of expenditures from the sale of surplus property. On January 11, 2006, the DHHS Controller's Office received instructions from the Regional SSA Office on how to resolve these balances. The Regional SSA Office requested that a final "amended" SSA-4513 report be submitted for FY 2001 and FY 2002, respectively, that reflects a reduction in the reported expenditures for the amounts of the refunds. Once the amended SSA-4513 reports are received, SSA will reduce the grant awards by the amount of the refunds. This, in turn, will leave zero balances in the ASAP accounts for FY 2001 and FY 2002. The amended SSA-4513 reports will be submitted in January 2006 in accordance with SSA instructions.

The \$666,960 balance remaining in the ASAP account for FY 2003 that was identified by the OIG auditor has been subsequently adjusted in accordance with SSA guidelines through December 2005. Federal Fiscal Year 2003 has now been closed and will have no further expenditures or draws as of December, 2005. As of December 31, 2005, there is a \$386.77 balance remaining in the ASAP account for FY 2003 that is due to refunds of expenditures from the sale of surplus property.

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In accordance with SSA Regional Office instructions, a final "amended" SSA-4513 report for FY 2003 will be submitted in January 2006 that reflects a reduction in the reported expenditures for the \$386.77. Once the amended SSA-4513 report is received, SSA will subsequently reduce the grant award by the amount of the refunds. This, in turn, will leave a zero balance in the ASAP account for FY 2003.

Once the amended SSA-4513 reports for FY 2001, 2002 and 2003 have been submitted, no further action will be necessary.

NC-DDS Response to Recommendation #2, 3 and 4

The basis for drawing funds is the Cost Allocation Report, which breaks down expenditures to the Federal Reimbursement Code (FRC) level by grant year. Until costs are injected and any costs allocated to FRC 99 are distributed, an exact total by FRC for each year is unknown. The majority of expenditures each month will be for the current Federal Fiscal Year. Payroll alone accounts for almost half of the total monthly expenditures, totaling just over \$2 million a month. The process that has been followed and approved for drawing funds allowed for a difference at the time the actual expenditure was made and the draw by grant year.

Reconciliation has always been completed to make any needed adjustment by grant year. At no time were funds drawn from one year versus another due to inadequate funding for a particular year. The SSA-4513, which is completed quarterly, accurately reflects the expenditures for the appropriate grant year. The ASAP cash disbursements have been reconciled to reported expenditures to assure that the disbursements were appropriate. This is standard procedure and is examined thoroughly prior to closing a grant year. At each month end, NC-DDS closes with the receipts and disbursement for that month in balance.

The DHHS Controller's Office has strengthened its cash management controls as a result of having more access to the data reported on the ASAP system than during the years covered by this audit. The draws are more timely between the Federal Fiscal Years. An additional position has added another layer to these controls. One responsibility of this position is to determine that draws are properly reported by our Federal Funds section, which completes these draws and that we are in agreement with the fund balances by year at all times. Additional Excel spreadsheets have been created since 2003 that also assist in this process.

OIG Finding: Consultative Examination Costs

NC-DDS paid \$18,705 in CE fees in excess of its fee schedule.... The NC DHHS Controller's office added employment tax (7.65%) to CE fees paid to medical providers that are employed by the State but perform services outside their State employment. The State deemed these employees to have "dual employment" status. Therefore, NC-DHHS considered it appropriate to add the tax, not realizing the mark up caused the fees to exceed the NC-DDS CE fee schedule. NC-DDS did not question this practice, and these excess CE costs were charged to SSA.

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Officials from both NC-DDS and NC-DHHS' Controller's Office agreed the addition of employment taxes caused NC-DDS to exceed its CE fee schedule. As a result of our audit, NC-DDS and NC-DHHS have revised their procedures to ensure CE payments to "dual employment" CE providers do not exceed the NC-DDS fee schedule.

OIG Recommendation

SSA should instruct NC-DDS to refund \$18,705 in unallowable CE fees resulting from the addition of employment taxes.

NC-DDS Response

We agree with the audit finding. The \$18,705 in excess CE fees resulted from reimbursing the parent agencies for the matching social security paid on behalf of NC-DDS for CE services. The practice had always been to pay the fee schedule amount plus the 7.5% matching social security. According to the State Personnel Manual, Section 3, all dual employment payments to the parent agency must include the employer's social security contributions computed on the amount of payment.

As a result of the audit finding, the NC-DDS and the DHHS Controller's Office have revised the procedure for processing Dual Employment to ensure that payments for consultative examination fees will not exceed the approved fee schedule in the future.

OIG Finding: Payroll Costs

In FY 2003, NC-DDS claimed reimbursement for \$2,338 in excess payroll costs. In January 2003, a DDS employee transferred from a position that was fully chargeable to SSA to one that was only partially chargeable because the new position was not 100 percent dedicated to SSA related work. At the beginning of January 2003, a manual payroll action was made to properly allocate the employee's salary expense for that month. However, because of a payroll processing error, a portion of the employee's wages was incorrectly charged to SSA from February through June 2003.

In July 2003, the NC-DHHS Controller's Office identified the error and took corrective action to ensure it did not charge the employee's future payroll expense to SSA. However, the Controller's Office did not retroactively adjust the payroll expense and, as a result, its unallowable wages and benefits of \$2,338 were charged to SSA. We discussed this matter with officials from the NC-DDS and the NC-DHHS Controller's Office. The officials agreed the payroll expense was incorrectly charged to SSA.

OIG Recommendation

SSA should instruct NC-DDS to refund \$2,338 for unallowable payroll expenses.

NC-DDS Response

The DHHS Controller's Office received an employee's PD-105 Personnel Action Form with an effective date of January 6, 2003 that reallocated an employee from Cost Center

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2125243072 to Cost Center 2125245199. The employee's wages, social security and retirement were split correctly during the month of January 2003. However, because of a keying error, the employee's salary and fringes were incorrectly split between cost centers for an additional five months (February - June 2003).

The DHHS Controller's Office has strengthened its internal control procedures to prevent this from happening again. In addition, the DHHS Controller's Office has posted adjusting entries with a general ledger effective date of May 31, 2005 to reclassify the \$2,338 payroll expenses that were incorrectly charged to SSA. This adjustment was included in the FY 2005 expenditures that were reported on the SSA-4513 report for the quarter ending June 30, 2005. Therefore, we consider this audit finding resolved.

OIG Finding: Inventory Controls

NC-DDS' inventory list was incomplete because it did not reflect 719 computers SSA purchased for the DDS. According to SSA instructions, "(t)he State is responsible for maintenance and inventory of all equipment acquired – whether purchased through SSA or the State." The State did not include the computers on the NC-DDS inventory because the equipment was known to be SSA's property. Failure to maintain a current and accurate inventory list reduces the DDS' ability to properly safeguard its assets.

OIG Recommendation

SSA should instruct NC-DDS to inventory all SSA-provided computers.

NC-DDS Response

We respectfully disagree that NC-DDS does not maintain a current and accurate inventory of equipment directly purchased by SSA. NC-DDS has always maintained an inventory listing of all equipment received from SSA that was not funded out of the NC-DDS budget. The inventory listing is maintained by the NC-DDS Information Technology Manager's position because all IT related equipment (computers, printers, etc.) are directly purchased by SSA.

All other equipment/fixed assets that are purchased through the NC-DDS budget are recorded on the NC DHHS Fixed Asset System (FAS) that is maintained by the DHHS Controller's Office. Throughout the year as items are purchased, NC-DDS submits documentation to the DHHS Controller's Office to update the FAS. A physical inventory is conducted annually and FAS reports are reconciled to the actual inventory counts for each agency.

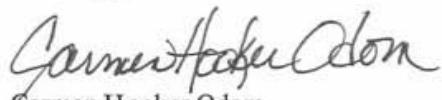
However, during the time of the audit, NC-DDS was not providing a copy of the SSA funded inventory listing to the DHHS Controller's Office to maintain in their files. The DHHS Controller's Office has revised its procedures to require NC-DDS to submit a copy of its SSA inventory along with the FAS reports when the annual inventory is completed.

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This concludes our detail response for each of the issues listed in the OIG report. The Department of Health and Human Services appreciates the opportunity to convey the background information and/or corrective actions that NC-DDS has taken to address the issues identified in the audit. We would also like to thank the OIG for the additional time granted to respond to this audit.

Should you have any questions or need additional information, please contact Dan Stewart, Assistant Secretary for Policy, Planning and Compliance at (919) 733-4534.

Sincerely,



Carmen Hooker Odom

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Appendix E

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