

AUDIT OF THE SOCIAL SECURITY  
ADMINISTRATION'S FISCAL YEAR  
2002 FINANCIAL STATEMENTS



November 19, 2002

To: Jo Anne B. Barnhart  
Commissioner

This letter transmits the PricewaterhouseCoopers LLP (PwC) *Report of Independent Accountants* on the audit of the Social Security Administration's (SSA) Fiscal Year (FY) 2002 and 2001 financial statements. PwC's Report includes the firm's *Opinion on the Financial Statements*, *Report on Management's Assertion About the Effectiveness of Internal Control*, and *Report on SSA's Compliance with Laws and Regulations*.

### **Objective of a Financial Statement Audit**

The objective of a financial statement audit is to determine whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation.

PwC's examination was made in accordance with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. The audit included obtaining an understanding of the internal control over financial reporting and testing and evaluating the design and operating effectiveness of the internal control. Because of inherent limitations in any internal control, there is a risk that errors or fraud may occur and not be detected. The risk of fraud is inherent to many of SSA's programs and operations, especially within the Supplemental Security Income (SSI) program. In our opinion, people outside the organization perpetrate most of the fraud against SSA.

### **Audit of Financial Statements, Effectiveness of Internal Control, and Compliance with Laws and Regulations**

The Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576), as amended, requires SSA's Inspector General (IG) or an independent external auditor, as determined by the IG, to audit SSA's financial statements in accordance with applicable standards. Under a contract monitored by the Office of the Inspector General (OIG), PwC, an independent certified public accounting firm, audited SSA's FY 2002 financial statements. PwC also audited the FY 2001 financial statements, presented in SSA's Performance and Accountability Report for FY 2002 for comparative purposes. PwC issued an unqualified opinion on SSA's FY 2002 and 2001 financial statements. PwC also reported that SSA's assertion that its systems of accounting and

internal control are in compliance with the internal control objective in OMB Bulletin 01-02 is fairly stated in all material respects. However, the audit identified one reportable condition in SSA's internal control:

### **SSA Needs to Further Strengthen Controls to Protect Its Information**

This is a repeat finding from prior years. It is PwC's opinion that SSA has made notable progress in addressing the information protection issues raised in prior years. Despite these accomplishments, SSA's systems environment remains threatened by security and integrity exposures to SSA operations.

### **OIG Evaluation of PwC Audit Performance**

To fulfill our responsibilities under the CFO Act and related legislation for ensuring the quality of the audit work performed, we monitored PwC's audit of SSA's FY 2002 financial statements by:

- Reviewing PwC's approach and planning of the audit;
- Evaluating the qualifications and independence of its auditors;
- Monitoring the progress of the audit at key points;
- Examining its workpapers related to planning the audit and assessing SSA's internal control;
- Reviewing PwC's audit report to ensure compliance with Government Auditing Standards and OMB Bulletin 01-02;
- Coordinating the issuance of the audit report; and
- Performing other procedures that we deemed necessary.

PwC is responsible for the attached auditor's report dated, November 14, 2002, and the opinions and conclusions expressed therein. The OIG is responsible for technical and administrative oversight regarding PwC's performance under the terms of the contract. Our review, as differentiated from an audit in accordance with applicable auditing standards, was not intended to enable us to express, and accordingly we do not express, an opinion on SSA's financial statements, management's assertions about the effectiveness of its internal control over financial reporting, or SSA's compliance with certain laws and regulations. However, our monitoring review, as qualified above, disclosed no instances where PwC did not comply with applicable auditing standards.



James G. Huse, Jr.  
Inspector General

## REPORT OF INDEPENDENT ACCOUNTANTS

To Ms. Jo Anne B. Barnhart  
Commissioner

In our audit of the Social Security Administration (SSA), we found:

- The consolidated balance sheets of SSA as of September 30, 2002 and 2001, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the fiscal years then ended are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- Management fairly stated that SSA's systems of accounting and internal control in place as of September 30, 2002 are in compliance with the internal control objectives in the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, requiring that transactions be properly recorded, processed, and summarized to permit the preparation of the consolidated and combined financial statements in accordance with accounting principles generally accepted in the United States of America and that assets be safeguarded against loss from unauthorized acquisition, use or disposal; and
- No reportable instances of noncompliance with the laws and regulations we tested.

The following sections outline each of these conclusions in more detail.

## OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of SSA as of September 30, 2002 and 2001, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the fiscal years then ended. These financial statements are the responsibility of SSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 01-02. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated and combined financial statements referred to above and appearing on pages 51 through 71 of this performance and accountability report, present fairly, in all material respects, the financial position of SSA at September 30, 2002 and 2001, and its net cost, changes in net position,



budgetary resources, and reconciliation of net cost to budgetary resources for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America. The consolidated and combined financial statements referred to above give retroactive effect to the change in entity, as described in Note 1 to the consolidated and combined financial statements.

## **REPORT ON MANAGEMENT'S ASSERTION ABOUT THE EFFECTIVENESS OF INTERNAL CONTROL**

We have examined management's assertion that SSA's systems of accounting and internal control are in compliance with the internal control objectives in OMB Bulletin No. 01-02, requiring management to establish internal accounting and administrative controls to provide reasonable assurance that transactions be properly recorded, processed, and summarized to permit the preparation of the consolidated and combined financial statements in accordance with accounting principles generally accepted in the United States of America and that assets be safeguarded against loss from unauthorized acquisition, use or disposal. SSA's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA), the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 01-02 and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination was of the internal control in place as of September 30, 2002.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that SSA's systems of accounting and internal control are in compliance with the internal control objectives in OMB Bulletin No. 01-02, requiring that transactions be properly recorded, processed, and summarized to permit the preparation of the consolidated and combined financial statements in accordance with accounting principles generally accepted in the United States of America and that assets be safeguarded against loss from unauthorized acquisition, use or disposal, is fairly stated, in all material respects, as of September 30, 2002.

However, we noted certain matters involving the internal control and its operation, set forth below, that we consider to be a reportable condition under standards established by the AICPA and by OMB Bulletin No. 01-02. A reportable condition is a matter coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the agency's ability to meet the internal control objectives described above.

A material weakness, as defined by the AICPA and OMB Bulletin No. 01-02, is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the principal financial statements being audited or to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned duties. We believe that the reportable condition that follows is not a material weakness as defined by the AICPA and OMB Bulletin No. 01-02.



## **SSA Needs to Further Strengthen Controls to Protect Its Information:**

Over the past year SSA has made notable progress in addressing the information protection issues raised in prior years. Specifically, in fiscal year 2002 SSA has:

- Issued final “risk models” to standardize platform security configuration settings for the Windows NT, Windows 2000, AS 400, Unix and WANG platforms;
- Established and implemented ongoing monitoring tools and procedures to ensure the consistency of platform security configuration standards for the Windows NT, Windows 2000, AS 400, Unix and WANG platforms;
- Established and implemented access based rule settings and standardized monitoring and logging procedures for firewalls;
- Continued progress on the Standard Security Profile Project (SSPP - the project consists of a full scale comparison of system user access assignments to job responsibilities to ensure propriety) and expanded the SSPP to include non-IT employees;
- Continued progress on the Dataset Naming Standards project, including setting naming conventions, determining tools for compliance and enforcement, and establishing data ownership;
- Strengthened physical security controls over Regional Office and Program Service Center offices; and
- Established and implemented procedures for enhanced review of security violations on the mainframe.

These enhancements have greatly improved the security over SSA’s systems environment. However, continued effort is needed to complete the implementation of platform security configuration settings for NT, Windows 2000, AS 400, Unix and WANG platforms. Continued effort is also needed to review security access assignments (SSPP), including (1) the full establishment of dataset naming conventions, (2) the establishment of a dataset dictionary for existing datasets and transactions, (3) the identification of system and data owners and (4) the enforcement of the new dataset naming rules and standards for sensitive systems. Specific disclosure of detailed information about these exposures might further compromise controls and are therefore not provided within this report. Rather, the specific details of weaknesses noted are presented in a separate, limited-distribution management letter.

Management has made and continues to make concerted efforts to address these issues; however, the full rollout of the risk models and the completion of the SSPP are time consuming tasks that will require substantial resources to complete. Further, the physical controls over the state Disability Determination Services sites continue to be a challenge because many of the sites are co-located with other state agencies or are housed in buildings with inherent physical security issues. Progress on the issue regarding monitoring of security violations on the mainframe has already been made, but full use of the new procedures needs to be demonstrated during fiscal year 2003.

The need for a strong security program to address threats to the security and integrity of SSA operations grows and transforms as the agency continues to move ahead with plans to increase dependence on the Internet and Web-based applications to serve the American public. To more fully protect SSA from risks associated with the loss of data, loss of other resources and/or compromised privacy of information associated with SSA’s enumeration, earnings, retirement, and disability processes and programs, SSA must complete the strengthening of its security program.



## **Recommendations**

We recommend that SSA explore methods to accelerate and continue to build on its progress to enhance information protection by continuing to implement the remaining portions of its entity-wide security program. Specifically, we recommend that SSA:

- Continue to follow established processes to conduct and enhance periodic risk assessments to identify inherent vulnerabilities from emerging technologies across mainframe, midrange and distributed systems;
- Implement cost-effective countermeasures to mitigate risk to an acceptable level, including effective monitoring of systems to ensure currency of security configuration settings for all platforms;
- Continue to implement risk models to achieve compliance with SSA standard platform security configuration settings;
- Accelerate the SSPP program to ensure that sensitive systems, as defined by SSA systems accreditation and certification process, are adequately addressed regarding proper access assignments, dataset naming standards, data ownership assignments and inclusion in the dataset dictionary;
- Ensure use of the new procedures for reviewing security violations on the mainframe;
- Ensure that employees with access to sensitive SSA data (soft or hardcopy) and equipment are properly assessed to determine their eligibility for access to such resources;
- Coordinate contingency planning between program services center/regional office sites, disability determination service sites and SSA central office functions and the national computer center; and,
- Continue to enhance the overall security policy for DDS sites and improve physical security controls for the disability determination service sites.

More specific recommendations focused upon the individual exposures we identified are included in a separate, limited-distribution management letter.

We noted other matters involving the internal control and its operation that we will communicate in a separate letter.

## **REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS**

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and OMB Bulletin No. 01-02.

The management of SSA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of SSA's compliance with certain provisions of applicable laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to SSA.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph exclusive of FFMIA that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether SSA's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.



The results of our tests disclosed no instances in which SSA's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

The objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions of laws and regulations and, accordingly, we do not express such an opinion.

## **INTERNAL CONTROL RELATED TO KEY PERFORMANCE MEASURES**

With respect to internal control related to those performance measures determined by management to be key and included on pages 28 to 40 of this performance and accountability report, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, and we determined that they have been placed in operation as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on the internal control over reported performance measures, and accordingly, we do not express an opinion on such control.

## **OTHER INFORMATION**

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined financial statements of SSA taken as a whole. The other accompanying information included on pages 1 to 6, and 95 to the end of this performance and accountability report, is presented for purposes of additional analysis and is not a required part of the consolidated and combined financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements and, accordingly, we express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined financial statements of SSA taken as a whole. The required supplementary information included on pages 7 to 48, and 76 of this performance and accountability report and the required supplementary stewardship information included on pages 77 to 94 of this performance and accountability report, is not a required part of the consolidated and combined financial statements but is supplementary information required by OMB Bulletin No. 01-09 and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures to such information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined financial statements of SSA taken as a whole. The consolidating and combining information included on pages 72 to 74 of this performance and accountability report, is presented for purposes of additional analysis of the consolidated and combined financial statements rather than to present the financial position, changes in net position, and reconciliation of net cost to budgetary resources of the individual SSA programs. The consolidating and combining information has been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated and combined financial statements taken as a whole.

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined financial statements of SSA taken as a whole. The required supplementary information, Schedule of Budgetary Resources, included on page 75 of this performance and accountability report, is not a required part of the consolidated and combined financial statements but is supplementary information required by OMB Bulletin No. 01-09. This information is also presented for purposes of additional analysis of the consolidated and combined financial statements rather than to present the budgetary resources of the individual SSA programs. This information has been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated and combined financial statements taken as a whole.



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This report is intended solely for the information and use of the management and Inspector General of SSA, OMB, General Accounting Office and Congress and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is fluid and cursive, with "Pricewaterhouse" on the first line and "Coopers LLP" on the second line.

Washington, DC  
November 14, 2002