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**OFFICE OF  
THE INSPECTOR GENERAL**

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**SOCIAL SECURITY ADMINISTRATION**

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**PUERTO RICO DISABILITY  
DETERMINATION PROGRAM  
INDIRECT COST REVIEW**

**September 2004**

**A-06-04-34035**

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**AUDIT REPORT**

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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.

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- 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.
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- Access to all information necessary for the reviews.
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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:** September 16, 2004 **Refer To:**

**To:** Beatrice Disman  
Regional Commissioner  
New York

**From:** Assistant Inspector General  
for Audit

**Subject:** Puerto Rico Disability Determination Program Indirect Cost Review (A-06-04-34035)

### **OBJECTIVE**

Our objectives were to (1) determine whether indirect costs charged to the Puerto Rico Disability Determination Program (PR DDP) for State Fiscal Year (SFY) 2002 were allowable and allocable; (2) identify any non-recurring indirect costs from Federal Fiscal Year (FY) 2002 that should not be considered in the indirect cost rate negotiations; and (3) identify and review the accumulated leave payments for PR DDP retirees.

### **BACKGROUND**

The Disability Insurance (DI) program was established in 1954 under Title II of the Social Security Act. The program provides a benefit to wage earners and their families in the event the wage earner becomes disabled.

The Social Security Administration (SSA) is primarily responsible for implementing policies governing the development of disability claims under the DI program.<sup>1</sup> In Puerto Rico, SSA uses the PR DDP to develop disability claims. The PR DDP is responsible for evaluating claimants' disabilities and submitting the results to SSA. In turn, SSA reimburses the Puerto Rico Department of Family (PR DF) for 100 percent of allowable PR DDP expenditures incurred in making disability determinations under the

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<sup>1</sup> Supplemental Security Income is not available to residents of Puerto Rico. Accordingly, PR DDP only makes disability determinations for applicants eligible under the DI program.

DI program. The total allowable expenditures are comprised of the allowable direct costs of the program plus allowable indirect costs based on the negotiated indirect cost rate.<sup>2</sup>

PR DDP is a component of the PR DF. PR DF submits its indirect cost proposal to the cognizant Federal agency, the Department of Health and Human Services, Division of Cost Allocation, for review and approval. The administrative expenses included in proposed indirect cost rates consist of (1) Central Service costs allocated as part of the State-wide cost allocation plan and (2) expenses the PR DF incurred in supporting the PR DDP. Puerto Rico hired a private contractor to develop the indirect cost proposal. Because PR DF did not have a cost accounting system, the contractor identified the total costs expended during the SFY from the PR DF records and assigned salary and related costs to cost components.<sup>3</sup> The contractor assigned salary and related costs based on prior year information and on discussions with Human Resources Division personnel who informed him where the individuals worked. Other costs were directly identified to the cost components.

The cost data used in the SFY 2004 Indirect Cost Proposal were based on actual administrative costs incurred during SFY 2002 (July 1, 2001 through June 30, 2002). During SFY 2002, PR DF allocated about \$39.2 million in costs to various funding sources. Of this amount, about \$27.3 million was for salaries and related benefits. To allocate the administrative expenses from each cost component to sponsoring agencies, the contractor used a step-down allocation method<sup>4</sup> and pre-defined allocation bases, such as number of employees for each component or number of transactions processed. Appendix B contains the Scope and Methodology of our review.

## **RESULTS OF REVIEW**

The administrative costs allocated to PR DDP in the SFY 2004 Indirect Cost Proposal were not reasonable. We found that allocation statistics were inflated, and the direct cost base was inaccurate. Also, PR DF improperly charged SSA directly for costs

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<sup>2</sup> Direct costs can be identified specifically with a particular cost objective (Office of Management and Budget [OMB] Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, Attachment A, Section E.1.). Examples include expenditures for personnel, equipment, and travel. Indirect costs arise from activities that benefit multiple cost objectives but are not readily assignable to any one cost objective (OMB Circular A-87, Attachment A, Section F.1.). Examples include the cost of services, such as accounting, auditing, budgeting, and payroll.

<sup>3</sup> We use the term “cost component” to refer to any department within PR DF that supplied goods, services, and facilities.

<sup>4</sup> The step-down allocation method, also called the sequential allocation method, allocates costs to cost components in sequence. Once a component’s costs have been allocated, they are removed from the allocation order, and the costs of any subsequent component are not allocated back to it. As a result, this method does not recognize the total services cost components provide each other. Further, different sequences will result in different allocations of costs to a particular cost component. The Division of Cost Allocation recommended this method for use by PR DF for its proposed indirect cost rate.

allowable as indirect expenses including (1) costs incurred for employees who elected early retirement and (2) payments for unused leave balances for employees who terminated their employment with the PR DDP.

## **REASONABLENESS OF PROPOSED INDIRECT COSTS**

Indirect costs assigned to the PR DDP from SFY 2002 costs were not reasonable because cost allocation statistics assigned to the PR DDP were inflated, and the total direct cost base used as the denominator in calculating the proposed rate was inaccurate.

PR DF's proposed indirect cost rate for SFY 2004 was calculated as a ratio between the PR DF's actual administrative costs allocated to the PR DDP (numerator) and the actual total direct costs identifiable to the PR DDP (denominator) during SFY 2002.

| <b>Indirect Cost Rate<br/>As Reflected in Puerto Rico's Indirect Cost Proposal for SFY 2004</b>   |             |                              |
|---|-------------|------------------------------|
| PR DF administrative costs<br>allocated to PR DDP   | \$1,392,141 |                              |
| Total PR DDP Direct Costs   | \$8,500,188 | ----- = Proposed Rate 16.38% |
| Amounts included in the Indirect Cost Proposal were based on actual administrative costs incurred during SFY 2002 (July 1, 2001 through June 30, 2002). |             |                              |

We limited our review to testing the reasonableness of (1) the \$1,392,141 in administrative costs included in the numerator by evaluating the allocation statistics used to derive the amount and (2) the \$8,500,188 in direct costs included in the denominator by reviewing amounts included in the total.

## **Accuracy of the Statistics Used in the Allocation of Costs**

Costs were allocated to the PR DDP from 15 cost components. Of the 15 cost components, 6 comprised 82.52 percent (\$1,057,566) of the total administrative costs allocated (\$1,281,565) to the PR DDP. The six cost components consisted of Payment, Federal Reports, Contract Control, Collection, Pre-audit, and Accounting (see Appendix C). PR DF increased the total amount of allocated costs with a cost adjustment (\$110,576) to recover non-recurring indirect salaries converted to direct costs.

We interviewed component directors and staff and reviewed allocation calculations to assess the reasonableness of the statistics used for these six cost components. Based on these discussions, we determined the level of support provided by the PR DF to PR DDP activities was inconsistent with the statistics used for allocating costs in four of six cost components. For example, the number of checks processed as used for the Payment cost component was unreasonable because the effort required by the Payment cost component to process PR DDP checks was distinctly less than that required to process other checks included in the statistic.

The PR DF allocated costs from the Payment cost component based on a count of 50,035 checks issued for the PR DDP, representing 98.97 percent of the total number of checks used as the allocation statistic. However, the total check count used for the PR DDP was inflated. The accounting records (a log maintained by the Payment cost component) supported a count of about 38,000 checks issued for the PR DDP and about 14,000 checks issued for other PR DF agencies. Further, the checks issued for the PR DDP did not require the same effort as checks issued for other agencies. Specifically, the checks were sent out in batches to be printed while checks for other agencies were individually printed in the Payment section. The PR DDP checks were sent out for printing in batch mode 6 times during the year averaging 6,000 checks per batch. Based on discussions with staff from the Payment cost component, the amount of work to write individual checks for other agencies was the same as for each batch of checks.

Other tasks performed by Payment staff, such as bank reconciliation, copying, mailing and filing, were the same for PR DDP checks and checks of other agencies. However, in view of the discrepancy with the number of checks included in the allocation statistic and the level of effort associated with each check, the allocation of 98.97 percent of the Payment cost component to the PR DDP did not represent a reasonable allocation.

Another example involved the statistics used for allocating administrative costs for the Contract Control cost component. While PR DF identified 196 contracts for consideration in the statistic, only 50 contracts were used because of the allocation methodology, and 33 (66 percent of 50) of these were PR DDP contracts. We were told that the PR DDP prepared about 25 of the contracts, which were for medical professional services, and PR DF's involvement was minimal because the contracts were forwarded to the Contract Control cost component only once each year. Based on interviews with personnel in the Contract Control cost component, we estimate the PR DDP-related workload was an average of 6.36 percent. Furthermore, according to the Contract Control Director, the bulk of the workload was derived from working over 600 contracts related to Family Services. However, the indirect cost proposal reflected the use of only 4 percent of the contracts, the equivalent of 2 of the 50 contracts, for Family Services.

The percentage of costs that was allocated to the PR DDP from the Accounting and Pre-audit cost components did not reasonably reflect the level of effort expended; however, for the Collection and Federal Reports cost components, the statistics used

were reasonable. PR DDP received 47.86 percent of costs from Accounting and 48.03 percent from Pre-audit. According to interviews with staff and administration, the level of effort expended on PR DDP-related activity for these two cost components averaged 23.30 percent and 25.00 percent, respectively.

The use of inflated statistics raised questions about the reasonableness of the proposed rate for SFY 2004 for the PR DDP as well as for indirect cost rates negotiated for prior years; particularly since PR DDP costs were fully funded while costs allocated to other sponsoring Federal agencies were only partially funded.

### **Accuracy of Costs Included in the Direct Cost Base**

The direct cost base (denominator) consisted of total direct costs incurred less medical costs (professional services) and equipment purchases over \$50 incurred during the SFY. The direct cost base used in the proposal was \$8,500,188. Based on the supporting documentation, the direct costs for SFY 2002 totaled \$9,012,570—\$512,382 more than the amount used to compute the proposed rate. The contractor did not provide any documentation to support reducing the direct cost amount by \$512,382. By using the lower amount in the denominator, the proposed indirect cost rate was increased by .93 percent. See Appendix D for the supported direct cost base compared to the base used in the proposal.

### **PROGRAM COSTS FOR EMPLOYEES ELECTING EARLY RETIREMENT**

Program costs for employees electing early retirement are an abnormal cost to the agency and are allowable if (1) approved by the cognizant Federal agency<sup>5</sup> and (2) are consistent with policies, regulations, and procedures applied uniformly to both Federal awards and other activities of the governmental unit.<sup>6</sup> Any authorizations or approvals obtained from SSA contain an implicit requirement that actions taken or costs incurred comply with applicable Federal regulations.

PR DF, through PR DDP, improperly charged early retirement program costs as direct costs because the costs were not approved by the cognizant Federal agency, and the treatment of the costs was not consistent with other activities of the governmental unit. While the New York Regional Office (NYRO) approved PR DF's request to participate in the first early retirement program, PR DF did not obtain the necessary approval from the Department of Health and Human Services. In Federal FY 2002, PR DF charged PR DDP \$131,382 in early retirement costs as direct costs, and it charged \$943,042 in similar PR DF costs as general administrative expenses (indirect costs). For FYs 2000 through 2002, PR DF charged \$407,057 directly to SSA for annuities and related costs for employees who participated in the early retirement program. According to the Human Resources Director, if SSA had not agreed to fund the early retirement program,

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<sup>5</sup> OMB Circular A-87, Attachment B, Section 11.g.(3) (as amended August 29, 1997).

<sup>6</sup> OMB Circular A-87, Attachment A, Section C.1.e. (as amended August 29, 1997).

PR DDP would not have allowed its employees to participate in the early retirement program. See Appendix E for the early retirement costs associated with PR DDP.

On November 21, 2003, the NYRO Commissioner sent correspondence to the PR DF stating that SSA was rescinding its financial support and authorization for the PR DDP to participate in future early retirement programs. NYRO informed the Secretary of PR DF that the initial authorization from SSA to participate in the first early retirement program was not intended to be a blanket authorization to participate in any subsequent offerings.

### **PROGRAM COSTS FOR UNUSED LEAVE PAYMENTS FOR EMPLOYEES WHO TERMINATED THEIR EMPLOYMENT WITH THE PUERTO RICO DISABILITY DETERMINATION PROGRAM**

Payments for unused leave for employees who terminated their employment through retirement or other separation are allowable "...provided they are allocated as a general administrative expense to all activities of the governmental unit or component."<sup>7</sup> PR DF improperly charged, as a direct expense, \$28,842 in costs associated with the unused leave payments for terminated employees during SFY 2002. In total, PR DF improperly charged SSA \$323,080 for costs associated with unused leave payments for these employees from SFYs 2000 through 2003. Additionally, \$50,193 had been paid during SFY 2004 to terminated employees as of the end of our field work, resulting in a total program cost of \$373,273. See Appendix F for the payments for unused leave by SFY.

PR DDP employees who were paid for the balance of their unused leave included employees who participated in the early retirement program, regular retirees, and employees who resigned. Fifteen PR DDP employees participated in the early retirement programs. Of the 15 employees, 7 received installment payments prorated over a period equal to the number of months needed to reach normal retirement, but not to exceed a period of 5 years, while the other 8 received lump-sum payments.<sup>8</sup> Additionally, 12 employees received lump-sum payments as regular retirees, and 12 employees received lump-sum payments because they separated from service. All payments for unused leave balances have been completed with the exception of two payments totaling \$13,991. These payments were pending completion of the necessary paperwork.

During its indirect cost negotiations with the PR DF, NYRO discussed Disability Determination Services Administrators Letter No. 615 (DDSL 615).<sup>9</sup> DDSAL 615 is a reminder of the correct procedure for reporting payments for accumulated leave or severance pay when an individual leaves the PR DDP. It also urged Disability

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<sup>7</sup> OMB Circular A-87, Attachment B, Section 11.d (3) (as amended August 29, 1997).

<sup>8</sup> Under the early retirement laws, the State has the option to make these payments in installments or in a lump sum. 1998 PR Laws 182 and 2000 PR Laws 174.

<sup>9</sup> DDSAL 615, effective July 31, 2002.

Determination Services to examine their indirect cost agreements to ensure they are structured to account for payment of unused leave to retired/terminated employees in accordance with OMB Circular A-87.

In a May 15, 2003 letter to the Secretary of the PR DF, the Regional Commissioner informed the Secretary that they were to cease improperly charging the accumulated leave cost as a direct cost, and that all costs improperly charged to SSA would be subject to disallowance.

## **CONCLUSIONS AND RECOMMENDATIONS**

The administrative costs allocated to the PR DDP in the SFY 2004 Indirect Cost Proposal were not reasonable because allocation statistics were inflated and the direct cost base was inaccurate. Also, the PR DF improperly charged SSA directly for costs allowable as indirect expenses. This included costs incurred for employees who elected early retirement and payments for unused leave balances for employees who terminated their employment with the PR DDP.

Accordingly, we recommend that SSA instruct PR DF to do the following:

1. Adjust the cost allocation statistics used for the SFY 2004 indirect cost proposal to better reflect the amount of effort PR DF expended on PR DDP activities. These adjustments should be used in negotiations with the Division of Cost Allocation to establish the indirect cost rate.
2. Reduce direct costs charged to SSA for early retirement costs for PR DDP employees who elected early retirement. These costs totaled \$407,057 for FYs 2000 through 2003.
3. Reduce direct costs charged to SSA for unused leave payments for PR DDP employees who terminated their employment through retirement or other separation. This consisted of \$323,080 identified during SFYs 2000 through 2003; \$50,193 identified as of December 1, 2003; and any additional amounts charged after December 1, 2003.

## **AGENCY COMMENTS**

SSA agreed with our recommendations. See Appendix G for the full text of SSA's comments.

## **STATE AGENCY COMMENTS**

PR DF stated its general disagreement with the findings but did not directly comment on the recommendations. However, specific comments provided by PR DF acknowledged the problems identified and indicated at least partial implementation of the recommendations.

With respect to the cost allocation statistics, PR DF stated it disagreed with our conclusion that costs allocated from the Payment, Contract Control, Accounting, and Pre-audit components to the PR DDP did not reasonably reflect the level of effort expended. PR DF also disagreed with our conclusion that 14,000 checks were issued for other PR DF agencies. PR DF acknowledged the direct cost base used in the SFY 2004 Indirect Cost Proposal was inaccurate and has adjusted the base accordingly.

Concerning program costs for early retirement and unused leave payments, PR DF partially agreed with our recommendations but stated it was not reasonable to shift all the responsibility for the incorrect treatment of these costs to the PR DF. According to the State response, neither the PR DF nor the New York Region was aware until July 2002 that these charges were inappropriate. PR DF believes only costs incorrectly charged after July 2002 should be considered improper.

See Appendix H for the full text of the State Agency's comments.

## OIG RESPONSE

PR DF's comments regarding the Payment component did not address our finding that batch processing of DDP checks greatly reduced the actual level of effort. We determined 14,000 checks were issued to other PR DF agencies through examination of the payment clerk's check log. While disagreeing with our specific estimates for the Contract Control and Accounting components, PR DF acknowledged its statistics were overstated. Regarding the Pre-audit component statistic, our estimate was based not only on our interview with the unit supervisor, but on interviews with eight other staff members.

Without regard to when either the NYRO or the PR DF became aware that early retirement and unused leave payment costs were being improperly charged, all governmental units are responsible for assuring proper administration of Federal awards.<sup>10</sup> In this case, all early retirement and unused leave payments costs charged directly to SSA were improper, including those charges made before July 2002.

NYRO, the Division of Cost Allocation, and the PR DF have agreed to work together to resolve these issues.



Steven L. Schaeffer

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<sup>10</sup> OMB Circular A-87, Attachment A, Section A.2.a.(3) (as amended August 29, 1997).

# *Appendices*

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[\*\*APPENDIX A\*\*](#) – Acronyms

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

[\*\*APPENDIX C\*\*](#) – State Fiscal Year 2002 Administrative Expenses Allocated to the Puerto Rico Disability Determination Program

[\*\*APPENDIX D\*\*](#) – Comparison of Direct Cost Bases

[\*\*APPENDIX E\*\*](#) – Costs Charged for the Early Retirement Program

[\*\*APPENDIX F\*\*](#) – Payments for Unused Leave by State Fiscal Year

[\*\*APPENDIX G\*\*](#) – Agency Comments

[\*\*APPENDIX H\*\*](#) – State Agency Comments

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

## **Appendix A**

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### **Acronyms**

|        |  |
|--------|--|
| DI     | Disability Insurance                         |
| FY     | Fiscal Year                                  |
| NYRO   | New York Regional Office                     |
| OMB    | Office of Management and Budget              |
| PR DF  | Puerto Rico Department of Family             |
| PR DDP | Puerto Rico Disability Determination Program |
| SFY    | State Fiscal Year                            |
| SSA    | Social Security Administration               |

## **Appendix B**

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### **Scope and Methodology**

We limited our review of the Puerto Rico Department of Family's (PR DF) indirect cost proposal for State Fiscal Year (SFY) 2004 to issues impacting the proposed rate for the Puerto Rico Disability Determination Program (PR DDP). The proposed rate for SFY 2004 was based on actual costs incurred during SFY 2002 (July 1, 2001 through June 30, 2002). We reviewed the appropriateness of the cost allocation statistics and determined whether costs were accurately reflected in the State's accounting records. We did not review the step-down allocation method used by the PR DF because the method used was recommended by the cognizant Federal agency, the Department of Health and Human Services, Division of Cost Allocation. We did not review supporting documentation for specific cost items that comprised the overall cost pools for the PR DF. Accordingly, we do not address the allowability of the costs taken as a whole for the PR DF or the rates proposed for other Federal agencies. We also limited our review of payments for early retirement costs and for unused leave balance for terminating employees to quantifying total amounts charged as direct costs that should have been charged as administrative expenses.

To accomplish our objectives, we

- reviewed Puerto Rico law provisions related to early retirement programs and payments for unused leave balances for terminated employees;
- interviewed PR DF staff, PR DDP staff, and the independent consultant who prepared the indirect cost proposal;
- analyzed the consultant's supporting documentation used to develop the proposal;
- reviewed the report on the Single Audit of the Commonwealth of Puerto Rico Department of Family for SFY 2001 for issues related to indirect cost findings;
- traced selected information related to indirect costs, payments for unused leave, and early retirement payments to Agency records;
- reviewed the personnel records of employees who elected early retirement to verify they were eligible to participate in the program; and
- compared the PR DF payment vouchers to the PR DDP General Obligations Ledger to verify costs charged to the early retirement program.

We conducted our field work from August 2003 through March 2004 at the PR DF and PR DDP in San Juan, Puerto Rico; SSA New York Regional Office, New York City; and the Office of the Inspector General in Dallas, Texas. We conducted the audit in accordance with generally accepted government auditing standards.

## Appendix C

### State Fiscal Year 2002 Administrative Expenses Allocated to the Puerto Rico Disability Determination Program (PR DDP)

| Cost Component                   | Total Costs Available for Allocation | Total Costs Allocated to the PR DDP | Percent of Component's Cost Allocated to the PR DDP | Cumulative Costs Allocated to the PR DDP | Cumulative Percent of Costs Allocated to the PR DDP |
|----------------------------------|--------------------------------------|-------------------------------------|---|--|---|
| Payment                          | \$495,526                            | \$490,899                           | 99.07   | \$490,899                                | 38.30   |
| Accounting                       | 395,634                              | 189,340                             | 47.86   | 680,239                                  | 53.08   |
| Federal Reports                  | 165,631                              | 112,233                             | 67.76   | 792,472                                  | 61.84   |
| Pre-audit                        | 223,404                              | 107,297                             | 48.03   | 899,769                                  | 70.21   |
| Contract Control                 | 160,724                              | 106,496                             | 66.26   | 1,006,265                                | 78.52   |
| Collection                       | 101,204                              | 51,301                              | 50.69   | <b>1,057,566</b>                         | <b>82.52</b>  |
| Statewide Cost Allocation        | 937,303                              | 51,265                              | 5.47  | 1,108,831                                | 86.52   |
| Secretary                        | 2,483,763                            | 46,380                              | 1.87  | 1,155,211                                | 90.14   |
| Personnel                        | 2,467,066                            | 46,373                              | 1.88  | 1,201,584                                | 93.76   |
| Property & Supply                | 1,311,503                            | 24,903                              | 1.90  | 1,226,487                                | 95.70   |
| Budget                           | 379,913                              | 20,790                              | 5.47  | 1,247,277                                | 97.32   |
| Training                         | 269,091                              | 11,641                              | 4.33  | 1,258,918                                | 98.23   |
| Payroll                          | 533,689                              | 10,306                              | 1.93  | 1,269,224                                | 99.04   |
| Purchasing                       | 577,054                              | 9,158                               | 1.59  | 1,278,382                                | 99.75   |
| Press & Public Relations         | 170,366                              | 3,183                               | 1.87  | 1,281,565                                | 100.00  |
| <b>Totals</b>                    |                                      | <b>\$1,281,565</b>                  |   |  |   |
| <b>Adjustment</b>                |                                      | <b>110,576</b>                      |   |  |   |
| <b>Total Allocated to PR DDP</b> |                                      | <b>\$1,392,141</b>                  |   |  |   |

The Puerto Rico Department of Family's administrative expenses from 15 cost components were allocated to the PR DDP. The top six allocated 82.52 percent to the PR DDP or \$1,057,566 of \$1,281,565.

## **Appendix D**

### **Comparison of Direct Cost Bases**

| <b>Comparison of Direct Cost Bases<br/>(Indirect Costs / Direct Cost Base = Rate)</b> |  |                         |   |
|---|--|-------------------------|---|
|   | <b>Indirect Costs Used<br/>in Proposal to<br/>Compute Rate</b> | <b>Direct Cost Base</b> | <b>Illustration of Calculated<br/>Indirect Cost Rate Using<br/>Different Direct Cost Base</b> |
| State Fiscal Year 2004<br>Proposal  | \$1,392,141  | \$8,500,188             | 16.38%  |
| Puerto Rico Department of<br>Family Ledger  | 1,392,141  | 9,012,570               | 15.45%  |
| <b>Amount Excluded from<br/>Base and Effect on Rate</b>                               |  | <b>(\$512,382)</b>      | <b>0.93%</b>  |

Note: The direct cost base consists of total direct costs incurred during State Fiscal Year 2002 for all grant years for the Puerto Rico Disability Determination Program (PR DDP) less medical costs and equipment purchases incurred during State Fiscal Year 2002 for all PR DDP grant years.

## ***Appendix E***

### **Costs Charged for the Early Retirement Program**

| <b>RETIREMENT COSTS BY FEDERAL FISCAL YEAR (FY) FOR DISABILITY DETERMATION PROGRAM EMPLOYEES WHO PARTICIPATED IN THE EARLY RETIRMENT PROGRAM</b> |                       |                |                |                |                |                  |
|--|-----------------------|----------------|----------------|----------------|----------------|------------------|
| <b>APPLICABLE PUERTO RICO LAW</b>  | <b>COST CATAGORY</b>  | <b>FY 2000</b> | <b>FY 2001</b> | <b>FY 2002</b> | <b>FY 2003</b> | <b>FY 2004</b>   |
| 1998 PR Laws 182, Article 7  | Retirement Annuity    | \$160,676      | \$0            | \$0            | \$0            | \$0              |
| 1998 PR Laws 182, Article 10   | Employer Contribution | 22,663         | 0              | 0              | 0              | 0                |
|  | Employee Contribution | 18,978         | 0              | 0              | 0              | 0                |
|  | Health Plan           | 4,080          | 0              | 0              | 0              | 0                |
| 2000 PR Laws 174, Article 7  | Retirement Annuity    | 0              | 54,651         | 100,331        | 0              | 0                |
| 2000 PR Laws 174, Article 10   | Employer Contribution | 0              | 7,231          | 14,460         | 0              | 0                |
|  | Employee Contribution | 0              | 5,956          | 11,911         | 0              | 0                |
|  | Health Plan           | 0              | 1,440          | 2,880          | 0              | 0                |
|  | Christmas Bonus       | 0              | 0              | 1,800          | 0              | 0                |
| Cost Per FY  |                       | \$206,397      | \$69,278       | \$131,382      | \$0            | \$0              |
| <b>TOTAL</b>   |                       |                |                |                |                | <b>\$407,057</b> |

The Commonwealth of Puerto Rico offered two early retirement programs: Puerto Rico Law #182, approved July 28, 1998, and Puerto Rico Law #174, approved August 12, 2000. Under the provisions of both Laws, eligible Puerto Rico Disability Determination Program (PR DDP) employees could collect retirement annuities up to 5 years earlier than they would have under regular retirement. The Puerto Rico Retirement System, as administrator of the retirement plan, invoiced the Puerto Rico Department of Family (PR DF) annually for the amount of annuities paid to and fringe benefits paid on behalf of the PR DDP and PR DF early retirees. The fringe benefits paid consisted of the employee and employer retirement contributions, health insurance, and annual Christmas bonus.

Based on our review of the Puerto PR DDP General Obligations Ledger and the related State Agency Report of Obligations, Form SSA-4513, there were no early retirement costs charged to the Social Security Administration in FYs 2003 and 2004.

## **Appendix F**

### **Payments for Unused Leave by State Fiscal Year (SFY)**

| <b>SUMMARY OF PROGRAM COSTS FOR UNUSED LEAVE PAYMENTS TO EMPLOYEES OF THE DISABILITY DETERMINATION PROGRAM</b> |                 |                  |                 |                  |                  |
|--|-----------------|------------------|-----------------|------------------|------------------|
| <b>Retirement Program</b>  | <b>SFY 2000</b> | <b>SFY 2001</b>  | <b>SFY 2002</b> | <b>SFY 2003</b>  | <b>Total</b>     |
| Early  | \$52,234        | \$111,818        | \$15,150        | \$4,900          | \$184,102        |
| Regular  | 0               | 2,331            | 10,790          | 100,358          | 113,479          |
| Separation/Termination   | 0               | 0                | 2,902           | 22,597           | 25,499           |
| <b>Total</b>   | <b>\$52,234</b> | <b>\$114,149</b> | <b>\$28,842</b> | <b>\$127,855</b> | <b>\$323,080</b> |

**PAYMENTS FOR UNUSED LEAVE - EARLY RETIREES, SFYs 2000 Through 2003**

| <b>Employee #</b>  | <b>Total Accumulated Leave Cost</b> | <b>Prorated or Lump Sum</b> | <b>SFY 2000</b> | <b>SFY 2001</b> | <b>SFY 2002</b> | <b>SFY 2003</b>  |
|--------------------|-------------------------------------|-----------------------------|-----------------|-----------------|-----------------|------------------|
| 1                  | \$6,220                             | Prorated                    | \$2,262         | \$2,262         | \$1,696         | \$0              |
| 2                  | 27,275                              | Prorated                    | 15,586          | 11,689          | 0               | 0                |
| 3                  | 17,918                              | Prorated                    | 8,959           | 8,959           | 0               | 0                |
| 4                  | 24,502                              | Prorated                    | 6,534           | 6,534           | 6,534           | 4,900            |
| 5                  | 13,924                              | Prorated                    | 5,063           | 5,063           | 3,798           | 0                |
| 6                  | 11,446                              | Prorated                    | 4,162           | 4,162           | 3,122           | 0                |
| 7                  | 6,290                               | Prorated                    | 6,290           | 0               | 0               | 0                |
| 8                  | 1,557                               | Lump Sum                    | 1,557           | 0               | 0               | 0                |
| 9                  | 1,821                               | Lump Sum                    | 1,821           | 0               | 0               | 0                |
| 10                 | 11,520                              | Lump Sum                    | 0               | 11,520          | 0               | 0                |
| 11                 | 14,873                              | Lump Sum                    | 0               | 14,873          | 0               | 0                |
| 12                 | 3,125                               | Lump Sum                    | 0               | 3,125           | 0               | 0                |
| 13                 | 9,442                               | Lump Sum                    | 0               | 9,442           | 0               | 0                |
| 14                 | 17,929                              | Lump Sum                    | 0               | 17,929          | 0               | 0                |
| 15                 | 16,260                              | Lump Sum                    | 0               | 16,260          | 0               | 0                |
| Total              | \$184,102                           |                             | \$52,234        | \$111,818       | \$15,150        | \$4,900          |
| <b>Grand Total</b> |                                     |                             |                 |                 |                 | <b>\$184,102</b> |

**PAYMENTS FOR UNUSED LEAVE - REGULAR RETIREES,**  
**State Fiscal Years 2001 Through 2004**

| Employee #         | Total Accumulated Leave Cost | Prorated or Lump Sum | SFY 2001 | SFY 2002 | SFY 2003  | SFY 2004         |
|--------------------|------------------------------|----------------------|----------|----------|-----------|------------------|
| 1                  | \$2,331                      | Lump Sum             | \$2,331  | \$0      | \$0       | \$0              |
| 2                  | 10,790                       | Lump Sum             | 0        | 10,790   | 0         | 0                |
| 3                  | 28,409                       | Lump Sum             | 0        | 0        | 28,409    | 0                |
| 4                  | 498                          | Lump Sum             | 0        | 0        | 498       | 0                |
| 5                  | 8,079                        | Lump Sum             | 0        | 0        | 8,079     | 0                |
| 6                  | 18,961                       | Lump Sum             | 0        | 0        | 18,961    | 0                |
| 7                  | 9,665                        | Lump Sum             | 0        | 0        | 9,665     | 0                |
| 8                  | 34,746                       | Lump Sum             | 0        | 0        | 34,746    | 0                |
| 9                  | 2,857                        | Lump Sum             | 0        | 0        | 0         | 2,857            |
| 10                 | 18,338                       | Lump Sum             | 0        | 0        | 0         | 18,338           |
| 11                 | 25,528                       | Lump Sum             | 0        | 0        | 0         | 25,528           |
| 12                 | 3,470                        | Lump Sum             | 0        | 0        | 0         | 3,470            |
| Total              | \$163,672                    |                      | \$2,331  | \$10,790 | \$100,358 | \$50,193         |
| <b>Grand Total</b> |                              |                      |          |          |           | <b>\$163,672</b> |

**PAYMENTS FOR UNUSED LEAVE - SEPARATING/RESIGNING EMPLOYEES**  
**SFYs 2001 - 2004**

| Employee #         | Total Costs for Unused Leave | Prorated or Lump Sum | SFY 2001   | SFY 2002       | SFY 2003        | SFY 2004        |
|--------------------|------------------------------|----------------------|------------|----------------|-----------------|-----------------|
| 1                  | \$98                         | Lump Sum             | \$0        | \$98           | \$0             | \$0             |
| 2                  | 137                          | Lump Sum             | 0          | 137            | 0               | 0               |
| 3                  | 90                           | Lump Sum             | 0          | 90             | 0               | 0               |
| 4                  | 274                          | Lump Sum             | 0          | 274            | 0               | 0               |
| 5                  | 640                          | Lump Sum             | 0          | 640            | 0               | 0               |
| 6                  | 254                          | Lump Sum             | 0          | 254            | 0               | 0               |
| 7                  | 650                          | Lump Sum             | 0          | 650            | 0               | 0               |
| 8                  | 3,963                        | Pending              | 0          | 0              | 0               | 0               |
| 9                  | 759                          | Lump Sum             | 0          | 759            | 0               | 0               |
| 10                 | 19,475                       | Lump Sum             | 0          | 0              | \$19,475        | 0               |
| 11                 | 793                          | Lump Sum             | 0          | 0              | 793             | 0               |
| 12                 | 940                          | Lump Sum             | 0          | 0              | 940             | 0               |
| 13                 | 10,028                       | Pending              | 0          | 0              | 0               | 0               |
| 14                 | 1,389                        | Lump Sum             | 0          | 0              | 1,389           | 0               |
| <b>Total</b>       | <b>\$39,490</b>              |                      | <b>\$0</b> | <b>\$2,902</b> | <b>\$22,597</b> | <b>\$0</b>      |
| <b>Grand Total</b> |                              |                      |            |                |                 | <b>\$25,499</b> |

Note: Pending payments totaling \$13,991 have not been made. Puerto Rico Department of Family personnel stated they were waiting on documents to be submitted for payment to be made.

Total costs of unused leave: \$25,499 paid + \$13,991 pending = \$39,490

## Agency Comments



## SOCIAL SECURITY

### **MEMORANDUM**

**Refer To:** S2D2G5

**Date:** August 12, 2004

**To:** Steven L. Schaeffer  
Assistant Inspector General  
for Audit

**From:** Regional Commissioner  
New York

**Subject:** Puerto Rico Disability Determination Program Indirect Cost Review (A-06-04-34035) -  
(Your Memorandum Dated June 25, 2004)

As a result of the discussions held between New York (NY) Regional Office (RO) staff and Office of Inspector General (OIG) staff, as well as between NYRO staff and Division of Cost Allocation (DCA) staff subsequent to my August 6<sup>th</sup> memorandum on this subject, we are supplementing our initial response.

The 3 recommendations for SSA included in your draft audit of this review are:

- SSA should instruct the Puerto Rico (PR) Department of the Family (DoF) to adjust the cost allocation statistics used for the State Fiscal Year (SFY) 2004 indirect cost proposal to better reflect the amount of effort PR DoF expended on PR Disability Determination Program (DDP) activities. These adjustments should be used in negotiations with the Division of Cost Allocation (DCA) to establish the indirect rate.
- SSA should instruct the PR DoF to reduce direct costs charged to SSA for early retirement costs for PR DDP employees who elected early retirement. These costs totaled \$407,057 for FYs 2000 through 2003.
- SSA should instruct the PR DoF to reduce direct costs charged for unused leave payments for PR DDP employees who terminated their employment through retirement or other separation. This consisted of \$323,080 identified during SFYs 2000 through 2003; \$50,193 identified as of December 1, 2003; and any additional amounts charged after December 1, 2003.

As previously stated, we agree with the first recommendation. In addition to requesting the PR DoF to adjust the cost allocation statistics used for the SFY 2004 indirect cost proposal, we have been and will continue to be in contact with Division of Cost Allocation staff on this issue.

As previously stated, we also agree with recommendations 2 and 3. The payments made to retirees who opted to take "early out" retirements as well as the payments for unused vacation leave made upon separation of DDP staff were proper and allowable, provided they were paid from DoF funds and reimbursed by SSA through the indirect cost mechanism. On November 21, 2003, we sent correspondence to the PR DoF rescinding SSA financial support and authorization for the PR DDP to participate in future early retirement programs. We also notified the Secretary of the PR DoF that unused vacation leave costs could no longer be charged directly to SSA.

As for the prior year charges, it may be better to correct the deficiencies on a prospective basis rather than attempt to retroactively correct or shift costs from direct to indirect. The New York Regional Office is working with both the Division of Cost Allocation and the PR DoF to resolve this issue.

If members of your staff have any further questions on this matter they should be directed to Gene Purk, (212) 264-7283 in the Center for Disability Programs.

/ s /

Beatrice M. Disman

## ***Appendix H***

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### **State Agency Comments**

[The names of some individuals have been redacted from the attached comments.]



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*Yolanda Zayas, MSW  
Secretary*

August 20, 2004

Steven L. Schaeffer  
Assistant Inspector General for Audit  
Social Security Administration  
Baltimore MD 21235-0001

**RE: PUERTO RICO DISABILITY DETERMINATION PROGRAM INDIRECT COST REVIEW (A-06-04-34035)**

Dear Mr. Schaeffer:

This in response to your letter dated June 25, 2004, related to the Puerto Rico Disability Determination Program (PR DDP) Indirect Cost Review draft report. The Department of the Family (DOF) responses to each finding are as follows:

1. Accuracy of the Statistics Used in the Allocation of Costs

- Finding: Out of the 15 cost components allocated to the PR DDP, six components' statistics (Payment, Federal Reports, Contract Control, Collection, Pre-audit and Accounting) were inconsistent with the level of support provided by the DOF to the PR DDP activities. This was determined by the OIG based on interviews with component directors and staff.
- DOF's response: We do not agree with this finding. We would like to obtain a copy of the source documents used by the OIG auditors to calculate statistics.
  - i. Payment Unit – our statistics on checks issued by the Special Disbursement Officer (OPE) and by the PR Department of Treasury are the following:

| Fiscal Year                   | 2002          | %           | 2003          | %           | 2004          | %           | Totals         | Avg. %      |
|-------------------------------|---------------|-------------|---------------|-------------|---------------|-------------|----------------|-------------|
| <b>Checks issued through:</b> |               |             |               |             |               |             |                |             |
| OPE for DDP (OSI)             | 50,319        | 92%         | 58,457        | 91%         | 33,619        | 88%         | 142,397        | 90%         |
| PRIFAS for DDP                | 2,061         | 4%          | 4,316         | 7%          | 4,105         | 11%         | 10,482         | 7%          |
| PRIFAS for Other DOF Programs | 2,490         | 5%          | 1,603         | 2%          | 562           | 1%          | 4,655          | 3%          |
| <b>Total</b>                  | <b>54,870</b> | <b>100%</b> | <b>64,376</b> | <b>100%</b> | <b>38,286</b> | <b>100%</b> | <b>157,534</b> | <b>100%</b> |

Therefore, based on these statistics, total checks issued for DDP account for 96%, 98% and 99% of total checks issued at DOF for years 2002, 2003 and 2004, respectively. We would like to obtain a copy of the statistics used by the auditors, because we understand that the information they used is wrong. The 14,000 checks reported by the auditors as issued for other PR DF agencies is incorrect.

- ii. Contract Control Unit – after consulting with the Director of the Legal Division of the DOF, she informed us that their statistics reflect that out of 200 contracts issued annually, approximately 28 to 30 belong to DDP. This represents a 14% to 15%. We agree that the percentage used by the consultant (66%) needs to be adjusted. However, the percentage proposed by the auditors (6.36%) seems to be too low.
- iii. Accounting Unit – PR DDP was allocated 47.86% of the costs from the Accounting Unit. As our consultant explained to from the Division of Cost Allocation (DCA), in his letter dated April 28, 2004, for the base year (FY 2002) this unit had five employees, of which two were the supervisor and her secretary. The remaining three employees were accountants, two working for other DOF programs and one working exclusively for the DDP. Therefore, it would be reasonable to conclude that **at least** 33% of the efforts of this unit were dedicated to the DDP. The rate calculated by the auditors of 23.3% for DDP seems to be too low.
- iv. Pre-Audit Unit - PR DDP was allocated 48.036% of the costs from the Pre-Audit Unit. However, the auditors concluded through personnel interviews that only a 25% of the unit's costs should be allocated to the DDP. As per our consultant, based on his interviews with the unit's supervisor, the allocation percentage should be closer to 55% taking into consideration that the type of transactions related to the DDP are more time consuming because of their complexity. is of the opinion that the information gathered by the auditors seems to be incomplete.

**2. Accuracy of Costs Included in the Direct Cost Base**

- Finding: The Direct Cost Base used as the denominator in calculating the proposed rate (\$8,500,188) was inaccurate. The direct costs for SFY2002 totaled \$9,012,570 or \$512,382 more than the amount used in the calculation. The contractor did not provide any documentation to support reducing the direct cost base by \$512,382.
- DOF's response: the difference is due to the lack of reconciliation at the time between the federal reports section and the Finance Division. This situation was corrected in September 2003. However, we wanted to clarify that the auditors did not request an explanation to about the difference found. It is incorrect that the contractor "did not provide any documentation", since he was never asked to in the first place. We will adjust the direct cost base accordingly.

**3. Program Costs for Employees Electing Early Retirement and for Unused Leave Payments**

- Finding: PR DOF improperly charged early retirement program costs as direct costs because the costs were not approved by the cognizant Federal agency, and the treatment of the costs was not consistent with other activities of the governmental unit. While the New York Regional Office (NYRO) approved DOF's request to participate in the first early retirement program, DOF did not obtain the necessary approval from the Department of Health and Human Services (HHS).
- DOF's response: First, we want to point out that the applicable Federal regulations (OMB Circular A-87) became effective in 1997. Second, the NYRO's letter of approval to DDP was dated December 8, 2000 (refer to Attachment 1). We do not understand why it was not notified to us in that letter that it was necessary for the DOF to obtain the approval from HHS. It was not until July 31, 2002 that SSA, through a memo with the Disability Determination Services (DDS) Administrator's Letter No. 615, provided a "reminder" to all regional commissioners on how to properly report payments for accumulated leave (refer to Attachment 2). Furthermore, this memo states that "[i]n a recent DDS audit, there was a finding that indicated the DDS had incorrectly charged such costs directly as personnel costs." Therefore, it seems that SSA became aware of the changes in the Circular A-87 through an audit performed way after the amendments became effective. We understand that it is unreasonable to shift all the responsibility of the incorrect treatment of these costs to the DOF when it is evident that SSA was not aware either that this was incorrect until 2002. We are of the opinion that the only costs that should be accounted for as improperly charged should be the ones that were charged after the July 31, 2002 memorandum.

In addition, the statement by the auditors that the DOF improperly charged as a direct expense the unused leave payments for SFY's 2000 through

2004 is partially incorrect. Payments made in SFY 2004 were charged to indirect costs and not to direct expense.

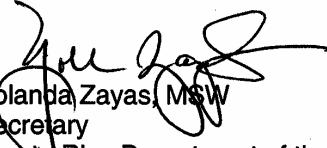
In summary, the applicable incorrect charges made to DDP after the July 31, 2002 memorandums are the following:

| Description                        | SFY 2003          | SFY 2004    | Total             | Amount to be adjusted per OIG | Difference          |
|------------------------------------|-------------------|-------------|-------------------|-------------------------------|---------------------|
| Costs charged for Early Retirement | \$ -              | \$ -        | \$ -              | \$ 407,057                    | \$ (407,057)        |
| Payments for Unused Leave          | 127,855           | -           | 127,855           | 373,273                       | (245,418)           |
| <b>Total</b>                       | <b>\$ 127,855</b> | <b>\$ -</b> | <b>\$ 127,855</b> | <b>\$ 780,330</b>             | <b>\$ (652,475)</b> |

We understand that the adjustments should be made for \$127,855 instead of \$780,330.

If you need further information regarding this matter, please contact CPA Rosana Morales, Assistant General Auditor for the Puerto Rico Department of the Family at 787-294-4900, extensions 3108 or 3208, or Ms. Nilda Muñoz, DDP Director at (787) 754-8915.

Cordially,

  
Yolanda Zayas, MSW  
Secretary  
Puerto Rico Department of the Family

## **Appendix I**

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# **OIG Contacts and Staff Acknowledgments**

### ***OIG Contacts***

Paul Davila, Director, (214) 767-6317

Ron Gunia, Audit Manager, (214) 767-6620

### ***Acknowledgments***

In addition to those named above:

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Clara Soto, Auditor

Brennan Kraje, Statistician

Kim Beauchamp, Writer-Editor

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