Memorandum

Date JUL 20 1993

From Bryan B. Mitchell
Principal Deputy Inspector General

Subject Financial Audit of the National Institutes of Health's Management and Service and Supply Funds (A-15-93-00008)

To Philip R. Lee, M.D.
Assistant Secretary for Health

The attached audit reports prepared by Price Waterhouse (PW), independent public accountants, under contract with the Office of Inspector General (OIG) indicate significant opportunity for improving financial management at the National Institutes of Health (NIH). The Chief Financial Officers Act requires that audit reports be prepared in accordance with Government Auditing Standards and the Office of Management and Budget's Bulletin 93-06, Audit Requirements for Federal Financial Statements.

The PW auditors did not express an opinion on NIH's Management and Service and Supply Funds' (Funds) financial statements because they were not able to satisfy themselves regarding the reported balances for inventory, property and equipment, and cash. These balances represent 94 percent of the value of the Funds' assets. In addition, the amount for accounts payable, representing 33 percent of the Funds' liabilities, could not be substantiated due to the lack of sufficient records. These conditions also resulted in PW not being able to express an opinion on revenues and expenses. We concur with PW's disclaimers of opinion.

The PW auditors noted the following material internal control financial and administrative management weaknesses.

- *Inventory Management* At no time during Fiscal Year (FY) 1992 was the Management Fund's inventory records of pharmaceuticals and hospital and medical supplies in agreement with the general ledger. As of May 1993, these records indicated a total inventory value of $9.4 million which was $3.6 million (38 percent) greater than the $5.8 million shown in the general ledger. These records were not reconciled. Also, Fund personnel made erroneous adjustments to inventory records because they did not adequately investigate discrepancies they noted between physical counts and the inventory records. The absence of a unique identifier in the accounting system precluded the identification of these adjustments from those occurring within the normal course of operations. A test conducted by PW in May 1993 of the accuracy of the inventory records indicated numerous differences for both Funds. For example, of the items PW selected for counting in the Service and Supply Fund, inventory records reflected differences

exceeding 5 percent in both the quantity and absolute value of items counted. Inventories totaled 6 percent of the assets reported by NIH for both Funds.

Inventory management problems noted by PW auditors are similar to those found in the audit of the Funds' financial statements for FY 1991. The Department of Health and Human Services (Department) noted these as part of the material weaknesses disclosed in its annual report to the President and Congress required by the Federal Managers' Financial Integrity Act.

- *Property and Equipment* The reported net value of personal property for both Funds was $74.2 million which represents 32 percent of the Funds' reported assets. The accuracy of reported value of the property is, however, questionable principally because of the lack of accounting controls that provide the ability to routinely reconstruct individual additions and deletions of property in the Property Management Information System. Also, adjustments were made to the general ledger balances without sufficient reconciliation and supporting documentation. Auditors noted that depreciation expense and accumulated depreciation was not accurately recorded in the general ledger. Property and equipment problems noted by PW auditors are similar to those found in the audit of the Funds' financial statements for FY 1991.

  In December 1991, the Department reported conditions similar to those found by PW as a material weakness in the NIH property management system. The NIH's resolution of its property management problems has been ongoing. The weakness involves $52 million in unaccounted for property. At the end of FY 1992, NIH valued its property at $813 million.

  A Public Health Service Board of Survey (Board) was initiated in FY 1992 to investigate property management problems at NIH, and their report was issued on June 30, 1993. The report describes a serious breakdown of management controls at NIH over a period of nearly 20 years. The Board made a series of recommendations to the Director of NIH to strengthen property management.

- *Accounts Payable* Approximately $21 million or 38 percent of the Funds' $54.9 million in accounts payable at September 30, 1992 were over 1 year old. Of this amount $16.4 million or 30 percent was over 2 years old. Both Funds lacked adequate procedures for the accrual of accounts payable on a timely basis, periodic reviews of the payables and a process for aging accounts payable. Aging of accounts payable would have identified invalid payables such as those that had accumulated in instances where obligations were overestimated and remained on the books. The presence of invalid payables and obligations in the records restricts funds which could have been made available for other activities.

> The PW auditors, as did the previous year's auditors, determined the weakness in accounts payable to be material. Although NIH maintains that payables shown on the financial statements are supportable by documented records, it was unable to provide PW auditors documentation needed to support half of the accounts payable transactions selected for testing.

Other significant internal control deficiencies noted by PW auditors included inadequate: (1) capitalization of costs associated with a lease of computer equipment and development of automated systems; (2) reconciliation of general ledger cash accounts with the Department of Treasury's records; (3) procedures relating to processing and recording disbursements and accounts payable transactions; (4) personnel training and written guidance for assigned accounting personnel; and (5) security over accounting system application software and data files.

The report on internal controls and compliance contains recommendations for corrective action, with which NIH officials generally agreed. Their comments have been incorporated within this report. We would appreciate receiving written comments and a status report on progress in implementing the recommendations within 60 days from the date of this memorandum.

We appreciate the courtesy and cooperation your staff extended to PW and our OIG staff during this review. If you wish to discuss this report, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3583.

Attachments

cc:
Ken Apfel, Chief Financial Officer
Department of Health and Human Services

Ruth L. Kirschstein, M.D.
Acting Director
National Institutes of Health

Anthony L. Itteilag, Chief Financial Officer
Public Health Service

John D. Mahoney, Chief Financial Officer
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Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

FINANCIAL AUDIT OF THE NATIONAL INSTITUTES OF HEALTH'S MANAGMENT AND SERVICE AND SUPPLY FUNDS

JULY 1993 A-15-93-00008

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date JUL 20 1993

From Bryan B. Mitchell
Principal Deputy Inspector General

Subject Financial Audit of the National Institutes of Health's Management and Service and Supply Funds (A-15-93-00008)

To Philip R. Lee, M.D.
Assistant Secretary for Health

The audit reports prepared by Price Waterhouse (PW), independent public accountants, under contract with the Office of Inspector General (OIG) indicate significant opportunity for improving financial management at the National Institutes of Health (NIH). The following PW reports on reasonableness of amounts, internal controls and compliance with laws and regulations for NIH's Fiscal Year (FY) 1992 financial statements for its Service and Supply and Management Funds (Funds) are located at the pages indicated.

Reports	Pages
Opinion on Service and Supply Fund	B-1 to B-3
Opinion on Management Fund	C-1 to C-2
Internal controls and compliance	D-1 to D-31

The Chief Financial Officers Act requires that audit reports be prepared in accordance with Government Auditing Standards and the Office of Management and Budget's Bulletin 93-06, Audit Requirements for Federal Financial Statements.

The PW auditors did not express an opinion on the Funds' financial statements because they were not able to satisfy themselves regarding the reported balances for inventory, property and equipment, and cash. These balances represent 94 percent of the value of the Funds' assets. In addition, the amount for accounts payable, representing 33 percent of the Funds' liabilities, could not be substantiated due to the lack of sufficient records. These conditions also resulted in PW not being able to express an opinion on revenues and expenses. We concur with PW's disclaimers of opinion.

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than the $5.8 million shown in the general ledger. These records were not reconciled. Also, Fund personnel made erroneous adjustments to inventory records because they did not adequately investigate discrepancies they noted between physical counts and the inventory records. The absence of a unique identifier in the accounting system precluded the identification of these adjustments from those occurring within the normal course of operations. A test conducted by PW in May 1993 of the accuracy of the inventory records indicated numerous differences for both Funds. For example, of the items PW selected for counting in the Service and Supply Fund, inventory records reflected differences exceeding 5 percent in both the quantity and absolute value of items counted. Inventories totaled 6 percent of the assets reported by NIH for both Funds.

Inventory management problems noted by PW auditors are similar to those found in the audit of the Funds' financial statements for FY 1991. The Department of Health and Human Services (Department) noted these as part of the material weaknesses disclosed in its annual report to the President and Congress required by the Federal Managers' Financial Integrity Act.

- *Property and Equipment* The reported net value of personal property for both Funds was $74.2 million which represents 32 percent of the Funds' reported assets. The accuracy of reported value of the property is, however, questionable principally because of the lack of accounting controls that provide the ability to routinely reconstruct individual additions and deletions of property in the Property Management Information System. Also, adjustments were made to the general ledger balances without sufficient reconciliation and supporting documentation. Auditors noted that depreciation expense and accumulated depreciation was not accurately recorded in the general ledger. Property and equipment problems noted by PW auditors are similar to those found in the audit of the Funds' financial statements for FY 1991.

  In December 1991, the Department reported conditions similar to those found by PW as a material weakness in the NIH property management system. The NIH's resolution of its property management problems has been ongoing. The weakness involves $52 million in unaccounted for property. At the end of FY 1992, NIH valued its property at $813 million.

  A Public Health Service Board of Survey (Board) was initiated in FY 1992 to investigate property management problems at NIH, and their report was issued on June 30, 1993. The report describes a serious breakdown of management controls at NIH over a period of nearly 20 years. The Board made a series of recommendations to the Director of NIH to strengthen property management.

- *Accounts Payable* Approximately $21 million or 38 percent of the Funds' $54.9 million in accounts payable at September 30, 1992 were over 1 year old. Of this amount $16.4 million or 30 percent was over 2 years old. Both Funds lacked adequate procedures for the accrual of accounts payable on a timely basis, periodic reviews of the payables and a process for aging accounts payable.

Aging of accounts payable would have identified invalid payables such as those that had accumulated in instances where obligations were overestimated and remained on the books. The presence of invalid payables and obligations in the records restricts funds which could have been made available for other activities.

The PW auditors, as did the previous year's auditors, determined the weakness in accounts payable to be material. Although NIH maintains that payables shown on the financial statements are supportable by documented records, it was unable to provide PW auditors documentation needed to support half of the accounts payable transactions selected for testing.

Other significant internal control deficiencies noted by PW auditors included inadequate: (1) capitalization of costs associated with a lease of computer equipment and development of automated systems; (2) reconciliation of general ledger cash accounts with the Department of Treasury's records; (3) procedures relating to processing and recording disbursements and accounts payable transactions; (4) personnel training and written guidance for assigned accounting personnel; and (5) security over accounting system application software and data files.

The report on internal controls and compliance contains recommendations for corrective action, with which NIH officials generally agreed. Their comments have been incorporated within this report. We would appreciate receiving written comments and a status report on progress in implementing the recommendations within 60 days from the date of this memorandum. If you wish to discuss this report, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3583.

1901 K Street, N.W.
Washington, DC 20006

Price Waterhouse

Report of Independent Accountants

To the Principal Deputy Inspector General and the
Acting Assistant Secretary for Health
Department of Health and Human Services

We were engaged to audit, in accordance with American Institute of Certified Public Accountants and General Accounting Office standards, and Office of Management and Budget Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, the Statement of Financial Position of the Service and Supply Fund of the National Institutes of Health (NIH) and the related Statements of Operations and Changes in Net Position, of Cash Flows, and of Budget and Actual Expenses, as of and for the year ended September 30, 1992 appearing on pages E-30 through E-39 of this report. These financial statements are the responsibility of management of the Service and Supply Fund. Other independent auditors were engaged to audit the financial statements of the Service and Supply Fund for the year ended September 30, 1991; however, their report, dated July 2, 1992, disclaimed from expressing an opinion on the financial statements because: (1) counts of physical inventory were not made at September 30, 1991 or 1990, and they were unable to satisfy themselves concerning inventory quantities on hand at those dates by other auditing procedures; (2) they were unable to ascertain the fair presentation of property and equipment, accounts payable, and accrued expenses; and, (3) depreciation expense and accumulated depreciation of property and equipment balances had not been recorded.

Although counts of inventory were taken during the months of September, October, and November 1992, we did not observe these inventory counts because they were taken prior to our appointment as independent accountants of the Service and Supply Fund. We were unable to satisfy ourselves regarding inventory balances stated in the financial statements, at approximately $10.1 million as of September 30, 1992, by means of other auditing procedures.

The Service and Supply Fund did not fully reconcile its records of cash disbursement/receipt activity with Treasury's records as of September 30, 1992. Specifically, NIH's budget clearing account contained unreconciled amounts totaling a net credit of approximately $9.0 million at that date. Because the budget clearing account includes amounts aggregated for a number of financial reporting units, including the Service and Supply Fund, the extent to which these unreconciled amounts impact the Service and Supply Fund's financial records, including cash and accounts payable, cannot be reasonably determined.

The Service and Supply Fund does not have a process for reconciling detailed property and equipment records to the general ledger. In addition, certain prior year records and supporting data were not available for examination. Therefore, we were not able to apply adequate auditing procedures to satisfy ourselves regarding the net property and equipment balance stated at approximately $16.9 million, as of September 30, 1992 as well as the related depreciation expense for the year ending September 30, 1992 of approximately $2.8 million.

Certain activities of the Service and Supply Fund are supported through the use of computer equipment made available to the Service and Supply Fund under the terms of a lease agreement. The initial period of the lease agreement was from October 1, 1988 through September 30, 1989, with nine one-year renewal options. The lease states that it is the intent of NIH to renew the lease; options were in fact exercised for each of the years ending September 30, 1989 through 1992. Rental expense for the year ending September 30, 1992 includes approximately $18.5 million related to this lease agreement. The financial statements treat this lease agreement as an operating lease. In our opinion, the lease should be recorded as a capital lease to conform with Statement of Financial Accounting Standards (FAS) 13, as amended. The effects on the financial statements of not recording this lease as a capital lease have not been determined. Additionally, disclosures have not been made in the notes to the financial statements of this lease as required by FAS 13.

Accounts payable, recorded in the Statement of Financial Position at approximately $23.7 million as of September 30, 1992, contains approximately $10.0 million in amounts over one year old, including $8.4 million over two years old. The Service and Supply Fund did not have sufficient records and data available to substantiate these amounts.

Data supporting expenditures and related revenues was not available for examination. Therefore, we were not able to apply adequate auditing procedures to satisfy ourselves regarding revenues or expenses of the Service and Supply Fund.

Because we were not able to apply other auditing procedures to satisfy ourselves regarding inventory, cash, property and equipment, and accounts payable balances, and revenue and expenditures, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

Report of Independent Accountants
June 14, 1993

We have reviewed the financial information presented in management's "Overview" appearing on pages E-6 through E-28 of this report. This information is presented by management for the purpose of additional analysis. Such information has not been audited by us and, accordingly, we do not express an opinion on it.

Price Waterhouse

June 14, 1993

Price Waterhouse
1801 K Street, N.W.
Washington, DC 20006

Price Waterhouse

Report of Independent Accountants

To the Principal Deputy Inspector General and the
Acting Assistant Secretary for Health,
Department of Health and Human Services

We were engaged to audit, in accordance with American Institute of Certified Public Accountants and General Accounting Office standards, and Office of Management and Budget Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, the Statement of Financial Position of the Management Fund of the National Institutes of Health (NIH) and the related Statements of Operations and Changes in Net Position, of Cash Flows, and of Budget and Actual Expenses, as of and for the year ended September 30, 1992 appearing on pages E-40 through E-49 of this report. These financial statements are the responsibility of management of the Management Fund. Other independent auditors were engaged to audit the financial statements of the Management Fund for the year ended September 30, 1991; however, their report, dated July 2, 1992, disclaimed from expressing an opinion on the financial statements because: (1) counts of physical inventory were not made at September 30, 1991 or 1990, and they were unable to satisfy themselves concerning inventory quantities on hand at those dates by other auditing procedures; (2) they were unable to ascertain the fair presentation of property and equipment, accounts payable, and accrued expenses; and, (3) depreciation expense and accumulated depreciation of property and equipment balances had not been recorded.

Although counts of inventory were taken during the months of September, October, and November 1992, we did not observe these inventory counts because they were taken prior to our appointment as independent accountants of the Management Fund. We were unable to satisfy ourselves regarding inventory balances stated in the financial statements at approximately $4.0 million as of September 30, 1992, by means of other auditing procedures.

The Management Fund did not fully reconcile its records of cash disbursement/receipt activity with Treasury's records as of September 30, 1992. Specifically, NIH's budget clearing account contained unreconciled amounts totaling a net credit of approximately $9.0 million at that date. Because the budget clearing account includes amounts aggregated for a number of financial reporting units including the Management Fund, the extent to which these unreconciled amounts impact the Management Fund's financial records, including cash and accounts payable, cannot be reasonably determined.

The Management Fund does not have a process for reconciling detailed property and equipment records to the general ledger. In addition, certain records and supporting data were not available for examination. Therefore, we were not able to apply adequate auditing procedures to satisfy ourselves regarding the net property and equipment balances stated at approximately $57.3 million.

Accounts payable recorded in the Statement of Financial Position at $31.2 million as of September 30, 1992 contains approximately $11.0 million in amounts over one year old, including approximately $8.0 million over two years old. The Management Fund does not have sufficient records and data available to substantiate these amounts.

Data supporting expenditures and related revenues of the Management Fund was not available for examination. Therefore, we were not able to apply adequate auditing procedures to satisfy ourselves regarding revenues or expenses of the Management Fund.

Because we were not able to apply other auditing procedures to satisfy ourselves regarding inventory, cash, property and equipment, and accounts payable balances, and revenue and expenditures, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

We have reviewed the financial information presented in management's "Overview" appearing on pages E-6 through E-28 of this report. This information is presented by management for the purpose of additional analysis. Such information has not been audited by us and, accordingly, we do not express an opinion on it.

Price Waterhouse

June 14, 1993

1801 K Street, N.W.
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Price Waterhouse

Report of Independent Accountants on Internal Controls and Compliance

To the Principal Deputy Inspector General and the
Acting Assistant Secretary for Health,
Department of Health and Human Services

We were engaged to audit, in accordance with American Institute of Certified Public Accountants and General Accounting Office standards, and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, the financial statements of the National Institutes of Health's (NIH) Management Fund and Service and Supply Fund (the Funds) as of and for the year ended September 30, 1992, and have issued our reports thereon dated June 14, 1993. Our reports indicated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on those financial statements.

INTERNAL ACCOUNTING CONTROLS

In planning and performing our examinations of the financial statements of the Funds for the year ended September 30, 1992, we considered their internal control structures in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structures.

Management of the Funds is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control policies and procedures in the following categories:

- Financial reporting
- Budget/Fund Control
- Cash/Treasury
- Revenue and accounts receivable
- Expenses, purchases, and accounts payable
- Payroll and related liabilities
- Inventory
- Property and Equipment
- Electronic data processing security
- Administrative controls over compliance with laws and regulations

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, assessed control risk, and performed tests of each Fund's internal control structure.

We noted certain matters involving the internal control structure 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 judgement, could adversely affect the organization's ability to ensure that: (1) transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets; (2) funds, property and other assets are safeguarded against loss from unauthorized use or disposition; and, (3) obligations and costs are in compliance with applicable laws and regulations that could have a direct and material effect on the financial statements. These matters are summarized below. Each of the matters is discussed in detail in the attachment to this report.

1. Reconciliations between the Inventory Management System and the general ledger need to be improved. Furthermore, there needs to be a more careful rationalization and coordination of entries affecting the perpetual inventory records and the general ledger.

2. Accounting for property and equipment transactions, as well as reconciliations between the general ledger and Property Management Information System, need improvement. In addition, subsidiary ledgers should be maintained to support all property and equipment general ledger balances.

3. An aging of accounts payable should be prepared and analyzed to ensure that payables are attributed to valid liabilities.

4. Leases which meet Statement of Financial Accounting Standards 13 criteria should be classified as capital leases, and all necessary disclosures related to operating and capital leases should be included in the financial statements.

5. Costs associated with development of automated systems should be capitalized and amortized based upon a systematic and rational allocation method, and the related asset should be reported as property and equipment rather than deferred charges.

6. Complete and timely clearing and cash account reconciliations should be performed.

7. Procedures related to processing and recording disbursement and accounts payable transactions should be improved.

8. Software for accounting systems is not protected by Resource Access Control Facility (RACF) against unauthorized changes or manipulation. In addition, the data files of the Central Accounting and Payroll Systems are not RACF protected to prevent manipulation.

9. Additional aspects of security over the automated systems should be improved.

10. Personnel should be properly trained and desk procedures should be developed to aid in the performance of assigned duties.

A material weakness is a condition in which the design or operation of one or more of the 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 or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Matters 1 through 3 above are considered material weaknesses.

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 as defined above.

The objective of the internal control structures for performance measures, according to OMB Bulletin 93-06, is to provide management with reasonable, but not absolute, assurance that data supporting reported performance measures are properly recorded and accounted for to permit the preparation of reliable and complete performance measures. The Bulletin's requirements specify that the auditor obtain an understanding of the control structure and assess risk related to management's assertions that the data is complete and relates to events that have occurred. Based on our understanding of the control structure, we found that the Funds have established policies and procedures over the reporting of performance measures that reduce the aforementioned risk to a moderate level.

COMPLIANCE WITH LAWS AND REGULATIONS

Compliance with laws and regulations applicable to the Funds is the responsibility of the Funds' management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Funds' compliance with certain provisions of laws and regulations. However, the objective of our examination of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes, regulations, contracts, or grants that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements.

In its departmental 1992 Federal Managers' Financial Integrity Act (FMFIA) report dated December 1992, the Department of Health and Human Services (HHS) reported two uncorrected material weaknesses that were applicable to the Management Fund and Service and Supply Fund. The material weaknesses not considered corrected as of December 1992 were as follows:

- Lack of accountability over personal property and inventory.

- Lack of NIH policy governing either NIH's or NIH employees' association with outside foundations.

In addition to the material weaknesses HHS reported in the 1992 FMFIA report, we identified one significant control weakness that we believe meets the OMB criteria for material weakness and should be reported as a material weakness under FMFIA. This material weakness was discussed in this report under the caption "Internal Accounting Controls" and is as follows:

- An aging of accounts payable should be prepared and analyzed to ensure that payables are attributed to actual liabilities.

The attachment to this report discusses the significant internal control weaknesses and instances of noncompliance in detail, and provides specific recommendations on actions the Funds should consider. In resolving these weaknesses and implementing recommendations, the Funds should look for actual results instead of planned or considered actions before a particular weakness is considered corrected. Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the Funds complied, in all material respects, with the provisions referred to in this report, and with respect to items not tested, nothing came to our attention that caused us to believe that the Funds had not complied, in all material respects, with those provisions.

We noted certain other matters involving the internal control structure and their operation and certain immaterial instances of noncompliance that we reported to management of the Funds in a separate letter.

This report is intended solely for the use of the Office of Inspector General and the managements of NIH and HHS. This restriction is not intended to limit the distribution of the report, when it becomes a matter of public record.

Price Waterhouse

June 14, 1993

MATERIAL WEAKNESSES PREVIOUSLY REPORTED BY MANAGEMENT

INVENTORY

Reconciliations between the Inventory Management System and the general ledger need to be improved. Furthermore, there needs to be a more careful rationalization and coordination of entries affecting the perpetual inventory records and the general ledger. Differences noted between the perpetual records and the inventory quantity on hand should be researched to determine their causes.

- ***There is a need for improved reconciliations between the Inventory Management System and the general ledger (the general ledger is derived from the Central Accounting System). Also, there needs to be a more careful rationalization and coordination of entries affecting the perpetual inventory records and the general ledger.***

  At no time during the year were the Management Fund's perpetual inventory balances in agreement with the general ledger. This occurred, in part, because the Materials Management (hospital supplies) storeroom, totaling approximately $2.4 million at September 30, 1992, was excluded from the general ledger throughout the year. An adjustment was posted directly to the financial statements to reflect this inventory balance at September 30, 1992. This exclusion occurred because during fiscal year 1992, the Materials Management Department incorrectly recorded all inventory purchases using a budgetary object class code reserved for the recording of expenses, rather than an inventory object class code. Management asserted that beginning in March 1993, inventory purchases were being correctly recorded under inventory object class codes. Regular and comprehensive reconciliations between the general ledger and the Inventory Management System (IMS) would detect this type of improper classification.

  Comparisons of the general ledger balance with the IMS were performed by management only twice during the fiscal year 1992. Both times, the general ledger was adjusted to agree to the IMS without complete reconciliations being performed. For example, when the general ledger was adjusted to agree to the September 30, 1992 IMS balance, October 1991 receipts and issuances from inventory were inadvertently omitted from the IMS balance calculations. This resulted in an overstatement of the general ledger inventory balance by approximately $100,000. Although this particular omission was relatively immaterial, it would have been detected through a comprehensive and timely reconciliation effort.

  Although not impacting fiscal year 1992, the year under audit, as an additional illustration of the need for greater review of reconciliations and a more careful rationalization and coordination of entries affecting the general ledger, as of May

1993 the perpetual inventory records (the IMS) showed the total inventory balance to be approximately $9.4 million, or $3.6 million greater than the amount reflected on the general ledger, which was $5.8 million as of that date. This occurred, in part, because the general ledger balance had been reduced by $5 million 2 months earlier to adjust what was thought to be transactions inaccurately affecting the inventory object class codes. As a result, the records of purchases reflected in the general ledger were $5 million less than the perpetual records as of March 1993. However, in May 1993, management subsequently discovered that $4.6 million of this adjustment to the general ledger was incorrect, and required reversal. A more careful rationalization and coordination of entries affecting the general ledger, including management review, likely would have precluded this sequence of adjustments.

Rationalization of the entries to the general ledger and the perpetual inventory records, and regular reconciliations of the two systems, would alleviate the need for large adjustments to bring the systems into agreement, and would help to avoid making erroneous adjustments. Furthermore, the IMS and general ledger entry processes should be subjected to a thorough review to identify and eliminate causes of disagreements, thereby enabling routine reconciliations to be accomplished. Harmonization and increased accuracy of the day-to-day accounting for inventory would provide a stronger basis for inventory custodian accountability for missing commodities should such situations occur.

The General Accounting Office's (GAO) *Policy and Procedures Manual for Guidance of Federal Agencies* (Title 2) states "Regular reconciliations of subsidiary accounts and records helps to substantiate and maintain the accuracy of account postings and balances by determining agreement between the sum of the detail in subsidiary accounts and the general ledger control balances."

The need for increased reconciliations between the IMS and the general ledger was reported by the predecessor auditors in their Report on Internal Controls dated July 2, 1992.

Recommendations:

We recommend that timely and comprehensive reconciliations between the IMS and the general ledger be performed. Differences identified should be investigated and resolved, with the resulting resolution documented to evidence adequacy of the reconciliation process.

NIH Comment:

The NIH officials concurred with this recommendation, and stated that during 1993, they have begun to perform reconciliations between the IMS and the general ledger monthly. These current monthly reconciliations will be modified to include additional data to improve the reconciliation process. They further stated that any differences exceeding one percent of the total will be thoroughly reviewed and resolved. These monthly reconciliations, along with any supporting documentation on the differences, will be reviewed and approved by higher level management.

- ***Differences noted between the perpetual records and the inventory quantity on hand should be researched to determine their causes.***

As a result of physical counts, differences are identified between the perpetual inventory records and the inventory stock on hand. Adjustments are then posted to the perpetual records to bring them into agreement with the results of the physical counts. However, these adjustments are made without fully investigating the cause of the differences between the perpetual records and physical counts. Fund personnel are unable to subsequently identify these adjustments because they are not uniquely identified from other types of adjustments occurring within the normal course of operations.

Although the perpetual records and inventory quantities on hand should generally be in agreement because the IMS is updated daily to reflect receipts and issuances, differences between the perpetual records and inventory quantities on hand exist. For example, test counts of 140 judgementally selected inventory items from a combination of both the Management Fund and the Service and Supply Fund in May 1993 indicated numerous differences. Of the items selected for counting within the Service and Supply Fund, the perpetual records reflected quantities in stock of 2,702, while physical counts indicated only 2,523 were on hand. The total value of the Service and Supply Fund inventory counted was $588,376, while the absolute value of differences (overages and shortages) between the amounts counted and that reflected in the perpetual inventory records was $61,001.

Recommendations:

Differences noted between the perpetual records and the inventory quantity on hand should be researched to determine their causes. This recommendation is consistent with the HHS Material Management Manual[1] which states that a Board of Survey action should be initiated whenever shortages are revealed in excess of $500. Any

[1]Section 103-25.5101 and 5104

resulting adjustments determined to be necessary should be documented and reviewed/approved by both appropriate inventory management, and Division of Financial Management prior to processing in the IMS. Additionally, adjustments should be classified according to frequently occurring categories, with each denoted by a unique code. This would afford management the opportunity to analyze trends and types of adjustments made throughout the year, as well as facilitate the audit process. This recommendation is consistent with the HHS Material Management Manual[2], which states "Form HEA-365, Inventory Adjustment, shall be used as a property voucher to record the circumstances creating the need for the adjustment and the data to be posted to the property and fiscal accounts."

NIH Comment:

The NIH officials agreed that all adjustments to the perpetual inventory system must be fully documented and that differences beyond a certain dollar limit must be submitted for Board of Survey action. The officials further stated that NIH is currently working with the Public Health Service to determine the appropriate dollar limit for requiring Board of Survey actions for supply items. HHS has been working on revising the Material Management Manual which, when issued, may provide additional guidance on this subject. The current Material Management Manual issuance on this subject dates from 1979.

PROPERTY AND EQUIPMENT

Accounting for property and equipment transactions, as well as reconciliations between the general ledger and Property Management Information System, need improvement.

- ***Accounting for property and equipment transactions should be improved.***

  The Property Management Information System (PMIS) was developed and brought on-line in July 1991 to improve accountability over property and equipment. At that time, a physical inventory of property and equipment was taken and data was entered into PMIS. Several issues surrounding this process have, however, adversely impacted the accuracy of the property and equipment balances, as well as the related accumulated depreciation and depreciation expense. These issues are discussed in the following paragraphs.

  Documentation did not exist to support purchase prices and acquisition dates of approximately 30 percent and 40 percent of the property and equipment physically observed within the Management Fund and the Service and Supply Fund,

[2]Section 103-27.5016

respectively. Therefore, this equipment was entered into PMIS at a median price of all similar equipment, and the acquisition date was considered to be the date which the property was entered into PMIS (i.e., the period of February through November 1991). Recording a significant amount of the property as newly acquired as of the date the property was entered into the system results in an understatement of accumulated depreciation at that date and an overstatement of depreciation expense over a multi-year period following implementation of the new system. An alternative approach, which may have allowed the accounting records to more closely estimate the remaining useful life of the property and equipment, would have been to assume that this equipment was approximately halfway through its estimated useful life as of that date, capitalizing its full "cost" and recording accumulated depreciation for half its life.

Management asserted that during fiscal year 1992, subsequent to implementation of PMIS, significant improvements had been made to the control system surrounding the property and equipment component. Acknowledging that documentation did not exist to support purchase prices and acquisition dates for a significant portion of property and equipment acquired prior to fiscal year 1992, we attempted to test management's assertion regarding improved controls over acquisitions made during fiscal year 1992. However, because PMIS did not provide an audit trail from which we could trace a sample of fiscal year 1992 acquisitions to purchase orders and invoices, we were unable to test management's assertion. Management also asserted that during 1993, improvements were made to PMIS to provide a complete audit trail. We did not, however, validate this assertion.

We also understand that much of the property and equipment data entered into PMIS, based on the physical inventory, could not be matched with data previously recorded. Therefore, a significant amount of equipment recorded in the former system was not reflected as being located during the physical count. During 1992, a Board of Survey was charged with investigating the disposition of these asset differences. To date, a report on the results of this investigation has not been issued.

The GAO's Title 2 states "Documentation of transactions or other significant events should be complete...and should facilitate tracing the transaction or event and related information from before it occurs, while it is in process, to after it is completed." Title 2 further states "A key test of the adequacy of an audit trail is whether tracing the transaction forward from the source or back from the result will permit verification of the amount recorded or reported."

Recommendations:

We recommend that management consider adjusting the detail property and equipment records to reflect capitalization of the "found" property and equipment based on using an assumption that such equipment was at the approximate midpoint in its useful life as of the physical inventory date. We believe considering the equipment to be halfway through its estimated useful life as of July 1991 would allow the current accounting records to more closely mirror the remaining useful life of those assets.

Because management has asserted that PMIS was modified during fiscal year 1993 to provide an adequate audit trail, no further recommendation in this regard is warranted.

NIH Comment:

The NIH officials agreed with the recommendation that accumulated depreciation and the remaining useful life of applicable capital assets be adjusted to assume that all "found" equipment was halfway through its estimated useful life as of July 1991. The NIH officials further stated that NIH will adjust its property and financial records.

The NIH officials also confirmed that the PMIS can now provide an audit trail as required by GAO's Title 2 for those items acquired after January 1993 (the date of system establishment).

- ***Comprehensive and timely reconciliations between the Property Management Information System and the General Ledger (Central Accounting System) should be performed.***

Periodic adjustments are made to bring the general ledger into agreement with PMIS, without the benefit of formal reconciliations between the general ledger and PMIS. Rather, PMIS is considered by management to be the accurate source of information, and any differences arising between the two systems are removed through adjustment of the general ledger balance. Differences existing between these systems, before the general ledger was adjusted to agree to PMIS, have been significant. For example, the September 30, 1992 property and equipment balance for the Service and Supply Fund in PMIS was approximately $18.9 million, or $9.1 million less than the general ledger balance of $28 million, as of that date. For the Management Fund, the property and equipment balance in PMIS was approximately $73.6 million, or $4.7 million greater than the general ledger balance of $68.9 million at September 30, 1992. The differences between the systems are primarily caused by ineffective automated interfaces between the systems, and the absence of an edit check within the Central Accounting System (CAS) to prevent acquisitions below the $5,000

capitalization threshold from being entered into the property and equipment asset accounts.

An analysis of the general ledger property and equipment asset account 1756 "ADP and TC equipment in use" with a balance of $1,121,309 as of September 30, 1992, and account 1751, "Equipment in use" in the amount of $2,007,782 indicated that $218,766 and $758,428, respectively, in property and equipment acquisitions below the $5,000 threshold, had been erroneously capitalized during fiscal year 1992. In their Report on Internal Controls dated July 2, 1992, the predecessor auditors recommended that the general ledger be modified to include an edit check whereby amounts below the $5,000 threshold are rejected from posting to the general ledger asset accounts. The aforementioned instances of erroneous capitalization occurred, in part, because the general ledger has not yet been modified to include this edit check.

In addition, management could not provide documentation in support of account 1730 "Buildings," reported in the general ledger at $2,366,563 as of September 30, 1992, or account 1740, "Other Structures and Facilities" in the amount of $1,452,080 or identify the specific assets capitalized.

The GAO's Title 2 states "Regular reconciliations of subsidiary accounts and records helps to substantiate and maintain the accuracy of account postings and balances by determining agreement between the sum of the detail in subsidiary accounts [or systems] and the general ledger control balances." Title 2 further specifies that accounting systems shall contain adequate controls to provide reasonable assurance that all transactions are processed once and only once, and that subsidiary ledger balances are accurately reflected on the general ledger. This is consistent with OMB's "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government" which states "...the accountability for resources, and all transactions and other events shall be clearly documented. Documentation shall be readily available for examination."

Recommendations:

General ledger balances should be reconciled with subsidiary accounts and records in a timely manner. Additionally, similar to the previously discussed need for identification of causes of differences impacting inventory balances, the methodology for posting to the PMIS and general ledger also needs to be studied so that causes of imbalances can be identified and eliminated, thereby enabling routine reconciliations to be accomplished. We also recommend that NIH continue to develop PMIS to better automate the interface into CAS.

Further, the CAS (which includes the general ledger) should be modified to include an edit check preventing acquisitions below the $5,000 threshold from being posted to

asset accounts. In addition, we recommend that postings to the non-capitalized equipment expense accounts be regularly analyzed to identify and correct any acquisitions above the $5,000 level which are erroneously expensed.

NIH Comment:

The NIH officials concurred that routine reconciliations between the general ledger and the PMIS needs to be accomplished on a timely basis. The NIH officials stated that NIH has placed in motion a work group dedicated to improving the methodology used for posting to the PMIS and the CAS to improve the integrity of the data in both systems. The documentation of the data flow through the two systems for additions, changes, and deletions will be included.

The NIH officials also stated that an improved interface among the Administrative Data Base, the PMIS and the CAS, will continue to be developed. They stated that the suggested edit check can be accomplished for future periods and the non-capitalized expense items will be reviewed to correct erroneously posted items.

OTHER MATERIAL WEAKNESS ARISING FROM THE EXAMINATION

EXPENSES, PURCHASES, AND ACCOUNTS PAYABLE

An aging of accounts payable should be prepared and analyzed to ensure that payables are attributed to actual liabilities.

In the prior year Report on Internal Controls, dated July 2, 1992, it was reported that the September 30, 1991 accounts payable balances of the Management Fund and the Service and Supply Fund included approximately $10 million and $9 million, respectively, in amounts over 1 year old. During the examination of the September 30, 1992 financial statements, we noted that accounts payable balances of the Management Fund and the Service and Supply Fund included approximately $11 million and $10 million, respectively, in amounts over 1 year old, of which $8 million and $8.4 million, respectively, were over 2 years old. For example, the September 30, 1992 "Open Documents Listing" showed that an accounts payable originally established in the amount of $1,500,000 had been partially liquidated through a $631,821.45 disbursement on February 14, 1987, leaving a remaining accounts payable balance of $868,178.55. Therefore, the accounts payable balance related to this transaction remained outstanding from 1987 through the date of the report. Management was not able to provide adequate documentation to substantiate these aged liabilities.

Accounts payable are customarily established based on the quantity of goods or services received, extended at the estimated price reflected in the purchase order. Aged accounts payable have arisen for a variety of reasons including:

- When payment is made in an amount less than the estimated unit cost per the purchase order, the difference between the extended value of the goods received at the purchase order cost and the disbursement amount remains in the accounting records as an accounts payable.

- When an invoice is received that cannot be readily matched with a previously recorded obligation or payable, an obligation and payable are simultaneously recorded and then subsequently liquidated through disbursement, leaving the originally established unmatched accounts payable in the accounting records.

Recommendations:

As recommended in the prior year report, a periodic aging and analysis of payables should be performed to identify invalid payables. Liquidating invalid payables would result in a more accurate financial statement presentation of liabilities of the Management Fund and the Service and Supply Fund.

NIH Comment:

The NIH officials stated that, as articulated in response to the prior year auditor's report, they do not believe the amounts shown as payables are an indication of material weakness. They further stated that the payables shown on the financial statements are supportable by documented records and are therefore valid obligations. The NIH officials also stated that they will enhance the current procedures for aging and analyzing account payables and will provide adequate training to accounts payable staff to facilitate accurate close-out of records after invoices are received. In addition, they will periodically review the validity of accounts payable balances.

Auditor's Reply to NIH Comment:

Notwithstanding the NIH officials' comment, as discussed below under the "Reportable Conditions" caption, approximately 50 percent of the documentation purported to support disbursement and accounts payable transactions selected for testing was not provided to us. Additionally, in many cases, individual payable balances were several years old and/or represented the difference between the extended value of goods received and the disbursement amount. This difference, which should have been liquidated on a timely basis, was not supported by documented records. We considered this matter to be of such significance as to contribute to the basis for disclaiming from the issuance of an opinion on the financial statements of ,the Management Fund and the Service and Supply Fund.

REPORTABLE CONDITIONS

PROPERTY AND EQUIPMENT

Lease transactions should be recorded in the general ledger and disclosed in the financial statements in accordance with generally accepted accounting principles.

Certain activities of the Service and Supply Fund are supported through the use of computer equipment made available to the Fund under the terms of a lease agreement. The initial period of the lease agreement was from October 1, 1988 through September 30, 1989, with nine one-year renewal options. The lease states that it is the intent of NIH to renew the lease; options were in fact exercised for each of the years ending September 30, 1989 through 1992. Amounts reported as rental expense under the lease contract for the year ending September 30, 1992 totalled approximately $18.5 million. This lease is treated as an operating lease in the financial statements of the Service and Supply Fund. However, consistent with the predecessor auditors' Report on Internal Controls dated July 2, 1992, we believe this lease should be recorded as a capital lease.

Statement of Financial Accounting Standards (FAS) 13, *Accounting for Leases*, provides four primary criteria with which to determine whether a lease should be considered a capital lease, one of which is transfer of title. During fiscal year 1992, ownership of certain equipment under this lease transferred to NIH. We believe the criteria for capital lease classification has been met.

Notwithstanding our opinion that the computer equipment lease discussed above should be recorded as a capital lease, adequate documentation was not maintained to permit full and fair disclosure of either the Service and Supply Fund's or the Management Fund's leases in the notes to the financial statements. For operating leases, generally accepted accounting principles (GAAP) require disclosure of rental expense for each period for which an income statement is presented, with separate amounts disclosed for minimum rentals. For both capital and operating leases, GAAP requires disclosure of future minimum lease payments in aggregate, and for each of the five years subsequent to the reporting date. In addition, a general description of the operating and capital leasing arrangements should be disclosed. Discussions with management indicated that the information was not assembled for presentation in the financial statements because management believed that specific GAAP disclosure requirements of FAS 13 pertained only to capital leases.

Recommendations:

We recommend that the leased computer equipment discussed above be recorded in the financial statements as capital equipment. Additionally, we recommend that management evaluate the proper accounting treatment for proposed leases as part of the procurement process. This up-front analysis would allow management the opportunity to determine

whether leases are capital or operating, as well as gather the information necessary for disclosure in the notes to the financial statements.

For all existing leases of the Funds, including capital leases and operating leases, we recommend that the provisions of the lease agreements be analyzed and information necessary for full and fair disclosure as required by FAS 13 be assembled for inclusion in the financial statements.

NIH Comment:

The NIH officials concurred and stated that they will implement the necessary procedures to properly account for capital leases, now that ownership has been established. The NIH officials further stated that they will take measures to advise the staff involved in the procurement process to analyze leases to determine whether they are operating or capital and properly assign the object classification codes. In addition, the NIH staff will apply the proper accounting treatment and disclose the necessary information for capital and operating leases as required by FAS 13.

Costs associated with development of automated systems should be capitalized and amortized based upon a systematic and rational allocation method, and the related asset should be reported as property and equipment.

During fiscal year 1992, projects to upgrade NIH telecommunications and develop a system for tracking and controlling travel expenses were ongoing. These projects were implemented in phases or "modules." The Service and Supply Fund capitalized the cost of these modules from inception and began to amortize the completed modules during fiscal year 1991. However, the unadjusted financial statements reflected the unamortized value of the systems of $3.5 million as "deferred charges" rather than "property and equipment." Additionally, the monthly amortization fluctuated between $33,000 for the last three months of fiscal year 1991, to $6,000 for the first seven months of fiscal year 1992, to $106,000 for the remainder of fiscal year 1992, and then to $2,000 for the first six months of fiscal year 1993.

Documentation supporting amounts amortized could not be provided by Fund personnel; however, inquiry with management indicated that inappropriate tracking of the costs related to development of the systems have prevented proper assignment of capitalized costs to individual modules.

Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, requires that such costs be allocated in a systematic and rational manner to periods during which the related assets are expected to provide benefits.

Recommendations:

We recommend that the Service and Supply Fund develop a consistent and comprehensive policy for amortizing costs associated with system development, such that the expenses are recognized over the period during which the expected benefit will be received (e.g., the useful life of the automated system). For financial statement presentation and disclosure purposes, the automated systems should be classified under the property and equipment financial statement caption, and the related amortization policy be disclosed.

NIH Comment:

The NIH officials concurred and stated that they are analyzing options for amortizing existing capitalized balances. They will develop a policy to assure that future costs are amortized in a consistent and comprehensive manner. The NIH officials reclassified the development of the automated systems from "deferred charges" to the "property and equipment" caption in the September 30, 1992 financial statements, and agreed to disclose the NIH amortization policy in the notes to future financial statements.

CASH/TREASURY

Complete and timely clearing and cash account reconciliations should be performed.

The Division of Financial Management (DFM) does not fully reconcile its cash disbursement/receipt activity with Treasury's records for either the Management Fund's or the Service and Supply Fund's cash activity. During our testing of the Management Fund's and Service and Supply Fund's September 30, 1992 fund balances with Treasury totaling approximately $123.7 million and $6 million, respectively, we noted a number of weaknesses in each Fund's accounting practices as outlined below:

- The NIH Statement of Differences (TFS-6652) for Agency Location Code 75080031 was not fully reconciled at September 30, 1992; an unreconciled difference of $334,000 existed. The TFS-6652 includes differences between Treasury's records of a reporting unit's cash balance, and the records of the reporting unit. Because DFM performs accounting services for a number of activities in addition to the Management Fund and the Service and Supply Fund, all of which are aggregated into the TFS-6652 for Agency Location Code 75080031, the extent to which these unreconciled differences impact the Funds' financial records cannot be readily determined.

- When differences between Treasury's records and DFM's records of disbursements and receipts are reported in the TFS-6652 as described above, after a period of 6 months the unreconciled amounts are posted by Treasury to a budget clearing account. The NIH budget clearing account contained unreconciled amounts totaling

approximately $9 million as of September 30, 1992. We also noted that NIH's suspense accounts contained unreconciled differences at September 30, 1992. Although these differences were relatively immaterial, they had not been analyzed and properly accounted for 8 months after the end of the fiscal year. Similar to the matter discussed in the aforementioned paragraph, the activities of reporting units other than the Management Fund and the Service and Supply Fund are aggregated into these budget clearing accounts; therefore, the extent to which these unreconciled balances impact either of the Funds' financial records cannot be readily determined.

- Differences between the Statement of Transactions (SF-224s) and the general ledger at September 30, 1992 were not corrected in a timely manner. We noted that a substantial portion of these differences were not resolved until March 1993, with less significant differences remaining unresolved after that date.

- Monthly reconciliations of the Undisbursed Appropriations Account (TFS-6653) are not performed on a regular or timely basis. More specifically, the September 30, 1992 reconciliations were not completed until after January 1993. In addition, several outstanding items noted on the September 30, 1992 reconciliations were more than 6 months old and were still outstanding as of May 1993. Although the Service and Supply Fund's TFS-6653 reconciliation identified all reconciling items, the Management Fund's TFS-6653 reconciliation only concentrated on the fiscal year 1992 appropriation year. The remaining appropriation years 1991, 1990, 1989, and "M" years have not been reconciled by the Management Fund and had an outstanding reconciling difference of approximately $900,000 at September 30, 1992. Furthermore, the Service and Supply Fund had not completed any reconciliations pertaining to months subsequent to September 30, 1992.

- The Funds' current policies and procedures do not include a procedure requiring formal management review of the monthly TFS-6653. In addition, there is no procedure requiring the preparer to initial the reconciliation to take responsibility for it and there is no evidence of review or approval of the reconciliation.

- Inappropriate segregation of duties exists surrounding the accounting for cash transactions. The same individuals who are responsible for performing cash reconciliations also prepare adjusting journal vouchers related to the cash accounts, and have the ability to make entries to the general ledger. Segregation of duties is a basic tenant of internal accounting control, and is contained in *Standards for Internal Controls in the Federal Government*, issued by the GAO. Failure to adhere to controls of this type increases the risk of loss to the Federal government.

A key step to ensuring strong internal controls, is the regular and complete performance of systems reconciliations. This includes regular reconciliations of the general ledger cash balances to the balances reported by Treasury. These reconciliations should be performed by

individuals whose jobs functions are segregated from other cash functions. Further, the reconciliations should be reviewed by management and they should ensure that appropriate steps are taken to clear any and all reconciling items in a timely manner.

This condition was reported by the predecessor auditors in their Report on Internal Controls dated July 2, 1992.

Recommendations:

The DFM has already initiated a project to investigate differences existing in its budget clearing account and the suspense account balances through fiscal year-end. Appropriate corrections should be made to each Funds' (or Treasury's) books for transactions found to be posted in error.

Presently, the DFM should perform complete reconciliations each month to ensure that each Funds' records are kept in balance with Treasury's records. These reconciliations should be prepared by individuals who do not have other accounting responsibilities (i.e., prepare adjusting journal vouchers). We recommend that this reconciling documentation be reviewed and approved by a DFM supervisor to ensure that the reconciliations are in fact performed, performed correctly, and differences are promptly investigated and correctly resolved. Further, the reconciliation should evidence the preparer (i.e., sign-off) and should include evidence of proper review or approval of the reconciliation. In the long run, we believe that regular and timely reconciliations will reduce the level of effort required for the reconciliation of funds available at Treasury.

NIH Comment:

The NIH officials concurred and stated that reconciliations of cash disbursement/receipt activity with Treasury will be performed each month to ensure that each Funds' records are kept in balance with Treasury's records. The NIH officials further stated that procedures will be developed to improve the current cash reconciliation process, incorporating the auditor's recommendations.

EXPENSES, PURCHASES, AND ACCOUNTS PAYABLE

Procedures related to processing and recording disbursement and accounts payable transactions should be improved.

Several control weaknesses relating to the processing and recording of disbursement and accounts payable transactions exist. Further, we consider these items to be pervasive in both the Management Fund and Service and Supply Fund. We believe these areas should be

promptly addressed by the management of the Funds and the Division of Financial Management. These weaknesses are summarized below.

- ***Management of the Funds should ensure that all disbursement transactions are properly supported and that appropriate supporting documentation is available for examination.***

  To gain assurance that amounts disbursed for goods and services were requested by requisitioning offices, received, and supported by invoices, we statistically selected approximately 100 disbursement transactions for testing from a combination of both the Management Fund and the Service and Supply Fund. For approximately 50 percent of these disbursements, management could not provide invoices supporting amounts paid.

  We selected an additional 40 disbursement/payable transactions of amounts exceeding $25,000 each to (1) test controls over the entry of original source documentation (including receiving reports, purchase requisitions, and purchase orders) by determining that the data within the automated system agreed to original "hard copy" documentation; and (2) to determine whether competitive bidding procedures had been performed. However, we were not provided with the documentation requested.

  The GAO's Title 2 states "...all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination."

- ***Invoices should be aged as of the date received, rather than the date processed.***

  Accounting clerks use incorrect dates when entering invoice data into the procurement system. Invoices are date-stamped upon receipt by the Accounts Payable Section, and can be entered into the procurement system on a subsequent day. Tracking invoices as of the date received is key to ensuring the amounts due vendors are paid promptly, and that the organization is in compliance with the Prompt Payment Act. We noted, however, that rather than entering the effective date of the invoice as of the date the invoice was received, the effective date is often recorded as of the date the invoice is entered into the system.

- ***Proper cut-off should be attained and accounts payable should be properly accrued at year-end.***

  As was noted by the predecessor auditors in their Report on Internal Controls dated July 2, 1992, the Management Fund and the Service and Supply Fund do not have

sufficient year-end cut-off procedures for recording disbursement transactions. For example, we judgementally selected for testing all Management Fund disbursements made during the first quarter of fiscal year 1993, which were individually in excess of $100,000, to determine that they were recorded in the proper period. These parameters resulted in a sample selection of 27 disbursement transactions, totaling approximately $7.2 million. Of the transactions tested, 8 disbursements totaling approximately $4.5 million related to goods or services which were received during fiscal year 1992; however, a payable was not accrued at year-end.

- ***Proper segregation of duties should be enforced.***

  We noted that an inappropriate segregation of duties exists surrounding the procurement and receiving transactions. The same individual who approves purchase requisitions also receives the goods. Additionally, because the individual has the purchase requisition and purchase order information, the receipt is not based on a "blind count."

  An employee with the ability to both procure goods and services and process the receipt of these transactions could, theoretically, procure goods or services for personal use and establish a fraudulent receiving report indicating that the goods were properly received and processed, when in fact, they were not. Failure to implement proper segregation of incompatible duties increases the risk of loss to the Federal government.

Recommendations:

Sound internal controls dictate that accounting records reflect a complete and accurate accounting of the year's activities. Supporting documents relating to accounts payable (i.e., invoices) should be maintained to ensure the accuracy and completeness of financial records, as well as the existence of a proper audit trail.

In addition, to ensure proper aging of invoices and amounts due vendors, as well as compliance with the Prompt Payment Act, we recommend that accounting clerks be instructed to enter the date the invoice is physically received (the date stamp), rather than the date the invoice is logged into the automated procurement system.

We recommend that NIH establish proper cut-off procedures, including a more thorough review of open invoices at year-end to determine if accrual is warranted.

We also recommend that the Funds review their internal control procedures surrounding the procurement and receipt of goods and services to ensure that all incompatible functions are

identified and segregated. Specifically, individuals with receiving functions should not also approve purchase requisitions.

NIH Comment:

The NIH officials concurred and stated that supporting documents relating to accounts payables should be maintained to ensure the accuracy and completeness of financial records. The NIH officials further stated that systems change requests have been initiated to ensure proper aging of invoices in the accounts payable office. Invoices are aged on the unpaid invoice listing produced by the automated system. A microfilm/fiche contract was established to ensure that supporting documentation is available for all accounts payable transactions. Additionally, procedures to review open invoices were established at year-end. Specifically, a special transaction code was developed to accrue invoices on hand at the end of the fiscal year, and an accrual was entered for each invoice. The NIH officials further stated they will review and further enhance these procedures as necessary.

Additionally, the NIH officials asserted that they will provide training to the accounts payable staff.

ELECTRONIC DATA PROCESSING (EDP) SECURITY

Software for accounting systems (Central Accounting System, Administrative Data Base, Time and Attendance, and Central Payroll) is not protected by RACF against unauthorized changes or manipulation. The Central Accounting System and Central Payroll data files also are not protected by RACF. The operating system is also not protected by RACF.

We conducted inquiries and tests to determine if software controls provided reasonable assurance that only the tested and approved versions of software were used to process accounting information. Based on our review of Resource Access Control Facility (RACF) security listings and information provided by NIH personnel, we found there is no RACF security protecting application software for the CAS, the Administrative Data Base (ADB) system, or the Payroll system. Improper modifications to the CAS, ADB, or Payroll software could be made to change inventory and property records, process fraudulent payments, modify payroll records, delete control edits, change management reports, or access privileged and confidential information. Although a degree of software protection for the CAS software exists, this protection does not achieve as high a level of security as provided by RACF.

We also found that the CAS and Payroll data files are not protected by RACF. As a result, the CAS and Payroll data files may be subject to accidental or intentional manipulation. Certain payments are made directly from CAS and CAS also maintains the accounts receivable.

Finally, we reviewed RACF listings of the protection for operating system software and noted that the software is not protected by RACF. Further inquiries revealed that although RACF is installed on the NIH computer system, the operating system files are not RACF protected. An NIH-developed security package is currently used. However, the management capabilities of the current security software are limited as compared to RACF. RACF is one of several industry and Federal government standard security packages for the type of mainframe computers used by NIH. RACF has the capability to provide a high level of security over computer files and includes a number of features to facilitate the management of security profiles, user IDs, password controls, audit trails, and other matters. Furthermore, while the capabilities (and vulnerabilities) of RACF are well known and documented, the capabilities and vulnerabilities of the current security software are not documented.

NIH Policy 2801, Access Control Facilities on Mainframe Computers, establishes the policy for the mandatory use of access control facilities (e.g., RACF) for high critical/high sensitive application systems residing on NIH mainframe computers. This is consistent with other Federal computer security policy. For example, the GAO's Title 2 states that the integrity and confidentiality of the systems's data and software must be protected from accidental or malicious modification, destruction, or unauthorized disclosure. Title 2 goes on to state that procedures for controlling [software] changes should require rigorous analysis of requested changes. Program or other changes to the system in operation should be subject to the general and application-specific internal control strategies applied during the development process. After the analysis is completed and documented, user and/or ADP management should approve it before modifications are made.

Recommendations:

We recommend that NIH management ensure that software for the CAS, ADB, Payroll, and all other financial systems is put under RACF protection. Source code, object code, JCL, copy members, and all other control files should be RACF protected. All data files should be RACF protected. Access to the data files should be restricted to operations personnel specifically authorized to access the files.

In addition to enhancing security, we recommend that NIH adopt standardized procedures for control of software changes for all NIH financial applications software. We noted there were different sets of procedural controls over software maintenance for each of the systems we reviewed. Although change control procedures are in place for the various financial software, there is no detailed NIH standard to ensure consistent application of the adequate control measures.

There are a number of industry standards to control software changes. The following procedures are described to illustrate the role of RACF protected software in the overall software change control process. Access to the software (source, object, and JCL) should be

restricted by RACF to appropriate control personnel. Control personnel should not be application programmers. Software change control procedures should require that control personnel make updates to application software only after approval is provided by a programming supervisor and a user representative. Approval of a turnover request should only be provided after the approver has verified that the new module has been adequately tested and that the test results have been approved by the user representative. The control personnel should control both source code and object code. Commercially available librarian software can provide a number of other desirable software control features such as version control, check-out/check-in procedures, code comparison, and audit trails of changes. We believe a detailed analysis of the Funds' software change control procedures should be performed and that controls implemented as soon as possible.

We recommend that the Division of Computer Research and Technology (DCRT) protect all operating system files with RACF. Access should be limited to specific personnel and their job-related needs. We understand that an action plan has been developed to fully implement RACF at the system resource level. We recommend that management continue its efforts in this regard.

NIH Comment:

The NIH officials concurred and stated that they will protect CAS, Payroll (Time and Attendance), and the ADB ***code***, JCL and data with RACF. DCRT protected ADB ***data*** with RACF as a result of the prior year audit. Only authorized personnel will have access to the data files.

The NIH officials further stated that change management procedures will be standardized and documented for these applications. DCRT will select, evaluate, and implement a Software Version Control Package.

Additionally, the project, which is currently underway to protect operating system datasets with RACF, will be completed. Update access will be given only to those with job-related requirements. The capabilities and vulnerabilities of current security software are documented in the Computer Center's Users Guide provided to the auditors.

There are limited batch processing controls in the Central Accounting System to ensure the complete processing of all inputs.

We reviewed CAS processing procedures to determine if controls were adequate to ensure that all files and transactions were input to CAS. Data is input to CAS by means of batch jobs initiated through WYLBUR[3] that take files from subsidiary systems such as the

[3]WYLBUR is an interactive method for programmers to submit batch jobs and edit programs.

Inventory Management System and the DFM Accounts Payable System and update the files to CAS. Manual transactions are also saved in files that are processed to update CAS similar to files from subsidiary systems. On occasion, some manual batches are held pending processing of other transactions. There are no controls to ensure that these batches are subsequently updated to CAS.

The GAO's Title 2 specifies that accounting systems shall contain adequate controls to provide reasonable assurance that all transactions are promptly recorded and properly classified.

Recommendations:

We recommend that NIH develop a report listing all batches that are held and not processed to CAS. This report should be reviewed to ensure that all transactions are input to CAS in a timely manner. Follow up action should be taken for all batches that are not processed within a determined period of time.

NIH Comment:

The NIH officials stated that the DCRT will provide a regular report to notify the Division of Financial Management/Finance staff, which will enable them to identify unprocessed batches.

The PMIS and Delegated Procurement System (DELPRO) do not provide adequate security codes to enforce proper segregation of duties.

We noted that there is only one security code in PMIS. This does not provide a sufficient number of discrete functions for PMIS to enforce adequate segregation of incompatible duties. For example, a single person is able to initiate and approve a transaction to move property from one property control code to the excess property control code, and to transfer the property to another agency.

We also noted that only one security code is used for placing and approving orders within DELPRO. Accordingly, an official is able to initiate and to approve his own order for materials. Procedural controls specify that all orders should be reviewed and approved by a person other than the initiator of the order. In addition, we noted that supervisor IDs and passwords are shared because some of the reporting functions of ADB currently need to be made available to backup supervisors. This also presents a segregation of duties problem in many areas because of the sharing of input and approval functions that should be limited to supervisory personnel.

Recommendations:

The PMIS and DELPRO should provide discrete security codes so that the systems can enforce the procedural control. We recommend that the procurement functions be reviewed to identify the specific functions that are to be performed by separate individuals. These should not only include review and approval functions, but also all activities that procedural controls would segregate. We recommend that individual PMIS and DELPRO security codes be developed so that the system can enforce the procedural separation of duties controls. Specifically, separate security codes should be provided for input and approval functions to maintain an adequate separation of duties over sensitive transactions. We understand that NIH is working on segregating the DELPRO ordering and approval function and we recommend that this process be completed giving due consideration to the weaknesses noted herein.

NIH Comment:

The NIH officials stated that the NIH is in the process of developing a procedure which will assure separation of duties among all functions within the ADB. They further stated that this approach will prevent reviewing officials from approving actions which they initiate, and will prevent functions such as ordering and receiving from being performed by the same individual. In addition, controls will be established in the PMIS to enforce procedural controls.

Management review of system users is inadequate to ensure that all system users are currently authorized for the ADB system. User IDs exist for terminated employees.

We found that user IDs remain active for separated or transferred employees in the ADB system resulting in an access control weakness. This is an access control weakness that could lead to system fraud or misuse. The primary cause is that there is no effective procedure for notifying the ADB security officer when an employee separates or transfers. A secondary cause is that there is no periodic distribution of security reports of active users and their functional access rights to be reviewed by appropriate management personnel. It is difficult to produce an effective list since the ADB security module data file does not include the name of the user along with the ID. The ADB security administrator attempts to maintain a manual listing of IDs and user names. However, we noted that the manual list is not being updated concurrently with online access authority updates. In any case, a manually maintained list is not nearly as effective for control purposes as a listing produced directly by the ADB system.

The GAO's Title 2 states that access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained. The Joint Financial Management Improvement Program Core Financial System

Requirements states that the system must allow entry only to those individuals who are authorized and only during times authorized.

Recommendations:

We recommend that NIH develop procedures to ensure that the ADB security officer is notified of all terminated or transferred employees. Procedures could involve a standard step for the personnel office to notify the ADB security officer of all transfers and separations at the time of the action. This would ensure the prompt deletion of all user IDs at the time of the transfer or separation. Another procedure would be to provide the ADB security officer a periodic (weekly) listing of all transfers and separations.

Furthermore, we recommend that the ADB security data file be expanded to include the name and specific organizational group for each user ID. Periodic (quarterly) reports including user names and access authorities should be generated and distributed to management at a level where the reviewer is personally knowledgeable of each user's current status and that the security codes for each person are appropriate.

As a result of the current finding, we recognize that NIH has recently initiated a clearance procedure whereby an employee is required to check out through administrative channels (i.e. ADP Security, Library, etc) upon leaving or transferring from NIH. In addition, DCRT is working towards implementing an electronic on-line access authorization and removal plan to strengthen access controls within ADB. The security administrator plans to remove all access from ADB IDs not used in the past six months to decrease the number of IDs that potentially could be misused. We recommend that efforts in these areas continue.

NIH Comment:

The NIH officials stated that the current procedures for handling terminated and transferred employees are being modified for the ADB. The Administrative Officers will be required to provide, in writing, the names of all reviewing officials to the ADB Security Officer. The ADB Security Officer will establish reviewing official authorities on the ADB security database. Then the ADB Security Officer will make available to the reviewing officials software that will allow them to establish individual user names and IDs. Further, the personnel checkout procedure at NIH will require that employees clear through the reviewing official and software will be provided for the reviewing official to modify the ADB password for the terminating or transferring employees.

The NIH officials further stated that the ADB on-line security database will be expanded to include user names.

Additionally, a special procedure was developed in response to the prior year audit, which enables account sponsors for WYLBUR and TSO accounts to invalidate the account-user IDs for terminating and transferred employees.

ADB user IDs are shared by multiple users.

In areas where employee turnover is high, user IDs currently are shared because of management decisions not to issue unique user IDs for persons that are not expected to remain with NIH for an extended period of time. In these areas, it is likely that a number of former NIH employees know the user IDs and passwords still in use. Additionally, this reduces the effectiveness of audit trails that are necessary to maintain individual accountability for activity on the system.

As previously stated, GAO's Title 2 requires that access is to be limited to authorized users. Individual accountability is also required as evidenced by the Joint Financial Management Improvement Program guidance that the system must maintain records of the actions of every user and every terminal and include the time and date of use, the type of transactions, the user, and the terminal.

Recommendation:

We recommend that individual IDs be issued to financial system users to safeguard sensitive accounting information.

NIH Comment:

Management stated that the DCRT will coordinate with account sponsors and ICD program officials to ensure that there is a one to one mapping of user name to ID. DCRT will design the procedure, and responsibility for maintenance of the list will reside with the ICD program official.

There is no arrangement or contract for an emergency disaster recovery center to be used in the event of a catastrophic emergency at the NIH data center.

Although DCRT is in the process of developing contingency plans and has begun some disaster recovery testing at NIH, there is no contract or other agreement for an alternate computer facility to be used in case of catastrophic disaster at the NIH data center. Because of the lack of a disaster recovery center, no offsite disaster recovery testing has been performed to ensure that systems can be recovered within the necessary time frames.

The GAO's Title 2 requires the agency to ensure continuing availability of information processing by providing backup, recovery, and retention procedures encompassing hardware, personnel, supplies, software, data, and vital documentation. This will help ensure continuation of data communications and processing capabilities in emergency situations or during power interruptions and will help ensure the capability of reconstruction in case part or all of a master file or data base is destroyed or damaged during processing.

Recommendation:

Recognizing that DCRT is in the process of making arrangements for a disaster recovery facility, we recommend that this process be carried out to completion and that a contract or interagency agreement be obtained.

NIH Comment:

The NIH officials stated that there is an existing action plan created as a result of the prior year financial audit. They will continue with this plan until a full disaster recovery facility is in place.

There is no uninterruptible power supply (UPS) to perform an orderly shut down of the system in the event of a power outage at the NIH data center.

The DCRT had contracted for delivery of a battery powered UPS; however delivery was postponed until a suitable location for the UPS was determined. Alternative locations were explored; however a location has not yet been determined and a UPS has not been installed.

The inability to perform an orderly shut down of the processing environment during a power outage can cause damage to hardware, software, and data files. In addition to losing online entry and edit functions, unexpected loss of power can result in partial updates to files and can require extensive procedures to restore files to a point prior to the power outage and the reprocessing of all transactions after that point. The restore and reprocessing procedures must be performed for all applications operating on the NIH systems. A UPS provides power for a period of time to allow orderly shut down of the applications and the computer system. Warning can be provided to users and prearranged shut down procedures can be implemented that will allow for prompt system availability when power is restored.

Note the GAO requirement for controls to minimize the negative results of power interruptions as stated in the previous condition.

Recommendation:

We recommend that a suitable location be identified and that a UPS be obtained and installed.

NIH Comment:

The NIH officials stated that there is an existing action plan created as a result of the prior year audit. They will pursue this effort until a suitable location has been identified and a UPS has been purchased and installed.

OTHER

Personnel should be properly trained and desk procedures should be developed to aid in the performance of assigned duties.

We noted several instances in which personnel require additional training to perform their assigned duties effectively. For example:

- Accounting personnel within the Reporting and Controls Branch (RACB) use different methodologies when preparing the SF-133 for the Management Fund and the Service and Supply Fund. More specifically, individual line items of the preliminary versus final SF-133s are not prepared based on the same source (e.g. general ledger account). For example, Reimbursement and other income - Change in unfilled customers' orders (line 3B), on the **preliminary** SF-133 is calculated using the obligations less reimbursements earned balances reported on the post closing general ledger. However, the same line item on the **final** SF-133 is calculated using the anticipated reimbursements as documented on the Report and Certification of Unexpended Apportionment Balance.

- The balance of budgetary resources as reported on the Statement of Budget and Actual Expenses does not agree with the amount reported on the Management Fund's SF-133 as required by OMB Bulletin 93-02, *Form and Content of Agency Financial Statements*. The amount reported on the Management Fund's SF-133 was the sum of revenue (general ledger series 5000) and expended apportionments (general ledger account 4210), and totalled $432,577,678. However, the same data presented on the Statement of Budget and Actual Expenses is $57,149,678 greater than the amount reported on the SF-133. OMB 93-02 states "the amounts of total budgetary resources available to the reporting entity in the current period should agree to the total budgetary resources balance reported on line 7 on the entity's SF-133."

- Data generated from various systems differs for a given financial statement component, depending on the accounting report reviewed or requested. In addition, we noted cases in which different reports from a common automated system differed. For example, we were provided with two PMIS reports of fiscal year 1992 Service and Supply Fund equipment acquisitions. Although these reports should have reflected the same data, one PMIS report reflected zero acquisitions, a second PMIS report reflected $2.5 million in acquisitions, and the fiscal year 1992 Statement of Budget and Actual Expenses reflected $4.6 million.

  In addition, we obtained three different Central Accounting System reports in support of the unliquidated obligations as of September 30, 1992, and two for fiscal year 1992 revenue. Similar to the aforementioned situation, in these cases, the amounts reflected on each report differed, and none agreed to the general ledger accounts as of the same date. Central Services Accounting Branch personnel indicated that the differences may be due to report parameters being specified inaccurately, perhaps because personnel were unfamiliar with the required query methodology. However, we were not provided with an exact cause for the differences between the reports.

Recommendations:

Responsibilities of personnel positions within the functional areas impacting the Management Fund and the Service and Supply Fund are defined; however, minimal documentation (e.g., "desk" procedures) exists regarding how to perform the specific tasks required by each staff position. This can result in assigned duties remaining unaddressed during employee absences, as well as duties being performed inconsistently or inaccurately. We recommend that the functional areas impacting the Management Fund and the Service and Supply Fund address this weakness by reviewing current job descriptions as documented in relation to the actual tasks being performed and develop desk procedures manuals documenting the standard operating procedures for each position.

We believe implementation of this recommendation will result in a more effective performance of assigned duties.

NIH Comment:

The NIH officials stated that it is difficult to develop the required documentation as more and more staff reductions are impacting their ability to generate this documentation. Further, contract support staff may be necessary to effect this requirement. Funds availability will dictate when the NIH can develop this documentation in the near future.

NATIONAL INSTITUTES OF HEALTH

FISCAL YEAR 1992

ANNUAL CFO REPORT

AUDITED FINANCIAL STATEMENTS

SERVICE AND SUPPLY FUND
MANAGEMENT FUND

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TABLE OF ABBREVIATIONS

ADAMHA	Alcohol, Drug Abuse and Mental Health Admin.
ADB	Administrative Data Base
AIDS	Acquired Immune Deficiency Syndrome
BEIP	Biomedical Engineering and Instrumentation Program
CAP	Corrective Action Plan
CC	Clinical Center
CFO	Chief Financial Officer
CPU	Central Processing Unit
CRISP	Computer Retrieval of Information on Scientific Projects.
DCRT	Division of Computer Research and Technology
DELPRO	Delegated Procurement
DES	Division of Engineering Services
DL	Division of Logistics
DPM	Division of Personnel Management
DRG	Division of Research Grants
DRR	Division of Research Resources
DRS	Division of Research Services
FDA	Food and Drug Administration
FMFIA	Federal Managers' Financial Integrity Act
FTE	Full-time Equivalent
FY	Fiscal Year
ICDs	Institutes, Centers and Divisions
IMPAC	Information for Management Planning Analysis and Coordination
IRM	Information Resource Management
LAN	Local Area Network
MAPB	Medical Arts and Photography Branch
MASB	Materials Acquisition/Supply Branch
MF	Management Fund
MVS	Multiple Virtual Storage
NCI	National Cancer Institute
NCRR	National Center of Research Resources
NHLBI	National Heart, Lung, and Blood Institute
NIAID	National Institute of Allergy and Infectious Diseases
NIEHS	National Institute of Environmental Health Sciences
NIH	National Institutes of Health
NIMH	National Institute of Mental Health
NINDS	National Institute of Neurological Disorders and Stroke
OIRM	Office of Information Resource Management
ORS	Office of Research Services
PHS	Public Health Service

RACF	Restricted Access Control Facility
SERP	Scientific Equipment Resources Program
SSF	Service and Supply Fund
TSO	Time Sharing Option
UPS	Uninterruptable Power Source
VRP	Veterinary Resources Program

Message from the Chief Financial Officer

I am providing this report on the financial performance and condition of the National Institutes of Health's (NIH's) commercial funds in accordance with the Chief Financial Officers' (CFO) Act of 1990. I fully support the CFO Act, which was passed to improve the overall financial management in the Federal agencies. We are providing an Overview and the financial statements for six accounts in compliance with the CFO Act: the Service and Supply Fund (SSF), the Management Fund (MF), Trust Funds, Royalties, Cooperative Research and Development Agreements, and the National Institute of Environmental Health Sciences' activities reimbursed by the Environmental Protection Agency's Superfund. However, only two NIH accounts, the SSF and the MF, are subject to an audit for Fiscal Year (FY) 1992: These two accounts represent approximately 7% of the total NIH budget.

This is the second CFO audit for the NIH's SSF and MF. We viewed last year's audit as a learning experience; and, as a result, have gained valuable insight and knowledge to improve our financial operations and to strengthen our internal controls. In FY 1992, we initiated major efforts that have brought us closer to meeting the requirements of the CFO Act. The NIH will continue to strive to support the CFO Act to improve overall financial management.

Corrective action plans were developed to address specific concerns identified for inventory management, electronic data processing security, and financial management issues. Progress has been tracked through monthly meetings with appropriate leadership for each area. Some of the actions taken are as follows:

1. Inventory Management

- A supply management policy and oversight function was established within the Office of Management. This new staff function officially began operation September 6, 1992. They have actively been:

  - Serving as the focal point for NIH for issuance of supply policy to ensure program uniformity; and
  - Formulating supply performance standards for NIH supply activities.

  They will soon begin to conduct annual reviews of all NIH supply activities.

- The end of FY 1992 inventories for all NIH supply activities were taken as close to fiscal year end as possible. This practice will be continued in future years.

- The results of physical inventories were reconciled with the perpetual inventory records and the General Ledger accounts and are being reconciled on a monthly basis.

- The use of inventory sub-object class codes have been restricted to those offices responsible for inventory.

- A comprehensive analysis has been undertaken to explore and recommend options to improve the security of the Matenals Management Section.

- A review has been conducted to adjust the General Ledger to reflect actual prices paid rather than purchase order prices.

- A contractor was engaged to evaluate all NIH Management/Service and Supply activities following the CFO Audit. As a result, a material weakness was disclosed for the NIH Supply Branch and Self Service Stores.

2. EDP Security

- The NIH Information Resources Management (IRM) Advisory Council has approved a manual issuance developed by the Office of Information Resources Management (OIRM) that established a policy requiring mandatory use of access controls by NIH's 54 high critical-high sensitive (HCHS) systems. The manual issuance will be distributed directly to HCHS Systems Managers in March and through the NIH manual issuance distribution system.

- An approach has been developed that will automatically register all users to Restricted Access Control Facility (RACF) making the RACF password the keyword for on line access. The Division of Computer Research and Technology (DCRT) expects to complete the implementation, user notification, training, and registration for all users by January 1994.

- The effectiveness of passwords has been strengthened.

  - The DCRT has modified the Administrative Data Base (ADB) to implement an automatic feature for changing passwords every six months and locking out users who have not changed their passwords. The DCRT will implement this automatic feature for changing passwords in Multiple Virtual Storage (MVS) by January 1994.

  - The DCRT has implemented procedures for variable length passwords in the ADB and the user community has been informed of the new procedures.

  - The OIRM and Division of Personnel Management (DPM) will reemphasize to system managers and sponsors their responsibilities in this area of password management. The OIRM is working with DCRT and DPM on developing automated tools that will assist administrative officers and system managers to modify or cancel passwords when personnel change positions or leave NIH. The OIRM will also utilize these automated tools to provide internal controls to ensure compliance. These activities will be completed by the second quarter of FY 1994.

- The DCRT has modified the ADB to logoff automatically after three failed attempts by a user. The user community has been informed of the new procedures.

- The DCRT is currently reviewing a draft Business Recovery Plan (BRP) that provides for an alternative off-site processing facility in case of an emergency. Tests of a backup and recovery version of DCRT's operating system have been completed at DCRT, and off-site testing of the disaster recovery version of the system is expected to begin in August 1993.

- The DCRT is currently attempting to identify an alternative Uninterruptable Power Source (UPS) site. The results of an engineering site survey indicated that the existing site for the UPS could not accommodate the UPS weight requirements. Alternatives are being explored.

- The DCRT has awarded a contract for storing back-up ADB and other DCRT system tapes at an off-site facility.

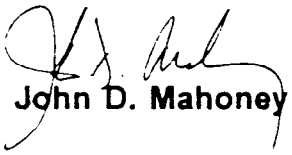
3. Accounts Payable

- In 1992, the year-end activities included a special review of accounts payable to ensure that accruals were properly recorded.
- New procedures have been issued to research invoices that cannot be readily matched to obligations, which has reduced duplicate obligations.
- Action has begun to periodically age and review accounts payable in order to identify and cancel invalid payables.

We continue to make progress in resolving our material weakness and improving internal controls regarding property. The NIH will use its property system as the basis for asset accounting and has adjusted its property records to reflect accurate property values as of September 30, 1992. Adjustments for trade-ins will also be reflected on the FY 1992 financial statement, and a system is being developed to make these adjustments automatically in the future.

Finally, actions have been taken to improve the overall internal control process at NIH. Following last year's CFO report, the NIH internal control function was transferred to the Office of Management Assessment and Internal Control. The firm of Dempsey and Associates was awarded a contract to provide advice on improving the internal control process and to develop an approach for segmentation in order to develop a new NIH Management Control Plan (MCP). This report was delivered on January 28, 1993. An implementation plan is now being developed with the objective of constructing a new MCP this year.

This report contains three sections: An Overview, a Federal Managers' Financial Integrity Act (FMFIA) Summary and the Principal Financial Statements and Notes. The Overview includes a Management's Discussion and Analysis that identifies the mission and objectives of each account, reviews program and financial performance, and highlights key program and financial activity.



John D. Mahoney

A GLANCE AT THE NATIONAL INSTITUTES OF HEALTH

The National Institutes of Health began as a one-room Laboratory of Hygiene in 1887, and today is one of the world's foremost biomedical research centers. An agency of the Department of Health and Human Services, the NIH is the Federal focal point for health research. Its mission is to uncover new knowledge that will lead to better health for everyone. The NIH conducts research in its own laboratories, supports the research of non-Federal scientists in universities, medical schools, hospitals, and research institutions throughout this country and abroad, helps in the training of research investigators and fosters and supports biomedical communication.

The NIH is located in Bethesda, Maryland, a suburb of the District of Columbia. On its campus-like grounds, the NIH maintains hundreds of laboratories containing complex and highly sophisticated research equipment. It also contains a 540-bed research hospital known as the Warren Grant Magnuson Clinical Center, and the National Library of Medicine, the world's largest repository of medical literature and a national center for biomedical communication. The NIH's FY 1992 obligations totalled $8.87 billion which represents an increase of 8% from FY 1991.

On July 10, 1992, the Alcohol, Drug Abuse and Mental Health Administration Reorganization Act (42 U.S.C. 201) transferred the three national research institutes of ADAMHA to the NIH. The three new institutes will conduct biomedical and behavioral research, health services research, research training and health information dissemination with respect to the prevention and treatment of disease. The research programs of these institutes encompass the same biomedical research objectives as the Institutes, Centers and Divisions (ICDs) that comprise the NIH. As part of the Reorganization Act, the NIH was mandated to incorporate the budgets of these three institutes into the NIH activity structure and include them in the NIH appropriations process effective in the FY 1993 appropriation which began October 1, 1992.

Since approval of the current master plans in 1972, significant growth on and off the NIH sites, the aging of the physical facilities and infrastructure, and the expansion of various biomedical research programs at NIH have rendered the existing plans nearly obsolete. Updated facility master plans are being developed to define the support requirements of the NIH for the next 20 years. The Buildings and Facilities appropriation will provide this funding. In FY 1992, the Silvio O. Conte Building was dedicated and construction of the William H. Natcher Building began. A replacement facility for the existing research hospital was proposed in FY 1992. The overall schedule for the hospital replacement facility is 12 years.

MANAGEMENT'S DISCUSSION and ANALYSIS

Service and Supply Fund

The NIH SSF was established on July 3, 1945, under 42 U.S.C. 231. This fund finances a variety of centralized research, support and administrative activities required for the efficient and effective operation of numerous NIH programs and facilities.

The SSF provides a mechanism for consolidating the financing and accounting of business-type operations involving the sale of services and commodities to customers. The majority of these services and commodities can be identified to specific customers. A specific rate is established for each type of service and are charged to the recipient appropriations on a fee-for-service basis. However, a smaller category of costs, called the General Expense, are general in nature. The General Expense costs are assessed on a formula in proportion to each Institute's total appropriation.

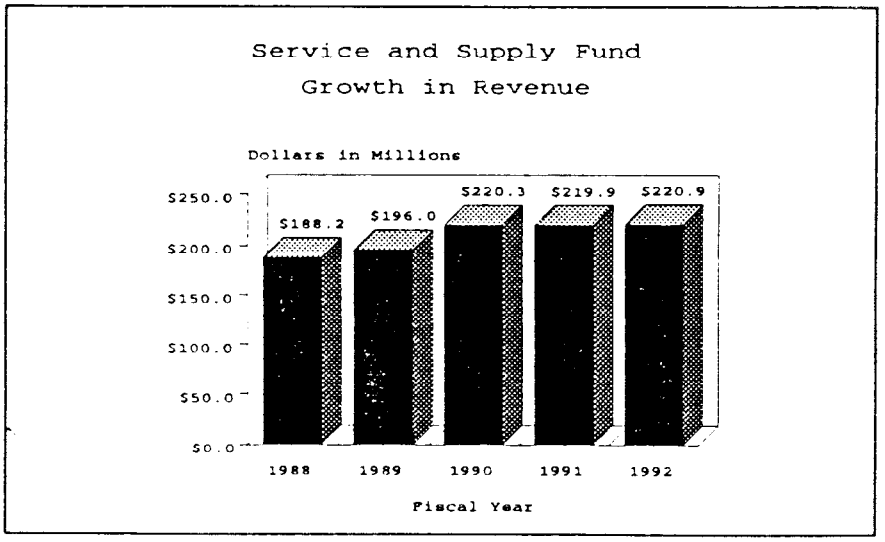
The services and commodities provided by the SSF activities include mainframe computing, engineering planning and design, printing, telecommunications, procurement, shipping and receiving, motor pool, research animals, fabrication and maintenance of scientific equipment, and other administrative support services. The following is a list of the SSF services and the contribution to the SSF revenue for FY 1992.

Service	Revenue (in millions)	Percent of Total
Logistics	$46.4	21.0
Computing	38.4	17.4
Research Resources	36.8	16.7
Engineering	21.8	9.9
Telecommunications	18.0	8.1
General Expense	16.8	7.6
Printing and Reproduction	12.4	5.6
Procurement	10.9	4.9
Other Services	19.4	8.8
TOTAL	* $220.9	100.0 %

*The total revenue includes intrafund sales.

The SSF generated revenue of $220.9 million in FY 1992. The graph shows a five-year trend of total revenue for the fund. With the exception of FY 1991, the SSF's revenue has steadily increased, as have the total NIH appropriations.

In FY 1992, 80% of the services were provided to the ICDs. Sales to non-NIH customers totalled 10%, while intrafund sales represented 10%.



Management Fund

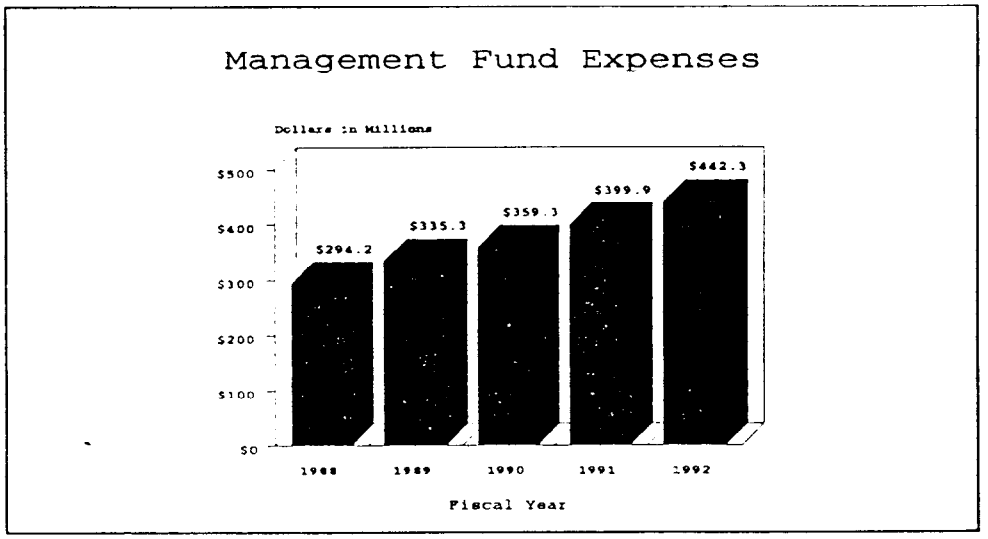
The MF was established on June 29, 1957, by Public Law 85-67. The MF was created to finance a variety of centralized research support services and administrative activities which are required for the efficient and effective operation of all NIH programs and facilities. Because these services and activities do not readily lend themselves to a system of charging recipient appropriations on a fee-for-service basis, they are assessed to the individual appropriations on a formula basis. The MF organizations providing these services do not receive an appropriation from Congress. Their costs are incorporated into the various NIH appropriations during the formulation phase of the budget process.

The services provided by the MF include utilities and plant maintenance, a 540-bed hospital and outpatient clinic, review and referral of research and training grant applications, collaborative computer science research, biomedical engineering, and general administrative support services. The MF reported total expenses of $442.3 million in FY 1992.

The following is a list of MF services and the FY 1992 expenses. Intrafund expenses represent 5.8% and are included in the total. The expenses also include the cost of equipment.

Service	Expenses (in millions)	Percent of Total
Clinical Center Services	$223.00	50.5
Intramural Research Support Service (includes Office of Acquisitions Mgmt. and Office of Research Svcs.	115.2	26.0
Grant Review & Approval	34.7	7.8
Intramural Scientific Svcs.	28.0	6.3
Computer Services	20.8	4.7
Standard Level User Charges (Rentals)	20.6	4.7
TOTAL	$442.3	100.0 %

The chart displays the MF growth over a five-year period. The MF resources have been growing at an average rate of 9.75% per year since FY 1988. In FY 1992, the MF fund expenses increased by 11%



Oversight of Service and Supply and Management Funds

A committee, Central Services Review Committee (CSRC), comprised of a broad cross-section of the NIH leadership and chaired by the Associate Director for Administration establishes the funding levels for the various programs/divisions funded by the SSF and the MF. Each program prepares a detailed annual budget request which reflects the resources needed to provide the required services. These requests are formally presented by the programs/divisions to the committee. They are then scrutinized by the DFM budget staff who recommend funding levels to the CSRC. The committee then votes on the recommendations which are then presented in the President's Budget. The funding levels are continually reviewed and monitored by the DFM staff and issues are raised to the committee in formal and informal meetings throughout the year. In addition, Congress sets a limitation so that the total amount presented in the President's Budget cannot be exceeded without a formal reprogramming action.

CLINICAL CENTER SERVICES

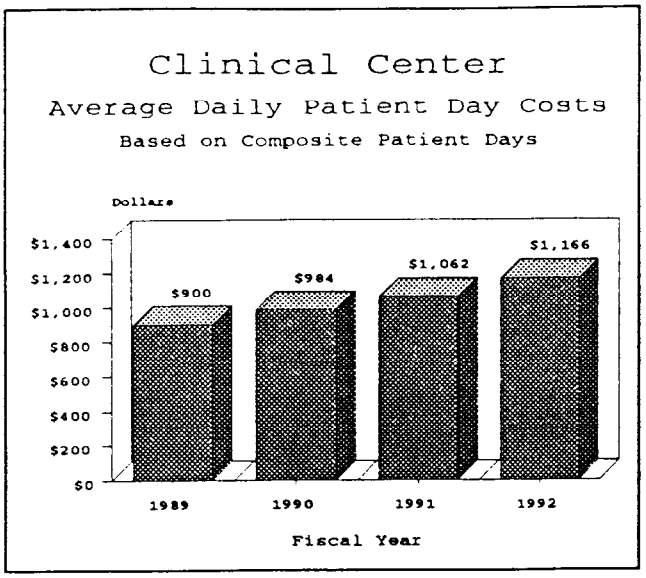
The Warren Grant Magnuson Clinical Center (CC), built in 1953, is the world's largest hospital devoted exclusively to clinical investigation and other biomedical research. It was specially designed to foster the exchange of information between scientists and clinicians. In FY 1992, scientists in more than 1,200 NIH laboratories worked side by side with clinicians caring for patients and conducted more than 2,700 research projects, making it one of the largest research sites in the world. This, along with the relative closeness in physical proximity of research laboratories to patient care units promotes the distinctive two-way exchange between advances in the laboratory and suggestions for new areas of investigation from the patient's health care team.

The CC is unique in that although its' patients receive quality medical treatment, the specific purpose is medical research. This is the heart of the NIH intramural program with almost 1,000 physicians and more than 800 registered nurses that provide professional care to patients. This situation poses a unique challenge to meet the sometimes conflicting needs of the NIH with those of the individual volunteer-patient. In addition, to most services found in treatment hospitals, the CC also supports such activities as spiritual ministry, social work, and patient activities.

The CC is funded by the MF and is organized into medical and administrative departments that are specially equipped to serve the needs of the Institutes' intramural biomedical research programs. The departments include Diagnostic Radiology, Nuclear Medicine, Clinical Pathology, Transfusion Medicine, Rehabilitation Medicine, Nursing, Pharmacy, Outpatient and Critical Care Medicine. Other departments provide administrative support to research service departments.

The graph below summarizes various measurement data for the Center over the last 5 years. It generally reflects a decline in inpatient activity and an increase in outpatient activity during the period, with the exception of a decline in outpatient visits in 1992. This was primarily a result of a change in the nature of certain protocols in the outpatient area for some Institutes, whereby the activity level of each individual patient increased on a per patient basis. Therefore, the raw level of outpatient visits is not representative of the level of research per outpatient visit.

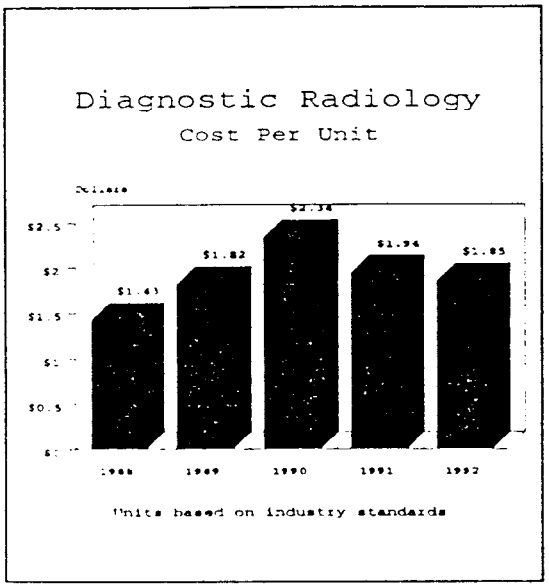
CLINICAL CENTER ACTIVITY					
	ACTUAL 1988	ACTUAL 1989	ACTUAL 1990	ACTUAL 1991	ACTUAL 1992
Bed Days Available	179,460	177,400	171,550	165,710	153,665
Inpatient Days	113,042	104,730	98,276	90,037	87,304
Average Length of Stay	12	11	11	10	9
Number of Inpatient Admissions	9,345	9,454	9,314	9,278	9,896
Total Inpatient Admissions since July 7, 1953	185,587	195,041	204,355	213,633	223,529
Clinic Visits-Outpatient	70,263	73,420	78,616	91,699	84,587

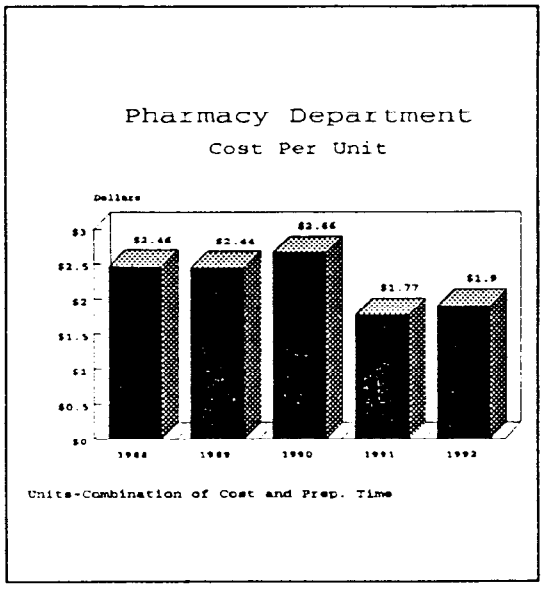


The costs used to determine the average daily costs in the graph to the left include all CC costs relating to patient activity only. The composite patient days was used as the denominator since there are both inpatient and outpatient days. An outpatient day equates to .45 of an inpatient day. The trend shows that average daily costs have increased by an average of 8.3% over the last three years. This growth rate is comparable to regional forecasts of health care costs as reflected in the industry-recognized source, DRI/McGraw-Hill Health Care Costs Analysis. For our geographical region of the nation, overall medical care services costs increased 8.7% over this period. Medical care commodities were projected at a growth rate of 7.4% and pharmaceuticals increased at a rate of 8.6%

The CC has a computerized Medical Information System for physicians and nursing personnel to record medical orders and patient information. This system collects workload units for various medical care and research services. Many of the workload units are based on industry standards, such as the Johns Hopkins Relative Value Unit for Diagnostic Radiology.

The following graphs demonstrate the continuous improved cost saving per workload unit for two major departments in the Clinical Center.





Major Accomplishments

The CC was accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) in FY 1992. The JCAHO is a national organization which accredits hospitals in areas such as levels of services and patient care. The CC has been reviewed annually over the past several years. At the close of the FY 1992 review, the CC was given a 3-year certification period rather than a 1-year period that had been approved in the past. This 3-year certification is given only to 5% of all hospitals surveyed. The fact that this multi-year certification was granted to the CC attests to both the reputation and quality of service delivered by the CC. The next review by the JCAHO is scheduled for the fall of 1994.

In addition to providing support services for 13 Institutes' clinical and research needs, the CC departments carry out their own original research projects. As an example, the Nursing Department, in addition to supporting biomedical research, has supported and expanded the unit-based nursing research program. The purpose of this research is to systematically evaluate nursing care interventions driven by practitioner's questions and quality assurance findings. Nursing research improves patient care by changing nursing practices, improving patient outcomes, and advancing efficiency of care. As of the end of FY 1992, over 30 research studies have been implemented in critical care, mental health, and oncology nursing.

Fiscal Year 1992 was the first year the Department of Transfusion Medicine collected and processed all blood and blood components used by CC patients. This is a particularly important accomplishment in a year that witnessed national blood shortfalls. Approximately 35,000 components were prepared in FY 1992, encompassing not only standard red blood cells, platelet and plasma components, but also such non-traditional components as peripheral blood lymphocytes for gene therapy and peripheral blood stem cells for enhancing bone marrow transplantation.

Clinical Center staff have contributed to maintaining the excellence in the Intramural Clinical Research Program. The CC employees have been involved in:

- expanding cells for Institute gene therapy initiatives,
- planning the new bone marrow/gene therapy patient care unit,
- supporting promising new AIDs therapy protocols,
- planning rooms in which safe care can be provided to patients with multiple drug-resistant tuberculosis,
- arranging to purchase a state-of-the-art PET (spell out) scanner and a 1.5T magnetic resonance imaging dedicated exclusively to clinical use, and
- working on a new pediatric unit for those Institutes who admit children, but do not have a dedicated pediatric program.

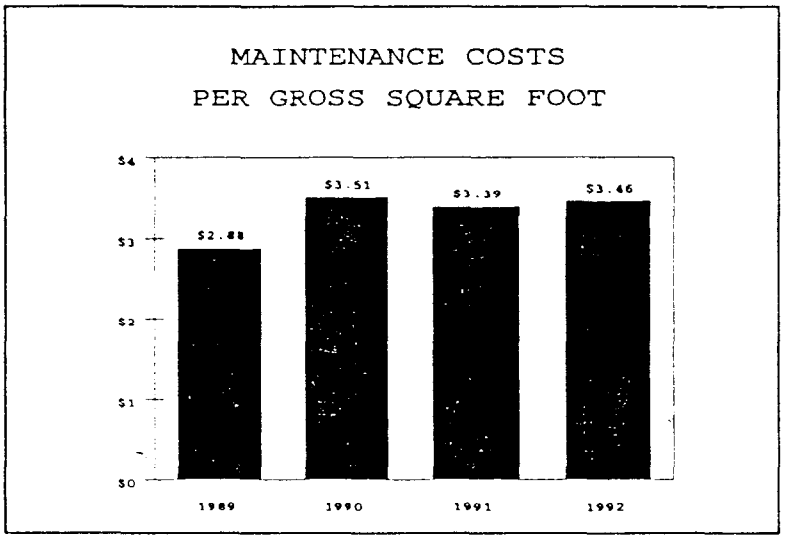
OFFICE OF RESEARCH SERVICES

The Office of Research Services (ORS) advises the Director, NIH, and staff on the management and provision of technical and administrative services to all components of NIH in support of the research mission. The ORS plans and directs service programs for engineering services, safety, security operations, space and facility management, and support activities for mail services and printing and reproduction services. The ORS is composed of an Office of the Director and Office of Administrative Management, and five divisions which include the Division of Safety, Division of Engineering Services, Division of Space and Facility Management, Division of Support Services, and Division of Security Operations. The ORS divisions are funded by the NIH Management Fund (MF) or dually funded with the NIH Service and Supply Fund (SSF). The ORS utilized 27.5% of the total MF resources in FY 1992 and 29% of the NIH SSF resources.

ENGINEERING SERVICES

The Division of Engineering Services (DES) provides architectural, engineering, technical and craft services for the operation, maintenance, alteration, repair, and management of the design and construction of NIH facilities to ensure the existence and integrity of the physical environment necessary to support the NIH mission. The DES is responsible for the facility operation and maintenance of the Clinical Center and all other clinical and laboratory buildings and support areas on the Bethesda campus. This includes a sophisticated infrastructure that consists of complex central plant equipment and utility distribution systems. Further, the DES is responsible for all aspects of the buildings's support systems and operations affecting NIH intramural research animal facilities. The maintenance of these facilities is critical to the research protocols and the overall NIH accreditation by the American Association of Accreditation of Laboratory Animal Care (AAALAC). In addition to the main campus, the NIH facilities management and technical engineering programs provide direction and support eight satellite components located throughout the United States.

The maintenance costs per gross square foot have increased slightly as depicted on the graph below. However, these increases are in line with inflation and improved inspections.



Major Accomplishments

Initiation of Clinical Center Complex Total Replacement Program
The NIH management has agreed on the recommended new construction total replacement option to resolve deteriorating infrastructure and overcrowded conditions in the existing Clinical Center (CC). The DES developed a draft Program Justification Document (PJD) required for approval of the CC Replacement Program. The PJD was distributed for comments and is now being finalized. The DES has also initiated a new program for the Essential Maintenance and Repair of the existing CC to ensure continued operation until the replacement facility is completed.

Facilities Construction
Closure on alternatives and construction phasing for the William H. Natcher Building was achieved in early 1992 and a design and construction Oversight Committee established. Approval for Phase I of the project was secured and a tight design and construction procurement schedule successfully executed to permit ground-breaking to take place in September, and construction began in October exactly on schedule.

Construction of the Silvio O. Conte Building was completed on schedule and move-in of scientific personnel as part of the Coordinated Occupancy Phase began in March. Dedication of the Building was held in September 1992. The Conte Building represented a unified approach to design and resulted in maximum flexibility. This was a major factor in enabling the NIH to meet the rapidly emerging national priority of Human Genetics research.

Initiation of Master Plans
The initial phases in the development of new Master Plans for both the Bethesda and Poolesville campuses have been completed. These include preparation of master plan concepts and the management plan for the project, presentations on the proposed concepts, and acquisition of architectural/engineering services, the award was made in September 1992.

SAFETY

The Division of Safety (DS) provides national leadership in research safety methodology to NIH and the extramural biomedical research community, and conducts, fosters, coordinates and supports technical assistance, service, compliance, training, and research programs to promote and maintain safety and environmental protection in biomedical research. The Division cooperates and collaborates with national and international organizations, Departmental agencies, and other institutions engaged in these activities. The DS collects and disseminates information on laboratory safety and environmental protection.

Major Accomplishments

Improvement of Radioactive, Chemical, and Mixed Waste Disposal
Management of all NIH waste streams is one of the major responsibilities of the DS, accounting for about one third of the Division's annual budget or about $5.5M each year. In FY 1992, the DS completed a year-long solicitation and award of a new multi-million dollar contract for disposal of radioactive, chemical and mixed wastes. The contract consolidates these activities under a single prime contractor in order to improve efficiency of handling the wastes in compliance with relevant laws and regulations. A new contract for solid and medical/pathological waste was also awarded and implemented early in FY 1992 with no disruption of service. Two new state-of-the-art compactors have been installed and placed in operation to reduce the volume of dry (low level) radioactive waste up to 40%. A savings of over $200,000 is projected from this initiative.

Safety Assessment of Rocky Mountain Laboratory

The DS conducted an audit for the Rocky Mountain Laboratory to determine compliance issues and possible environment regulatory problems. The recommended improvements were listed in priority order for management review. Recommendations were also made for interim corrective measures for Bitteroot Sanitary Landfill in Montana. In addition, the DES secured the assistance of the Public Health Service, Region VI, Office of Engineering Services to conduct a comprehensive facility adequacy survey to identify priority repair needs such as life safety, equipment reliability, and structural upgrades.

SPACE AND FACILITY MANAGEMENT

The Division of Space and Facility Management (DSFM) manages the NIH comprehensive space management programs that provide policy oversight of laboratory, clinical, office, and storage space. The DSFM administers space programs for over 200 Federally-owned buildings amounting to more than 9 million square feet of floor space on some 2,000 acres of land. In addition, the DSFM is responsible for more than 30 leased buildings representing nearly 1 million square feet of floor space. The DSFM oversees ad hoc facilities such as the NIH Credit Union, banks, child care facilities, and the Recreation and Welfare Association; manages residential housing for NIH staff; and also provides conference, sanitation, and telecommunication services to the NIH.

Major Accomplishments

Improved Telecommunications Services

An Information and Instructions (I&I) paper was developed and issued to the ICDs outlining the procedures for requesting and receiving telecommunication services. This is the first detailed I&I ever issued for telecommunications.

SUPPORT SERVICES

The Division of Support Services (DSS) plans, coordinates and manages the provision of specialized services to the NIH in the areas of mail services, and printing and reproduction. United States, international, and interoffice mail services are provided as well as some courier services. In addition to the printing, publishing, and related services, the DSS also manages copiers, maintains a data base of mailing lists with over 250,000 names, makes name badges, laminates, and provides bulk mailing services.

Major Accomplishments

Enhanced Printing Services

The DSS has increased commercial printing procurement by utilizing the Blanket Purchase Agreement (BPA) The BPA limit was increased to five thousand dollars ($5,000) which allowed an increase in procurement activity for the ICDs. By eliminating the procurement from the Government Printing Office (GPO) the BPA procurements save the customer six to nine percent per order. The BPAs also improve the quality of service to the customer which include: better quality of the printed materials; improved delivery schedules; and overall control of the entire project is much better when dealing directly with the commercial printer.

The duplicating volume continues to increase on an annual basis. In FY 1992 the production section produced 147.6 million copies while in FY 1991 125.9 million copies were made. This is an increase of 21.7 million copies. During this time of increased production the DSS continued to maintain the workload and reduce the cost per copy rate. The copy page rate was decreased from .015 cents per copy to .013 cents per copy while quality and deliveries were accomplished with a minimum of errors. The projected copies for fiscal 1993 is in the excess of 160 million.

SECURITY OPERATIONS

The Division of Security Operations (DSO) is responsible for the planning, directing, coordinating and evaluating of a comprehensive protection and security program that includes providing security and protection for the entire NIH campus. The Division also provides security programs for off-campus facilities and manages all contract guard services. The DSO provides security related education, training, technical assistance, physical security, hospital security, government drivers license issuance, parking and traffic control, law enforcement, criminal investigations, and traffic mitigation programs for the NIH.

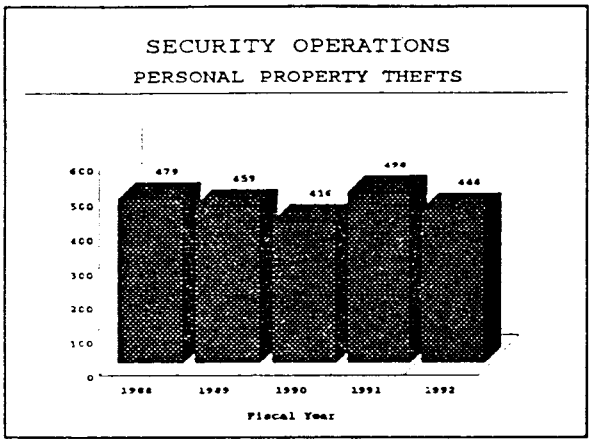
Major Accomplishments

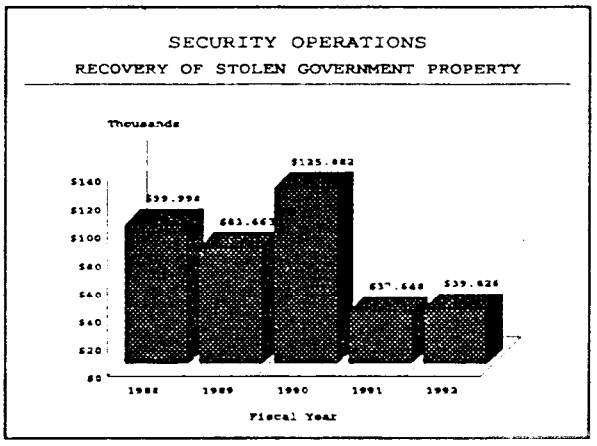
Enhanced Security For Animal Facilities

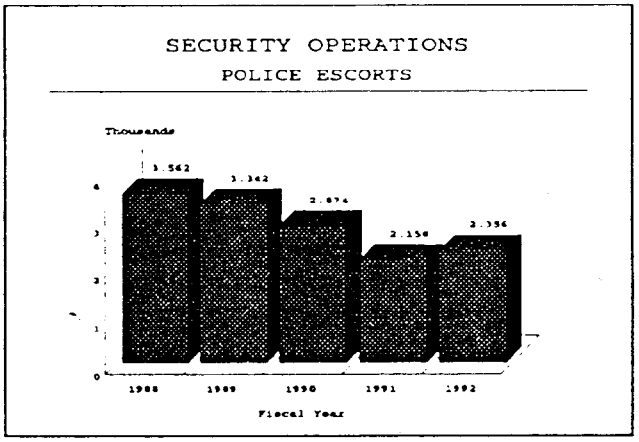
The DSO developed policy and established procedures for no less than yearly security surveys of all intramural animal facilities. In addition, NIH program managers are required to notify the DSO when animals are moved from one holding area to another. As a matter of policy, the DSO also surveys NIH animal holding areas located within the Washington metropolitan area.

Improved Crime Prevention and Control

In FY 1992, the DSO provided services resulting in a 10 percent decrease in personal property thefts, along with a 5 percent increase in the recovery of stolen government property, and a 9 percent increase in police escorts.



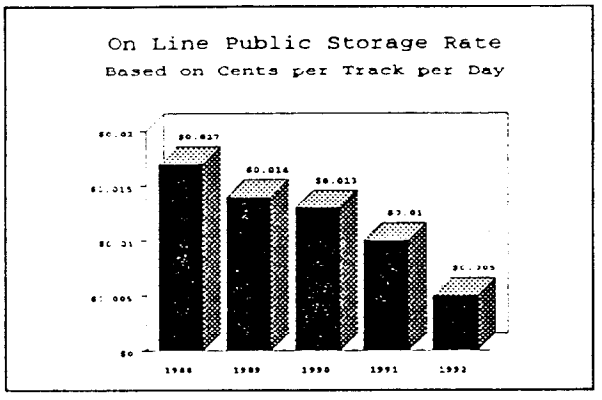


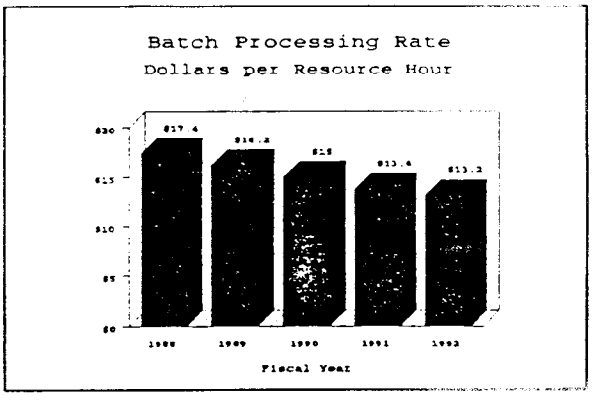


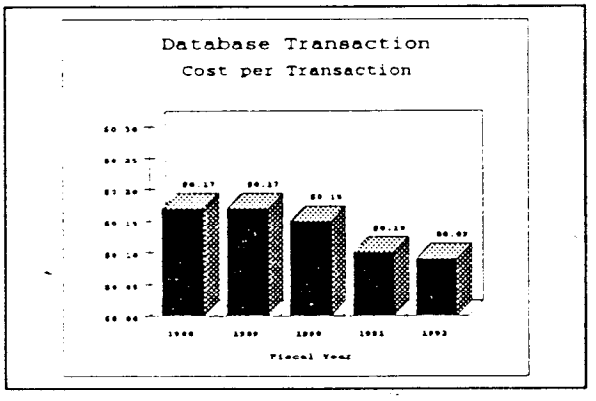
COMPUTING SERVICES

The Division of Computer Research and Technology (DCRT) was established in 1964 to incorporate the power of modern computers into the biomedical programs and administrative procedures of the NIH. Funded jointly from the NIH Management Fund and the NIH Service and Supply Fund, DCRT offers support, consultation, and collaboration in all aspects of biomedical computing to the intramural, extramural, and administrative communities at the NIH. DCRT supports a wide array of computing including personal computers, MacIntoshes, Digital Equipment Corp, VAX mincomputers, UNIX workstations, a Convex supercomputer, an Intel highly parallel supercomputer and a large IBM System 270 Installation. The IBM system serves as the primary resource for administrative and statistical computing at NIH and accommodates customers from some twenty Federal agencies outside the NIH parent organization, the Department of Health and Human Services. Largest customers include the Departments of Labor, Commerce, and Education, and the General Accounting Office. Over twenty thousand individuals are currently registered as users of the IBM systems and annual revenues are approximately $40 million.

In FY 1992, 33% of the DCRT funding came from the MF while 67% was from the SSF. The DCRT generated 17.4% of the total FY 1992 SSF revenue and provided the NIH with an outstanding data processing facility. The NIH Computer Utility operated 24 hours a day, 7 days a week. It processed an average of 11,200 interactive sessions, 116,550 database transactions and 20,750 batch jobs daily. Over 90% of all interactive commands were executed with subsecond response time, and six service classes for batch jobs provided turnaround times of from less than 30 minutes to overnight processing (at a discount). The following graphs depict the efficiency of the DCRT operations. They continue to reduce the costs of providing services to the NIH Community.

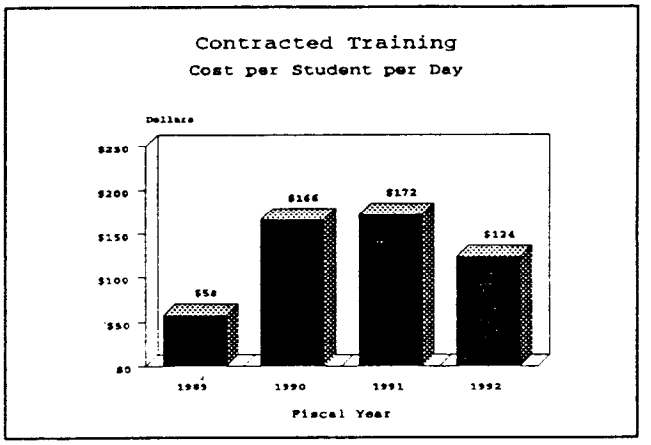






The DCRT has a training program that offers training on a wide variety of courses and seminars with the goal of helping scientists and administrators of the NIH to make effective and efficient use of computers in their programs. Most of the instructors are computer scientists, mathematicians, engineers, and computer specialists from the DCRT. The program is open to all NIH employees and users of the Computer Center. Three terms are offered each year with brochures containing course descriptions and dates. The number of courses offered increase from year to year. The number of distinct subject matters offered increased from 96 in 1991 to 120 in 1992. Topics given during 1992 included DB2 Application Programming, SAS Analysis, Network Services, Managing Data Effectively, Organizing Biomolecules, Finding Sequenced Homologies in GenBank, Topics in Flow Cytometry, PC Viruses, Mackintosh Software for the Scientist and Introduction to Image Processing.

The graph shows the contracted training cost per student per day. The costs significantly increased in FY 1990 due to a change in the program of a local contractor to teach old technologies to bring in expert teachers for new high technology subjects. The decrease in FY 1992 was due to an increase in class attendance.



The DCRT also provides networking services to the entire NIH campus. The services include a campus "backbone" which in turn interconnects dozens of local area networks and thousands of individual computers to each other and, through the internet and BITNET, to computing facilities around the world.

The DCRT conducts an active research program in collaboration with scientists elsewhere at NIH, and throughout the world such as:

The Molecular Graphics and Simulation (MGS) unit studies problems of biological significance using theoretical techniques of molecular dynamics, molecular mechanics, modeling, *ab initio* analysis of small molecule structure, and molecular graphics.

The Computational Molecular Biology Section (CMBS) collaborates with NIH intramural scientists in specific scientific areas including the analysis and management of primary DNA and protein sequence data, and the chemical structures of proteins, nucleic acids, and their interaction with other biomolecules. Other goals are to develop tools to analyze and explore the global arrangement of genetic control information in chromosomes, and to better understand the genetic basis of metabolic regulation within a species.

The Analytical Biostatistics Section develops, tests, and applies new statistical, mathematical, and computational techniques and programs to assist in ongoing studies of molecular biology, physiology, pharmacology, endocrinology, protein structure, and related research area.

New Initiatives for FY 1992

The development of the NIH Strategic Plan, and especially the DCRT contributions in the areas of structural biology, high performance computing and communication, molecular medicine, and communication and information flow have shaped many new DCRT initiatives. In parallel, the DCRT has been developed its own strategic plan, to operate in support of and in concert with the NIH Strategic Plan A firm foundation, a working document with major initiatives in science, technology, service and support is in place In turn, the DCRT strategic plan will help chart the course for the next 5 years and very possibly into the next century.

The DCRT has also completed a series of *ad hoc* reviews of the entire Division, with 8 visits to 10 program areas. The penetrating looks at the plans, performance, and people give the basis for interim tactical management for the next few years, and have led to the development of new programs, new laboratories and branches, and a reorganization of the entire Division.

Three new areas deserve particular attention:

Scientific Computing Resource Center. This new walk-in center for scientific computation has both a physical facility and a scientific consultation entity. The physical facility houses an array of computational tools for trial use by NIH scientific staff. The consultative entity provides a single point of contact to the DCRT for many experts in a range of disciplines.

The Advanced Laboratory Workstation Project. Winner of the 1992 "Best in Open Systems" award among government wide competition, ALW is a support system for high performance, UNIX-based workstations. ALW offers scientists powerful, easy to use computing, nearly unlimited file space, and access to the latest scientific software.

Intel IPSC/860 Highly Parallel Supercomputer. This "cutting edge" machine runs unwieldy calculations so much faster than conventional computers that scientists now wait minutes instead of weeks for results. The DCRT is developing biomedical applications for the highly parallel machine, and some NIH scientists are already using the system to attack computationally demanding biomedical research problem areas such as image processing, sequence analysis, protein folding prediction, and medical imaging.

The past year has been momentous for the DCRT in several other aspects. The Computer Center Branch has created a Capacity Planning/Management Staff. This group has performed a series of extensive and intensive studies, including the use of the BEST/1 capacity planning software from BGS, Inc. This has led to the decision to reduce the number of our MVS based mainframes from four to three, by combining the test and backup function with the workload of another machine. Further, CCB has made the decision not to pursue the AIX/370 operating system, and instead will transfer the clientele of this machine to an expanded version of the Convex Supercomputer. Further studies have led to a reduction in the amount of on-line storage for the MVS system with further savings. The rates for mainframe services and disk storage will have dropped by nearly 50% in less than one fiscal year, with a 25% reduction in October 1991 and another 25% in April 1992. This is largely due to a decision to keep equipment longer, reflecting the maturation of the technology for mainframes.

Also, in the past year, planning has begun for the reprocurement of the mainframe computer and associated peripherals, services and support. A series of studies are now ongoing with the assistance of the General Services Administration to develop a needs assessment and an acquisition strategy, leading to a new procurement to be completed by September 1996. As requirements for this procurement will be driven only by DHHS needs, in the long term, the DCRT expects to lose customers from other federal agencies. We will continue to service these agencies until they can make suitable plans for a reasonably graceful transition to another provider of services.

LOGISTICS

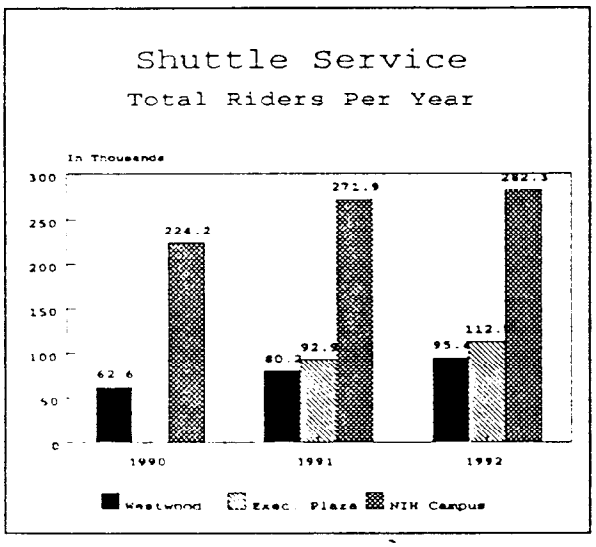
The Division of Logistics (DL) manages and/or has oversight responsibility for all logistics functions at the NIH. Specifically, the DL has responsibility for the personal property management, shipping and receiving, supply management, and transportation functions supporting the worldwide biomedical and research activities of the NIH, and certain other components of the DHHS. The Division provides central policy and oversight for all logistics functions NIH-wide. The DL is composed of four branches, which are funded by the NIH SSF.

PERSONAL PROPERTY BRANCH (PPB)

The PPB manages personal property which embraces accountability functions and preservation, utilization, and disposal operations for all Government property used by the NIH. The PPB coordinates decentralized personal property management activities, and formulates and disseminates policies and procedures to implement Federal and Departmental regulations. As of September 30, 1992, the Property Management Information System showed a balance of 242 thousand items with an acquisition cost of $801 million.

SHIPPING AND RECEIVING BRANCH (S&RB)

The S&RB manages and is responsible for all phases of general freight traffic management for the NIH. This includes receiving, checking, temporary storage, custom clearance on international shipments, and the distribution of incoming freight. Also included are arrangements for shipment of all types of freight to both foreign and domestic destinations, including packing and crating. In addition, during FY 1992 receipt and delivery of controlled substances and alcohol and syringes was assumed as a function of the branch. The establishment of an electronic data invoicing (EDI) system achieved significant improvements in the efficiency of processing shipping requests from the NIH community and facilitated the prompt payment of invoices.



TRANSPORTATION BRANCH (TB)

The TB manages and provides transportation services at the NIH, including: operation of a local motor pool consisting of buses, passenger vehicles and light trucks; coordination of delivery of specimens, blood, cash orders, etc., between the NIH and various Government organizations; movement of expendable supplies, equipment, and office furniture between the NIH buildings in the Washington and Baltimore areas, and; management of a comprehensive preventive maintenance program and major repair facility for the NIH motor vehicle fleet, including a variety of special purpose vehicles and non-automotive equipment such as scooters, forklifts, etc.

Additional services include operation of a shuttle bus service to provide scheduled transportation between buildings on the Bethesda main campus of the NIH and rental buildings, as well as oversight of

the contractor-operated shuttle service between the NIH main campus and Executive Plaza. Efforts to improve the NIH Shuttle program by instituting additional runs and/or modifying existing services resulted in a steady increase in ridership.

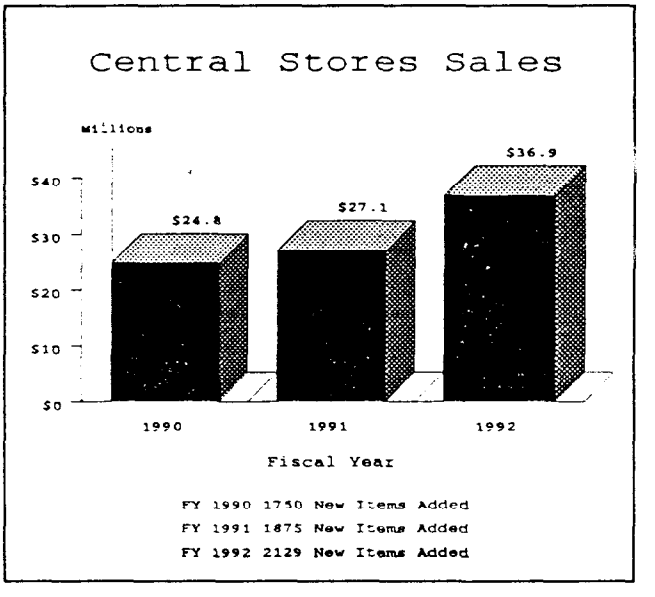
SUPPLY BRANCH (SB)

The SB manages and is responsible for the requirements determination and for automated inventory control of the NIH Central Stores System, covering a broad variety of commodities including laboratory supplies and glassware, hospital and surgical supplies, chemicals, office supplies and equipment, and animal food and bedding. These supply groups include items most used by the NIH and its foreign and domestic field stations.

In FY 1992 Central Stores sales to the NIH community totaled $37 million, representing a 35% increase over FY 1991. Stock on hand at the end of the fiscal year was valued at $5.3 million and included 254 new items added to the inventory throughout the year. Central Stores maintained a stock availability rate of 98%. The SB operates three major warehouses: the NIH warehouse; Animal Food and Bedding (AFB); and, Chemicals (CHM).

Customers can order from the warehouses or visit one of severl Self Service Stores (SSS) to make purchases. Requisition line items processed in FY 1992 totalled 290 thousand. More information including the inventory ratio analysis is discussed in the "SSF Inventories" section of this document.

More new stock items were added to the Central Stores Inventory than ever before, while at the same time a reduction in surcharges to the community was achieved. Approval and effectiveness of these efforts is reflected by the increasing sales.



PROCUREMENT SERVICES

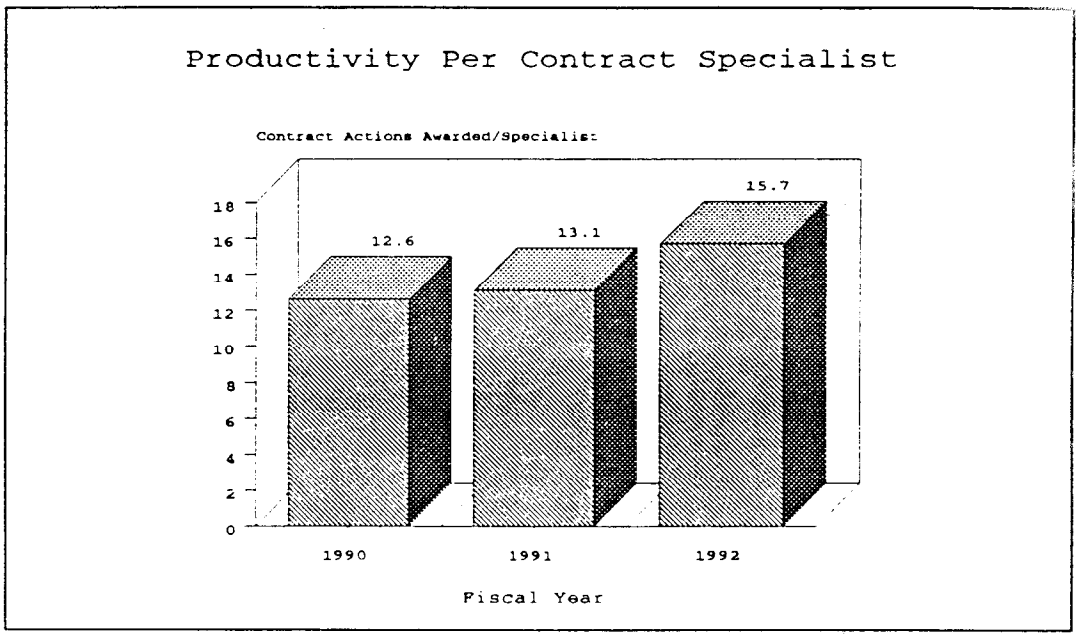
The Division of Procurement (DP) is responsible for all aspects of the NIH station support and intramural procurement program. In implementing these responsibilities, the DP procures specialized scientific equipment and supplies, comprehensive support services, architectural-engineering services, construction services, automated data processing equipment and services and a multiplicity of other equipment, supplies and services.

The Division provides complete acquisition support through a variety of contracting mechanisms, including small purchases, federal supply schedule procurements and sealed bid and negotiated contracts. In FY 1991, the DP processed 33,028 procurement actions totalling $336.6 million in value.

While the majority of the purchases support the needs of the intramural research program, it should be noted that this Division is responsible for the procurement of all architectural-engineering and construction contracts for NIH. Among the major projects completed or in progress are Building 29B, Building 49, Building 30 Tower, and the Clinical Center project.

A limited decentralization of the Division of Procurement was initiated in FY 92 and will be completed in 1993. Four ICDs, NCI, NHLBI, CC, and NIDDK, will be provided authority to conduct small purchases.

The following chart displays the increasing productivity of DP staff over a three-year period.

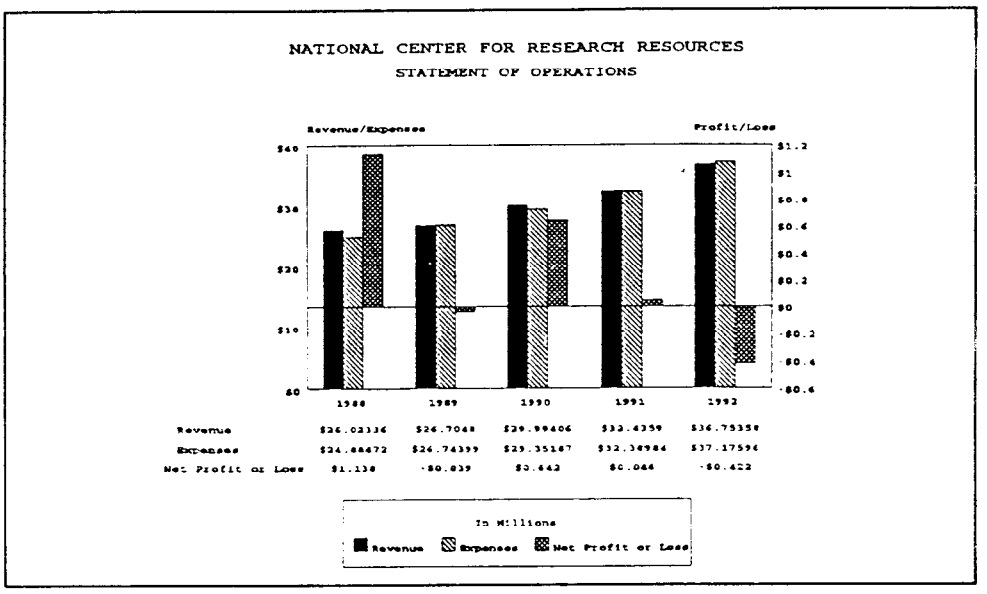


At the same time, steps have been taken to improve the quality of the contracting services. In FY 1992, the Division also established a Quality Assurance Team to ensure that contract files are as complete and accurate as possible and represent a consistent high level of quality. Early comments from the NIH Contract Review Board indicate that the team actions have had significant impact on the quality of DP's contracting practices and file documentation.

NATIONAL CENTER FOR RESEARCH RESOURCES

The National Center for Research Resources (NCRR) provides biomedical engineering and instrumentation collaboration and services, professional and technical support services related to the care and use of laboratory animals, a scientific library, and medical arts and photography to the intramural NIH community. The NCRR is funded by both the SSF and MF. In FY 1992, the NCRR received 68% of the intramural funding from the SSF and 32% from the MF. The NCRR generated approximately 16.7% of the total SSF revenue in FY 1992. The NCRR is comprised of four areas under the SSF: Veterinary Resources Program (VRP), Biomedical Engineering and Instrumentation Program (BEIP), the Medical Arts and Photography Branch (MAPB) and the Library Branch.

The following is a graphic portrayal of NCRR's SSF operations over the past five years showing revenue, expenses and profit/loss. The FY 1992 loss resulted primarily because NCRR was not reimbursed for utilities and maintenance costs relating to various ICD single-occupancy animal facilities.



THE VETERINARY RESOURCES PROGRAM

The VRP facilitates intramural research by providing comprehensive, centralized professional and technical support for the NIH biomedical research using animals. In FY 1992, 36% of the VRP funding was provided by the MF while 64% was provided by the SSF. The professional staff of the VRP collaborate with intramural scientists to identify appropriate animal models, provide animal health surveillance and disease diagnosis, monitor nutritional needs and assess caging requirements. A centralized pharmacy for the intramural community is in the planning stages. A variety of animals are housed in 7 centralized facilities on the NIH campus and in 12 facilities at the NIH Animal Center near Poolesville, Maryland.

Major Accomplishments

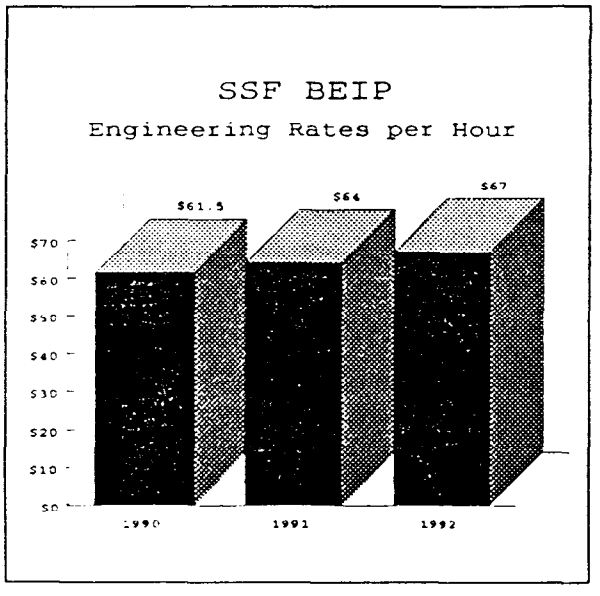
In FY 1992, the VRP established a Health Surveillance Program. The Program's computerization of data facilitated in updating the health status of the NIH animals. In FY 1992, the VRP focused on renovating existing central animal facilities in support of the successful NIH-wide effort to obtain accreditation from

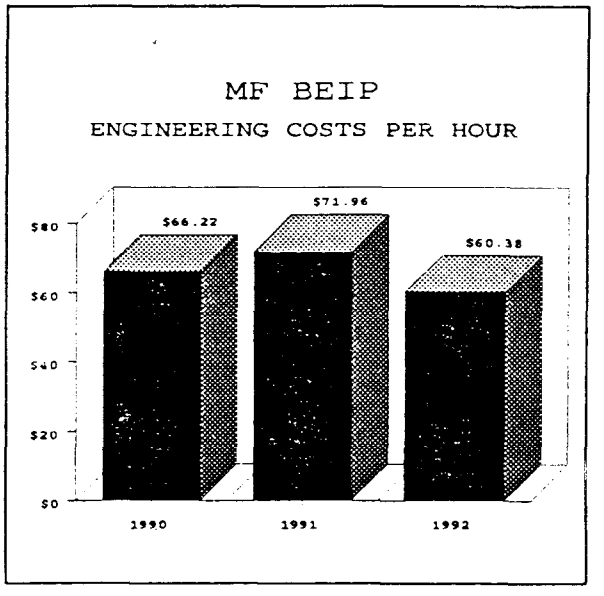
the American Association for Accreditation of Laboratory Animal Care. The VRP added a veterinary behaviorist and associated staff to implement a new animal behavior program. This team employs a variety of techniques to enrich the living environment of laboratory animals at the NIH facilities. This program is considered one of the foremost of its kind in the country and has now been enthusiastically implemented in other areas of the NIH.

BIOMEDICAL ENGINEERING AND INSTRUMENTATION PROGRAM

The BEIP provides collaborative research and centralized support services to the NIH intramural scientists. The BEIB contributes to advances in biomedical research through applications of engineering, mathematics and the physical sciences. The BEIB staff, of approximately 40 physical scientists and engineers and 75 technical support employees, collaborates each year on more than 200 projects to produce advanced instrumentation, models and techniques dedicated to the acquisition of biomedical information previously unavailable to the NIH scientists. In addition, they typically respond to about 1,400 requests for fabrication or major modification of laboratory devices and over 10,000 requests for repairs and minor modifications of scientific equipment.

Approximately two thirds of BEIP is funded by the SSF while the remaining third is funded by the MF. Based on the total expenses and hours of service provided by the engineers, the rates for SSF engineering services have slightly increased as a result of higher costs due to inflation. However, the cost of providing MF engineering services has decreased. The cost for providing an hour of service in FY 1992 was $60.38 compared to $66.22 in FY 1990.





LIBRARY BRANCH (LB)

The NIH library is the biomedical research library of the NIH. It serves as the primary literature, referral and information resource in the biomedical sciences for the NIH staff. The 56-member staff provides a diverse range of services, including a clinical library service, photocopying, English translation of scientific papers published in foreign languages, compilation of bibliographies and teaching bibliography-related courses. The Library Branch is funded by the MF. The FY 1992 expenses totalled almost $5 million.

The LB's popular photocopying services which is used mainly for manuscripts, articles and journals grew 18% in FY 1992 with 5.3 million copies made. In addition, the library staff filled 200,000 requests, a 30% increase over FY 1991. A new feature installed in FY 1992 to the Library's LAN allows users to request library materials through the online catalog instead of making manual requests.

MEDICAL ARTS AND PHOTOGRAPHY BRANCH

The MAPB is funded by the SSF. It provides a wide variety of medical arts and photography services. MAPB's staff includes professional artists, photographers and audiovisual specialists who produce communication materials ranging from slides, exhibit designs, statistical drafting, display charts, posters, medical illustrations, publication design, videotapes and support for special events.

Major Accomplishments

The MAPB completed over 75,000 ICD requests for services during FY 1992. The MAPB also produced five video films that received awards from the National Association of Government Communicators. To maintain and improve its high quality standards and meet changing requirements, MAPB's technology and skills are continuously being improved.

GRANT REVIEW

The Division of Research Grants (DRG) is the central receipt point for all applications submitted to the U.S. Public Health Service seeking research grant support. The division assesses each application for relevance to the health mission of the PHS and assigns those that are acceptable to an appropriate scientific review group (SRG) for scientific and technical merit review, and also to the appropriate PHS awarding institute or center to consider for an award. The SRGs in the DRG are called study sections. There are 101 study sections and they each meet three times a year to review grant applications. Study sections operate under the Federal Advisory Committee Act (P.L. 92-463) and are chartered under section 222 of the Public Health Service Act. The DRG also collects, stores, retrieves, and analyzes management and program data needed in the management and operation of the grant and award programs. In addition, the DRG reviews and analyzes the character and direction of research and research training supported by PHS grants. These DRG activities are central and essential to the entire grant-making research funding system of the PHS.

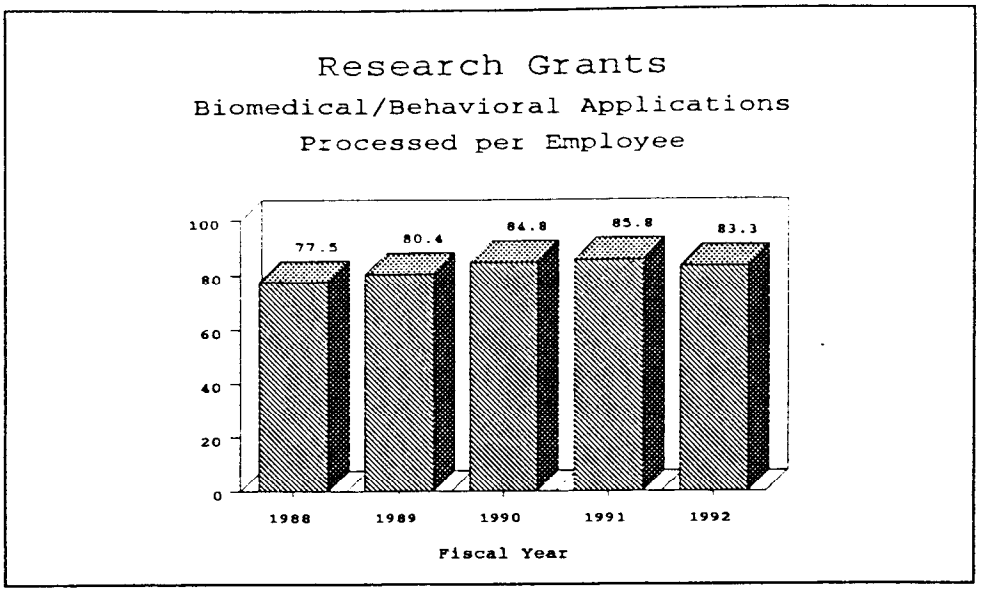
The DRG is funded by the MF and accounted for 8% of the total MF resources in FY 1992. In FY 1992, the DRG obligated $34.5 million and utilized 454 employees, representing increases over 1987 of 30% and 7% respectively. The DRG continued to manage extremely heavy workloads. The DRG received, processed, and referred 37,826 biomedical/behavioral research grant applications in FY 1992, compared to 32,771 in FY 1988. The DRG completed 610,926 information processing tasks directly related to research programs in FY 1992, compared to 326,421 in FY 1988.

Major Accomplishments

The DRG evaluated and implemented a new system of review committees to replace ad hoc groups with committees fully consonant with the Federal Advisory Committee Act regulations. In the area of information systems, the DRG was instrumental in expanding the electronic distribution of the **NIH Guide for Grants and Contracts** and related material to over 275 research institutions. The DRG also developed an electronic bulletin board that made readily available to the public NIH extramural program guidelines and other publications in electronic formats. Additional resources available to the PHS community and, in some cases, to the external biomedical research community include an extensive collection of publications and audiovisual materials on the DRG organization and functions, the peer review process, the grant application process, and the NIH extramural programs. The Division also has developed and distributed several video tapes on the peer review process, how to apply to the NIH for a research grant, how to review research grant applications to the NIH, and the history and responsibilities of the DRG.

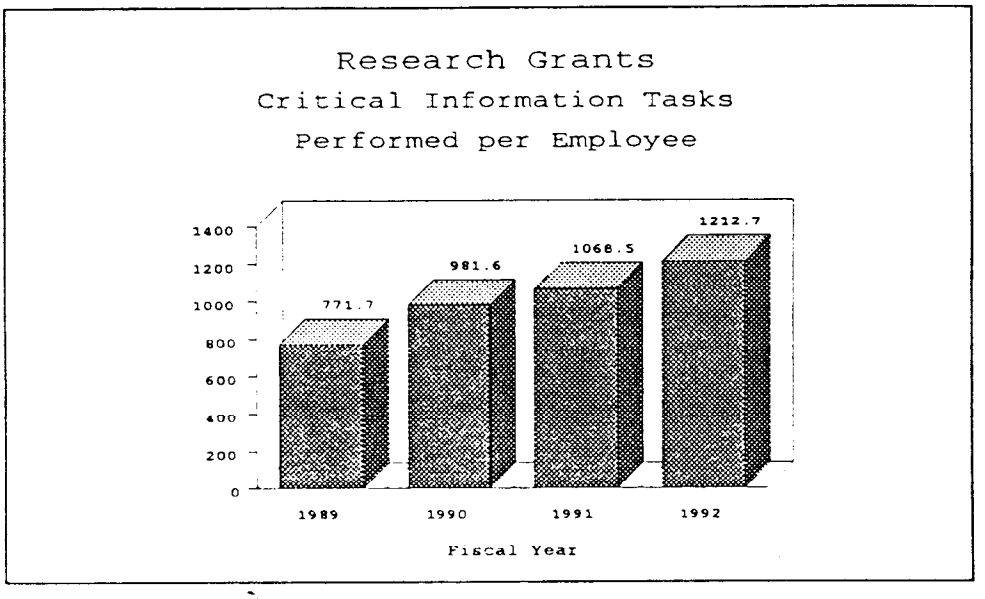
Productivity

The DRG workload trend over the last several years has been on the rise. The tasks have also become more complex and the DRG management has met these challenges by applying a larger amount of professional time and effort to increasingly complex tasks. The DRG has also been successful at developing and implementing automated systems to meet the growing workload. The DRG will continue to evaluate and implement cost-effective, efficient alternatives to meet anticipated increases in workload.



The FY 1991 data in the graph above included 667 applications from the Office of Minority-Health entered by special arrangement and 630 applications from the NCRR without comparable applications in FY 1992. The FY 1991 one-time entries caused the apparent FY 1992 decrease in the number of applications processed per employee.

The tasks in the graph below include mission-critical analyses needed for decision making, information system development and testing, Study Section support procedures and processes, and Information for Management, Planning, Analysis, and Coordination System updates.



INVENTORIES

Service and Supply Fund

In FY 1992, the SSF financed four inventories. Sales of inventory stock total $47.7 million and accounted for 21.6% of the total SSF sales in FY 1992. This is an increase of $7.7 million over FY 1991. The total value of the inventory purchased and cost of goods sold in FY 1992 were $42.8 and $40.9 million, respectively.

The inventories are composed of administrative, laboratory, and office supplies, construction material, fabrication material and scientific equipment. The Supply Branch, Division of Logistics and the Materials Acquisition/Supply Branch, Division of Engineering Services, ORS, are the largest inventory areas accounting for 94% of the total inventory sales. The FY 1992 inventory turnover ratios are as follows:

Inventory Turnovers

Inventory Area	Turnover Ratio		Average Inventory
	1991	1992	1992
Supply Branch	3.8	5.1	$6,298,539
Materials Acquisition/ Supply Branch	1.4	2.3	2,646,060
Inventory Management Unit	1.6	3.2	434,343
Scientific Equipment Resources Program	2.9	7.6	179,079

In the "Message From the CFO," (Par. 3, Item 1), several initiatives began under the auspices of the Supply Branch, Division of Logistics, to improve the accountability of inventory property at the NIH.

Management Fund

The Clinical Center maintains two inventory operations which are funded by the MF. One inventory is comprised of pharmaceutical products while the other consists of hospital/ medical supplies. Unlike the SSF inventories, the stock items are not held for resale but are issued to other components of the CC for use. The average inventory values for the Pharmacy and the Materials Management Department in FY 1992 were $1.5 and $2.3 million, respectively, while the issues for those two areas during the FY were $8.8 and $6.2 million, respectively.

Major Accomplishments

The CC pharmacy staff worked with physicians and hospital staff through various committees to reduce drug costs at the CC. In FY 1992, by changing brands of intravenous immune globulin, the pharmacy was able to save $150,000. Through their clinical program they worked with physicians to reduce the use of the new antiemetic, ondansetron, using cheaper and equally effective forms of therapy that saved approximately $80,000. The pharmacy staff also worked with nursing to convert the hospital over to a needle-less heparin lock system that is safer for personnel to use and saved $26,000.

The Material Management Department developed options for increasing the security of warehouse areas to restrict unauthorized access. This options are being explored with the goal of implementing the recommendations suggested in the FY 1991 CFO report.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires all federal agencies to have financial and other systems to ensure that the internal control objectives of the Act are met.

A limited FMFIA (Section 4) review of the NIH Central Accounting System was conducted in FY 1992. No material weaknesses, material nonconformances, or corrective actions were identified. A detailed FMFIA (Section 4) review will be conducted in FY 1993.

Two NIH material weaknesses were corrected during FY 1992. The weaknesses were the NIH's Animal Care and Use Program, and the Capacity Planning, Management and Oversight of the Computer facility (DCRT).

- The NIH received provisional accreditation of its animal facilities from the American Association for Accreditation of Laboratory Animal Care (AAALAC) during FY 1992, successfully resolving the material weakness.

- In addition, a Public Health Service review team certified NIH's Delegated Procurement System which had been dramatically restructured following a detailed review by the PHS and the OIG. While the contracting function of the Division of Procurement remains to be certified, the endorsement of the DELPRO system is a major accomplishment.

- A capacity management system was developed for the NIH computer facility in FY 1992, rather than FY 1993 as originally projected.

In addition to the successful resolution of two material weaknesses, the NIH staff worked within written corrective action plans (CAPs) to correct three FMFIA (Section 2) material weaknesses. Those weaknesses involved procurement, foundations, and (nonexpendable) property.

- As noted above, work continues to resolve deficiencies within the Division of Procurement. A limited decentralization of the Division will occur in FY 1993. It is anticipated that a procurement certification review will be conducted at the end of FY 1994.

- A material weakness was declared by NIH in FY 1990 because the NIH lacked a policy regarding its employees' relationship with foundations. This policy has now been developed and implemented, and this weakness is anticipated to be removed in FY 1993.

- The property management system was identified by NIH as material weakness in FY 1990. The CAP for this weakness included the development of a new automated Property Management Information System, increased management awareness of personal property management objectives, strengthened personal property policies and procedures and a complete wall-to-wall physical inventory of accountable personal property. In addition, inventory management of the NIH Supply Branch was added to this item in FY 1992 as a result of the findings of the 1992 CFO Audit. Extensive progress has been made in the completion of the CAP and we are hopeful that this weakness will be removed in 1993.

In addition to the corrective actions with regard to material weaknesses, 126 internal control reviews were completed in FY 1992 in such diverse areas as budget execution, personnel management, and space management. Of particular note were the results of the space management review which led to substantial change in operating policies with regard to the leasing of facilities.

SERVICE AND SUPPLY FUND

FISCAL YEAR 1992

FINANCIAL STATEMENTS AND NOTES

Department of Health and Human Services
National Institutes of Health
Service and Supply Fund
STATEMENT OF FINANCIAL POSITION
As of September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
ASSETS		
Financial Resources:		
Fund Balance with Treasury	$6,011	$17,677
Accounts Receivable, Net - Non-Federal (Note 2)	70	120
Inventories Held for Sale, Net (Note 3)	10,128	8,078
Intragovernmental Items, Federal:		
Accounts Receivable, Net (Note 2)	9,705	12,278
Advances	1,427	492
Total Financial Resources	27,341	38,645
Non-Financial Resources:		
Advances, Non-Federal	113	78
Property, Plant and Equipment, Net (Note 4)	16,899	15,522
Total Non-Financial Resources	17,012	15,600
Total Assets	$44,353	$54,245
LIABILITIES		
Funded Liabilities:		
Accounts Payable, Non-Federal	$20,036	$20,891
Accrued Payroll and Benefits	2,142	3,483
Deferred Revenue, Non-Federal	25	25
Intragovernmental Liabilities:		
Accounts Payable, Federal	3,666	5,789
Total Funded Liabilities	25,869	30,188
Unfunded Liabilities:		
Accrued Leave	3,309	2,880
Total Unfunded Liabilities	3,309	2,880
Total Liabilities	$29,178	$33,068
NET POSITION		
Revolving Fund Balance: (Note 5)	15,175	21,177
Net Position	15,175	21,177
Total Liabilities and Net Position	$44,353	$54,245

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Service and Supply Fund
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
For the Period Ended September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
REVENUES AND FINANCING SOURCES		
Revenue from Sales of Goods and Services		
To the Public	$22,087	$312
Intragovernmental	177,116	197,075
Other	62	4
Total Revenues and Financing Sources	199,265	197,391
EXPENSES		
Program Operating Expenses (Note 6)		
Logistics	11,418	13,741
Computing	35,929	48,092
Research Resources	30,012	25,491
Engineering	15,678	12,462
Telecommunications	18,720	15,476
General Expense	13,825	12,691
Printing and Reproduction	11,821	10,754
Procurement	9,149	8,482
All Other	16,591	12,798
Cost of Goods Sold		
To the Public	4,087	54
Intragovernmental	36,780	33,810
Depreciation and Amortization	2,782	1,734
Interest - Other	2	2
Other	271	0
Total Expenses	207,065	195,587
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments	(7,800)	1,804
Plus (Minus): Prior Period Adjustments (Note 7)	1,798	0
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(6,002)	1,804
Plus: Unfunded Expenses	352	1,854
Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses	($5,650)	$3,658
Net Position, Beginning Balance	21,177	19,373
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(6,002)	1,804
Net Position, Ending Balance	$15,175	$21,177

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Service and Supply Fund
STATEMENT OF CASH FLOWS
For the Period Ending September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($6,002)	$1,804
Adjustments Affecting Cash Flow:		
Decrease in Accounts Receivable	2,623	783
Increase in Inventories	(2,051)	(701)
(Increase) Decrease in Other Assets	(935)	1,149
(Decrease) Increase in Accounts Payable	(4,186)	11,688
(Decrease) Increase in Other Liabilities	429	(11,659)
Other Unfunded Expenses	2,782	1,734
Other Adjustments	0	1,196
Total Adjustments	(1,338)	4,190
Net Cash Provided (Used) by Operating Activities	(7,340)	5,994
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property, Plant and Equipment	(4,326)	(8,832)
Net Cash Used by Non-Operating Activities	(4,326)	(8,832)
Net Cash Used by Operating and Non-Operating Activities	(11,666)	(2,838)
Fund Balance with Treasury, Beginning	17,677	20,515
Fund Balance with Treasury, Ending	$6,011	$17,677

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Service and Supply Fund
STATEMENT OF BUDGET AND ACTUAL EXPENSES
For the Period Ended September 30, 1992
(Dollars in Thousands)

	BUDGET			ACTUAL
		Obligations		
Program Name	Resources	Direct	Reimbursed	Expenses
Service and Supply Fund	$235,438	$0	$289,040	$207,065
Totals	$235,438	$0	$289,040	$207,065

Budget Reconciliation:

Total Expenses	$207,065
Add:	
Inventory Acquisitions	42,094
Equipment Acquisitions	4,563
Less:	
Depreciation and Amortization	2,782
Unfunded Annual Leave Expense	352
Accrued Expenditures	250,588
Less Reimbursements	199,265
Accrued Expenditures, Direct	$51,323

The accompanying notes are an integral part of the statements.

NATIONAL INSTITUTES OF HEALTH
SERVICE AND SUPPLY FUND
NOTES TO THE FINANCIAL STATEMENTS
FOR THE PERIOD ENDING SEPTEMBER 31, 1992
(DOLLARS IN THOUSANDS)

Note 1. Significant Accounting Policies

Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations, cash flows and budget and actual expenses of the National Institutes of Health (NIH) Service and Supply Fund (SSF), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the SSF in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 93-02, "Form and Content of Agency Financial Statements", and the SSF's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared for the SSF pursuant to OMB directives, that are used to monitor and control the SSF's use of budgetary resources.

Reporting Entity

The NIH SSF was established on July 3, 1945 under 42 U.S.C. 231 to provide a means for consolidating the financing and accounting of certain NIH centralized research support and administrative activities. Services provided through the SSF are readily identifiable to a specific user, therefore, the cost of these services are charged to the recipient appropriation on a fee-for-service basis.

The SSF is administered under fund account 75 X 4554, and is a revolving fund that does not require annual appropriations from Congress. Budgeting for the operations of the SSF is approved by the Central Services Review Committee.

Basis of Accounting

The accompanying financial statements have been prepared on an accrual accounting 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. In addition, SSF transactions are recorded on a budgetary basis, to ensure compliance with legal constraints and controls over the use of Federal funds.

All intrafund balances and transactions have been eliminated. Certain FY 1991 account balances have been reclassified to correspond to OMB Bulletin 93-02 requirements.

Revenues and Other Financing Sources

Fee-for-service revenues are charged to the SSF's customers based upon service units applied to a predetermined rate. Because the rate is based upon budgeted volumes and cost, actual costs incurred by the SSF are reviewed regularly to identify necessary rate adjustments and/or rebates.

Funds with the U.S. Treasury

The SSF does not maintain cash in commercial bank accounts. Rather, its receipts and disbursements are processed by the U.S. Treasury. The balance of funds with the U.S. Treasury represents funds that are available to pay current liabilities and finance authorized purchase commitments relative to goods or services which have not been received.

Inventories

The SSF inventories are comprised of building repair supplies, office supplies, repair and replacement parts for scientific equipment, animal food and bedding, and research chemicals. Inventories are valued using the moving average method. An annual physical inventory is performed and balances are adjusted to reflect the results of the inventory. As inventories are sold, the cost of the goods sold is expensed.

Property, Plant and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis, with estimated maximum useful lives of 10 years. Property and equipment with an acquisition cost of less than 5 thousand dollars and an estimated useful life of less than 2 years is expensed when purchased.

Retirement Benefits

The majority of the SSF's employees participate in the Civil Service Retirement System (CSRS), to which the SSF makes matching contributions equal to seven percent of pay. The SSF does not report CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting of such amounts is the responsibility of the Office of Personnel Management.

On January 1, 1987, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, can elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to the SSF employees which automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. For most employees

hired since December 31, 1983, the SSF also contributes the employer's matching share for Social Security.

The SSF's costs associated with its employee retirement programs during fiscal years 1992 and 1991 amounted to approximately $3,429 and $2,895 respectively.

Note 2. Accounts Receivable

	1992	1991
Accounts and interest receivable - public:		
Current	$ 38	$ 90
Non-Current	32	30
	$ 70	$ 120
Accounts Receivable - federal	9,705	12,278
Total accounts receivable	$ 9,775	$12,398

The NIH SSF does not currently record an allowance for bad debts because the majority of the customers are federal agencies. In addition, based on prior years' history of write-offs, there is no need to record an allowance.

Note 3. Inventories

Inventories Held for Sale	1992	1991
Laboratory and Office Supplies	$ 6,753	$ 5,332
Construction Material	2,801	2,165
Fabrication Material	433	460
Scientific Equipment	141	121
Total	$ 10,128	$ 8,078

The moving average costing method is used for valuation of SSF inventories. There are no restrictions on inventory use, sale, or disposition. An allowance is not recorded to estimate future losses because inventory losses are minimal and are expensed when incurred.

Note 4. Property and Equipment

Balances at 9/30/92:

	Acquisition Value	Accumulated Depreciation	Net Book Value
Systems Development	$ 4,188	$ (739)	$ 3,449
Equipment	23,862	(10,412)	13,450
Total	$ 28,050	$(11,151)	$ 16,899

Balances at 9/30/91:

	Acquisition Value	Accumulated Depreciation	Net Book Value
Systems Development	$ 2,037	$ (170)	$ 1,867
Equipment	24,632	(10,977)	13,655
Total	$26,669	$ (11,147)	$ 15,522

The systems development costs pertain to internally produced software to be used in the operations of the SSF.

Note 5. Revolving Fund Balance

	1992	1991
Invested Capital	$ 269	$ 269
Cumulative Results of Operations	9,494	15,496
Transfers	5,412	5,412
Total	$15,175	$21,177

The cumulative results of operations contains $14,686 of profits from the Division of Computer Research and Technology (DCRT) operations. The DCRT is on a multi-year breakeven budget cycle as opposed to a one-year cycle. This policy was adopted by the DCRT management due to a long-term total systems contract. The multi-year cycle was intended to prevent large rate variations to the DCRT customers. This retained amount is intended to offset future losses anticipated in the multi-year budget. However, in FY 1992 the DCRT management discovered it had overcharged its customers in previous years. Therefore, the DCRT issued rebates and discounts contributing to a net loss of $1,729 in FY 1992.

Note 6. Program Operating Expenses

	1992	1991
Operating Expenses by Object Classification:		
Personnel Compensation and Benefits	$ 53,094	$ 46,224
Travel and Transportation	2,189	1,498
Rental, Communication and Utilities	39,258	57,372
Printing and Reproduction	448	2,969
Contractual Services	57,210	41,003
Supplies and Materials	8,998	9,185
Equipment not Capitalized	1,944	1,736
Other	2	0
Total Expenses by Object Class	$ 163,143	$ 159,987

Note 7. Prior Period Adjustment

During FY 1992 prior period adjustments were made for the write-off of invalid liabilities and the accrual of FY 1991 income and expense which were excluded from the FY 1991 financial statements. These are detailed as follows:

	1992
Write-off of invalid payroll accruals	$ 60
Write-off of invalid accrued liabilities	4,549
Write-off of invalid accounts payable	454
FY 91 income accrual	167
FY 91 expense accruals	(3,432)
Total	$ 1,798

Note 8. Commitments and Contingencies

The SSF has one major capital lease which is with IBM. The lease is a "Total Systems Contract" and covers a 10 year period. EDP equipment, which can be returned or exchanged at any time, is leased for three years with NIH obtaining ownership at the end of the lease. There are several operating leases which are renewable annually. These leases consist mainly of EDP and office equipment.

MANAGEMENT FUND

FISCAL YEAR 1992

FINANCIAL STATEMENTS AND NOTES

Department of Health and Human Services
National Institutes of Health
Management Fund
STATEMENT OF FINANCIAL POSITION
As of September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
ASSETS		
Financial Resources:		
Fund Balance with Treasury	$123,697	$122,846
Accounts Receivable, Net - Non-Federal	103	26
Intragovernmental Items, Federal:		
Accounts Receivable, Net	137	544
Advances	693	876
Total Financial Resources	124,630	124,292
Non-Financial Resources:		
Advances, Non-Federal	1,093	848
Inventories Not Held for Sale (Note 2)	3,960	3,562
Property, Plant and Equipment, Net (Note 3)	57,318	43,801
Total Non-Financial Resources	62,371	48,211
Total Assets	$187,001	$172,503
LIABILITIES		
Funded Liabilities:		
Accounts Payable, Non-Federal	$27,950	$20,832
Accrued Payroll and Benefits	9,687	13,713
Intragovernmental Liabilities:		
Accounts Payable, Federal	3,222	8,519
Deferred Revenue (Note 4)	85,089	82,366
Total Funded Liabilities	125,948	125,430
Unfunded Liabilities:		
Accrued Leave	8,865	8,194
Total Unfunded Liabilities	8,865	8,194
Total Liabilities	$134,813	$133,624
NET POSITION		
Fund Balance: (Note 5)	52,188	38,879
Net Position	52,188	38,879
Total Liabilities and Net Position	$187,001	$172,503

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Management Fund
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
For the Period Ended September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
REVENUES AND FINANCING SOURCES		
Intragovernmental Reimbursements for Goods and Services	$407,030	$376,105
Other Revenues and Financing Sources	40	71
Total Revenues and Financing Sources	407,070	376,176
EXPENSES		
Program Operating Expenses (Note 6)		
Clinical Services	185,434	171,438
Intramural Research Support Services	110,497	107,050
Grant Review and Approval	30,430	30,347
Intramural Scientific Services	23,012	19,205
Computer Services	17,514	15,755
Rentals	20,444	15,879
Depreciation	6,422	5,386
Interest - Other	8	3
Total Expenses	393,761	365,063
Excess of Revenues and Financing Sources Over Total Expenses	13,309	11,113
Plus: Unfunded Expenses	1,071	217
Excess of Revenues and Financing Sources Over Funded Expenses	$14,380	$11,330
Net Position, Beginning Balance	38,879	13,518
Excess of Revenues and Financing Sources Over Total Expenses	13,309	11,113
(Minus): Non Operating Changes (Note 7)	0	14,248
Net Position, Ending Balance	$52,188	$38,879

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Management Fund
STATEMENT OF CASH FLOWS
For the Period September 30, 1992 and 1991
(Dollars in Thousands)

	1992	1991
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$13,309	$11,113
Adjustments Affecting Cash Flow:		
Decrease in Accounts Receivable	330	(145)
Increase in Inventories	183	47
Increase in Other Assets	(246)	(848)
(Decrease) Increase in Accounts Payable	(2,752)	8,988
(Decrease) Increase in Other Liabilities	2,723	(11,417)
Other Unfunded Expenses	671	602
Other Adjustments	1,426	9,845
Total Adjustments	2,335	7,072
Net Cash Provided by Operating Activities	15,644	18,185
CASH FLOWS FROM INVESTING ACTIVITIES:		
Disposition of Inventories	0	366
Purchase of Inventories	(398)	0
Purchases of Property, Plant and Equipment	(14,395)	(7,120)
Net Cash Used by Non-Operating Activities	(14,793)	(6,754)
Net Cash Provided by Operating and Non-Operating Activities	851	11,431
Fund Balance with Treasury, Beginning	122,846	111,415
Fund Balance with Treasury, Ending	$123,697	$122,846

The accompanying notes are an integral part of these statements.

Department of Health and Human Services
National Institutes of Health
Management Fund
STATEMENT OF BUDGET AND ACTUAL EXPENSES
For the Period Ended September 30, 1992
(Dollars in Thousands)

Program Name	BUDGET			ACTUAL
		Obligations		
	Resources	Direct	Reimbursed	Expenses
Management Fund	$489,726	$0	$511,447	$393,761
Totals	$489,726	$0	$511,447	$393,761

Budget Reconciliation:

Total Expenses	$393,761
Add:	
Inventory Acquisitions	14,866
Equipment Acquisitions	14,989
Less:	
Depreciation	6,422
Unfunded Annual Leave Expense	1,071
Other Unfunded Expenses	25
Accrued Expenditures	416,098
Less Reimbursements	407,070
Accrued Expenditures, Direct	$9,028

The accompanying notes are an integral part of the statements.

NATIONAL INSTITUTES OF HEALTH
MANAGEMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
FOR THE PERIOD ENDING SEPTEMBER 31, 1992
(DOLLARS IN THOUSANDS)

Note 1. Significant Accounting Policies

Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations, cash flows and budget and actual expenses of the National Institutes of Health (NIH) Management Fund (MF), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the MF in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 93-02, "Form and Content of Agency Financial Statements", and the MF's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared for the MF pursuant to OMB directives, that are used to monitor and control the MF's use of budgetary resources.

Reporting Entity

The NIH MF was established on June 29, 1957 by Public Law 85-67 to facilitate the financing of certain common research supporting services and central administrative activities which are required in the operations of NIH. Services provided through the MF services cannot be readily associated with a specific user and generally benefit multiple appropriations.

The MF is administered under fund accounts 75 2 3996, 75 1 3996, 75 0 3996, 75 9 3996, and 75 M 3996, which are one year availability funds. The MF does not receive a direct appropriation from Congress. Instead, the fund is financed by agreed upon advances from other NIH and federal agency appropriations, which incorporate the MF program costs. Budgeting for the funding of the MF is approved by the Central Services Review Committee.

Basis of Accounting

The accompanying financial statements have been prepared on an accrual accounting 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. In addition, MF transactions are recorded on a budgetary basis, to ensure compliance with legal constraints and controls over the use of Federal funds.

All intrafund balances and transactions have been eliminated. Certain FY 1991 account balances have been reclassified to correspond to OMB Bulletin 93-02 requirements. In addition, certain FY 1991 balances have been restated, as discussed in Note 6.

Revenues and Other Financing Sources

Because MF expenses cannot be readily associated with a single customer, as discussed above, incurred expenses are distributed to MF customers on an allocated

basis. Revenues are recognized as expenses are incurred, and each customer is billed according to the allocation formula.

Deferred Revenue

The MF receives from its customers quarterly advances, which are recorded as deferred revenue until the revenue is realized. These cash advances are based upon the estimated cash required for payment of unliquidated obligations.

Funds with the U.S. Treasury

The MF does not maintain cash in commercial bank accounts. Rather, its receipts and disbursements are processed by the U.S. Treasury. The balance of funds with the U.S. Treasury represents funds that are available to pay current liabilities and finance authorized purchase commitments relative to goods or services which have not been received.

Inventories

The MF inventories are comprised of pharmaceuticals and hospital/medical supplies that will be consumed in future operations. Inventories are valued using the moving average method. An annual physical inventory is performed and balances are adjusted to reflect the results of the inventory. For financial statements purposes, inventory is expensed when consumed.

Property, Plant and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis, with estimated maximum useful lives of 10 years. Property and equipment with an acquisition cost of less than 5 thousand dollars and an estimated useful life of less than 2 years is expensed when purchased.

Retirement Benefits

The majority of the MF's employees participate in the Civil Service Retirement System (CSRS), to which the MF makes matching contributions equal to seven percent of pay. The MF does not report CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting of such amounts is the responsibility of the Office of Personnel Management.

On January 1, 1987, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, can elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to the MF employees which automatically contributes one percent of pay and matches any employee contribution

up to an additional four percent of pay. For most employees hired since December 31, 1983, the MF also contributes the employer's matching share for Social Security.

The MF's costs associated with its employee retirement programs during fiscal years 1992 and 1991 amounted to approximately $12,491 and $11,036 respectively.

Note 2. Inventories

Inventories Not Held for Sale	1992	1991
Pharmaceuticals	$ 1,579	$ 1,287
Hospital/Medical Supplies	2,381	2,275
Total	$ 3,960	$ 3,562

The moving average costing method is used for valuation of MF inventories. There are no restrictions on inventory use, sale, or disposition. Both the pharmaceutical inventory and the hospital/medical supply inventory is for patient and research use within the NIH Clinical Center. An allowance is not recorded to estimate future losses because inventory losses are minimal and are expensed when incurred.

Note 3. Property and Equipment

Balances at 9/30/92:

	Acquisition Value	Accumulated Depreciation	Net Book Value
Buildings and Other Structures and Facilities	$ 3,819	$ 0	$ 3,819
Equipment	73,799	20,300	53,499
Total	$ 77,618	$ 20,300	$ 57,318

Balances at 9/30/91:

	Acquisition Value	Accumulated Depreciation	Net Book Value
Buildings and Other Structures and Facilities	$ 3,819	$ 0	$ 3,819
Equipment	53,860	13,878	39,982
Total	$ 57,679	$ 13,878	$ 43,801

Note 4. Deferred Revenue

As stated above, the MF records customer advances as deferred revenue until the revenue is realized. The deferred revenue received from customers is maintained for future payment of unliquidated obligations. Deferred revenue and corresponding unliquidated obligations at the end of FY 1992 and 1991 were as follows:

	1992	1991
Deferred Revenue	$ 85,089	$ 82,366
Unliquidated Obligations	$ 78,897	$ 79,770

Note 5. Fund Balance

The MF's net position of $52,188 and $38,879 in FY 1992 and FY 1991, respectively, primarily consist of invested capital in property. The MF receives funding (which equates to spending authority) from the institutes. Currently, the institutes are billed for the full cost of the equipment received and not only the portion that has been expensed (annual depreciation). Therefore, the net position represents the net book value of the property.

Note 6. Program Operating Expenses

	1992	1991
Operating Expense by Object Classification:		
Personal Compensation and Benefits	$ 186,475	$ 169,646
Travel and Transportation	1,858	2,198
Rental, Communication and Utilities	47,525	42,752
Printing and Reproduction	2,427	2,523
Contractual Services	106,258	101,999
Supplies and Materials	36,786	36,634
Equipment not Capitalized	5,988	3,913
Other	14	9
Total Expense by Object Class	$ 387,331	$ 359,674

The FY 1991 operating expenses and revenue were restated to eliminate intrafund activity of $24,284. This reduction is reflected in the contractual services expense. In addition, FY 1991 operating expenses were restated to eliminate capitalized property acquisitions of $17,340, which were already included as an asset in the Statement of Financial Position.

Note 7. Non Operating Changes

Increases (Decreases)	1992	1991
Transfers-in from Treasury	0	$ 15,085
Transfers-out to Treasury	0	(837)
Net Non Operating Changes	$ 0	$ 14,248

Note 8. Commitments and Contingencies

The Management Fund has several operating leases which are renewable annually. These leases consist primarily of rental office space along with office and EDP equipment.