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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Liberal Deposit Requirements Of States' Social Security Contributions Adversely Affected Trust Funds

AGC00026

The Social Security Administration could have earned about $1.1 billion in interest for the years 1961 through 1979 if States had been required to make more frequent deposits of Social Security contributions. If requirements were not changed, the trust funds would lose an additional $1 billion for the years 1980 through 1984 and significant amounts each year thereafter.

New regulations were published in the Federal Register on November 20, 1978, but under law are not effective until July 1, 1980. These regulations will partially correct the problem, but they are still too liberal and will not maximize interest income to the trust funds.

UNITED STATES GENERAL ACCOUNTING OFFICE

GAO 1

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

GAO reviewed

This ~~report points~~ out (1) how the Social Security trust funds were affected in the past by State depository requirements and (2) the effects of the Health, Education, and Welfare Department's decision to require more frequent deposits of Social Security contributions.

During the review, GAO ~~we~~ found that the Social Security trust funds have lost interest income due to special treatment given to States. ~~and we~~ GAO also found that the latest requirements on the frequency of State deposits are less desirable than an earlier proposal.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Health, Education, and Welfare; the Secretary of the Treasury; and the Commissioner of the Social Security Administration.

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

LIBERAL DEPOSIT REQUIREMENTS OF STATES' SOCIAL SECURITY CONTRIBUTIONS ADVERSELY AFFECTED TRUST FUNDS

D I G E S T

If quarterly deposit requirements to the Social Security trust funds were continued, an additional $1 billion in interest would be lost from 1980 through 1984. The funds could have earned about $1.1 billion in additional interest from 1961 through 1979 had the States been required to deposit contributions more frequently--monthly instead of quarterly--thus making the funds available for earlier investment. (See p. 4.)

In March 1978 the Department of Health, Education, and Welfare published in the Federal Register a proposal to require these deposits to be made on a monthly basis, but in November 1978 it decided to modify the proposal to require less frequent deposits. GAO could find no logical or valid justification for the modification, which will result in the trust funds earning an estimated $30 million less in interest income the first year than could have been earned under their March proposal, and a total of several hundred million dollars less in 5 years. (See pp. 16 to 20.)

The Social Security Act requires that regulations be designed to make the deposit requirements imposed on States the same, so far as practicable, as those imposed on private employers. In earlier discussions with HEW officials, GAO suggested that, where applicable, HEW should consider requiring States to deposit contributions more often than monthly--semimonthly or biweekly. This would increase interest earnings to the trust funds and more closely aline frequency of deposits by States with that of the Internal Revenue Service regulations, which generally require private employers to deposit Federal income and social security taxes weekly, biweekly, or monthly. Based on semimonthly or bi-weekly deposits, an estimated additional $73 million in interest earnings could be earned over the amount from monthly deposits during the same 5-year period, 1980-84. (See pp. 4 to 8.)

The States' principal objections to increasing the frequency of deposits are loss of interest earnings or cash flow and administrative problems and additional costs. GAO believes social security contributions should be deposited in and earning interest for the trust funds, and were not intended to provide States with interest earnings or cash flow. In addition, the Secretary of HEW stated that, under its March 1978 proposal, the States could still earn about $50 million annually from prudent short-term investment of contributions prior to deposit with the U.S. Treasury. States and local governments indicated that administrative problems such as collecting and depositing funds, reporting, documenting States' liabilities, etc., would result if more frequent deposits are required. (See pp. 9 to 15.)

GAO recognizes that some problems will occur but believes that the 18-month implementation delay provided by law should be sufficient to deal with such problems.

New regulations were published in the Federal Register on November 20, 1978. These regulations call for deposits within 15 days of the end of each of the first 2 months of a calendar quarter, and within a month and 15 days of the end of the third month of the calendar quarter. (See p. 16.)

In commenting on the draft of this report, HEW stated:

"In arriving at the depository schedule contained in the new regulations, the Department was concerned about its responsibility to protect the interest of the Trust Funds. At the same time, it had to consider the concerns expressed by State Social Security Administrators, numerous local governments, governors, and many Members of Congress. The process agreed upon protects the trust fund interests; at the same time it is a reasonable accommodation to the States' concerns about administrative costs and problems in collecting and transmitting more frequent deposits."

HEW's response to GAO's draft report did not comment on (1) GAO's arguments regarding the revised proposal or (2) the significant amounts of interest income which will be lost under the revised proposal. Therefore, GAO still believes that the regulations as published in the Federal Register are not in the best interest of the trust funds since they do not maximize interest earnings to the trust funds. GAO further believes that financial assistance to States should be specifically legislated and not provided at the expense of the trust funds. (See p. 22.)

Since these regulations will not become effective until July 1, 1980, the Secretary, HEW, should reconsider his decision to require deposits less frequently than monthly. GAO urges semimonthly or biweekly deposits to substantially increase interest earnings to the trust funds. However, at a mimimum, the HEW original (monthly) proposal would be a viable alternative.

To carry out this change in frequency of deposits, the Secretary, HEW, should consider the feasibility of requiring State and local governments to make their deposits together with their withheld income tax deposits. (See pp. 21 and 22.)

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ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
IRS	Internal Revenue Service
SSA	Social Security Administration

CHAPTER 1

INTRODUCTION

Effective January 1, 1951, the Social Security Act, as amended (42 U.S.C. 418), extended social security coverage to State and local government employees. Coverage is through voluntary agreements between the Secretary of Health, Education, and Welfare (HEW) and the individual States to avoid the constitutional question of Federal authority to impose social security taxes on State and local government employers. The States, in turn, generally have agreements with local governments and are responsible for depositing and reporting social security contributions (employees' and employers' shares) by State agencies and local governments within State boundaries. All 50 States, Puerto Rico, the Virgin Islands, and about 60 interstate instrumentalities (treated as States for coverage purposes) have made agreements with the Secretary of HEW for social security coverage.

About 9.4 million (73.8 percent) of State and local government employees are currently covered by the program and represent about 10.3 percent of covered workers. Contributions paid by workers and their State and local government employers increased from about $865,000 in 1951--the first year the States participated--to about $825 million in 1961, about $4 billion in 1971, and over $10 billion in 1977.

Each State deposits the combined State and local government social security contributions directly with the Federal Reserve bank for transfer to the trust funds. As required by HEW, each State files wage reports of covered employees with HEW within 1 month and 15 days after the end of each calendar quarter. This time frame was requested by the States and has been in effect since 1959. Before 1959 the States were required to file wage reports and make deposits within 30 days after the end of each calendar quarter.

PURPOSE AND SCOPE OF REVIEW

On March 30, 1978, HEW published in the Federal Register its proposal to increase the frequency by which States must deposit social security contributions. We evaluated the issues surrounding the frequency of State deposits and the reasonableness of HEW's proposal. (1)

Our work was performed in Arkansas, Louisiana, Maryland, New Jersey, and Texas and at Social Security Administration (SSA) headquarters in Baltimore, Maryland.

We reviewed the legislative history of certain sections of the Social Security Act, as amended, interviewed SSA and State and local government officials, and reviewed and analyzed necessary agency records.

FINANCING THE SOCIAL SECURITY SYSTEM

The Federal Old-Age and Survivors Insurance Trust Fund, the Federal Disability Insurance Trust Fund, and the Federal Hospital Insurance Trust Fund (hereafter referred to as trust funds) were established as separate accounts in the Treasury on January 1, 1940, August 1, 1956, and July 30, 1965, respectively.

Program funds are accounted for and administered separately. The major sources of receipts of all of these trust funds are paid by (1) workers and their employers, (2) individuals with self-employment income, and (3) workers employed by State and local governments and their employers.

In general, an individual's contributions are computed on annual wages or self-employment income, or both. In 1977 the maximum amount payable by an employee was 5.85 percent of $16,500 ($965.25) while the maximum amount payable by a self-employed individual was 7.90 percent of $16,500 ($1,303.50).

In recent years the financial stability of the trust funds has been seriously impaired. In fiscal year 1977 receipts to the trust funds totaled $96.5 billion while disbursements totaled about $100.3 billion. This reflected a continued drain on the assets of the trust funds. In December 1977 the Congress enacted the Social Security Amendments of 1977 (Public Law 95-216) in an attempt to maintain the trust funds on a sound financial basis and to strengthen both the short- and long-range financial stability of these funds. One of the major provisions of Public Law 95-216 increased the social security tax rate and contribution base for both employees and employers. For example, the tax rate will increase from 5.85 percent for 1977 to 7.15 percent through 1989. After 1989 the rate will be 7.65 percent. The contribution base will increase from $16,500 for 1977 to $29,700 for 1981. For 1982 and later years, the changes in the contribution base will be indexed to the changes in average earnings in covered employment.

The Board of Trustees of the trust funds is composed of the Secretaries of Treasury, Labor, and HEW. The SSA Commissioner serves as Secretary of the Board of Trustees. 1/ The 1978 Trustees report dated May 15, 1978, reflects the enactment of the Social Security Amendments of 1977. The report indicates that the near-term financing seems adequate, and for the last decade of this century the year-by-year income should be considerably more than expenditures. However, after the first decade of the next century income should be considerably less than expenditures; the Federal Disability Insurance Trust Fund may be depleted in 2021 and the Federal Old-Age and Survivors Insurance Trust Fund in 2029.

The Federal Hospital Insurance Trust Fund, according to the Trustees, is adequately financed over the next 7 years; however, the tax rates scheduled for the mid-1980s are not adequate. As a result, the Federal Hospital Insurance Trust Fund is expected to be depleted about 1990, rather than 1987, as was estimated in 1977.

The improved financial outlook for the old-age survivors and disability insurance programs developed because the 1977 amendments decreased future expenditures and increased future income. The hospital insurance program, however, was left in approximately the same financial position that it would have been in if the amendments had not been enacted.

1/Section 5 of Public Law 95-292, approved June 13, 1978, transfers this responsibility from the SSA Commissioner to the Administrator of the Health Care Financing Administration for the Federal Hospital Insurance Trust Fund.

CHAPTER 2

THE SOCIAL SECURITY TRUST FUNDS

HAVE LOST INVESTMENT INCOME

The Social Security trust funds could have earned about $1.1 billion in additional interest income from 1961 through 1979--19 years. The loss of this interest resulted from allowing States to make less-frequent deposits of social security contributions than HEW could have required. If States had made deposits monthly instead of quarterly the moneys would have been available for earlier investment to earn additional interest. If quarterly deposit requirements were continued, over $1 billion would be lost from 1980 through 1984--5 years--as shown below. 1/

Year	Amount (millions)
1980	$ 180.4
1981	216.7
1982	237.9
1983	255.9
1984	275.2
Total	$1,166.1

The amount of interest lost increases each year and will continue to increase as the contribution rate and contribution base increase.

MORE FREQUENT STATE DEPOSITS NEEDED

The Social Security Act, as amended, provides for social security coverage to State and local government employees. To accomplish this, the act further provides that:

--The HEW Secretary shall enter into an agreement with the State to extend the program to State and local government employees.

1/New regulations increasing the frequency of deposits were published in the Federal Register on November 20, 1978, and are discussed in chapters 4 and 5.

--The agreement requires the State to pay State and local government social security contributions to the Secretary of the Treasury at such time as the HEW Secretary may prescribe by regulations.

--The regulations of the HEW Secretary shall be designed to make the requirements imposed on States the same, so far as practicable, as those imposed on private employers.

--The Secretary of the Treasury, as managing trustee, shall invest contributions not currently needed for withdrawals in obligations of the United States or in obligations guaranteed by the United States.

The 1951 Federal regulations required the States to report on wages and salaries paid to covered employees and to deposit both the employers' and employees' contributions within 30 days after the end of each calendar quarter. In 1959 the States petitioned HEW for additional time and were granted an extra 15 days after the end of each calendar quarter for reporting and depositing contributions. These requirements are still in effect.

The Internal Revenue Service (IRS) requires private employers to follow a depository schedule based on accumulated withheld income and social security taxes. The social security amounts are then transferred to the trust funds.

The State and local governments are subject to the IRS depository schedule only for withheld income taxes, since the States remit social security contributions directly to the U.S. Treasury. Generally, the current IRS deposit rules for accumulated withheld income and social security taxes are:

--Deposit at end of month after end of the quarter if the total undeposited taxes are less than $200.

--Deposit within 15 days after the end of month if taxes are $200 to less than $2,000.

--Deposit within 3 banking days after the quarter-monthly period in which a payday occurred (7th, 15th, 22d, and last day of the month) if taxes are $2,000 or more.

Since 1951 IRS has made several changes requiring deposits to be made monthly, semimonthly, biweekly, or weekly. However, HEW has made no changes from 1959--when States were given 15 additional days to make deposits, from 30 days after the end of each calendar quarter to 1 month and 15 days after the end of each calendar quarter--to November 1978.

EFFORTS TO INCREASE FREQUENCY OF STATE DEPOSITS

Monthly State deposits of contributions were considered by HEW in 1969. However, HEW decided that it was not the proper time to propose more frequent deposits. HEW believed that monthly or semimonthly deposits would eventually be required if the trust funds could reasonably be expected to earn additional interest income in excess of $20 million annually through more frequent deposits. The effort to require more frequent deposits was apparently not vigorously pursued at that time, although States' contributions for 1969 were about $3 billion.

Again in 1974, HEW considered initiating procedures for increasing the frequency of deposits by the States from quarterly to monthly. The States opposed HEW's position because they used contributions for investments or cash flow. Some States indicated that they would have administrative and legal problems if they were required to make more frequent deposits. No changes were made at that time.

During these times HEW considered having the State and local governments make their deposits to IRS together with their Federal withholding tax deposits; but, apparently because of legal problems which would have required changes in the Social Security Act and in some State laws, this change in procedure was not pursued.

The Subcommittee on Social Security of the House Committee on Ways and Means looked into these problems in late 1975 by using a questionnaire prepared in conjunction with SSA and States. The questionnaire was designed to secure data from States and to assume, for purposes of computation and analysis, the establishment of a monthly depository procedure. The Subcommittee requested SSA to summarize States' responses to the questions. The SSA report summarized the data but did not attempt to evaluate facts or draw conclusions.

In February 1978 we became aware of HEW's proposal to change its regulations requiring that deposits be made 15 days after the end of each month, and we discussed this matter with SSA officials. Although we had not looked into this matter in detail, it appeared to us that if it was reasonable for the States to deposit contributions 15 days after the end of each month, then it was just as reasonable for those States where employees were paid semimonthly or biweekly to deposit contributions 15 days after each semimonthly or biweekly payday. We pointed out that:

--Over half of the State and local government employees are currently being paid more often than monthly--generally semimonthly or biweekly.

--Some States require State agencies and local governments to remit social security contributions to them more often than quarterly (semimonthly, biweekly, or monthly). The semimonthly or biweekly submissions are more stringent than the monthly deposits proposed by SSA.

--Deposits after each semimonthly or biweekly payday would increase interest earnings to the trust funds.

We also stated that if HEW was going to change its regulations to require monthly deposits and decide at a later date to change them again (to more frequently than monthly), it would be better to make the entire change at one time. A subsequent effort to change the regulations would be subject to the 18-month waiting period required in Public Law 94-202. (See p. 15.) SSA officials acknowledged that our suggestion for requiring deposits more frequently than monthly was valid and could be implemented. However, they were reluctant to request more stringent deposit requirements because the States had been told that the HEW proposal would require deposits no more frequently than monthly.

PROPOSED REGULATION TO INCREASE FREQUENCY OF DEPOSITS

On March 30, 1978, HEW published in the Federal Register its proposed rulemaking increasing from quarterly (1 month and 15 days after the end of each calendar quarter) to monthly (15 days after the end of each month) the frequency with which States must deposit social security contributions on wages and salaries paid to covered employees. Reporting by States is to remain on a quarterly basis--1 month and 15 days after the end of each calendar quarter.

Monthly deposits, 15 days after the end of the month under the proposed rulemaking, and prompt investment could result in additional interest earnings to the trust funds of over $1 billion during the 5-year period 1980-84. (See p. 4.)

Semimonthly or biweekly deposits could result in an additional $73 million of interest income for the trust funds during the same 5-year period:

Year	Amount
	(millions)
1980	$11.3
1981	13.6
1982	14.9
1983	16.0
1984	17.2
Total	$73.0

The additional interest income which can be earned by requiring deposits more frequently than monthly increases each year; this additional interest income will continue to increase as the contribution rate and contribution base increase.

However, several bills 1/ have been introduced in the 95th Congress to permit States and local governments to continue making social security deposits on a calendar-quarter basis. Any of these bills, if enacted, would prevent the trust funds from earning the additional interest income.

1/H.R. 1300, Jan. 4, 1977; S. 1967, Aug. 1, 1977; and H.R. 11117, Feb. 23, 1978.

CHAPTER 3

STATE AND LOCAL GOVERNMENT

OBJECTIONS TO MORE FREQUENT DEPOSITS

We visited five States and a selected number of local governments to evaluate their views on the proposed regulations, published in the Federal Register on March 30, 1978, requiring monthly deposits of social security contributions. The States and local governments visited expressed strong opposition to the proposed regulations. The principal objections were: (1) loss of interest earnings or cash flow and (2) additional administrative costs and problems.

LOSS OF INTEREST EARNINGS OR CASH FLOW

The States' primary objection to more frequent deposits is loss of interest earned from investing contributions remitted to States by State agencies and local governments and the loss of cash flow from using these contributions from the time the employees are paid and their deductions are retained by the State until deposits are made with the Treasury Department.

SSA's report on the results of the Subcommittee on Social Security of the House Committee on Ways and Means questionnaire showed that, for those responding, an estimated $45 million was earned by the States in 1974 on social security contributions and that, if monthly deposits were required, these States would lose about $30 million, resulting in a net investment income of about $15 million. We noted, however, that estimates were not always comparable. For example, one State's estimated interest income resulted from investing State employees' shares only, while another State's estimated interest income included both the State and local employees' shares. The estimated amounts of interest income reported for the five States visited ranged from about $184,000 to $6,067,000 and totaled about $10,100,000 for 1974.

It is important to note, however, that the interest earnings on the employer and employee social security contributions held by the States and local governments are derived from funds that should be deposited in and earning interest income for the trust funds. These contributions were not intended to provide the States with interest earnings or cash flow.

Most of the State and local governments visited were required to make, and were making, deposits of withheld income taxes to IRS within 3 banking days after each quarter-monthly period in which a payday occurred (7th, 15th, 22d, and last day of the month). Thus, a State which pays its employees semimonthly or biweekly and withholds $2,000 or more remits withheld Federal income taxes to IRS semimonthly or biweekly (3 banking days after the quarter-monthly period in which the payday occurred), but that State is not required to remit to a Federal Reserve bank the social security contributions it deducts from the pay of these same employees until 1 month and 15 days after the end of each calendar quarter. Under HEW's proposed regulations States would be required to make deposits within 15 days after the end of each month during the calendar quarter.

In a July 5, 1978, letter to Senator Gaylord Nelson, the HEW Secretary pointed out that States and local governments could still earn, under the proposed monthly depository procedures, a minimum of $50 million annually from prudent short-term investment of withheld contributions before depositing them with the U.S. Treasury.

We noted that, of the five States visited, two are investing in U.S. securities. It was not possible to specifically identify these investments as coming from trust fund moneys because the sources of States' invested funds are not always identified. However, it seems reasonable to assume that some of these investments are being made with trust fund moneys or with moneys which are available because of cash flow furnished by trust fund moneys. Thus, it appears that the Treasury may be paying interest to States on moneys which should be deposited in and earning interest for the trust funds. We believe that HEW deposit regulations which allow States to earn interest on investments by using funds which should be deposited in and earning interest for the trust funds are not only detrimental to the financial stability of these trust funds but cannot be rationally justified and should be changed.

ADMINISTRATIVE PROBLEMS AND ADDITIONAL COSTS

The States' other objections to more frequent deposits are the administrative problems and the related additional costs. Their concerns were conveyed

- --in responses to the 1975 questionnaire of the Subcommittee on Social Security of the House Committee on Ways and Means,

--in meetings with HEW/SSA officials,

--during our visits to the State and local governments, and

--in subsequent letters to us.

These concerns are discussed below.

Collecting and depositing funds and reporting

With regard to the timeliness of collecting and depositing funds and the frequency of reporting, three of the five States require State agencies and local governments to remit social security contributions to them more often than quarterly (semimonthly, biweekly, and monthly). 1/ In these instances, the funds are already deposited with the States and the additional administrative work, other than reconciling conributions to the entities' quarterly reports, has already been accomplished.

Other States, however, require social security deposits from State agencies and local governments on a quarterly basis. Since social security contributions are based on the same payroll records as withheld income taxes, it would seem reasonable that State agencies and local governments could remit social security contributions to States in the same timely manner as withheld income taxes are remitted to IRS. Most State agencies and local governments visited were required and were making these deposits to IRS within 3 banking days after each quarter-monthly period. This time frame should allow States sufficient time to remit these contributions to HEW on a "payday" basis.

Monthly reporting is another issue raised by the States. Some States feel that a wage report is required to be forwarded

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1/The summary report of responses to questionnaires sent to States prepared by SSA regarding the dates payments are due in State Social Security agencies from other State agencies and political subdivisions stated that "in 17 States some or all of the contributions are paid to the State social security agency more than once each quarter (primarily each pay date or monthly). * * * In two States, it was indicated that only the employees' shares for State agencies are paid more frequently * * *."

along with each deposit of social security taxes, no matter how frequently. When States and local governments make semimonthly, biweekly, or monthly deposits of Federal income taxes, only one report to IRS is required and that report is not due until 1 month after the end of each calendar quarter. Similarly, if as stated under the HEW proposed rulemaking, States and local governments were required to make monthly deposits of social security contributions, no additional wage reports would be required--only one report to HEW would be required, and that report would not be due until 1 month and 15 days after the end of each calendar quarter.

Documentation to support States' liabilities

Another administrative matter which concerned the States was the documentation required to support payment of contributions by both local government agencies and the States. Examples of required documentation included vouchers, warrants, certification statements, wage statements, payroll information or records, etc.

Payments to the State by local governments would be based on payrolls at the local levels, which should provide sufficient documentation to support the employees' and the employers' shares if the local agency is responsible for both. As such, the State, having received both the employers' and employees' shares, should be able to forward these amounts to Treasury for deposit to the trust funds. However, some States also pay the employer's share of some non-State or local employees, such as teachers, librarians, and Boards of Education. One of the States visited contended that it has no knowledge of its employer liability on behalf of these individuals until it receives a quarterly report from each entity; the State would only pay the employer cost based upon evidence of an established liability.

We believe that the evidence required by the States is a matter for them to determine; however, as we understand it, the amount transmitted by local governments and other State agencies representing the employees' shares would be about one-half of the total liability. Accordingly, this would seem to be reasonable evidence to indicate the States' liability, keeping in mind that the exact liability is not determined until 1 month and 15 days after the final month ending the calendar quarter and that any minor adjustments can be made at that time. If, however, under the above-described procedure the State would require additional evidence to support its liability, it could request a certified statement from the reporting agencies or a copy of the payroll. We see no insurmountable problems in this matter that could not be reasonably worked out.

<u>Other areas of concern</u>

The following are some of the other statements made during our visits to the States and local governments:

--The workload would increase because of additional deposits, reconciliations, and adjustments.

--There would be no major problems in more frequent deposits to the States if no additional reporting was required.

--More checks would have to be issued if the frequency of deposits were increased.

--15 days is not sufficient time because some entities are unable to meet the present deadline.

--Additional personnel and space would be needed to handle the increase in workload.

Some of the above items would increase administrative costs. However, we noted that three of the five States we visited charge each State agency and local government within the State a fee for each person covered under the social security program; these fees were sufficient to recover all (in two States) and part (in one State) of the administrative costs of operating the social security program.

We did not study the reasonableness of the 15-day time frame for depositing monthly contributions. Although 15 days seems to be a reasonable amount of time to make deposits to the trust funds, the exact number of days should be determined by HEW after consulting with the States. If all State and local government employees are paid twice a month on the 15th and 30th of the month, the interim deposits (if semimonthly) could be required by the 30th and the following 15th, respectively, if the 15-day time frame is decided upon. However, if all State and local employees are paid twice a month and paid on many different days, so that some employees were being paid on every working day of the month, HEW could consider requiring the interim deposits of that State to follow the IRS quarter-monthly rule or perhaps a "half-monthly" rule.

As mentioned previously (see p. 10), administrative problems were examined in 1975 by the Subcommittee on Social Security of the House Committee on Ways and Means by using a questionnaire prepared in conjunction with HEW and the States. In response to a question regarding admininstrative changes States believed were needed to implement a monthly deposit procedure, the study pointed out that most States indicated additional employees would be needed. The study further added that some States indicated it was difficult to provide precise information. We believe that some of the reponses indicating substantial increases in personnel and related costs could have been based on the States' misunderstanding in 1975 that the frequency of reporting requirements to HEW would be increased; i.e., each time a deposit was made, a report would be required from the local governments and from the State. This possible misunderstanding was discussed in our comments on the notice of proposed rulemaking dated June 9, 1978, where we suggested that clarification was needed. (See app. I.)

In the July 5, 1978, letter to Senator Gaylord Nelson, the HEW Secretary stated there could be some minor increases in administrative costs. In view of the minimum $50 million interest earnings the States could still realize annually under the monthly deposit procedure, the Secretary stated that the total cost of administration by the States should continue to be more than fully compensated. As a point of reference, the Secretary stated that the cost of IRS administration of the contribution collecting and reporting functions required of the States under the proposed regulation would be less than $2 million annually. Our review did not include an evaluation of the reasonableness of the $2 million figure used by the HEW Secretary. The Secretary further stated that he could see no reason for a reduction in the present level of accuracy in reporting contributions by the States (another issue raised by the States) since reporting contributions, including reconciliation of accounts, will continue on a quarterly basis--exactly as presently done.

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We agree that the States would have to perform additional work in collecting and reporting funds and in issuing more checks, reconciling checks to the quarterly reports, and maintaining appropriate records--particularly in States with large numbers of reporting entities. We recognize that in a situation involving all 50 States, about 60 interstate instrumentalities, and over 60,000 local governments that problems will arise due to a lack of uniformity or exceptions to the norm.

For example, not all States and local governments pay their employees on the same frequency or on the same day. Thus, one should not expect a State or local government to remit deposits semimonthly or biweekly if it pays its employees monthly.

Another example is where a State pays some or all of the contribution for a State or local employee or elected official. It may not be possible to determine the exact State liability on a semimonthly, biweekly, or monthly basis. In these instances, exceptions to the general depositing requirements should be allowed by HEW.

Public Law 94-202 provides that any changes pertaining to frequency of deposits may not become effective until 18 months after the date of HEW's final publication of the rulemaking in the Federal Register. The purpose of Public Law 94-202 is to assure that States would be given ample lead time to implement any changes and would also give the Congress an opportunity to review any changes which the HEW Secretary might propose. We believe the States and local governments should be able to effectively and efficiently implement the change in the frequency of deposits within 18 months.

CHAPTER 4

HEW'S MODIFICATION TO PROPOSED REGULATIONS

In chapter 2 we discussed HEW's (1) efforts to increase the frequency of deposits and (2) proposed regulations to increase the frequency of deposits published in the Federal Register on March 30, 1978. In chapter 3, we discussed the State and local governments' objections to more frequent deposits.

HEW ACTIONS ON COMMENTS ON PROPOSED REGULATIONS

HEW received about 3,300 comments, primarily from State officials, local political subdivisions, and governmental organizations. The commenters were overwhelmingly opposed to any changes in the States' deposit procedures. Reasons given included those discussed in chapter 3. HEW officials also met with members of the National Conference of State Social Security Administrators, who opposed any plan for more frequent deposits under which the States would remain liable for the contributions due.

HEW considered both the oral and written comments on the proposal to require States to deposit 15 days after the end of each month and, as a result, made a significant change. HEW then proposed to retain the requirement that the States deposit the social security contributions for each of the first 2 months of a calendar quarter by the 15th day after each month. For example, the contributions for the months of January and February will be due February 15 and March 15, respectively. However, the contributions for the third month of the quarter (March) will not be due until 1 month and 15 days after the end of that month--May 15. These changes were published in the Federal Register on November 20, 1978, and are to become effective July 1, 1980.

The following are excerpts from some of the documents, which explain HEW's rationale for the modifications to the March 1978 published proposal and discuss the issues raised.

--States need time to receive, account for, and transmit payment from the employing entities. HEW believes, however, that a 15-15-45 day depositing requirement strikes a reasonable balance in (1) allowing the States time to receive moneys from their local governments,

(2) making the treatment of government and private employers more equitable, and (3) increasing the interest income to the social security trust funds.

--HEW is considering an annual reporting system; if it is adopted, the 45-day deposit schedule will still accommodate the States, which will continue to reconcile their payment quarterly.

--One commenter indicated that it would be "* * * just as practical to require deposits to be made 15 days after the end of the pay period as it is to be made 15 days after the end of the month as currently proposed." This proposal does not take into account the States' need to accumulate the necessary information and funds from the local governments.

--HEW believes there are many advantages to the 15-15-45 method which were not present in the methods previously published or suggested in response to those proposals:

(1) The States will have more use of the social security contributions than under the 15-15-15 day requirement and will be able to use these moneys to defray any administrative expenses.

(2) The States will also have more control of their liability under the agreement since they will have time each quarter to reconcile their total liability.

(3) This method causes less change in existing State procedures and facilitates the accommodation of State processes.

(4) The social security trust funds will receive more money than they currently do under quarterly payments, and the flow will be more predictable and steady than at present.

(5) The Secretary will be fulfilling his statutory responsibility to make requirements for States and private employers as similar as possible.

Additionally, in a September 26, 1978, letter to Senator Gaylord Nelson, the acting Commissioner of Social Security stated that the new proposed depository schedule for the States (15-15-45) is designed to fulfill HEW's trust fund obligation and to meet two basic concerns:

--Elimination of additional administrative complexity.

--Assurance that the States have sufficient use of the contributions to pay the administrative costs involved in handling reports and moneys for the employees of the States and their localities.

The letter also stated that the 15-15-45 proposal will reduce the amount of interest earnings to the trust funds by about $30 million annually. It does, however, provide opportunities for earnings in at least that amount by the States through judicious short-term investment, thus more than compensating them for costs attributable to administering the program.

HEW'S MODIFICATION WILL RESULT IN ADDITIONAL LOSS OF INTEREST INCOME

On November 1, 1978, before the revised proposal was approved by HEW, we met with HEW officials and informed them that (1) we could find no logical or valid justification for delaying the last monthly deposit from HEW's initial proposal and (2) a biweekly or semimonthly deposit requirement appeared to us to be just as valid as when we initially discussed it in February 1978. We pointed out, among other things, that:

--If the third monthly deposit (15-15-15) were required on April 15, July 15, etc., any monetary adjustments could be made when the quarterly report is filed on May 15, August 15, etc., since the current reconciliation quarterly form includes a line for adjustments. Also, by delaying the last deposit in the proposed 15-15-45 method, States would be sending in two deposits on the same day. For example, the payment for the third month (March) of the first quarter would be due on May 15, and the deposit for the first month (April) of the second quarter would also be due on May 15. If the 15-15-15 method were retained and the third deposit for the first quarter were made on April 15, any adjustments needed for the first quarter could be made when the May 15 first deposit of the second quarter is made.

--Delaying the third monthly deposit in a quarter would allow States which pay their employees on March 1 and June 1, etc., to retain the funds until May 15 and August 15, etc.--about 2-1/2 months.

--The HEW Secretary previously stated in his letter of July 5, 1978 (see p. 10), that the States and local governments could still earn under the proposed (15-15-15) monthly depository procedures a minimum of $50 million annually from prudent short-term investments, which should fully compensate the States for administrative costs. We see no need for the trust funds to lose an additional $30 million in interest income in the first year. (See annual and cumulative effects on p. 20.)

--In 1959, when the States were granted the additional 15 days at the end of each quarter to send in their contributions, it was estimated that the extra 15 days was costing the trust funds $0.5 million annually in interest income and that perhaps, to offset the loss of income, monthly deposits should be required. We estimate that for 1977 the additional 15 days at the end of each quarter resulted in a loss of investment income of about $31 million to the trust funds. It seems to us that, by delaying the last deposit under the 15-15-45 proposal, HEW is placing itself in the same position it did in 1959, which will result in a significant loss of investment income to the trust funds over the years.

--If annual reporting is adopted, there would be less administrative reporting by the States, which would seem to negate the argument that the States need more time to receive, account for, and transmit payment.

The following table shows the estimated additional amounts of interest income which could be earned if deposits were made (1) semimonthly, (2) monthly (as originally proposed by HEW), and (3) under HEW's revised published regulations. Although July 1, 1980, is the earliest the change can become effective, the table shows (for illustrative purposes) the effect on a calendar-year basis. The amounts were based on estimated calendar year State and local government contributions using simple interest.

Estimated Additional Interest Income That Could Be Earned By The Trust Funds Over Present Depository Method

Calendar year	Deposit requirements: Semi-monthly	HEW original proposal (15-15-15)	HEW revised regulations (15-15-45)	Differences: Semi-monthly/ 15-15-15	15-15-15/ 15-15-45	Semi-monthly/ 15-15-45
	(millions)					
1980	$ 191.7	$ 180.4	$ 150.3	$11.3	$ 30.1	$ 41.4
1981	230.3	216.7	180.5	13.6	36.2	49.8
1982	252.8	237.9	198.2	14.9	39.7	54.6
1983	271.9	255.9	213.2	16.0	42.7	58.7
1984	292.4	275.2	229.3	17.2	45.9	63.1
Total 1980-84	$1,239.1	$1,166.1	$ 971.5	$73.0	$194.6	$267.6
1985	314.3	295.8	246.5	18.5	49.3	67.8
Total 1980-85	$1,553.4	$1,461.9	$1,218.0	$91.5	$243.9	$335.4
Total 5 years (7/1/80 to 6/30/85) (note a)	$1,300.4	$1,223.8	$1,019.6	$76.6	$204.2	$280.8

a/Estimated by including one-half of the amounts for both 1980 and 1985.

As shown above, for 1980 the trust funds would earn $30.1 million less in interest income under the 15-15-45 requirements than under the 15-15-15 proposal and $41.4 million less under the 15-15-45 requirements as compared with a semimonthly deposit schedule. Comparable amounts for 1985 would be $49.3 million and $67.8 million, respectively. It should be noted that these annual differences will continue to increase after 1985 as the contribution rate and contribution base increase.

For the 5 years from July 1, 1980, to June 30, 1985, the trust funds would earn $204.2 million less in interest income under the 15-15-45 requirements than under the 15-15-15 proposal and $280.8 million less under the 15-15-45 requirements than under a semimonthly deposit schedule.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The States' and local governments' objections to more frequent deposits are (1) the loss of investment income because the social security contributions would no longer be in their possession for a longer period of time and (2) the administrative problems and additional costs of more frequent deposits. We believe that these social security contributions should earn investment income for the trust funds; we see no valid reason for the continued extended retention of these social security contributions by the State and local governments. With respect to the administrative problems and related costs, we believe that these problems can be reasonably worked out within the time frame provided by Public Law 94-202.

It cannot be overlooked that the Social Security trust funds could have earned about $1.1 billion additional interest from 1961 to 1979 if monthly deposits were required. The loss of this interest income resulted from HEW permitting the States to continue to make quarterly deposits of social security contributions rather than requiring more frequent deposits, as required of private employers who generally must deposit social security taxes to IRS weekly, semimonthly, biweekly, or monthly. Increasing the freqency of deposits and relating such deposits for social security contributions to the payday will increase interest earnings for the trust funds. Accordingly, the frequency of deposits should be increased.

We believe, HEW's original proposal to increase the frequency of deposits to a monthly basis was a step in the right direction and would result in the trust funds earning additional interest income of over $1 billion from 1980-84. However, if these contributions were required to be deposited biweekly or semimonthly, an additional $73 million could be earned during the same time period.

In a draft of this report submitted for comment on November 14, 1978, we stated that we do not agree with the then-revised proposal to delay the final quarterly deposits. We could find no logical or valid justification for such a delay which, in the next several years, would result in the trust funds earning several hundred million dollars less in investment income than could be earned if deposits were required monthly (as originally proposed by HEW) or semimonthly. (See p. 20.)

Moreover, in view of the continued increase in contributions in future years which should result from increases in both the tax rate and contribution base, the potential for additional investment income by requiring deposits more frequently than monthly will be even greater, and the change to more frequent deposits would seem to be more justified.

Accordingly, we suggested in the draft report that the Secretary, Health, Education, and Welfare expedite issuing the revised regulations and strongly consider semimonthly or biweekly deposits to substantially increase interest earnings to the trust funds. We suggested that once the frequency was decided, the number of days to make such deposits should be determined after consultation with the States. We also suggested that to carry out this change in frequency of deposits, the Secretary should consider the feasibility of requiring State and local governments to make their deposits with their withheld income tax deposits if this deposit procedure (1) would reduce administrative problems and costs at State and local levels and (2) could be arranged with IRS and State and local governments, provided any required changes in the Social Security Act and State laws can be made. (See p. 6.)

New regulations were published in the Federal Register on November 20, 1978. These regulations call for deposits within 15 days of the end of each of the first 2 months of a calendar quarter, and within a month and 15 days of the end of the third month of the calendar quarter (15-15-45).

In commenting on the draft of this report, HEW stated:

> "In arriving at the depository schedule contained in the new regulations, the Department was concerned about its responsibility to protect the interest of the Trust Funds. At the same time, it had to consider the concerns expressed by State Social Security Administrators, numerous local governments, governors, and many Members of Congress. The process agreed upon protects the trust fund interests; at the same time it is a reasonable accommodation to the States' concerns about administrative costs and problems in collecting and transmitting more frequent deposits."

HEW's response to our draft report did not comment on (1) our arguments regarding the revised proposal or (2) the significant amounts of interest income which will be lost under the revised proposal. Therefore, we still believe that the regulations as published in the Federal Register are not in the best interest of the trust funds since they do not maximize interest earnings to the trust funds. We further believe that financial assistance to States should be specifically legislated and not provided at the expense of the trust funds.

RECOMMENDATION TO THE HEW SECRETARY

Since the revised regulations will not become effective until July 1, 1980, we recommend that the Secretary, HEW, reconsider his decision to implement the 15-15-45 requirements and urge that semimonthly or biweekly deposits be required. However, at a minimum, the HEW original proposal (15-15-15) would be a viable alternative.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

9 JUN 1978

Mr. Donald I. Wortman
Acting Commissioner of Social Security
Department of Health, Education, and Welfare

Dear Mr. Wortman:

We have reviewed your "Notice of Proposed Rulemaking," Federal Register, Volume 43, Number 62, Thursday, March 30, 1978, concerning more frequent deposits of social security contributions by the States. We agree that more frequent deposits will result in increased interest earnings to the Social Security Trust Funds and be more consistent with the requirement placed on employers in the private sector who generally must make deposits more often than the States.

Because of the preferential treatment afforded the States under current regulations, the Social Security Trust Funds will have lost at least $1 billion in investment income until such changes can become effective in 1980.

While we agree that your proposal to increase the frequency of deposits is a step in the right direction, we have reservations as to whether this proposed change goes far enough to maximize interest earnings to the trust funds. Furthermore, we believe the phasing in options of your proposal are not a viable means for implementing more frequent deposits and the frequency of reporting may not be clearly understood by the States and should be clarified. Our comments on these matters follow.

FREQUENCY OF DEPOSITS OF STATE, LOCAL, AND EMPLOYEES' SHARE OF SOCIAL SECURITY CONTRIBUTIONS

Section 218(e) of the Social Security Act, as amended, provides "* * * that the State will pay to the Secretary of the Treasury, at such time or times as the Secretary of Health, Education, and Welfare may by regulations prescribe, * * *." (Emphasis supplied.) This requirement is included in contracts between the Secretary and the States.

Your proposal under section 218 will increase the frequency with which States and interstate instrumentalities must deposit social security contributions on wages and salaries paid to covered employees from quarterly (15th day of the 2d month after the end of the calendar quarter) to monthly (15 days after the end of each month). The present quarterly deposit requirement for States results in a substantial loss of interest earnings to the Social Security Trust Funds, and is inequitable to employers in the private sector who generally must deposit Federal income and social security taxes weekly, biweekly, or monthly.

Section 218(i) of the act provides that the same deposit requirements should be imposed on the States, so far as practicable, as is imposed on employers of the private sector. The Internal Revenue Service (IRS) requires private employers to follow a depository schedule based on accumulated social security taxes and withheld income taxes. Generally, the current deposit rules for accumulated social security taxes and withheld income taxes are as follows:

Deposit at end of month after end of the quarter if the total undeposited taxes are less than $200.

Deposit within 15 days after end of month if taxes are $200 to less than $2,000.

Deposit within 3 banking days after the quarter-monthly period ends (end of 1st, 2d, or 3d week) if taxes are $2,000 or more.

State and local government employers are subject to this schedule for withheld income taxes only since social security contributions are remitted to the Social Security Administration (SSA). In our visits to a limited number of State and local governments, we noted that these governments generally deposited withheld income taxes in accordance with the IRS deposit rules. Thus, governments having biweekly payrolls were making deposits of withheld income taxes biweekly.

Your proposal to increase the frequency of the deposits will result in substantial interest earnings to the Social Security Trust Funds. However, we believe that in accordance with the provisions of the law, it is just as practical to require deposits to be made 15 days after the end of the pay period as it is to be made 15 days after the end of the month as currently proposed. In this connection, we noted that:

(1) over half of the State and local employees are currently being paid more often than monthly;

(2) many States already require State agencies and local governments to remit social security contributions to them more often than quarterly (biweekly or monthly); and

(3) State and local governments are remitting withheld income taxes in accordance with the IRS depository schedule.

In effect, a State which pays its employees biweekly remits the Federal income taxes it withholds to the IRS biweekly, but is not required to remit to SSA the social security contributions it deducts from the pay of these same employees until the 15th day of the 2d month after the end of the calendar quarter.

Because the States make less frequent deposits than private sector employers, the Social Security Trust Funds have lost a potential for about $1 billion interest earnings since the States were brought under the social security program in 1951. Deposits by the States rose from about $26 million in 1952 to over $10 billion in calendar year 1977. Based on present wages, salaries, and interest and inflation rates, interest earnings are substantial and should become more substantial in future years. For example, assuming your monthly deposit proposal becomes effective January 1, 1980, additional trust funds interest earnings will total about $856 million (at simple interest rates) for the 4 calendar years 1980-1983. These interest earnings would increase an additional $54 million for the same period if deposit requirements were changed to 15 days after the end of the pay period.

PHASING IN OPTIONS

Your proposal sets forth a plan for immediate implementation no less than 18 months after the final rules are published. The 18-month provision was provided by Public Law 94-202, enacted January 2, 1976. In addition, there are five options for phasing in the proposed rules.

In our visits to the State and local governments, we discussed the need for the five options. The State and local governments advised that immediate implementation would be more desirable than the five options for phasing in the proposed rules. The five phase-in options would be more confusing and difficult to implement since these options require quarterly and/or yearly changes in frequency of social security contribution deposits until the rules are fully implemented. We agree with the State and local governments that immediate implementation would be more desirable than a phase-in under any of the five options. In addition, the States would have the 18-month period for planning and dealing with immediate implementation of your proposal on or about January 1, 1980.

FREQUENCY OF REPORTING REQUIREMENTS

The proposed rules appear ambiguous as to the frequency of required reporting by the States on contributions for employees' wages and salaries. It is our understanding that the proposal requires only more frequent deposits, and that the required frequency for reporting will remain quarterly.

Paragraph 404.1255a, (c) of your proposal, pertaining to filing of contribution returns and wage reports for months on or after the effective date of your proposal states

> "Contribution returns (Form OAR-S1) will be sent to the * * * Social Security Administration * * * with respect to each deposit at the same time that the deposit is made. Wage reports, on Form OAR-S3, together with a recapitulation report (Form OAR-S2) shall also be filed with the * * * Social Security Administration." (Emphasis supplied.)

Since the above paragraph might be interpreted as requiring a report each time a deposit is made, we believe you should advise all States that the current quarterly reporting requirements will remain the same.

- - - -

We appreciate the opportunity to comment on your "Notice of Proposed Rulemaking" and would like to be advised of any consideration given to our comments. As you are aware, we are currently reviewing the effects of delayed social security contribution deposits by the States under section 218 of the act, and plan to issue a report to the Congress at a later date.

Sincerely yours,

Gregory J. Ahart

Gregory J. Ahart
Director

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

DEC 11 1978

Mr. Gregory J. Ahart
Director, Human Resources
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

This responds to your letter asking for our comments on your report, "Trust Funds Adversely Affected By Delayed Payments of Social Security Contributions by the States."

The report recommends that the Secretary expedite the issuing of revised regulations and strongly consider semimonthly or biweekly deposits of social security contributions by the States.

The regulations referred to were issued in final form on November 20. They call for deposits within 15 days of the end of each of the first 2 months of a quarter, and within a month and 15 days of the end of the third month of the quarter. Formerly, States' deposits were required to be made on a quarterly basis.

The matter of increasing the frequency of States' deposits of social security contributions has been thoroughly considered by the Department, including the views expressed by the GAO team.

In March 1978, the Department issued a Notice of Proposed Rulemaking which called for monthly deposits by the States. More than 3,000 respondents registered their concerns about accelerating the depository schedule.

In arriving at the depository schedule contained in the new regulations, the Department was concerned about its responsibility to protect the interest of the Trust Funds. At the same time, it had to consider the concerns expressed by State Social Security Administrators, numerous local governments, governors, and many members of Congress. The process agreed upon protects the trust fund interests; at the same time it is a reasonable accommodation to the States' concerns about administrative costs and problems in collecting and transmitting more frequent deposits.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,

Thomas D. Morris
Inspector General

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