

August 14, 1998

Ms. Linda Dorn
Director, Family Independence Agency
Disability Determination Service
1st Floor Ottawa Building
611 West Ottawa
Lansing, Michigan 48933

Dear Ms. Dorn:

The enclosed final report presents the results of our review, "Audit of Administrative Costs at the Michigan Disability Determination Service" (A-05-96-51095). The objectives of our review were to evaluate the Michigan Disability Determination Service's internal controls over the accounting and reporting of administrative costs and to determine the allowability and allocability of costs claimed.

We would appreciate your views and the status of any further action taken or contemplated on our recommendation within the next 60 days. If you wish to discuss the final report, please call me or have your staff contact Daniel R. Devlin, Deputy Assistant Inspector General for Audit, at (410) 965-9702.

Sincerely,

Pamela J. Gardiner
Assistant Inspector General
for Audit

Enclosure

**OFFICE OF
THE INSPECTOR GENERAL**

SOCIAL SECURITY ADMINISTRATION

**AUDIT OF ADMINISTRATIVE
COSTS AT THE MICHIGAN
DISABILITY DETERMINATION
SERVICE**

August 1998 A-05-96-51095

AUDIT REPORT



EXECUTIVE SUMMARY

OBJECTIVES

The objectives of this review were to evaluate the Michigan Disability Determination Service's (MDDS) internal controls over the accounting and reporting of administrative costs and to determine the allowability and allocability of costs claimed.

BACKGROUND

The Disability Insurance (DI) program was established in 1954 under title II of the Social Security Act (*the Act*). The program is designed to provide benefits to wage earners and their families in the event the family wage earner becomes disabled. Supplemental Security Income (SSI) was created as a result of the Social Security Amendments of 1972 with an effective date of January 1, 1974 (Public Law (P.L.) 92-603). SSI (title XVI of *the Act*) provides a nationally uniform program of income and disability coverage to financially needy individuals who are aged, blind or disabled.

The Social Security Administration (SSA) is primarily responsible for implementing the general policies governing the development of the disability claims under the DI and SSI programs. Determinations of disability under both DI and SSI are performed by Disability Determination Services (DDS) in each State in accordance with Federal regulations. In carrying out its obligations, each DDS is responsible for determining the claimants' disabilities and ensuring that adequate evidence is available to support its determinations. To assist in making proper disability determinations, the DDS is authorized to purchase medical examinations, x-rays, and laboratory tests on a consultative basis to supplement evidence obtained from claimants' physicians or other treating sources.

SSA reimburses the DDS for 100 percent of allowable expenditures. Each year, the DDS submits a budget request to SSA for review and approval. Once approved, the parent agency responsible for disability determination services is allowed to withdraw Federal funds through the Department of the Treasury (Treasury) to meet immediate program expenses. At the end of each quarter of the fiscal year (FY), the parent agency submits to SSA a "State Agency Report of Obligations for SSA Disability Programs" (Form SSA-4513) to account for program disbursements and unliquidated obligations.

For FY 1994, MDDS claimed \$52,212,239 in administrative costs to process 159,108 disability claims under SSA's DI and SSI programs. For FY 1995, \$53,257,613 was claimed to process 143,033 disability claims.

Our audit was conducted in accordance with generally accepted government auditing standards. We conducted our audit from July 1996 through July 1997 at the MDDS in Lansing, Michigan, and in our Chicago, Illinois, office.

RESULTS OF REVIEW

For FYs 1994 and 1995, we reviewed administrative costs for personnel, fringe benefits, travel, equipment, and rent. These costs were allowable and properly allocated. We also examined costs claimed for medical payments, indirect costs and Federal financial reporting. While medical payments and Federal financial reporting were adequate, we cannot recommend that SSA accept MDDS' calculation of indirect costs.

Indirect costs claimed by MDDS were calculated using fixed¹ instead of final indirect cost rates. Indirect costs were calculated without an adjustment being made to actual costs, once actual rates became known. As a result, MDDS claimed \$352,233 more than allowable in indirect costs during FY 1993 and the first 3 months of FY 1994 because it did not recalculate its claims once final indirect cost rates were known.

RECOMMENDATION

We recommend that SSA disallow the indirect costs claimed (\$352,233) that were in excess of allowable costs.

SSA/MDDS COMMENTS

Both SSA and MDDS agreed with our recommendation.

¹ Section II of the Indirect Cost Rate Agreement negotiated between the U.S. Department of Education and the Michigan Department of Education under the caption "fixed rate" states,

"the negotiated fixed rate is based on an estimate of the costs which will be incurred during the period to which the rate applies. When the actual costs for such period have been determined, an adjustment will be made in a subsequent negotiation to compensate for the difference between the costs used to establish the fixed rate and the actual costs."

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INTRODUCTION

OBJECTIVES

The objectives of this review were to evaluate MDDS' internal controls over the accounting and reporting of administrative costs and to determine the allowability and allocability of costs claimed.

BACKGROUND

The DI program was established in 1954 under title II of *the Act*. The program is designed to provide benefits to wage earners and their families in the event the family wage earner becomes disabled. SSI was created as a result of the Social Security Amendments of 1972 with an effective date of January 1, 1974 (P.L. 92-603). SSI (title XVI of *the Act*) provides a nationally uniform program of income and disability coverage to financially needy individuals who are aged, blind, or disabled.

SSA is primarily responsible for implementing the general policies governing the development of the disability claims under the DI and SSI programs.

Determinations of disability under both DI and SSI are performed by DDSs in each State in accordance with Federal regulations. In carrying out its obligations, each DDS is responsible for determining the claimants' disabilities and ensuring that adequate evidence is available to support its determinations. To assist in making proper disability determinations, the DDS is authorized to purchase medical examinations, x-rays, and laboratory tests on a consultative basis to supplement evidence obtained from claimants' physicians or other treating sources.

SSA reimburses the DDS for 100 percent of allowable expenditures. Each year, the DDS submits a budget request to SSA for review and approval. Once approved, the parent agency responsible for disability determination services is allowed to withdraw Federal funds through the Treasury to meet immediate program expenses. At the end of each quarter of the FY, the parent agency submits to SSA a "State Agency Report of Obligations for SSA Disability Programs" (Form SSA-4513) to account for program disbursements and unliquidated obligations.

For FY 1994, MDDS claimed \$52,212,239 in administrative costs to process 159,108 disability claims under SSA's DI and SSI programs and for FY 1995, \$53,257,613 was claimed to process 143,033 disability claims.

On January 1, 1994, MDDS changed parent agencies from the Michigan Department of Education (MDE) to the Michigan Department of Social Services (MDSS). MDSS changed its name to the Family Independence Agency (FIA) during 1996. MDDS is currently a component within FIA.

SCOPE AND METHODOLOGY

Our audit was conducted in accordance with generally accepted government auditing standards. The objectives of this review were to evaluate MDDS' internal controls over the accounting and reporting of administrative costs and to determine the allowability and allocability of costs claimed.

To accomplish our objectives, we:

- Reviewed applicable Federal laws, regulations, and instructions.
- Reviewed relevant MDDS policies and procedures.
- Reviewed Federal financial reports and supporting documentation submitted by MDDS for FYs 1994 and 1995 to account for program disbursements and unliquidated obligations. Based on our review of FYs 1994 and 1995 disbursements and unliquidated obligations, we expanded our review to include prior and subsequent FY disbursements for those areas in which findings were identified.
- Evaluated significant internal control areas regarding MDDS administration and tested selected transactions related to those internal control areas.
- Reviewed the State of Michigan's Single Audit reports for MDE and MDSS for the FYs ended September 30, 1993 and September 30, 1994, respectively. At the time of our review, these were the most recently completed Single Audits performed. We reviewed applicable working papers prepared by the Michigan Office of the Auditor General in its Single Audit of MDE and MDSS for FYs 1993 and 1994, respectively. Based on that review, we relied on the work of the Michigan Office of Auditor General to reduce the extent of testing in the eight significant internal control areas we identified.
- Reviewed MDDS supporting documentation for medical service records.
- Verified reconciliation of MDDS accounting records to administrative costs reported by MDDS to SSA for FYs 1994 and 1995.

- Reviewed relevant Medicare Part B Clinical and Laboratory test fee schedules in force for Michigan during Calendar Years 1994 and 1995.
- Reviewed American Medical Association (AMA) "Physician's Current Procedural Terminology Book for Medicare" laboratory test procedure codes.
- Interviewed AMA officials to determine the proper Medicare procedure codes for laboratory tests.

We identified eight significant internal control areas relevant to our audit objectives. These were personnel, fringe benefits, duplicate medical payments, employee travel, equipment purchases, rent, letter of credit, and financial reporting. We reviewed each of the significant areas identified for compliance with applicable laws and regulations. Except as noted in the RESULTS OF REVIEW section of this report, we found no instances of noncompliance.

We conducted our audit from July 1996 through July 1997 at MDDS in Lansing, Michigan, and in our Chicago, Illinois, office.

RESULTS OF REVIEW

INDIRECT COSTS CLAIMED BY MDDS

Our review of indirect costs claimed by MDDS disclosed that costs were calculated using fixed instead of final indirect cost rates. When the actual costs for FY 1993 and the first 3 months of FY 1994 were determined, adjustments were not made to compensate for the differences between the cost used to establish the fixed rates and the final rates. As a result, MDDS claimed \$352,233 more in indirect costs during FY 1993 and the first 3 months of FY 1994 by using fixed indirect cost rates and not recalculating its claims once final indirect cost rates were known.

Section II of the Indirect Cost Rate Agreement negotiated between the U.S. Department of Education and MDE under the caption "fixed rate" states,

"the negotiated fixed rate is based on an estimate of the costs which will be incurred during the period to which the rate applies. When the actual costs for such period have been determined, an adjustment will be made in a subsequent negotiation to compensate for the difference between the cost used to establish the fixed rate and the actual costs."

FY 1993 Indirect Costs

On January 1, 1994, MDDS changed parent agencies from MDE to MDSS. Subsequently, MDSS changed its name to FIA. MDDS is currently a component within FIA. FIA does not use an indirect cost rate for allocating parent agency costs. Rather, parent agency costs are directly allocated to subsidiary agencies based on the number of employees (indirect costs are allocated based on the percentage of MDDS staff identified to the total FIA staff).

In FY 1993, MDDS claimed \$2,162,646 in indirect costs using a 4.7 percent fixed rate. We asked MDE officials to obtain a final indirect cost rate for FY 1993. MDE is responsible for obtaining indirect cost rates on behalf of MDDS from the U.S. Department of Education. The final indirect cost rate was 3.4 percent. Using the 3.4 percent final indirect cost rate, we calculated the FY 1993 indirect costs to be \$1,564,467. Therefore, MDDS claimed \$598,179 more in indirect costs for FY 1993 by using a fixed rather than final indirect cost rate. MDE officials

informed us that a final indirect cost rate was not obtained for FY 1993 since they obtained a final indirect cost rate for FY 1994.

FY 1994 Indirect Costs

When MDDS changed parent agencies on January 1, 1994 from MDE to MDSS, MDDS calculated indirect costs of \$181,786 for the period October 1, 1993 through December 31, 1993 using a 1.7 percent fixed rate. Although MDE obtained a final indirect cost rate for FY 1994 in September 1995 of 4 percent, MDDS failed to recalculate its indirect cost claim once it changed parent agencies. We believe that indirect costs for the first 3 months of FY 1994 should have been \$427,732 based on the 4 percent final indirect cost rate. When the indirect costs for FY 1994 were determined, an adjustment was not made to compensate for the difference between the cost used to establish the fixed rate and the final rate. Therefore, MDDS underclaimed \$245,946 in indirect costs by using a fixed rather than final indirect cost rate.

The net MDDS overclaim of \$352,233 resulted from the difference between the FY 1993 overclaim of \$598,179 and the underclaim of \$245,946 for the first 3 months of FY 1994.

RECOMMENDATION

We recommend that SSA disallow the indirect costs claimed (\$352,233) that were in excess of allowable costs.

SSA MDDS COMMENTS

Both SSA and MDDS agreed with our recommendation. (See Appendices A and B for the complete text of the SSA and MDDS comments, respectively)

OTHER MATTERS

SSA asked us to determine the disposition of funds allotted to MDDS to purchase the Intelligent Workstations/Local Area Network (IWS/LAN) and Disability Determination Claims Processing System (DDCPS). This project was initially funded by SSA during FY 1992. SSA informed us that MDDS could not provide supporting documentation for this project and asked us to determine if costs for this project were properly documented.

We found that MDE entered into an agreement with the Office of Information Technology, Michigan Department of Management and Budget, to develop and implement this system for MDDS. Based on invoices provided to us by MDDS, as of September 30, 1996, MDDS incurred expenditures of \$4,921,158 for this project. We examined three purchase invoices amounting to \$1,460,983, (almost 30 percent of total incurred expenditures by MDDS). We selected the three invoices because they contained the largest dollar amount of computer hardware and software purchases since the inception of the project. Based upon our review, we believe that the documentation is available to support the \$4,921,158 claimed for the IWS/LAN-DDCPS project as of September 30, 1996.

APPENDICES

SSA COMMENTS

MDDS COMMENTS

MAJOR REPORT CONTRIBUTORS

Office of Inspector General

Roger Normand, Director, Northern Program Audit Division

Barry Shulman, Deputy Director, Northern Program Audit Division, Chicago

Richard Dubin, Auditor

For additional copies of this report, please contact the Office of the Inspector General's Public Affairs Specialist at (410) 966-9135. Refer to Common Identification Number A-05-96-51095.

SSA ORGANIZATIONAL CHART
