DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

# Memorandum

Date: NOV 26 1996

From: Deputy Inspector General
for Audit Services

Subject: Report on the Audit of the Working Capital Fund for Fiscal Year 1994
(A-17-97-00014)

To: George H. Strader
Deputy Assistant Secretary for Finance

The attached report presents the results of audit by the certified public accounting firm Ernst and Young LLP (E&Y) in its examination of the Office of the Secretary, Working Capital Fund (Fund) financial statements for the fiscal year (FY) ended September 30, 1994. The Office of Inspector General exercised technical oversight and quality control of the audit.

We engaged E&Y to audit the financial statements and to express an opinion on them. The firm issued a "qualified" opinion on the Fund financial statements because detail records for property and equipment and the related depreciation expense--recorded as $6,249,000 and $1,522,000, respectively--were incomplete and did not support the purchase price and the date purchased. In addition, support for certain aggregations of expense by object class was not available. Accordingly, E&Y determined that, except for the effects of such adjustments that might have been necessary had the Fund maintained accurate and complete records, the Fund's 1994 financial statements present fairly, in all material respects, the financial position of the Fund as of September 30, 1994.

As part of the audit engagement, E&Y also rendered separate reports on internal controls and on compliance with laws and regulations. In the report on internal controls, E&Y noted one material weakness and three reportable conditions. A material weakness was noted for an inability to support property and equipment balances (resulting in the report qualification described above). Reportable conditions were noted in: (1) maintaining control over the general ledger, preparing financial statements, and detecting errors and irregularities; (2) the recording of liabilities; and (3) various aspects of computer security, such as access to the mainframe computer, to the payroll application, and to the core accounting system libraries, and maintaining a disaster recovery plan. In the report on compliance with laws and regulations, E&Y noted no instances of noncompliance required to be reported under government auditing standards.

In our oversight of the audit, we found nothing to indicate that E&Y's work is inappropriate or that E&Y's reports cannot be relied upon. The Assistant Secretary for Management and Budget concurred with E&Y's findings and recommendations.

We want to thank you for the courtesy and cooperation your staff extended to E&Y and our staff during the audit. If you wish to discuss the report, please call me or have your staff contact Joseph E. Vengrin, Assistant Inspector General for Audit Operations and Financial Statement Activities at (202) 619-1157.

Thomas D. Roslewicz

Attachment

# OFFICE OF THE SECRETARY
# WORKING CAPITAL FUND

March 1996

**Department of Health and Human Services**

# OVERVIEW OF THE WORKING CAPITAL FUND

# OS WORKING CAPITAL FUND

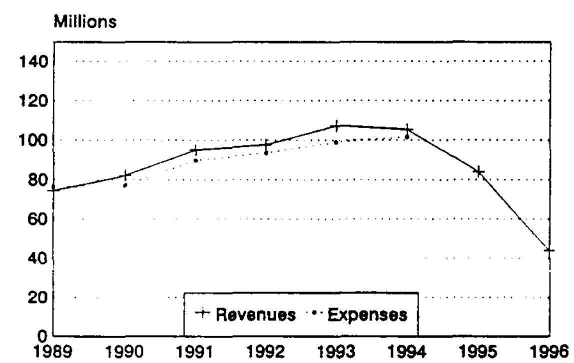
## INTRODUCTION

The Office of the Secretary (OS) Working Capital Fund (WCF) is a non-appropriated commercial type revolving fund in the Department of Health and Human Services (HHS) authorized in 1952 by 42 U.S.C. 3513 and expanded in 42 U.S.C. 3513(a) and 3513(b). Its mission is to provide consolidated financing and accounting services for HHS business-type operations involving the provision of 19 common and administrative services (described in Appendix A) to customer agencies. The WCF mechanism allows OS to bill individual HHS Operating Divisions (OPDIVs) and agencies for the services they receive. These billings are based upon actual measured usage (fee-for-service basis) thereby placing the burden of costs for services with the recipients of those services. Unlike appropriated funds, the WCF provides the flexibility to respond to changing service requirements, which will vary as OPDIV and agency program and staffing needs change.

The three primary goals for the WCF are:

- to minimize costs for the level and quality of services provided to customers determined appropriate by the WCF's Board of Governors;
- to provide for the consolidated budgeting, financing and accounting for common services;
- and to maintain the fiscal integrity of the WCF.

OS Working Capital Fund




revenues are projected for FY 1995 and 1996

A primary, and continuing objective of the WCF is to improve its management of property and equipment. To highlight the importance of this issue, and ensure implementation of needed improvements, the OS Property Work Group was established in April, 1994. This group's main objective was to initiate corrective action to clear various internal control weaknesses in the management and control of the WCF's capitalized equipment. Building upon the regional efforts in FY 1993, headquarters activities began following procedures to ensure that the Integrated Property Management System (IPMS) property records are reconciled with official financial records on a regular basis. Additionally, more in-depth training and IPMS systems enhancements were completed during FY 1994. These procedures, in conjunction with the IPMS system, have allowed the WCF to improve internal controls concerning custodial management of property and equipment in HHS.

Several subsequent events which have occurred during FY 1995 are of special importance to the WCF. As of April 1, 1995 the Social Security Administration became an independent agency outside the HHS organization. For FY 1996 this will reduce the Funds by approximately $40 million. Also, effective October, 1 1995, the Office of the Secretary will devolve its regional administrative services to the operating components of the Department. This streamlining and delayering action will further reduce the WCF's FY 1996 revenues by $20 million. This projected reduction in Fund revenues can be seen in the above figure.

Additionally, the HHS REGO II process has analyzed all administrative services provided within the Department and determined that the most efficient structure to provide centralized services would be the creation of a separate Program Support Center. This Center should be operational in FY 1996 and will include most, if not all of the current WCF activities. This will either dramatically shrink or eliminate the current WCF.

The financial statements have been prepared to report the financial position and results of operations of the WCF, pursuant to the requirements of the Chief Financial Officers Act of 1990. While the statements have been prepared from the books and records of the WCF in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

# REGIONAL PERSONNEL
# SW WASHINGTON PERSONNEL

The mission of the Regional Personnel Offices (RPO) and the SW Washington Personnel office (SWP) is to provide a full range of personnel services. Their goal is to provide timely, high quality and cost effective services that contribute to the accomplishment of the missions of its customers. The major functions of RPO and SWP are to provide advice to managers and employees on the full range of personnel services, including staffing, benefits, employee and labor relations and training.

SWP services OS, Administration on Aging and Administration for Children and Families employees located in Washington, DC. and the Inspector General's field staff (a total of about 4,300 employees). RPO services HHS's regional employees (approximately 61,000) located in the ten regional headquarters and other affiliated field locations. In addition to direct service responsibilities, four of the RPOs have oversight responsibility for the Indian Health Service personnel offices which service an additional 16,000 employees (not included in the 61,000 mentioned above).

Figure 1 illustrates that the cost per personnel account decreased from FY 1993 to FY 1994 by 3 percent for RPO and 16 percent for SWP. RPO's and SWP's operating costs decreased 1 and 17 percent, respectively, primarily due to reduced staffing levels in support of the Department's streamlining efforts.

Cost per Personnel Account
RPO & SWP

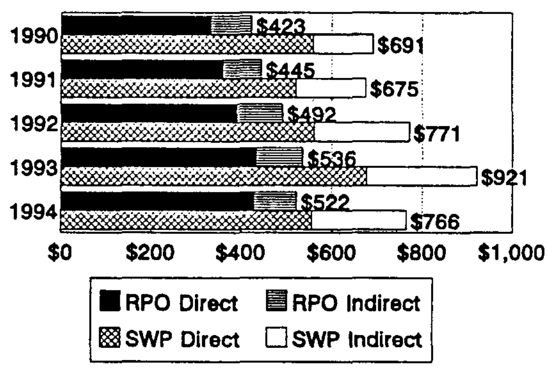



Figure 1

Servicing Ratios
RPO & SWP

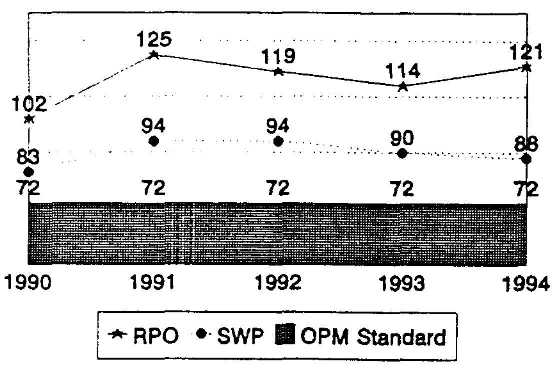



Figure 2

The ratio of serviced employees to personnel office employees is a measure of efficiency. The OPM performance standard ratio is 1 personnel office employee for every 72 serviced employees and RPO and SWP have set this ratio as their performance standard. Figure 2 shows that both RPO and SWP have exceeded that standard for the last five years. In FY 1994, RPO's ratio increased six percent due to a reduction in staff on board while the servicing positions increased. Because SWP services the Departmental headquarters staff, there are unique servicing needs which cause the SWP ratio to be lower overall than RPO's.

RPO and SWP conduct annual surveys to determine their customers' perception of the services provided. Figure 3 depicts the overall assessment of the quality of RPO's services by randomly sampled managers and supervisors. Their response rate was 55 percent. For the last four years, over 86 percent of respondents rated RPO services fully satisfactory or better.

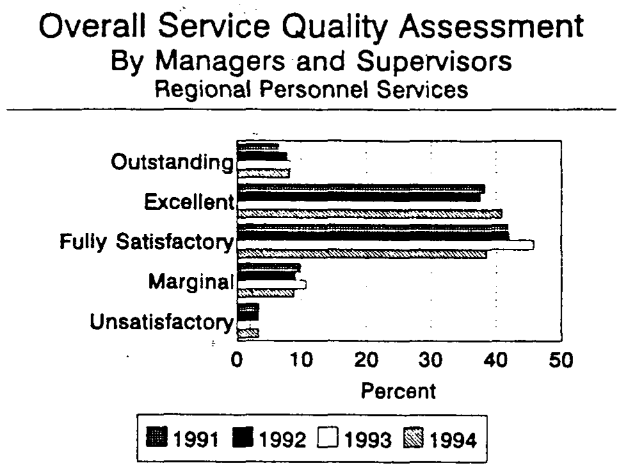



Figure 3

SWP conducts its own surveys, one for employees serviced and one for supervisors and managers, each sent randomly in alternate years. The supervisors and managers' overall assessment of the quality of SWP's services in FY 1992 and FY 1994 is presented in Figure 4. The ratings fully satisfactory or better increased from 74 percent in FY 1992 to over 78 percent in FY 1994. The response rate was greater than 50 percent. Randomly surveyed employees, presented at WCF-SUPP-A, rated the SWP's services fully satisfactory or better 74 and 86 percent of the time, in FY 1991 and 1993, respectively.

Some of the initiatives to improve efficiency and increase customer satisfaction originated in prior years have now become an established policy or procedure. Examples include the use of automated systems to process merit promotion actions, thus improving timeliness and reducing the amount of RPO and SWP staff needed to process the actions. Offices are now using automated open continuous announcements, eliminating the need to issue individual vacancy announcements for many positions. At least one office has established automated procedures for tracking workers compensation cases in the hope of getting injured employees off OWCP rolls and back to productive employment.

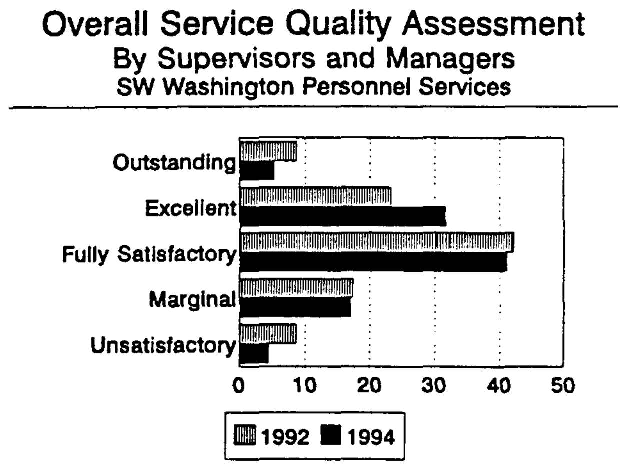



Figure 4

The following are new initiatives undertaken to improve efficiency and increase customer satisfaction:

SWP has joined several RPOs in instituting automated telephone answering systems which allow callers to get information on such subjects as vacancies and to leave their questions for a specialist to research and answer.

A six-month pilot program was established to test using one site as a hub for all personnel action processing from multiple RPOs, thereby reducing staff time and space/equipment needs. This activity was very successful and expects to be replicated in the future as automation allows such consolidation.

SWP began participation in an HHS Reinvention Laboratory (which will continue into FY 1995) as a partner with the Administration for Children, Youth and Families.

## PERSONNEL AND PAYROLL SYSTEMS

The mission of Personnel and Payroll Systems (P & P) is to provide personnel and payroll actions processing and pay services by utilizing an automated system. Their goal is to provide responsible and service-oriented personnel and payroll services to all HHS employees (more than 130,000). Its principal objective is to provide services in support of HHS's missions that are timely, high in quality and cost effective. P & P's three major functions are:

- personnel transaction processing (promotions, accessions, separations, reassignments)
- time and attendance transaction processing, production of paychecks and earning and leave statements
- ad hoc personnel/pay reporting such as gender and racial diversity of HHS employees and FTE usage by OPDIV and for the Department

Figure 5 illustrates how the cost per personnel/payroll account increased 10 percent between FY 1993 and FY 1994. As a measure of human resource efficiency, an additional measure showing the average number of personnel accounts processed per FTE is presented at WCF-SUPP-B. There was a three percent increase in this measure between FY 1993 and FY 1994. The number of personnel accounts processed decreased two percent and the number of FTE decreased four percent.

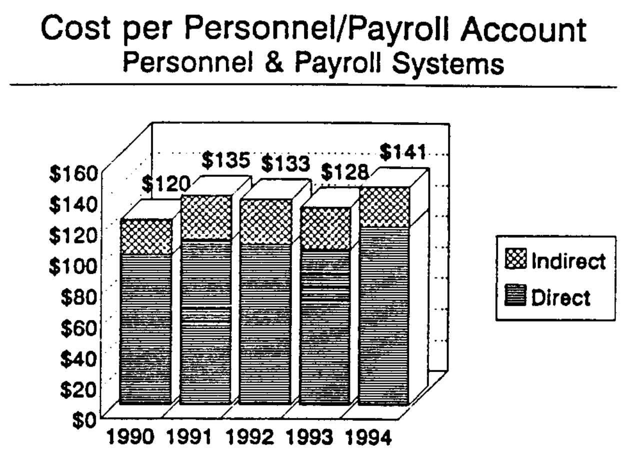



Figure 5

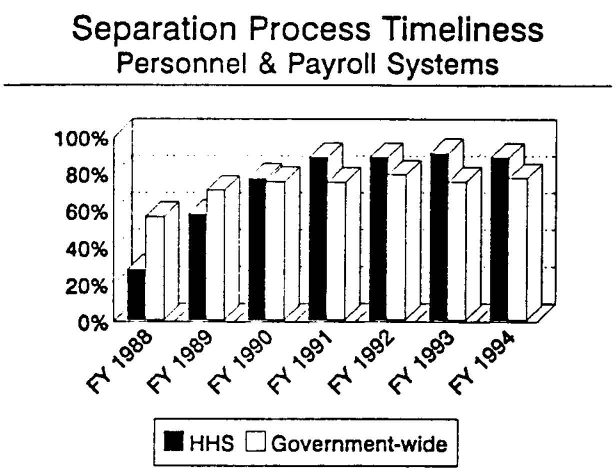



Figure 6

Figure 6 is a timeliness measure that shows the percent of HHS separation packages (averaged on a quarterly basis) submitted to the Office of Personnel Management (OPM) within 30 days after the effective date as compared to government-wide performance. Although OPM measures performance at 30, 60 and 90 days, P & P has chosen to compare their performance against the 30 day benchmark as it is the most stringent one (the one to emphasize for quality and productivity improvement efforts).

A new PC based time and attendance system is being implemented throughout HHS (replacing a 20 year old paper and punch card process) and is expected to be completed by December 1995. This system eliminates the need for timecards and should simplify data transmission requirements. This system meets most of the recommendations related to time and attendance outlined by the National Performance Review and should minimize occurrences of pay related errors as input data is edited and corrected at the source prior to being transmitted to the processing center for pay computation. The new system also meets most of the recommendations related to time and attendance outlined by the National Performance Review. The PC based system is being enhanced to execute in a Local Area Network (LAN) environment, thereby providing more functionality to the HHS user community. This functionality will be available in early FY 1996.

The automated training request and approval system continues to be implemented nationwide. As it will be incorporated into the automated personnel system, this system will provide automated links with finance and accounting, making a training request, approval and payment a single process.

The conversion of the automated payroll and personnel system to a modern 'open systems environment' was undertaken due to the obsolescence of the current system. This new system will enable the automation of many of the remaining manual payroll applications, thereby providing P & P with the ability to maintain service levels despite reduced staffing. To expedite the implementatin of a new system, P & P has procured and plans to customize for Federal use a commercial off-the-shelf software package. The implementation of the prototype system, with the same functionality as the current system, is scheduled for FY 1996. Complete modernization and enhancement of the entire system is scheduled for completion by September 1997. The new package will use a single data base, thereby eliminating the data synchronization problem associated with the current use of multiple data bases. This should also minimize the cost of new application additions.

## EEO COMPLAINTS INVESTIGATIONS

Individual EEO complaints in HHS are investigated by three contracting firms that service separate geographical areas of the country. The mission of the EEO Complaints Investigation function (EEO) is to manage the contracting operations to assure compliance with the Federal sector processing and timeliness requirements as set forth in 29 Code of Federal Regulations, Part 1614 and EEOC Management Directive 110. Their goal is to have EEO complaints processed on a cost effective and timely basis.

Figure 7 illustrates the average customer cost per case and number of cases for the last five years. Average contractor costs increased less than one percent in FY 1994 due to built-in contract rate increases, increased airfare and per diem costs, and the addition of investigation tasks resulting from new Federal mandates. This increase is well below the inflation rate because of continuing efforts to manage the geographical assignments of cases, thereby reducing contractor travel costs. The number of cases increased unexpectedly by 13 percent in FY 1994, primarily due to increased caseloads from Public Health Service Agencies and Social Security. It is hoped that the use of alternative dispute resolution efforts, which use mediation to resolve EEO discrimination complaints, will reduce the number of cases sent for investigation in the future. The number of cases processed per EEO FTE increased 14 percent in FY 1994. There has been a 37 percent caseload increase in the past two years, as shown in WCF-SUPP-C.

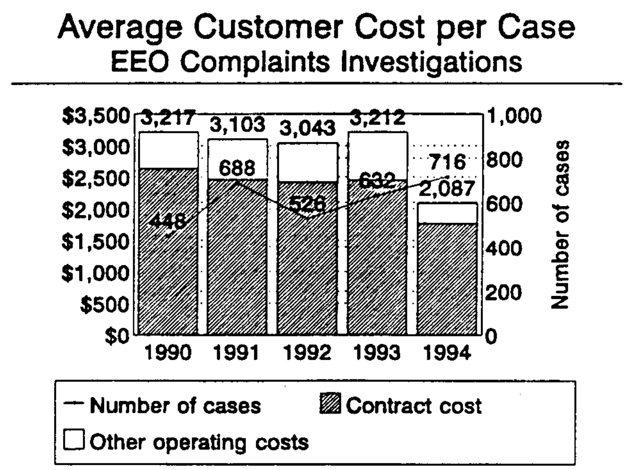



Figure 7

Federal law dictates that an EEO complainant must be issued the notice of appeals rights and the investigative file on or before the 180th day after the filing date. EEO set an internal goal of delivering the investigative files to the complainant by no later than the 150th day after the filing date for the period April 1993 to March 1994. This goal was not obtained due to constraints contained within the investigations contracts in effect in FY 1994. New contracts will be in place in FY 1995 which should allow this goal to obtained.

## DIVISION OF ACCOUNTING OPERATIONS
## REGIONAL DIVISIONS OF FINANCE
## REGIONAL ACCOUNTING SYSTEM

The WCF has two entities whose mission it is to provide accounting, fiscal and financial reporting services - the Division of Accounting Operations (DAO) and the regional Divisions of Finance (DOF), whose headquarters component is the Regional Accounting System (RAS). DAO services the Office of the Secretary (OS), the Administration for Children and Families (ACF), and the Administration on Aging (AoA) and DOF services the OPDIVs and STAFFDIVs in the ten regions. The primary goal of these financial transaction processing activities is to perform transactions timely, accurately, and efficiently.

There were numerous changes in FY 1994 that effected DAO's and DOF's performance. DAO's accounting system was replaced by the CORE accounting system on March 31, 1994. The new system had numerous unexpected problem areas which required refinements and system modifications which resulted in changes in normal accounting operations. This was compounded by buy-outs offered as part of the Departmental streamlining program which resulted in staff shortages in DAO. In addition, the WCF Board of Governors voted to close the DOFs as of September 30, 1995. Due to the pending closure, DOF personnel departed in increasing numbers in FY 1994. This resulted in a strain on normal accounting procedures that meant that, unless noted otherwise, no performance data was collected for DOF in FY 1994.

1. Timely Payments and Interest Penalty - Number & Dollar Amount. Figure 8 shows the percentage of payments made on time and the number of payments subject to the Prompt Payment Act. In FY 1992, OMB established a minimum standard of 95 percent as a government-wide goal.

Additionally, DAO is trying to convert the payments it makes to more cost efficient and timely automated payments. Figure WCF-SUPP-D shows the breakdown of payments by number and dollar amounts. In FY 1995, DAO anticipates that the percentage of automated payments will exceed 90 percent as all travel reimbursement is directly deposited as of March 1995.

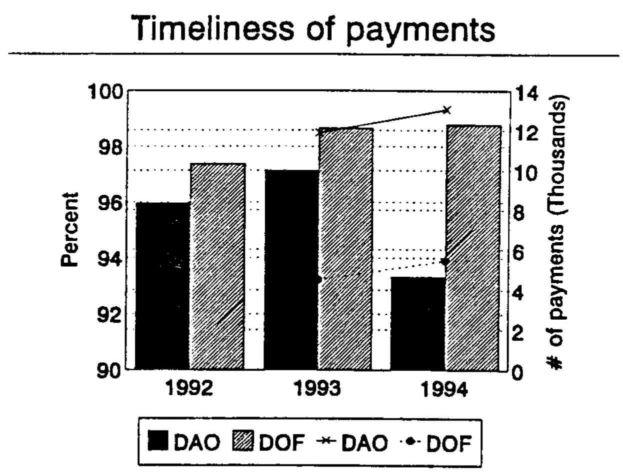



Figure 8

As a result of the accounting system conversion problems and a 25 percent reduction in accounts payable personnel, the frequency rate for late payment interest penalties increased from 0.46 to 1.53 percent for DAO. It decreased from 1.27 to 1.21 percent for DOF (whose accounting system remained the same). The number and amount of penalties are presented in Figure WCF-SUPP-E.

2. Timely Posting of Inter-Agency Charges - Average Posting Time. Inter-agency charges via Treasury's On-line Payment And Collection system (OPAC) are posted on the day they are received. However, these charges are then posted into a "clearing" account pending receipt of supporting documentation and/or time to distribute charges to the appropriate accounts. An internal analysis of this process resulted in staff reassignments within DAO in January 1995. As a result, DAO's average number of days to distribute costs out of the clearing account decreased from 67 days in the last half of FY 1993 to 60 days in FY 1994. DAO hopes to streamline current operations so that the use of a clearing account is totally eliminated by the end of FY 1995.

Cost per Transaction

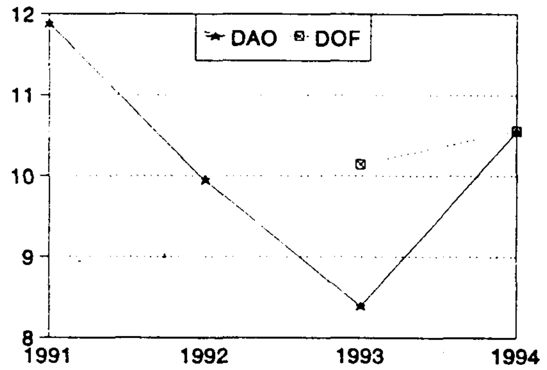



Figure 9

3. Timely Travel Payments - Average Process Time. Except for isolated small offices, DAO converted to an automated travel payment system in FY 1993 and FY 1994. A statistical sampling of vouchers processed by the automated system indicated that an average time from when a voucher was electronically reviewed to the date a third party draft was issued to the traveler was one day; which is a decrease from 2.7 days in FY 1993.

4. Cost Per Transaction. Costs per transaction increased approximately 26 percent in FY 1994. This increase is attributed to increased costs associated with conversion of accounting systems as two systems were operational for the first six months of FY 1994, coupled with the actual transaction count decreasing primarily as a result of the Payroll General Ledger being transferred from DAO to ASPER. See Figure 9.

5. % Of Collections to Current Receivables. Receivables are primarily from grant recipients. Figure 10 shows the overall percentage of collections to net receivables and the magnitude of receivables that were under appeal (collection actions are suspended for receivables under appeal). The six largest receivables pertained to one state and comprised 64 percent of the outstanding receivable balance. The increase in collections was due to more collections by current grant award offsets and enhanced communication between the program offices and the accounting offices.

Accounts Receivable and Collections
FYs 1993 and 1994

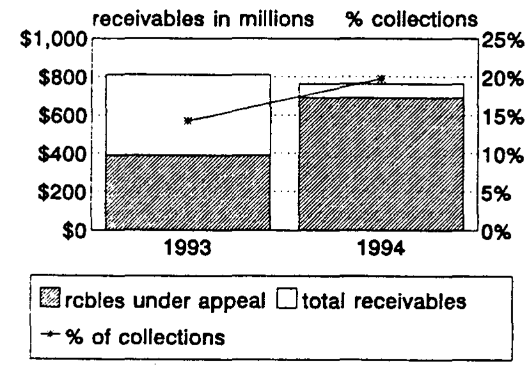



Figure 10

% of Collections to Collectible Receivables
FY 1994

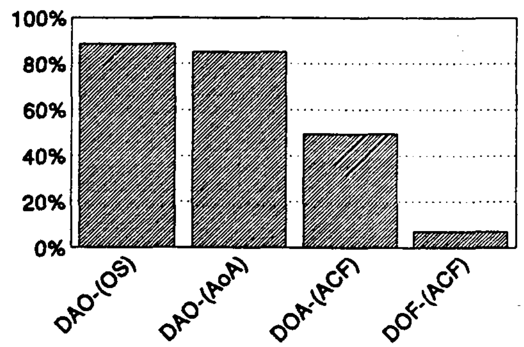



Figure 11

Figure 11 shows the breakdown of percentage of collections to collectible (not under appeal) receivables between DAO and DOF as well as the breakdown within DAO.

6. % Of Fully Reconciled Cash Reconciliations. In FY 1993, cash differences were reduced to the extent that previous audit qualifications for cash were removed. However, with the implementation of new accounting system in FY 1994, the number of cash differences increased from 0.13 percent of the overall cash balance in Treasury at the end of FY 1993 to 2.97 percent at the end of FY 1994. This was due to problems with interfaces from feeder systems (ex. third party draft

subsystems), the inability to prepare internal cash reconciliation reports for six months, urgent day to day operational issues and the time necessary to learn the new system.

Contractual help has been engaged for recurring operational processes, which includes the increased accounting functions being transferred from the DOFs to DAO. The following functions have also been planned to improve cash reconciliation: improve data input in the accounts payable subsystem, eliminate the preparation of manual schedules, and automate reporting to Treasury.

Due to the pending closure of the DOFs, the planned cash reconciliation consolidation of DAO and DOF was cancelled. This function will be centralized at headquarters effective October 1, 1995.

7. <u>% Of Fully Reconciled Suspense Accounts.</u> The suspense Account is maintained by DAO but consists of amounts entered into it by the DOFs, the Payment Management System, and Central Payroll, as well as DAO. Unlike the clearing account noted in #2 above, where DAO has full control of the account, the suspense account is monitored by DAO with follow-up and corrective actions required by DAO and the various external users.

This account had a balance of ($890,843) as of September 30, 1994, down from $4.1 million at the end of FY 1993. However, this net balance is misleading as DAO activity to be identified and removed from the account totaled $2.6 million. The major offsetting amount in the account pertained to recurring payroll activity, which is reconciled on a monthly basis. Ongoing analyses of this account were not actively pursued during FY 1994, due to the urgent day-to-day operational difficulties resulting from the system conversion. In addition, this account was used in numerous situations throughout the year to temporarily capture the total amounts for payment schedules when the new system was unable to produce a breakdown by individual appropriation symbol, thereby adding to the reconciliation problem. Delays experienced in FY 1994 have been overcome and actions to fully reconcile the account prior to the end of FY 1995 are ongoing.

## DIVISIONS OF ADMINISTRATIVE SERVICES

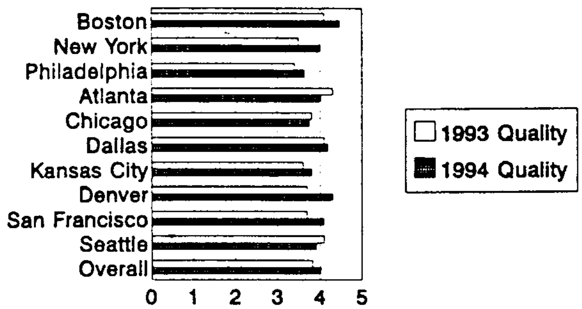
The Divisions of Administrative Services (DAS) provides administrative services for all HHS activities co-located at regional headquarters offices. DAS also provides limited administrative services to the IG's field offices and the Public Health Service's Federal Occupational Health clinics. These services will become the responsibility of HHS's OPDIVs after September 30, 1995.

DAS conducted a customer satisfaction survey and received an 88 percent response rate. Figure 12 shows the overall assessment of the quality of the services provided by region and Figure 13 presents the overall quality assessment by service.

### Division of Cost Allocation

In FY 1994, the Federal Government awarded about $12 billion to State and local governments, colleges and universities, hospitals and other nonprofit organizations. These funds were used to reimburse the organizations for administrative expenses they incurred to operate Federal programs (such as Medicaid, Food Stamps, medical research, Head Start, School Lunch, Job Training Partnership Act amongst others) that are administered by these organizations. The organizations assign joint administrative costs, such as the expenses required to operate an accounting or budget office, to the Federal programs that they administer. Indirect cost rates are the mean by which associated administrative costs are identified for reimbursement under Federal grants and contracts. It is the government-wide responsibility of the Division of Cost Allocation (DCA) to ensure that these costs are assigned in a fair and reasonable manner to all Federal programs.

### Overall Assessment by Region
Quality - DAS




3 = Satisfactory, 4 = Excellent, 5 = Outstanding

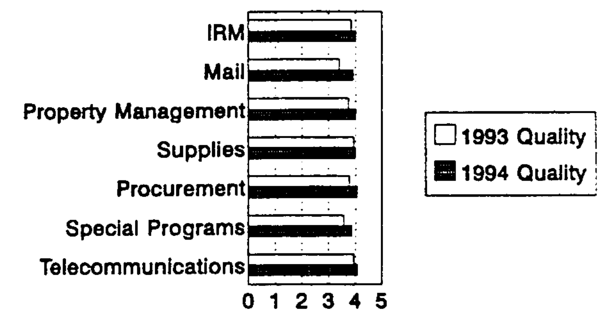
**Figure 12**

DCA's mission is

- to approve incurred joint costs for reimbursement by the Federal Government and
- to distribute these allowable joint costs on rational bases amongst Federally sponsored programs.

Their goal is to negotiate the approval of cost allocation plans and indirect cost rates in a timely manner and, also, to protect the Federal Government from overcharges to their programs. Rate and plan negotiations are conducted on behalf of all Federal departments and agencies under the cognizant agency concept established by OMB. DCA is the cognizant agency for about 95 percent of colleges and universities, all hospitals, all state-wide cost allocation plans, all state health and welfare departments and a significant number of other nonprofit (including independent research institutes) organizations.

### Overall Assessment by Service
Quality - DAS




3 = Satisfactory, 4 = Excellent, 5 = Outstanding

**Figure 13**

### Total Cost Savings vs. Full-Time Staff
Eleven Years Ended September 30, 1994

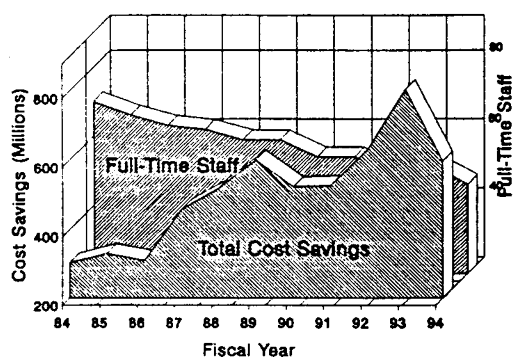



**Figure 14**

In the last eleven years, DCA's efforts have resulted in total cost savings/avoidances of over **$5.6 billion** while their staff has been reduced by 30 percent (see Figure 14). In FY 1994 alone, DCA's cost negotiations saved the Federal Government $597 million, over $13.8 million per negotiator (see Figure WCF-SUPP-F) while incurring about $5.2 million in operating costs. See Figure 15 for the return on investment for the last four years. The $597 million cost savings/cost avoidance consisted primarily of

### Return on Investment

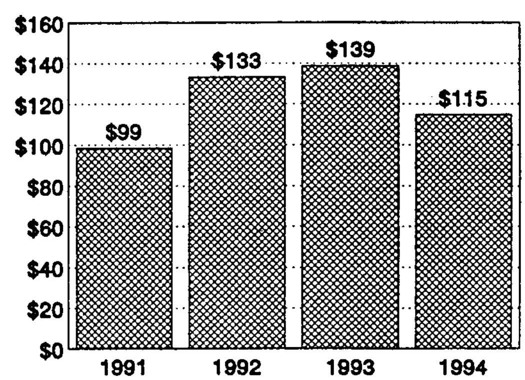



**Figure 15**

negotiating lower future indirect cost claims by organizations receiving Federal grants and contracts.

Figure 16 shows the results of a nationwide survey of DCA's customers (grant and contracting officers in Federal agencies). Survey responses indicated that the negotiated indirect cost rates should be disseminated to DCA's customers faster. DCA responded by streamlining their customer mailing list and is planning to distribute their information electronically via the Internet and GrantsNet. Figure WCF-SUPP-G shows DCA's case backlog.

Overall Assessment of the Quality of
Cost Allocation Services Provided
Nationwide

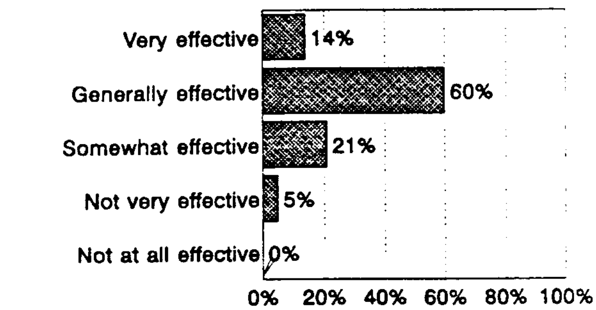


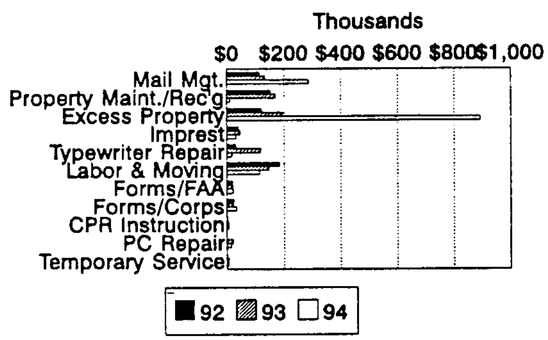

Figure 16

## COOPERATIVE ADMINISTRATIVE SUPPORT UNITS (CASUs)

The CASU program is an interagency initiative of the President's Council on Management Improvement to promote sharing of common administrative services thereby reducing costs and improving accessibility and productivity in local Federal complexes. The goal of the CASUs is to provide less expensive, more accessible and better-quality administrative services to Federal agencies through consolidation and economies of scale. HHS functions as the lead agency through the WCF and has management responsibility for two CASU operations, the Kansas City Downtown CASU and the New York Javits Building CASU.

The New York CASU surveyed 30 of its customers that received more than one of its services; 10 responded. Based on a five point scale, they were rated a 4.20 on quality, 4.00 on timeliness and 4.05 on price. Kansas City CASU did not perform a survey in FY 1994.

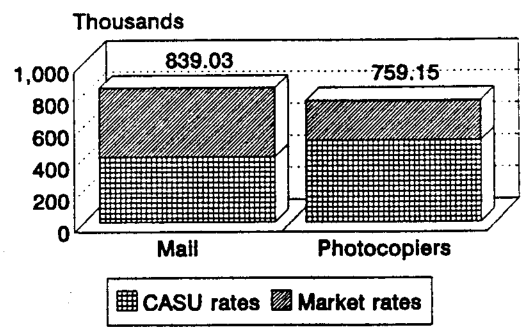
Net Savings and Avoidance by Service
Kansas City Downtown CASU




Initial report for PC Repair and Temporary Service in FY 93

Figure 17

Customer Savings - Market vs. CASU
New York Javits Building CASU




photocopier market is based on leasing copiers from GSA's Federal Supply Schedule
mail market assumed customers' costs to provide service in-house

Figure 18

Figure 17 shows the estimated savings and cost avoidances for Kansas City's participating agencies for the last three years.

Mail services and the photocopier program are the largest operations in the NY CASU. Figure 18 reflects the rates the NY CASU charged their customers to provide these services as opposed to the costs the customers would have had to pay if the CASU did not provide them.

Both CASU savings/avoidance graphs reflect monetary savings only, arising primarily from the consolidation of personnel and space and economies of scale.

# PRINCIPAL STATEMENTS AND RELATED NOTES

U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF THE SECRETARY
WORKING CAPITAL FUND
STATEMENT OF FINANCIAL POSITION
as of September 30, 1994 and 1993
(Dollars in Thousands)

| | 1994 | 1993 |
|---|---|---|
| ASSETS | | |
| Intragovernmental Assets: | | |
| Fund Balance with U.S. Treasury (Note 2) | $ 46,440 | $ 37,143 |
| Accounts Receivable, Net (Note 3) | 3,260 | 10,677 |
| Advances and Prepayments | 0 | 19 |
| Governmental Assets: | | |
| Accounts Receivable, Net (Note 3) | 45 | 11 |
| Advances and Prepayments | 36 | 40 |
| Property and Equipment, Net (Note 4) | 6,249 | 4,858 |
| TOTAL ASSETS | $ 56,030 | $ 52,748 |
| LIABILITIES | | |
| Intragovernmental Liabilities: | | |
| Accounts Payable | $ 3,655 | $ 1,788 |
| Governmental Liabilities: | | |
| Accounts Payable | 3,335 | 6,136 |
| Accrued Payroll and Benefits (Note 6) | 2,676 | 2,338 |
| Funded Annual Leave | 4,593 | 4,631 |
| Lease Liabilities (Note 5) | 254 | 85 |
| TOTAL LIABILITIES | 14,513 | 14,978 |
| NET POSITION | | |
| Revolving Fund Balances (Note 7): | | |
| Invested Capital | 3,399 | 3,235 |
| Cumulative Results of Operations | 38,118 | 34,535 |
| TOTAL NET POSITION | 41,517 | 37,770 |
| TOTAL LIABILITIES AND NET POSITION | $ 56,030 | $ 52,748 |

The accompanying notes are an integral part of these statements.

U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF THE SECRETARY
WORKING CAPITAL FUND
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
for the years ended September 30, 1994 and 1993
(Dollars in Thousands)

| | 1994 | 1993 |
|---|---|---|
| REVENUES AND FINANCING SOURCES | | |
| Intragovernmental Revenue: | | |
| DHHS Agencies | $ 103,815 | $ 105,665 |
| Outside Agencies | 1,488 | 1,760 |
| Total Revenues and Financing Sources | 105,303 | 107,425 |
| EXPENSES | | |
| Program/Operating Expenses (Note 8) | 100,034 | 97,102 |
| Depreciation and Amortization | 1,522 | 1,827 |
| Total Expenses | 101,556 | 98,929 |
| Excess of Revenues and Financing Sources Over Total Expenses | $ 3,747 | $ 8,496 |
| Net Position, Beginning Balance, as Previously Stated | 37,770 | 28,656 |
| Prior Period Adjustment (Note 9) | 0 | 618 |
| Net Position, Beginning Balance, as Restated | 37,770 | 29,274 |
| Excess of Revenues and Financing Sources Over Total Expenses | 3,747 | 8,496 |
| Net Position, Ending Balance | $ 41,517 | $ 37,770 |

The accompanying notes are an integral part of these statements.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF THE SECRETARY
WORKING CAPITAL FUND
NOTES TO FINANCIAL STATEMENTS
For Years Ended September 30, 1994 and 1993

**Note 1. Summary of Significant Accounting Policies**

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Working Capital Fund (WCF), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the WCF in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 94-01, and the WCF's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared by the WCF pursuant to OMB directives, that are used to monitor and control the WCF's use of budgetary resources.

B. Reporting Entity

The WCF is a component of the Office of the Secretary of the U.S. Department of Health and Human Services (HHS). The WCF provides consolidated financing and accounting services for business-type operations that provide centralized administrative services to operating components of HHS. The WCF also has cross-servicing agreements with other agencies of the U.S. Government for selected activities. The funding of the WCF is without fiscal year limitation, and its operations are fully funded by operating division customers and approved by the WCF Board of Governors (the Board).

C. Basis of Accounting

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. All intrafund balances and transactions have been eliminated.

D. Revenues and Financing Sources

The WCF receives its fee-for-service revenues by charging its customers based upon service units applied to a predetermined rate. The rates are based on a full cost budget, and the charter of the WCF requires funding of annual leave and depreciation. Since the rate is set prior to the expenditure of funds and is based upon budgeted volumes and cost, there is an inherent risk to the WCF that the rate will be too low, resulting in a loss. Conversely, there is a risk to the WCF's customers that the rate will be too high, resulting in a profit.

E. Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis, with a half-year convention, over five years. Acquisitions of individual ADP equipment costing less than $300, and non-ADP equipment costing less than $5,000, are expensed as incurred.

F. Advances from Federal Agencies

The WCF is required by its charter to draw funds from its customers in advance. The cash advances are based upon the estimated cash required to provide services for approximately ninety days. Advances were taken in amounts adequate to cover WCF disbursements.

G. Accrued Liabilities

Accrued liabilities represent the amount of monies or other resources that are likely to be paid by the WCF as the result of a transaction or event that has already occurred. All the liabilities of the WCF are funded, including annual leave.

H. Employee Benefit Plans

Most employees of the WCF are covered by the Civil Service Retirement System. The employees' retirement (7%) and Medicare (1.45%) contributions are matched by the WCF and are transferred to the Civil Service Retirement Fund, from which these employees will receive retirement benefits. The other employees are covered by the Federal Employees' Retirement System (FERS), a retirement program which is comprised of Social Security and a tax-deferred savings plan in which the WCF participates. The WCF contributes 7.65% for Social Security. Employees covered by FERS can contribute a maximum of 10% of their salaries with the WCF matching 50% of contributions.

I. Annual, Sick and Other Leave

Annual leave is accrued and funded as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

J. Comparative Data

Comparative data for the prior year has been presented in Note 7 to reflect rebates of $2,743,100 approved by the Board on June 7, 1994.

**Note 2. Fund Balance with the U.S. Treasury**

The WCF does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The Fund Balance with U.S. Treasury as reported is the balance in the WCF's books and records, which was $39,452 lower than the amount reflected in the records of the U.S. Treasury. The difference is attributable to timing differences and cumulative unreconciled amounts from previous years.

**Note 3. Accounts Receivable, Net**

The Intragovernmental Accounts Receivable of $3,259,630 represents amounts due to the WCF for services provided during 1994, and Governmental Accounts Receivable of $45,216 represents refunds receivable. In 1993, the Intragovernmental Accounts Receivable included $4,179,027 due to WCF for services rendered during the year and $5,361,891 in advances not collected prior to fiscal year end.

**Note 4. Property and Equipment, Net**

A physical inventory of equipment was taken in the WCF regional offices and in the headquarters activities on or about September 30, 1994.

The cost and net book for fiscal year 1994 are as follows (in 000's):

| Classes | Acquisition Value | Accumulated Depreciation | Net Book Value |
|---|---|---|---|
| Equipment | $16,373 | $10,405 | $5,968 |
| Assets Under Capital Lease | 332 | 51 | 281 |
| Total | $16,705 | $10,456 | $6,249 |

The cost and net book for fiscal year 1993 are as follows (in 000's):

| Classes | Acquisition Value | Accumulated Depreciation | Net Book Value |
|---|---|---|---|
| Equipment | $15,876 | $11,229 | $4,647 |
| Assets Under Capital Lease | 312 | 101 | 211 |
| Total | $16,188 | $11,330 | $4,858 |

The WCF funds the replacement cost of equipment by including depreciation in its billing rates. As a matter of Board policy, the amount of WCF equity reserved for asset replacement costs consists of accumulated depreciation less the cost of assets acquired during the period. The asset replacement cost reserved for fiscal years 1994 and 1993 is presented below:

| Asset Replacement Cost (in 000's): | 1994 | 1993 |
|---|---|---|
| Asset Replacement Cost, Beginning | $ 5,589 | $ 6,638 |
| Depreciation expense and adjustment | (823) | 3,506 |
| Less: Acquisitions for period | (498) | (4,555) |
| Asset Replacement Cost, Ending | $ 4,268 | $ 5,589 |

**Note 5. Leases**

The WCF capital leases are for 60 months, with a bargain purchase option at the end of the lease. The liability is being amortized over five years using an 8% imputed interest rate.
The total lease payments over the next five years, less imputed interest, are $254,498.

**Note 6. Accrued Payroll and Benefits**

The Accrued Payroll and Benefits represents salaries and related withholdings. Although the WCF contributes a portion for pension benefits and makes the necessary payroll withholdings, it is not responsible for contribution refunds, employee benefits or the system's assets. Therefore, it does not disclose the actuarial data with respect to the accumulated benefits or unfunded pension liability on the WCF's financial statements. Reporting of such amounts is the responsibility of the Office of Personnel Management.

**Note 7. Net Position (in 000's)**

| | FY 1994 | FY 1993 |
|---|---|---|
| Capital Transfers In: | | |
| Assets (NBV) | $ 6,273 | $ 6,109 |
| Annual Leave Liability | (2,874) | ( 2,874) |
| Total Capital Transfers In | 3,399 | 3,235 |
| Cumulative Results of Operations: | | |
| Reserved for: | | |
| Annual Leave Liability | 4,593 | 4,631 |
| Asset Replacement Cost | 4,268 | 5,589 |
| Customer Rebates | 0 | 2,743 |
| ASPER Furniture/ADP Systems | 0 | 500 |
| PMS Systems Development | 3,800 | 3,800 |
| Finance/Accounting ADP Equipment | 398 | 700 |
| ASPER Wang Equipment Replacement Plan | 2,058 | 1,100 |
| Regional Finance Transition | 350 | 0 |
| Other Liabilities-Net | 6,579 | 0 |
| Total Reserved Equity | 22,046 | 19,063 |
| Unreserved Equity | 16,072 | 15,472 |
| Total Cumulative Results of Operations | 38,118 | 34,535 |
| Net Position | $41,517 | $37,770 |

The WCF charter requires that the WCF break even over time. In order to avoid building unacceptable fund balances, the Board voted on June 7, 1994 to rebate $2,743,100 to customers in the form of a credit on the customers' 1994 bills. Rebates or reserves for further improvement initiatives must be approved in advance by the Board.

Of the $16,072,000 unreserved equity, $14,602,543 represents obligations of budgetary resources.

**Note 8. Expenses (in 000's)**

The operating expenses by object classification (unaudited) are:

| | FY 1994 | FY 1993 |
|---|---|---|
| Personnel Services and Benefits | $63,932 | $62,372 |
| Travel and Transportation | 987 | 934 |
| Rents, Communications and Utilities | 10,671 | 12,950 |
| Printing and Reproduction | 1,785 | 1,814 |
| Contractual Services | 19,149 | 16,339 |
| Supplies and Materials | 1,265 | 1,228 |
| Equipment not Capitalized | 2,245 | 1,465 |
| Total Operating Expenses | $100,034 | $97,102 |

**Note 9. Subsequent Events**

In October, 1994 the Graphics function was added as an activity of the WCF. Effective October 1994, the Payment Management System (PMS) and Departmental Contracts Information Systems activities became activities of the Public Health Service.

In January, 1995, HHS decided to transfer regional activities of the WCF to the operating divisions, effective October 1, 1995. On April 1, 1995, the Social Security Administration (SSA), formerly an operating division of HHS and a customer of the WCF, became an independent agency. SSA will continue to receive Payroll and Personnel services from the WCF, on a reimbursable basis, through the end of 1997. SSA's share of the reserve will be paid during fiscal year 1995.

The WCF Board of Governors voted to close the WCF regional activities during FY95 and transfer the functional responsibilites to the operating divisions in the regions and headquarters. Effective October 1, 1995, a new operating division, the Program Support Center, was established which combines the activities of the OS Working Capital Fund and the Public Health Service and Supply Fund. The new division will carry out a wide range of administrative support services to components of DHHS and other federal departments. The Working Capital Fund will continue to finance the former WCF activities under the new organization during FY96, after which Program Support Center will have a combined budget.

# SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

(Unaudited)

# SUPPLEMENTAL INFORMATION

**The statement of operations by activity type is presented for purposes of additional analysis and is not a required part of the basic financial statements.**

## Overall Service Quality Assessment
### By Serviced Employees
SW Washington Personnel Services

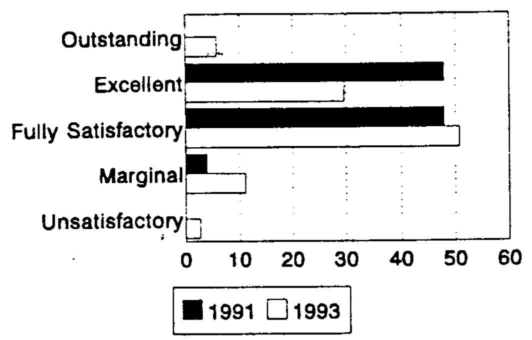



Figure A

## Personnel Accounts Processed per FTE
### Personnel & Payroll Systems

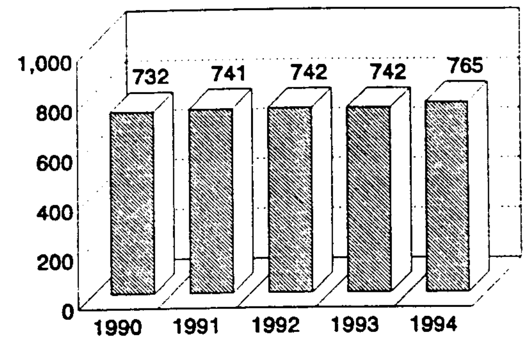



Figure B

## Investigations Processed per FTE
### EEO Complaints Investigations

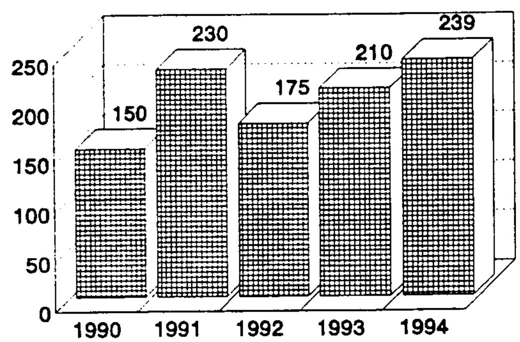



Figure C

## Payment Breakdown
### DAO - FY 1994

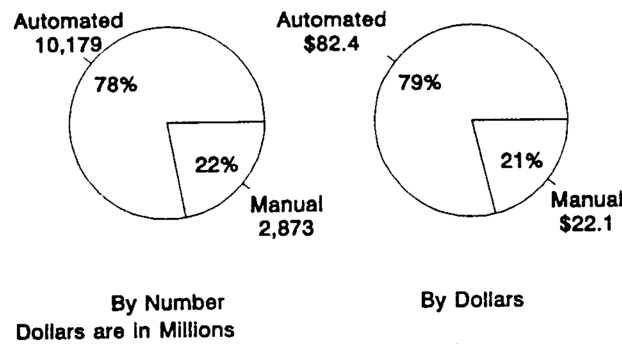



Figure D

## Prompt Payment Penalties
### DAO & DOF

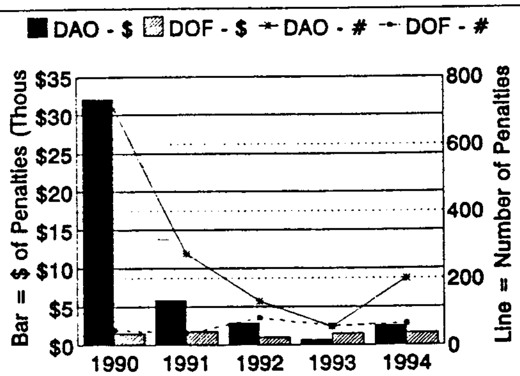



Figure E

## Cost Savings Per Negotiator
### DCA

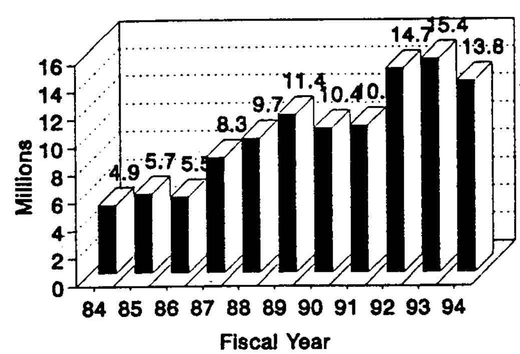
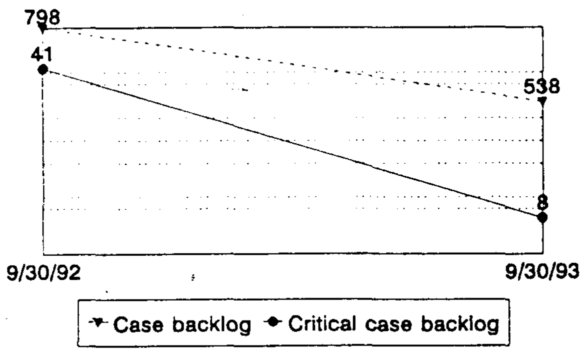



Figure F

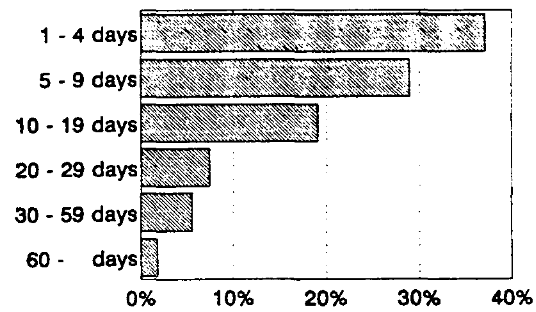
## Reduction in Case Backlog
### DCA




Critical cases are those over 12 months old

**Figure G**

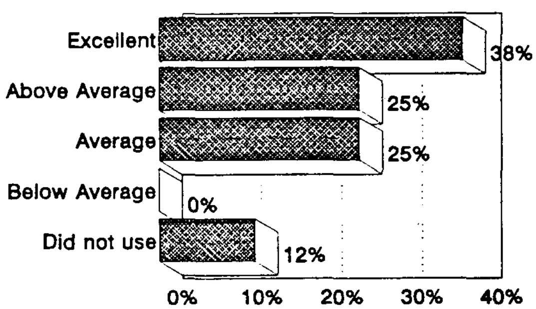
## Order Cycle - Over the Counter Items
### Unique Supplies




for the period June through September 1994

**Figure H**

## Overall Assessment of the Direct Delivery Program
### Unique Supplies




The Direct Delivery Program constitued 56% of total revenues in the last third of the year

**Figure I**

## Mail Delivery Time Study
### OS Mail

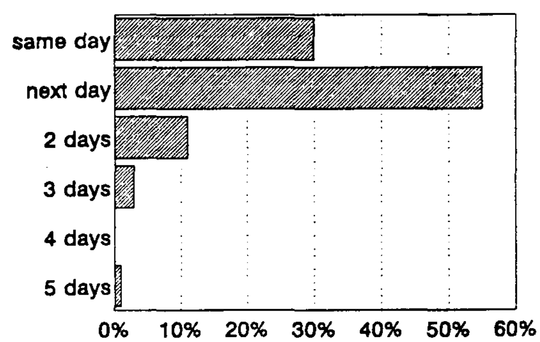



**Figure J**

## Customer Satisfaction Survey
### OS Mail

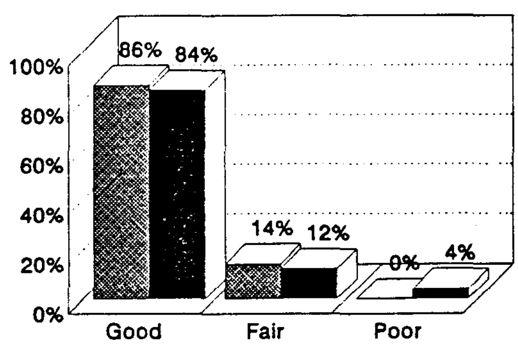



**Figure K**

| | AUDIT RESOLUTION | | | |
|---|---|---|---|---|
| | # appeals | appeal rate | cost/case | # cases |
| 1993 | 7 | 1% | $920 | 682 |
| 1994 | 5 | <1% | $738 | 788 |

Department of Health and Human Services
Office of the Secretary
Working Capital Fund
Consolidated Statement of Operations
For the Period Ended 9/30/94
(Unaudited)

| | Fee For Service | Overhead Pools | Total | Intra-Fund Eliminations | WCF Consolidated |
|---|---|---|---|---|---|
| Operating Income: | | | | | |
| DHHS Agencies | $103,814,309 | $0 | $103,814,309 | | $103,814,309 |
| Outside Agencies | 1,488,333 | 0 | 1,488,333 | | 1,488,333 |
| Intra-Fund Transfers | 4,006,043 | 15,126,598 | 19,132,641 | (19,132,641) | 0 |
| Total Operating Income | 109,308,685 | 15,126,598 | 124,435,283 | (19,132,641) | 105,302,642 |
| Less- Direct Operating Cost | | | | | |
| Compensation & Benefits | 60,945,034 | 2,986,717 | 63,931,751 | | 63,931,751 |
| Travel and Transportation | 862,129 | 124,759 | 986,888 | | 986,888 |
| Rents, etc. (Non-GSA) | 2,020,121 | 8,651,090 | 10,671,211 | | 10,671,211 |
| Printing | 1,781,178 | 3,826 | 1,785,004 | | 1,785,004 |
| Contract & Other Services | 17,718,246 | 1,430,679 | 19,148,925 | | 19,148,925 |
| Supplies | 1,184,092 | 81,402 | 1,265,494 | | 1,265,494 |
| Equipment (Non-Cap.) | 1,496,230 | 748,482 | 2,244,712 | | 2,244,712 |
| Total Direct Operating Expense | 86,007,030 | 14,026,955 | 100,033,985 | 0 | 100,033,985 |
| Less - Indirect Operating Cost | | | | | |
| GSA Rent | 9,893,355 | 305,559 | 10,198,914 | (10,198,914) | 0 |
| Telephone & Other | (271,684) | (12,913) | (284,597) | 284,597 | 0 |
| Depreciation Expense | 1,507,891 | 13,590 | 1,521,481 | | 1,521,481 |
| Annual Leave Expense | 316,302 | 44,897 | 361,199 | (361,199) | 0 |
| Total Indirect Operating Expense | 11,445,864 | 351,133 | 11,796,997 | (10,275,516) | 1,521,481 |
| Less - Transfers-In | | | | | |
| WCF Management | 1,324,081 | 0 | 1,324,081 | (1,324,081) | 0 |
| Director, Financial Operations | 921,321 | 0 | 921,321 | (921,321) | 0 |
| Director, Financial Systems | 754,100 | 0 | 754,100 | (754,100) | 0 |
| Headquarters Finance | 284,197 | 731,254 | 1,015,451 | (1,015,451) | 0 |
| RASC Director | 1,851,580 | 0 | 1,851,580 | (1,851,580) | 0 |
| Other | 629,886 | 8,355 | 638,241 | (638,241) | 0 |
| ASPER | 1,068,005 | 8,901 | 1,076,906 | (1,076,906) | 0 |
| Regional Activities | 1,275,445 | 0 | 1,275,445 | (1,275,445) | 0 |
| Total Transfers-In | 8,108,615 | 748,510 | 8,857,125 | (8,857,125) | 0 |
| Total Cost of Operations | 105,561,509 | 15,126,598 | 120,688,107 | (19,132,641) | 101,555,466 |
| Net Operating Income(Loss): | $3,747,176 | ($0) | $3,747,176 | ($0) | $3,747,176 |

Department of Health and Human Services
Office of the Secretary
Working Capital Fund
FFS Statement of Operations
For the Period Ended 9/30/94
(Unaudited)

| | Fee For Service | ASPER | PMS | Regional Activities | Headquarters Finance | CASU 2 & 7 | Other |
|---|---|---|---|---|---|---|---|
| Operating Income: | | | | | | | |
| DHHS Agencies | $103,814,309 | $63,748,270 | $5,885,964 | $19,267,812 | $7,224,725 | $4,043,065 | $3,644,473 |
| Outside Agencies | 1,488,333 | 129,645 | 1,191,149 | - | 125,000 | - | 42,539 |
| Intra-Fund Transfers | 4,006,043 | 1,076,906 | 0 | 1,275,445 | 1,015,451 | - | 638,241 |
| Total Operating Income | 109,308,685 | 64,954,821 | 7,077,113 | 20,543,257 | 8,365,176 | 4,043,065 | 4,325,253 |
| Less- Direct Operating Cost | | | | | | | |
| Compensation & Benefits | 60,945,034 | 38,628,994 | 3,460,415 | 12,925,565 | 2,703,366 | 2,197,361 | 1,029,333 |
| Travel and Transportation | 862,129 | 467,169 | 28,100 | 217,349 | 8,296 | 137,413 | 3,802 |
| Rents, etc. (Non-GSA) | 2,020,121 | 62,850 | 329,196 | 249,443 | 21 | 1,149,556 | 229,055 |
| Printing | 1,781,178 | 138,771 | 9,074 | 19,895 | 7,309 | 2,402 | 1,603,727 |
| Contract & Other Services | 17,718,246 | 8,145,609 | 1,808,733 | 1,166,107 | 4,549,165 | 1,255,006 | 793,626 |
| Supplies | 1,184,092 | 780,233 | 10,188 | 267,204 | 7,048 | 12,995 | 106,424 |
| Equipment (Non-Cap.) | 1,496,230 | 894,944 | 173,199 | 205,071 | (527,234) | 14,235 | 736,015 |
| Total Direct Operating Expense | 86,007,030 | 49,118,570 | 5,818,905 | 15,050,634 | 6,747,971 | 4,768,968 | 4,501,982 |
| Less - Indirect Operating Cost | | | | | | | |
| GSA Rent | 9,893,355 | 6,732,221 | 0 | 2,228,552 | 362,672 | - | 569,910 |
| Telephone & Other | (271,684) | (188,723) | 0 | (63,984) | (13,704) | - | (5,273) |
| Depreciation Expense | 1,507,891 | 837,285 | 83,022 | 344,561 | 129,148 | 19,951 | 93,924 |
| Annual Leave Expense | 316,302 | 447,103 | 88,073 | (144,495) | (9,415) | (15,040) | (49,924) |
| Total Indirect Operating Expense | 11,445,864 | 7,827,886 | 171,095 | 2,364,634 | 468,701 | 4,911 | 608,637 |
| Less - Transfers-In | | | | | | | |
| WCF Management | 1,324,081 | 781,121 | 97,857 | 263,188 | 104,474 | - | 77,441 |
| Director, Financial Operations | 921,321 | 0 | 0 | - | 921,321 | - | - |
| Director, Financial Systems | 754,100 | 0 | 0 | - | 754,100 | - | - |
| Headquarters Finance | 284,197 | 186,573 | 0 | 97,624 | | | |
| RASC Director | 1,851,580 | 0 | 0 | 1,851,580 | - | - | - |
| Other | 629,886 | 357,580 | 8,891 | 3,074 | 66,117 | - | 194,224 |
| ASPER | 1,068,005 | 765,128 | 0 | 217,372 | 70,456 | - | 15,049 |
| Regional Activities | 1,275,445 | 862,049 | 0 | 413,396 | - | - | - |
| Total Transfers-In | 8,108,615 | 2,952,451 | 106,748 | 2,846,234 | 1,916,468 | 0 | 286,714 |
| Total Cost of Operations | 105,561,509 | 59,898,907 | 6,096,748 | 20,261,502 | 9,133,140 | 4,773,879 | 5,397,333 |
| Net Operating Income(Loss): | $3,747,176 | $5,055,914 | $980,365 | $281,755 | ($767,964) | ($730,814) | ($1,072,080) |

Department of Health and Human Services
Office of the Secretary
Working Capital Fund
Statement of Overhead Pools
For the Period Ended 9/30/94
(Unaudited)

| | Overhead Pools | WCF Mgmt | Director Fin Ops | Director Fin Sys | RASC | Phone & Other | Annual Leave | GSA Rent |
|---|---|---|---|---|---|---|---|---|
| Operating Income: | | | | | | | | |
| DHHS Agencies | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| Outside Agencies | 0 | - | - | - | - | - | - | - |
| Intra-Fund Transfers | 15,126,598 | 1,324,081 | 921,321 | 754,100 | 1,851,580 | (284,597) | 361,199 | 10,198,914 |
| Total Operating Income | 15,126,598 | 1,324,081 | 921,321 | 754,100 | 1,851,580 | (284,597) | 361,199 | 10,198,914 |
| Less- Direct Operating Cost | | | | | | | | |
| Compensation & Benefits | 2,986,717 | 335,592 | 244,786 | 652,996 | 1,320,545 | 71,599 | 361,199 | - |
| Travel and Transportation | 124,759 | (1,976) | 849 | 47,201 | 48,685 | 30,000 | - | - |
| Rents, etc. (Non-GSA) | 8,651,090 | - | - | - | 35,921 | (756,692) | - | 9,371,861 |
| Printing | 3,826 | - | - | - | 3,826 | - | - | - |
| Contract & Other Services | 1,430,679 | 226,439 | (5,000) | 302 | 88,628 | 370,496 | - | 749,814 |
| Supplies | 81,402 | 1,402 | 625 | 5,236 | 74,139 | - | - | - |
| Equipment (Non-Cap.) | 748,482 | (4,978) | 611,582 | 8,096 | 56,543 | - | - | 77,239 |
| Total Direct Operating Expense | 14,026,955 | 556,479 | 852,842 | 713,831 | 1,628,287 | (284,597) | 361,199 | 10,198,914 |
| Less - Indirect Operating Cost | | | | | | | | |
| GSA Rent | 305,559 | 31,136 | 24,846 | 55,858 | 193,719 | - | - | - |
| Telephone & Other | (12,913) | (1,600) | (1,250) | (3,321) | (6,742) | - | - | - |
| Depreciation Expense | 13,590 | 1,617 | - | - | 11,973 | - | - | - |
| Annual Leave Expense | 44,897 | 3,033 | 36,765 | (14,597) | 19,696 | - | - | - |
| Total Indirect Operating Expense | 351,133 | 34,186 | 60,361 | 37,940 | 218,646 | 0 | 0 | 0 |
| Less - Transfers-In | | | | | | | | |
| WCF Management | 0 | N/A | - | - | - | - | - | - |
| Director, Financial Operations | 0 | - | - | - | - | - | - | - |
| Director, Financial Systems | 0 | - | - | - | - | - | - | - |
| Headquarters Finance | 731,254 | 731,254 | | | | | | |
| RASC Director | 0 | - | - | - | - | - | - | - |
| Other | 8,355 | 1,059 | 7,256 | 40 | - | - | - | - |
| ASPER | 8,901 | 1,103 | 862 | 2,289 | 4,647 | - | - | - |
| Regional Activities | 0 | - | - | - | - | - | - | - |
| Total Transfers-In | 748,510 | 733,416 | 8,118 | 2,329 | 4,647 | 0 | 0 | 0 |
| Total Cost of Operations | 15,126,598 | 1,324,081 | 921,321 | 754,100 | 1,851,580 | (284,597) | 361,199 | 10,198,914 |
| Net Operating Income(Loss): | ($0) | $0 | $0 | $0 | ($0) | $0 | $0 | $0 |

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**Independent Auditor's Report**

To the Office of Inspector General of the Department of Health and Human Services and the Board of Governors of the Office of the Secretary Working Capital Fund

## Executive Summary

We have audited the accompanying Statement of Financial Position of the Office of the Secretary Working Capital Fund (the Fund), a fund within the Department of Health and Human Services, and the related Statement of Operations and Changes in Net Position, (the "Principal Financial Statements") as of and for the year ended September 30, 1994. The Principal Financial Statements of the Fund for the year ended September 30, 1993, were audited by other auditors whose report dated March 11, 1994 expressed a qualified opinion on those statements because they were unable to satisfy themselves regarding the 1993 property and equipment balances or the related depreciation expense.

Except for the limitations on the scope of our work described below our audit was performed in accordance with generally accepted auditing standards, Government Auditing Standards issued by the Controller General and OMB Bulletin 93-06, *Audit Requirements for Federal Financial Statements* and included related tests of the financial reporting internal control structure policies and procedures and of compliance with laws and regulations. Our reports on the financial statements and our reports and findings regarding the internal control structure and compliance with laws and regulations follow this summary. This report also includes a description of management's responsibilities and our responsibilities under the above standards and guidance.

In summary,

- o Except for the effects of such adjustments that might have resulted had the Fund maintained accurate and complete records of its property and equipment, and been able to support the summarization of certain expenses, the Fund's 1994 Principal Financial Statements referred to above are presented fairly, in all material respects, in conformity with the accounting principles described in Note 1.

- o We noted certain matters in the internal control structure we consider to be reportable conditions including an item identified as a material weakness.

- We noted no material noncompliance with the selected provisions of applicable laws and regulations tested.

- We noted no material conflicts with management's report on internal controls prepared under the Federal Managers' Financial Integrity Act (FMFIA) of 1982. We did, however, note a number of matters which merit consideration in developing subsequent reports under FMFIA.

## Report on Principal Financial Statements

We were unable to satisfy ourselves regarding the Fund's property and equipment, which was reported in the Fund's financial statements at $6,249,000, net of depreciation, as of September 30, 1994, and the related depreciation expense of $1,522,000 for the year then ended because detail records were incomplete and did not support the purchase price and the date purchased. In addition, support for certain aggregations of expense by object class, and related support for certain such expenses recorded was not available.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to place reliance on the reported balance of property and equipment, and the related effects on depreciation, or audit the amounts disclosed in the notes to the financial statement as expensed by object class in Note 8, the financial statements referred to in the first paragraph of this report, including the accompanying notes thereto, present fairly, in all material respects, the financial position of the Office of the Secretary Working Capital Fund as of September 30, 1994, and the results of its operations, for the year then ended in conformity with the accounting principles described in Note 1.

Our audit was conducted for the purpose of forming an opinion on the principal financial statements taken as a whole. The information in the Overview and Supplemental Financial and Management Information is not a required part of the financial statements, but is supplementary information required by OMB Bulletin 94-01, *Form and Content of Agency Financial Statements,* and is presented by Fund management for purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the principal financial statements, and, accordingly, we do not express an opinion on it.

## Report on Internal Control

We noted certain matters in the internal controls and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure, that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition noted below was also considered to be a material weakness. This condition was considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the financial statements of the fund for the year ended September 30, 1996.

In addition, we obtained an understanding and assessed control risk of the Fund's relevant policies and procedures with respect to the financial systems to provide reasonable assurance that data supporting reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Our evaluation of the controls for performance information was limited to controls that ensure the existence and completeness of the performance information derived from significant accounting applications. As noted in our report on the Principal Financial Statements for the year ended September 30, 1994, we do not express an opinion on the performance information in the Overview and Supplemental Financial and Management Information.

A material weakness is a reportable condition in which the design or operation of one or more internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

A weakness in the Fund's internal control structure which we have classified as a material weakness is as follows:

Inability to Support Property and Equipment Balances. We were unable to satisfy ourselves regarding the Fund's property and equipment, which was reported in the Fund's financial statements at $6,249,000, net of depreciation, as of September 30, 1994, and the related depreciation expense of $1,522,000 for the year then ended because detailed records were incomplete and did not support the purchase price and the date purchased.

The reportable conditions include the following:

Impact of Decentralized Accounting Environment on Internal Controls

During Fiscal Year (FY) 1994, the Fund experienced significant changes in its operating environment to include the implementation of a new automated accounting system. In FY 1995, the regional reorganization and reduction in staff also impacted the audit. These changes coupled with a decentralized accounting system impacted the Fund's control over the general ledger, preparation of the Financial Statements, and the Fund's ability to effectively detect errors and irregularities in a timely manner.

Accounts Payable and Accrued Expenses

We noted that the Fund did not routinely accrue for liabilities until the day that the invoice was paid for object classes 24 through 31, although it could be months after the goods or services were rendered. In connection with the audit process, the Fund did review automatically accruing obligations to determine whether the funds should be de-obligated and if the obligation related to activity which had occurred and should therefore be accrued.

EDP Controls

At the time of our review, we noted a number of matters regarding access to the mainframe computer system, core accounting system libraries, program change controls, disaster recovery and backup which merit continued management attention.

These reportable conditions, with our recommended corrective actions, are discussed in an attachment to this report. In addition, the attachment addresses the status of prior year findings.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

We also noted certain matters involving the financial reporting internal control structure and its operation that we reported to management of the Fund in a separate letter dated February 21, 1996.

## Compliance with Laws and Regulations

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Working Capital Fund's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under Government Auditing Standards.

We reviewed the Fund's report on internal controls, dated December 12, 1994, prepared under Federal Managers' Financial Integrity Act (FMFIA), and nothing came to our attention to indicate that it conflicts materially with the results of our understanding and tests of the financial reporting internal controls. We did, however, note a number of matters which merit consideration in developing subsequent reports under FMFIA.

## Management's Responsibilities

Management is responsible for:

- designing and maintaining a financial reporting internal control structure that provides reasonable, but not absolute, assurance that the following objectives are met:

  - transactions are properly recorded and accounted for to permit the preparation of reliable and timely financial statements and to maintain accountability over assets;

  - funds, property, and other assets are safeguarded against loss from unauthorized use of disposition;

  - transactions, including those related to obligations and costs, are executed in compliance with applicable laws and regulations; and

  - data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

- preparing the financial statements in conformity with the accounting principles described in Note 1.

- complying with laws and regulations including those that do not necessarily affect financial transactions or financial reporting.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

## Auditor Responsibilities and Methodologies

Our responsibilities are:

- to express an opinion on the Principal Financial Statements based on our audit. Accordingly, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and are presented in accordance with the accounting principles described in Note 1.

- to report the results of our related tests of the Fund's financial reporting internal control structure to the extent that its inadequate design or ineffective operation, if applicable, could significantly affect the Fund's financial statements taken as a whole.

- to report deficiencies in the internal control structure policies and procedures established to ensure the performance measure data are complete and relate to events that occurred, but not to test the underlying data.

- to report the results of or related tests of the Fund's compliance with applicable laws and regulations that could materially affect the financial statements examined by us, taken as a whole.

In fulfilling our responsibilities to audit the Fund's statements of financial position, operations and changes in net position, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing an opinion on the statements of financial position, and operations and changes in net position; and not to provide assurance on the internal control structure. To fulfill these responsibilities we obtained an understanding of the Fund's financial reporting internal control structure policies and procedures to the extent we considered necessary under the circumstances. We also:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

- assessed the accounting principles used and significant estimates made by management;

- evaluated the overall presentation of the financial statements;

- obtained an understanding of the Fund's internal control structure and assessed control risk surrounding Management's objective that data in the Fund's reported performance measures be complete and relate to events that have occurred;

- tested compliance with selected provisions of laws and regulations that may materially affect the financial statements; and

- compared the Fund's FMFIA report on internal controls with the results of our tests of internal controls.

This report is intended solely for the use of the Office of Inspector General of the Department of Health and Human Services and the Director of the Working Capital Fund. However, this report is a matter of public record and its distribution is not limited.

Ernst + Young LLP

Washington D.C.
February 21, 1996

**Attachment to Report on Internal Control**

This attachment presents certain of the more significant comments on the internal control structure and other matters noted in connection with the audit of the Working Capital Fund for the year ended September 30, 1994. As noted in a concluding section on "Status of Prior Years Comments" certain of the matters raised under the captions "Fixed Assets", "Cash" and "Access Control Weaknesses Affecting the CORE Accounting System" contain elements of findings noted in connection with prior audits.

**Fixed Assets**

Management has addressed a prior finding that physical inventory procedures were needed for fixed assets, with a contractor engaged to review the 1994 physical inventory counts taken by HHS personnel. However, the lack of complete cost records for such fixed assets impacted management's ability to fully support and reconcile general ledger and subsidiary ledger balances for fixed assets.

The Departmental Accounting Manual, Chapter 1-30, "Property," states: "Detailed property records shall serve as accountable records and support the balances in the general ledger accounts....They will disclose the unit acquisition cost or other value at which the property is to be recorded and also identify and classify the types of property."

The Fund could not provide support for $6.2 million, net of depreciation, for property and equipment, as of September 30, 1994, or the related depreciation expense of $1,522,000 for the year then ended because detail records were incomplete and did not support the purchase price of fixed assets or the date purchased/placed in service. We noted that the Fund implemented the Integrated Property Management System (IPMS) for headquarters during FY 1994 having previously implemented IPMS in the regions. Prior to implementing the IPMS, fixed assets for headquarters activities were tracked using a manual perpetual system that was not always properly maintained; therefore, the Fund could not adequately support reclassifications to fixed assets.

While the implementation of IPMS and follow-up activities by Fund accounting personnel are expected to lead to appropriate support for fixed asset additions going forward, accounting records were not available to support opening balances of fixed assets. Given the reorganization, and probability that with the passage of time the opening balances will become less material, we understand that further efforts to support opening balances may not be viewed as cost justified. In the interim, we suggest that management continue to focus on physical inventory procedures to safeguard fixed assets, and that efforts be initiated to quantify the unsupported balance, net of estimated depreciation. Assuming that the net unsupported balance declines with the passage of time, the impact of this matter on the fair presentation of the Fund's financial statements should lessen.

## Impact of Decentralized Accounting Environment on Internal Controls

During Fiscal Year (FY) 1994, the Funds experienced significant changes in its operating environment to include the implementation of a new automated accounting system, and a reorganization and reduction in staff. These changes coupled with a decentralized accounting system impacted the Fund's control over its general ledger, preparation of the financial statements, and the Fund's ability to effectively detect errors and irregularities in a timely manner.

## Changes in the Operating Environment

CORE System

Reports produced by the old accounting system were no longer available under the new CORE system, and certain reports produced by the CORE system did not always meet the Fund's financial statement preparation needs. The Accounting Manual, Chapter 1-00-40 "Basic Principles and Standards," states: " Each system shall regularly produce effective cost reports for internal management....Each system shall have built into it adequate controls to insure the accuracy of the accounts and the data produced from the accounts." As a result of not obtaining the reports with the information sorted, accumulated and presented in a useful manner, the Fund had to invest valuable resources in manually preparing reports and spreadsheets. Although the information appears to be included in the CORE system, report writing routines, and file saving activities had not yet been refined to provide all such information in a useful format. Most of the reports are summarized by can code which designates the division or area in which for example, the expense occurred and not by the object classification code which identifies the type of expense, i.e. OC 21, Travel, or by transaction code which may be more useful for the Fund's needs. Although the system is capable of sorting the information in the needed format, the Fund has expressed concerns that they have not been able to obtain timely information when they have requested special sorts, and therefore, has elected to sort the information manually. Sorting the information manually is also time consuming, especially when the Fund's staff has been reduced, and lends itself to errors particularly when the information being sorted is voluminous. We noted several cases where the Fund manually calculated volumes of information that the system should have been able to make available in a timely fashion, not only for audit purposes but for management use.

For example, although the Fund identifies the type of expense or payable by object classification codes, and reports the expenses by type in a note to the financial statements, the Fund was not able to provide support for the breakdown of the expenses. Fund Management represented that such information was provided in file format from the CORE accounting system and RAS at a major object class level for each cost center and was combined in a database format to develop expenses by type. However, the detailed information was not sorted to test the calculated totals without manually going through volumes of data and try to redevelop the totals.

In a similar instance, we noted that the Fund had to manually sort over 220 pages with up to 40 line items by object classification codes to determine the amount of unliquidated obligations by object classification codes to summarize information needed to test accounts payable. The computer system should be capable of providing these sorts more timely and accurately than manually sorting large volumes of data. However, management has expressed concern that the data is not reliable when specially requested programs are run.

Although the system ran a special report for repairs and maintenance expenses, the report could not be agreed to the general ledger to ensure that it was complete because repairs and maintenance was a sub-object classification code and only one of several expenses included in the account balance.

Not having information available when needed impacts the Fund's ability to effectively manage its funds.

In addition, there were instances in which information was not entered in the general ledger in a timely manner. For example, the first two quarters revenue was not recorded in the general ledger until September 1994 due to billing system problems in generating general ledger input files related to intra-fund transfers of income and expenses. The fourth quarter billing information was not recorded in the general ledger until February 1995, due to rate adjustments, late receipt of billing information and corrections of billing information from service providers.

Reduction in Staff

In addition to the impact of implementing the new CORE System and having to manually prepare reports that should become available via the system, the Fund has undergone a reduction in staff and had two HHS-wide furloughs that have further strained resources. The impact of these HHS-wide initiatives has been acute in the activities of the Fund, as changes in regional structures, and reassignments of responsibilities, has impaired the Fund's ability to provide timely documentation for the audit. For example, the Social Security Administration (SSA) became a separate agency in April 1995 and a significant number of the Fund's staff and equipment moved to SSA. In addition to a reduction of staff at headquarters, the regional Finance offices closed and records went into storage. The Kansas City regional Department of Finance (DOF) closed in March 1995 and the remaining nine regional DOF offices were operating with a reduced staff or closed during the audit.

## Decentralized Accounting

In addition to the above changes, the Fund does not have a centralized accounting system and there is not adequate control over the input of information from independent sources such as the regions. The regions have their own accounting system, the Regional Accounting System (RAS), which processes accounting information for the regions and passes summary information to the CORE system. Although Regional Finance Directors are responsible for regional accounting and related internal controls, a headquarters review for completeness and accuracy of information prepared by regions was not completed. At year end, the Fund did not obtain and maintain the detail support or subsidiary ledgers for accounts payable related to Third Party Drafts that were processed in the regions. Headquarters staff did not review the regions to ensure that regions accounted for transactions properly. For example, headquarters staff accepted regional memos or E-mail as support for income accrual information from Regions 2 and 7. In other cases, when the regions did provide support, the Fund did not review or monitor it. For example, cash reconciliations received from the regions by the Reports and Controls Branch were not properly monitored to determine that they are properly performed and reconciling items are cleared.

The Accounting Manual, Chapter 2-40, "Reconciliations and Internal Control," states: "All necessary data elements must be coded and reviewed by competent personnel prior to input to the financial system to assure the highest degree of accuracy attainable. (It is by far more advantageous to exercise care and accuracy on the input than to devote even more manpower to the task of searching and correcting errors, perhaps after management decisions have been made - on erroneous data.)"

The lack of routine accrual procedures resulted in the Fund spending a considerable amount of resources making adjustments to the financial statements. Other needed adjustments were not identified on a timely basis. For example, headquarters' responsibility for reviewing the regions' nonaccruing obligations to determine if the regions had properly accrued for liabilities and expenses incurred at year-end was not defined. In forming management's assertion that such statements are fairly stated, review processes are particularly important in decentralized accounting operations.

Additionally, the Fund had difficulties obtaining documentation from various divisions within headquarters. In a number of cases, repeated requests were needed to obtain sufficient detailed documentation to provide audit support for transactions processed because the support was not provided in a timely manner and was often incomplete.

## Financial Statement Preparation

As a result of the accounting environment discussed above, the Fund had to expend resources to research and make approximately 150 adjustments to the general ledger as of

September 30, 1994, to prepare the financial statements. The Fund experienced difficulty identifying adjustments in a timely manner due to difficulties experienced in implementing CORE accounting system. Many of these adjustments occurred because of erroneous entries made throughout the year that the Fund manager's staff detected through routine accounting reconciliations. Other adjustments were the result of the need to reflect accruals in the financial statements that were not recorded in the general ledger. For example, the Fund recorded an income accrual for the 4th quarter for over $26 million that was not processed and approved until February 1995. In addition, the Fund had to incorporate balances from the HRSA accounting system for the PMS activity, which was a Working Capital Fund financed activity that was functionally managed by the Public Health Service and Supply Fund. To produce reliable and timely financial statements, it is essential to have procedures in place to maintain a reliable and timely general ledger. Manual adjustments to the general ledger lends itself to errors and omissions.

Aside from encountering difficulties in implementing the CORE System, we noted $1.6 million in adjustments made to the general ledger for Accounts Receivable because DAO consistently used the wrong transaction code to recognize income from customers outside HHS. The correct transaction code recognizes income; DAO used a transaction code that recorded an advance from customers. The Fund Manager's staff is aware that DAO used the wrong transaction code for outside customers, and tracks the income through general ledger account reconciliations. Manual adjustments to the financial statements and the general ledger were made after year-end. Although adjustments were recorded to financial statements to reflect income, it is a concern that the information was entered in the system incorrectly throughout the year and manually adjusted to the financial statements.

Recommendation

As a result of the accounting environment, the Fund does not have adequate internal controls to effectively detect errors and irregularities in a timely manner. The Fund can implement changes that can provide a stronger internal control environment. While it is inevitable that changes to a new accounting system will impact information formats and availability, additional focus on maximizing the capabilities of the system appear warranted in the short term. Developing such capability is particularly important given the many changes that are occurring in Fund activities and the need to adapt to staff reductions. We recommend that the Fund strengthen controls to improve the reliability and documentation of its financial statements to include:

1. Implement accounting polices and procedures which require that all accounting activity be under general ledger control and reduce the adjustments needed to the general ledger and financial statement balances at year-end. Documentation should be provided and maintained for all journal vouchers that are made to the general ledger to include those made during the preparation of financial statements and for the

other accounting systems that are ultimately included in the CORE system. All such documentation should be readily accessible to Fund management, with appropriate approval processes in place.

2. Identify reports or subsidiary ledgers (either from the CORE system or the other accounting systems) that are needed to provide support to the balances in the general ledger and establish policies and procedures for monthly reconciliations.

3. Review the CORE Accounting System to ensure that it is operating as intended to identify program and systematic errors and correct these errors; and identify needed reports and sorts of information to avoid costly manual sorting.

4. Establish procedures to ensure accountability of divisions responsible for audit documentation and that required accounting reports, subsidiary ledgers, and adequate detailed documentation is available on a timely basis to support the financial statements and audit requirements.

5. Provide adequate training for the accounting staff to ensure that they understand the importance of posting entries correctly such as accruing liabilities, running year-end reports, and maintaining supporting documentation.

6. Maintain cut-off files at least at year-end of all data files with audit significance.

## Accounts Payable and Accrued Expenses

In reviewing obligations, accounts payable and accrued expenses, we noted several matters which, in aggregate, suggest that additional management attention is needed to ensure that cut-off procedures are implemented to evaluate unliquidated obligations for potential deobligations and that accruals are recorded.

### Unliquidated Obligations and the Deobligation of Funds

The accounting system automatically creates an accrued liability when obligations are set up for object classification codes 11 through 23 which includes personnel compensation and benefits, travel and transportation, and rent. In reviewing the unliquidated automatically accruing obligations, we noted that there were unliquidated obligations and therefore accrued liabilities dating back to funding year 1989. The Departmental Accounting Manual, Chapter 2-30-40, "Review of Unliquidated Obligations," states: "Review of unliquidated obligations should be performed quarterly but an annual year-end review is mandatory." At our request, Fund personnel researched the unliquidated funds, and as a result, de-obligated over $750,000 in prior years' funds in which $450,000 related principally to unemployment. The accrual of over $750,000 did not represent valid liabilities, and therefore, we recommend that the Fund review both automatically accruing and non-accruing obligations at least annually to determine that they are still valid obligations and should be accrued.

We recommend that the Fund review its outstanding obligations in accordance with its Departmental Accounting Manual.

**Accrued Adjustments**

During our test of disbursements, we noted that the Fund did not accrue for liabilities under object classes 24 through 31 until the day the invoice was paid, although it could be 30 or more days after the goods or services were received. Chapter 1-10-20, of the Departmental Accounting Manual, states that accrual accounting will be on a monthly basis and that accrual accounting produces accrued costs and accrued expenditures related to goods and services used without regard to when ordered, delivered, or paid. Budgetary accounting defines the "obligation" as the value of goods and services ordered, "accrued expenditures" as the value of goods and services received actually or constructively, and "disbursements" as the payment for goods and services.

To compensate for the lack of automatic accruals in the general ledger for object classes 24 through 31, the Fund reviewed unliquidated obligations that exceeded $50,000 for potential accruals. Having to review a large volume of transactions at year-end opens the Fund to errors. For example, in the year-end analysis of obligations exceeding $50,000, the Fund made several errors such as erroneously setting up accruals and missing other accruals. If the Fund were to implement good cutoff accrual procedures, it could reduce this time consuming and not as reliable year-end analysis.

As a result, we recommend that the Fund implement routine cutoff procedures to accrue an estimated liability in the proper accounting period, via the purchase order or receiving report, when goods or services are received or performed.

**Regions**

As discussed earlier, headquarters personnel did not review $3.5 million in regional undelivered orders for object classes 24 through 31, which do not automatically accrue, to determine if accrued liabilities were accurately reported in the general ledger. At our request, headquarters did attempt to review a sample of undelivered orders, but it was difficult to obtain supporting documentation because many of the regions had downsized or closed during the audit.

Audit documentation as of September 30, 1994 for the regional Third Party Draft System, which is a stand-alone perpetual system, was not available because year-end reports were not saved and could not be recreated. The Fund Manager's staff attempted to support the September 30, 1994 balance by backing out the FY 1995 activity from August 1995 reports, but could not reconcile the results to the general ledger. For one region, the Fund had originally calculated a $64,000 debit balance, a receivable, versus the region reported credit balance, a payable. Further analysis revealed that the Fund had not originally received all of the needed documentation to recalculate the balance. Once the additional information was received, the Fund recalculated a credit balance of $14,000 versus the $127,500 reported in the general ledger.

Additionally, we noted that three regions had debit balances or receivables in the payable subsidiary ledgers. Although the amounts are immaterial, regional accounting system (RAS) staff could not obtain explanations for the abnormal balances from the DOF offices.

As discussed earlier, Fund management is responsible for the fair presentation of its financial statements. Enhancements in review procedures and record retention practices are appropriate to support fulfillment of management's responsibilities.

EDP Controls

At the time of our review, we noted a number of matters regarding access to the mainframe computer system, core accounting system libraries, program change controls, disaster recovery and backup which merit continued management attention.

**Access Control Weaknesses affecting the CORE Accounting System**

*Access to CDC's Mainframe Computer System* - The Core Accounting System used by HHS runs on a mainframe computer system operated by the Center for Disease Control (CDC) in Atlanta, Georgia. The computer processing services are provided to HHS by the CDC under a fee-for-service contract. This computer system utilizes IBM's Multiple Virtual Storage (MVS) operating system and Computer Associates' TopSecret product as the primary access control mechanism to prevent unauthorized access to this system and the data resources maintained on this system.

Since this system is primarily used by CDC for internal scientific and development applications, there are a large number of users (approximately 7,000) who have been provided with access to this system. In addition, due to the nature and purpose of the applications which are maintained on this system, remote dial-up access capabilities are available. Access to the CDC mainframe computer system is not restricted to individuals physically located within the CDC campus.

In our review of the CDC computer environment, we observed that current Information System (IS) procedures at the CDC provided all new CDC employees with access to the mainframe computer system immediately upon employment regardless of the individual's job function or business needs. The initial passwords, which are established for these user accounts, are set to values which are easy for the new user to remember and which may also be easy for unauthorized individuals to compromise. This scenario creates the potential for unauthorized users to obtain access to CDC's mainframe computer system and scan for system vulnerabilities and unprotected information. Since the financial data for the Core Accounting System resides on this system, this exposure could affect the disclosure/integrity of this information.

We recognize that CDC access to CORE accounting system requires a CORE user ID that is controlled by CORE accounting staff plus a password. However, to reduce the potential for unauthorized system access, we recommend that CDC restrict access to the mainframe computer system to individuals with a valid business need. In addition, we also suggest that CDC consider establishing initial passwords for new users that cannot be easily compromised.

*Access to Core Accounting System libraries* - In our review of the protection of key libraries of the Core Accounting System, we observed that a number of these libraries were accessible to all users of this system to create, modify or destroy the contents of these libraries. There are over 7000 individuals who have been provided with access to this system. However, we have been informed access to CORE libraries is restricted to the CORE user group and the key libraries of the CORE Accounting System are defined such that only a few individuals designated by HHS are authorized and allowed to access these libraries. Some input/output files of the CORE accounting system were not fully protected and unauthorized modification of the data within these files could affect the integrity of the information within the Core Accounting System. Since the mainframe computer system which processes the Core Accounting System hosts a wide array of applications and a large population of users, it is critical that the key libraries of the Core Accounting System be defined such that only individuals designated by HHS are authorized and allowed to access these libraries. In addition, we observed that problems with the maintenance/integrity of the CA-TopSecret rules which are being used to protect these libraries can result in unauthorized access to these libraries. Examples of problems with the CA-TopSecret rules are contradicting rules (e.g., Rule 1 provides User "A" with READ access and Rule 2 provides User "A" with CREATE/MODIFY/DELETE access.) and out-of-date rules (e.g., User "C" no longer has a business reason for access to these libraries.).

We recommend that HHS carefully review the protection levels of the key libraries belonging to the Core Accounting System and ensure that adequate controls are put in place to restrict access to these libraries. In addition, we recommend that HHS perform a re-validation of those users who have been provided with access to these libraries to ensure that a valid business reason for access currently exists.

## Weaknesses in Program Change Control Procedures for Core Accounting System

As a result of the small size of the HHS' programming staff for the Core Accounting System, it is currently not feasible to implement program change procedures which ensure segregation of duties for program development, quality assurance and production control responsibilities. There are currently 7 individuals (all contractors) who have access to make changes to both the development and production environments for the Core Accounting System. As a result, the lack of segregation of duties controls may allow changes, which have not been appropriately authorized, approved or tested, to be implemented in the production environment. An additional concern is that the environment used to install program changes does not ensure that an audit trail for all program changes is created. Consequently, it is not possible to review historical program change data to determine if any occurrences of unauthorized changes to the Core Accounting System had taken place.

We recommend that HHS review the current program change control procedures and implement appropriate controls to ensure that all changes to the Core Accounting System have been authorized, approved and tested. While the current environment may not allow for complete segregation of duties, HHS may want to consider the implementation of compensating controls to reduce the possibility of unauthorized changes to the Core Accounting System. One item that HHS should consider is a process (preferably automated) that will ensure that all changes made to the Core Accounting System are recorded. In addition, HHS may want to consider the usage of program change control software packages (e.g., PANVALET, ENDEVOR, etc.) to automate the process of migrating program changes from the development environment to the production environment and to create a historical audit trail of all program change activity for the Core Accounting System.

**Disaster Recovery Procedures for Core Accounting System**

*Application Recovery Testing Procedures* - The Core Accounting System runs on a mainframe computer system operated by the Center for Disease Control (CDC) in Atlanta, Georgia. CDC assumes responsibility for the recovery of their mainframe computer system and each of the critical applications which are processed on this system in the event of a disaster situation. The Core Accounting System has been identified as one of the critical applications on this system. Currently, CDC maintains a contract for a external "hot-site" facility. In August 1994, CDC successfully performed their first live testing of their disaster recovery plan which included restoration of the operating system software, critical applications (including the HHS - Core Accounting System) and communications. Since the test window was for only 16 hours and this was the first live testing of the disaster recovery plan, additional time for actual user testing of the critical applications (e.g., Core Accounting System) was not available.

To ensure that the Core Accounting System and related data files for this application can be fully recovered and operable after a disaster situation, we recommend that HHS personnel, responsible for the Core Accounting System, participate in user testing procedures of the Core Accounting System in follow-on tests of CDC's disaster recovery plan. The user testing will help to ensure that the "hot-site" system is accessible from the HHS business locations and that the Core Accounting System is fully functional.

*Data File Backups* - Manual procedures exist to create periodic tape backups of the month-end closing data for the Core Accounting System and are performed by the application owner. This is for the convenience of HHS and in addition to the backup disaster files stored at CDC's off-site location. This data is created in the event that a situation would arise that would require the retrieval and analysis of this historical information. Since these procedures are manual and performed outside of CDC's normal backup procedures, this data is not stored at CDC's off-site location.

To ensure that the month-end closing data is not destroyed in the event of a disaster situation at the CDC computer center, we recommend that HHS work with CDC to store these tape backups at the off-site storage facility.

**Access Control Weaknesses affecting the Payroll Application**

HHS' Payroll application is processed on a mainframe computer system at the National Institutes of Health (NIH) in Bethesda, MD. This computer system utilizes IBM's Multiple Virtual Storage (MVS) operating system and Resource Access Control Facility (RACF) product as the primary access control mechanism to prevent unauthorized access to this system and the data resources maintained on this system.

At the time of our review, there were over 20,000 users who were provided with access to this system. In our review of the RACF implementation and overall security controls on this system, the following weaknesses were observed:

o All users were provided with the ability to read the primary and backup RACF databases. These files contain user Ids and passwords for all of the users on this system and can potentially be used to obtain unauthorized access to data on this system.

o Several authorized system software libraries were not adequately protected allowing all users of this system to make unauthorized and unapproved changes to these libraries.

o Insufficient protection and controls existed over sensitive authorized programs which could allow circumvention of existing security controls.

- o RACF PROTECTALL feature was not implemented. This feature provides automatic file protection by default. When not used, file protection must be explicitly defined by the owner and is frequently forgotten or overlooked. Several instances were noted of unprotected system libraries which were a direct result of this particular weakness.

- o Insufficient audit trail for activities of privileged users, i.e., activities of users with ability to bypass RACF security controls were not being recorded.

As a result of the weaknesses described above, the potential exists for unauthorized individuals to obtain undetected access to this system and the resources which are maintained on this system.

We recommend that HHS ensure that adequate controls exist within the computer environment used to process the Payroll application to prevent unauthorized alteration to the data maintained within this system.

### NIH Management Response

Each recommendation has been addressed as follows:

- o DCRT has now protected these RACF databases to prevent access from non-authorized individuals.

- o This oversight was immediately rectified. Additionally, the procedures and processes that permitted this to occur were reviewed and modified so that new system libraries would be automatically protected at the time they are created.

- o There were several applications included in the eligible (authorized) program list. This list has been re-examined and DCRT found that one of the programs no longer required this level of authorization. That program has now been removed. Additionally, we have reviewed our procedures for including programs in this list to ensure that only those required by systems facilities are included in the future.

- o The RACF parameters have been set so that this information is now being recorded.

### Status of Prior Years Comments

In a report dated March 11, 1994, prior auditors raised a number of issues related to the internal control structure of the Working Capital Fund. Summarized comments, and comments as to the current status of resolutions of the matters raised follow.

**Comment - Complete Physical Inventories of the Funds Property and Equipment Inventory Should Be Taken.** It was suggested that all Fund property and equipment be inventoried periodically, preferably at fiscal year-end, and that physical inventory results be promptly reconciled to general ledger and subsidiary account balances.

**Current Status** - As further discussed under the caption "Fixed Assets" earlier in this attachment, although management has implemented procedures to physically inventory fixed assets, the process of reconciling and supporting general ledger and subsidiary ledger account balances was impacted by the lack of complete cost records for fixed assets.

**Comment - Cash Reconciliations Should Be Performed.** To investigate differences existing in its Statements of Differences and its budget clearing account, prior auditors recommended that DAO expand efforts to identify the remaining balance within its suspense account balance. Appropriate corrections should be made to the Fund's books (or Treasury's) for transactions found to be posted in error. Going forward, it was suggested that DAO perform a complete reconciliation each month to ensure that its records are kept in balance with Treasury's records.

**Current Status** - As noted under the caption "Cash", management has significantly reduced the carry forward amounts in suspense accounts. However, further emphasis is needed to clear suspended balances.

**Comment - Program Change Controls Must be Improved.** It was recommended that programmer access to the Regional Accounting System (RAS) production data and program files be restricted through use of formal Change Management Controls and RACF security (for RAS) to ensure that all modifications are authorized, tested, and approved prior to being placed into production. Although the previous recommendation concerns the RAS, the recommendation also applies to the CORE accounting system.

**Current Status** - As further discussed under the caption "Access Control Weaknesses affecting the CORE Accounting System" program change control concerns continued during the period under audit. Additional comments regarding EDP were made in a separate letter to management.

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of the Secretary

Washington, D.C. 20201

June 27, 1996

Ernst & Young, LLP
1225 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Sirs:

We have reviewed your draft report on the Working Capital Fund (WCF) financial statements for Fiscal Year 1994. Thank you for the constructive comments provided by Ernst and Young, LLP. We concur with the recommendations contained in the draft report.

As noted in the draft audit report, HHS experienced a reorganization during the audit. As part of the reorganization, the Working Capital Fund will complete its merger into the Service and Supply Fund at the beginning of Fiscal Year 1997. Additionally, most WCF services have organizationally moved from the Office of the Secretary to the new Program Support Center. We have strived to improve financial information and internal controls during the reorganization. As recommended, management will focus on procedures to safeguard fixed assets and to support fixed asset balances. Management will continue to improve internal controls in the accounting, operating, and computer environments.

Thank you for your suggestions for improvements. I am strongly committed to ensuring fiscal integrity and improving associated internal controls.

Sincerely,

John J. Callahan

John J. Callahan
Assistant Secretary for Management and Budget