# SECTION III:

## Overview of Financial Performance

# Financial Statement Reporting

HHS has prepared department-wide financial statements since FY 1996, as required by law. The preparation of department-wide financial statements is important in promoting improved accountability and stewardship over the public resources entrusted to the Department. Preparation of these financial statements is part of the Department's overall goals to improve financial management and to provide accurate and reliable information that is useful in assessing performance and allocating resources. Responsibility for the integrity and objectivity of the financial information presented in the financial statements rests with Department management. Financial statements are also prepared for all HHS components. The financial statements for the Centers for Disease Control and Prevention (CDC) include financial data from the Agency for Toxic Substances and Disease Registry (ATSDR).

HHS financial managers believe there is no better measure to enhance their financial accountability than subjecting an organization's financial statements to an independent audit. Eleven (including ATSDR) of the thirteen HHS component agencies' financial statements are subject to an independent audit. The financial data of audited components account for virtually all HHS assets and expenditures. In addition to the department-wide audited financial statements, OMB requires "stand-alone" audited financial statements for HCFA.

HHS received an unqualified, or "clean" audit opinion for the department-wide FY 2000 financial statements. This represents two consecutive years the Department received a "clean" audit opinion, and a notable accomplishment over our FY 1996 disclaimer of opinion. For details, please see the Section V, Independent Auditors' Report on Department's Financial Statements and Management Response to the Audit.

In this *Accountability Report*, HHS is presenting its department-wide FY 2000 audited financial statements. Readers are encouraged to refer to Section IV of this report for the actual financial statements, notes and supplemental schedules, and to the HHS FY 1996–1999 *Accountability Reports* for prior years' audited financial statements.

# Financial Statement Audit Findings and Management Comments

Individual HHS component audit findings were not all finalized as this report went to print. When available, those reports will be posted to the respective HHS component home pages.

Reviews in accordance with Statement on Auditing Standards (SAS) Number 70 for service providers were conducted during FY 2000 for several shared financial systems, and the auditor's findings from those reviews were incorporated into the department-wide Independent Auditor's Report.

In keeping with the U.S. CFO Council's "streamlining" philosophy of issuing one "accountability" document and one "planning" document per year, the Department's published annual *Financial Management Five-Year Plan* provides information on our plans and goals for maintaining our "clean" opinion and resolving our audit findings.

## Limitations of the Financial Statements

In accordance with OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," we are disclosing the following limitations of the HHS FY 2000 financial statements, which are contained in this *Accountability Report*.

- The financial statements have been prepared to report the financial position and results of operations of HHS, pursuant to the requirements of the Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act (GMRA) of 1994, and the Reports Consolidation Act of 2000.
- While statements have been prepared from HHS' books and records in accordance with the formats prescribed by OMB, the statements are different from the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of a sovereign entity, liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

## HHS Audit Findings History: FY 1996–FY 2000

| Issue Category | 1996 Qualification | 1996 Material Weakness | 1997 Qualification | 1997 Material Weakness | FY 1998 Qualification | FY 1998 Material Weakness | FY 1999 Qualification | FY 1999 Material Weakness | FY 2000 Qualification | FY 2000 Material Weakness |
|---|---|---|---|---|---|---|---|---|---|---|
| Medicare Accounts Payable | X | X* | | X | | | | | | |
| SMI Revenue | X | | | | | | | | | |
| Medicare/Medicaid Accounts Receivable | X | X* | X | | X Includes Medicare contractor receivables only, excludes Medicaid | X Includes Medicare contractor receivables only, excludes Medicaid | | X Includes Medicare contractor receivables only, excludes Medicaid | | Merged into Financial Systems and Processes material weakness |
| Cost Reports | X | | X | | | | | | | |
| Net Position | X | X | X | ** | | | | | | |
| Pension Liability | X | | | | | | | | | |
| Initial Audit | X | | | | | | | | | |
| Medicare EDP Controls | | X | | X | | X | | X | | X |
| Grants Oversight and Accounting | | X Includes oversight | X Excludes oversight | X Excludes oversight | | | | | | |
| Medicare Claims Error Rate | | X | | X | | | | | | |
| Intra-entity Department-wide Transactions | | | X | | | | | | | |
| Financial Reporting Systems and Processes | | | | X** | | X | | X | | X |
| New Statements | | | | | X | | | | | |
| **TOTAL** | **7** | **5** | **5** | **5** | **2** | **3** | **0** | **3** | **0** | **2** |
| Resolved from Prior Year | Not applicable | Not applicable | 4 | 1** | 4 | 3 | 2 | 0 | 0 | 1† |
| New | 7 | 5 | 2 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| **Opinion** | **Disclaimer** | | **Qualified** | | **Qualified** | | **Unqualified** | | **Unqualified** | |

* Consolidated into one material weakness citing both accounts payable and receivable in FY 1996.

** Net position issue from 1996 was consolidated into financial reporting issue in FY 1997.

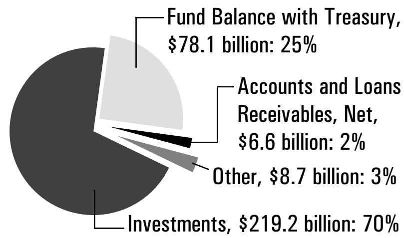
† Medicare accounts receivable was merged with financial systems material weakness in FY 2000.

# Analysis of Financial Position (Balance Sheet)

## Assets

HHS had over $312.6 billion in total assets (including non-entity assets) as of September 30, 2000. Investments of $219.2 billion, Fund Balance with Treasury of $78.1 billion, and Accounts and Loans Receivable of $6.6 billion comprise 97% of this amount. Investments essentially consist of non-marketable U.S. Government Securities held in various trust funds including Medicare.

**HHS FY 2000 Assets by Type**




Note: Most HHS assets are Medicare's claims on the U.S. Treasury for investments in securities, and are categorized as Intra-governmental.

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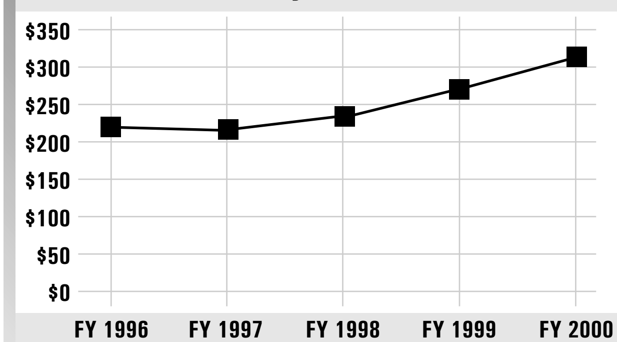
The Department's assets reported in the Consolidated Balance Sheets in Section IV are summarized in the accompanying chart.

**FY 2000 HHS Assets Summary (in millions)**

| | FY 1996 | FY 1997 | FY 1998 | FY 1999 | FY 2000 |
|---|---|---|---|---|---|
| Investments | $ 155,885 | $ 155,140 | $ 161,943 | $ 184,764 | $ 219,173 |
| Fund Balance with Treasury | 47,170 | 56,345 | 64,701 | 73,204 | 78,093 |
| Accounts and Loans Receivables, Net | 4,127 | 4,528 | 5,687 | 11,424 | 6,581 |
| Other Assets | 14,403 | 1,653 | 2,958 | 2,242 | 8,790 |
| **TOTAL ASSETS** | **$ 221,585** | **$ 217,666** | **$ 235,289** | **$ 271,634** | **$ 312,637** |

Total assets increased by $41 billion (15%) from the $271.6 billion in total assets at the end of FY 1999. This 15% increase is due largely to increased balances in the Medicare Trust Funds and in Fund Balances with Treasury.

**HHS Total Assets by Fiscal Year (in billions)**

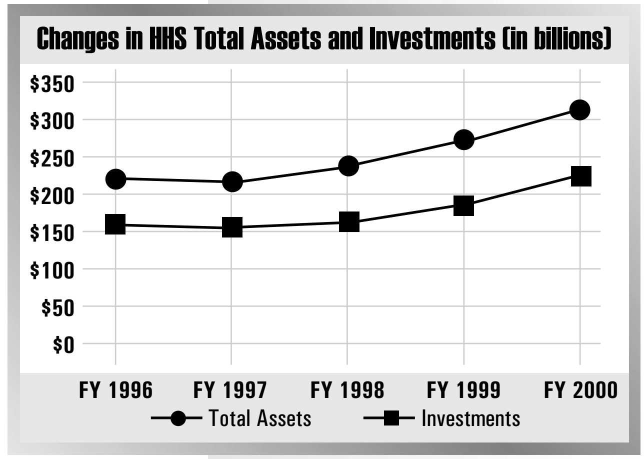



The balance sheet separately identifies intra-governmental assets from all other assets. The bulk of HHS' assets are intra-governmental, meaning that they are HHS claims against other federal agencies. These are for accounts such as the Medicare Trust Funds' Investments in U.S. Treasury Securities and the Fund Balance at Treasury.

### *Asset Analysis by Account Type*

#### Investments

Investments remain the largest HHS asset with $219.2 billion at September 30, 2000, which was increased by $34.4 billion from the $184.8 billion at September 30, 1999. It made up almost 70% of total assets at Fiscal Year ending September 30, 2000 compared to 68% in 1999. The trends in Investment balance in relation to the total asset balance are illustrated in the accompanying graph.

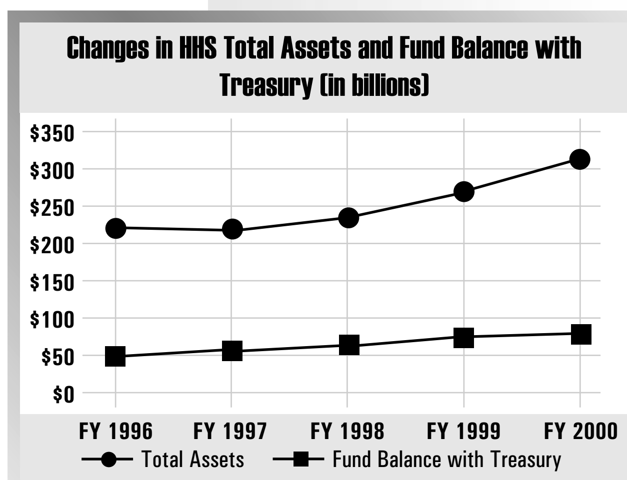



These investments represent the cumulative excess of collections and appropriations over expenditures of the Medicare HI and SMI trust funds, which are invested with the U.S. Treasury Special Issue Securities. Treasury, in turn, uses these funds to finance other operations of the federal government thus reducing the need for federal borrowing from the public. These securities had been accumulating since the inception of the Medicare program in 1966. According to the 1999 Trustees Report, 1995 was the first year that expenditures exceeded income and Medicare started to call upon its Trust Fund resources. These resources will continue to be called upon in years where annual expenditures exceed revenues.

Reflecting both the law and existing federal accounting standards, no liability is recorded for benefits which may be paid in the future on behalf of today's workers who are currently paying taxes into the trust funds and who expect to be future beneficiaries upon their retirement. See also Section IV for required supplementary information on Medicare Trust Funds.

### Fund Balance with Treasury

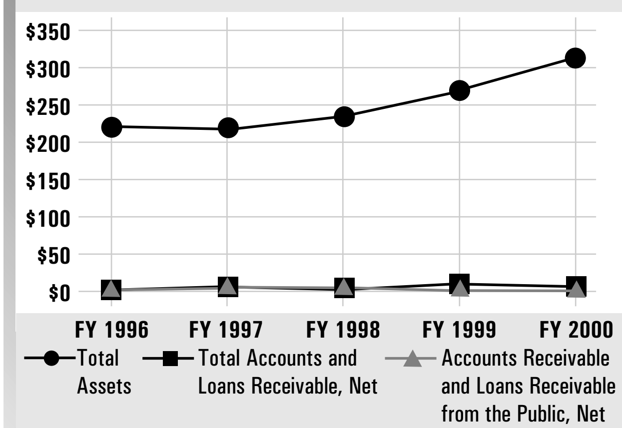
Fund Balance with Treasury remains the second largest HHS asset item with $78.1 billion at September 30, 2000, an increase of $4.9 billion from the September 30, 1999 balance of $73.2 billion. The balance at September 30, 2000 accounts for approximately 24% of the total assets, which represents appropriated, revolving, trust, and other funds maintained at the Treasury Department to pay current liabilities. The changes in Fund Balance Treasury in relation to the changes in Total Assets are illustrated in the accompanying graph.



### Accounts Receivable and Loans Receivable from the Public (Net)

Gross accounts and loans receivable amounted to $11.6 billion with an offsetting allowance of $4.9 billion (42% of the gross). Included in total Accounts and Loans Receivable, net of $6.6 billion at September 30, 2000 is Accounts Receivable and Loans Receivable from the Public, net at $4.4 billion. The changes in Accounts Receivable and Loans Receivable from the Public, net in relation to the total Accounts and Loans Receivable, net and the total assets are illustrated in the accompanying graph.

**Changes in HHS Total Assets and Accounts and Loans Receivable (Net) (in billions)**




Although the Accounts Receivable and Loans Receivable from the Public, net represent only 1.4% of HHS total assets, the account draws a great deal of attention with respect to our debt collection initiatives, which are covered in Section II of this report. During FY 1999, HCFA management directed an in-depth analysis of accounts receivable balances at Medicare contractors. The analysis revealed that many receivables included the items whose collectability was extremely unlikely as well as those items which could not verified with documentation or the debtor organization no longer exists. The effort resulted in the write-off of nearly $3 billion in Medicare contractor receivables. In FY 2000, the write-off was $.6 billion. For further details, see Note 4 to financial statements in Section IV of this report.

### Property, Plant, and Equipment (PP&E)

Property, Plant and Equipment, Net at $2.0 billion (net of accumulated depreciation) amounts to less than one percent of total assets, and is largely concentrated at NIH (numerous high technology research centers with high technology equipment), IHS (many facilities), FDA, and CDC. Since FY 1997, the capitalization threshold was increased from $5 thousand to $25 thousand, reducing the burden of accounting for smaller equipment purchases.

### Assets Analysis by Budget Function

When assets are analyzed by budget function (see other accompanying information in Section IV of this report), Medicare (with its own budget function category) holds the vast majority (72%) of HHS assets (composed largely of the Trust Fund account balances). The health budget function (which covers the Medicaid program, NIH, HRSA, CDC, SAMHSA, IHS, FDA and AHRQ), the second largest (18%), is composed mostly of Fund Balances with Treasury, with lesser amounts attributed to Investments and PP&E.

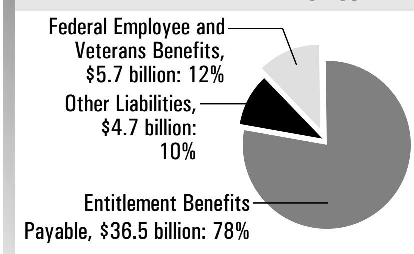
## Liabilities

The Department had total liabilities of nearly $47.0 billion as of September 30, 2000. The Entitlement Benefits Payable of $36.5 billion and Federal Employee & Veterans Benefit of $5.7 billion comprise of 90% of the total liabilities.

The Department's liabilities reported in the Consolidated Balance Sheets in Section IV are summarized in the accompanying chart.

Trends in liability account balances show that total liabilities decreased by $450 million (1%) from the $47.4 billion in total liabilities at the end of FY 1999. Changes in total liabilities from FY 1996 to FY 2000 is illustrated in the accompanying table.

**HHS FY 2000 Liabilities by Type**

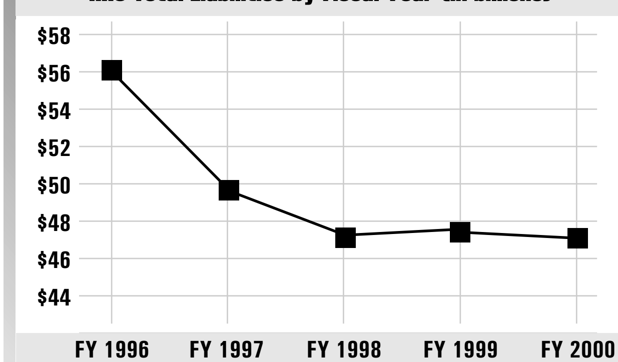



Relative to HHS assets, there are few liabilities. This is because neither federal law nor federal accounting standards recognize any long term liabilities associated with covering future Medicare costs for today's workers contributing to the system today who become beneficiaries upon their retirement. In other words, the amount of trust fund assets accumulated over more than three decades do not have an offsetting liability for future retirees.

**FY 2000 HHS Liabilities Summary (in millions)**

| | FY 1996 | FY 1997 | FY 1998 | FY 1999 | FY 2000 |
|---|---|---|---|---|---|
| Entitlement Benefits Payable | $ 44,182 | $ 41,760 | $ 39,570 | $ 35,302 | $ 36,522 |
| Federal Employee & Veterans Benefits | 3,280 | 3,463 | 3,643 | 4,940 | 5,746 |
| Employment Tax Revenue Adjustment | – | – | – | 2,867 | – |
| Other Liabilities | 8,670 | 4,439 | 3,889 | 4,298 | 4,689 |
| **TOTAL LIABILITIES** | **$ 56,132** | **$ 49,662** | **$ 47,102** | **$ 47,407** | **$ 46,957** |

**HHS Total Liabilities by Fiscal Year (in billions)**

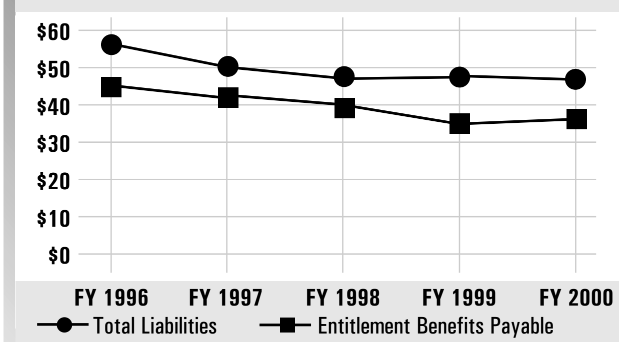



Of the Department's total liabilities, $6.4 billion (14%) was not covered by budgetary resources which are largely unfunded pension expenses of the Public Health Service Commissioned Corps recognized at PSC, but also include accrued annual leave and disability compensation for employees at all HHS components. The federal budget process does not recognize the future employee benefits costs of today's employees, but instead budgets for those future expenses in the future years when they are actually paid. The result is that while employee expenses (present and future) are recognized in accrual-based financial statements, they are under-represented in the cash-based federal budget. The largest portion of the liabilities not covered by budgetary resources is $5.7 billion in Federal Employee and Veterans Benefits.

## *Entitlement Benefits Payable*

Entitlement Benefits Payable remains the largest HHS liabilities with $36.5 billion at September 30, 2000, which was increased by $1.2 billion from the $35.3 billion at September 30, 1999. Entitlement Benefits Payable represents benefits due and payable to the public from entitlement programs enacted by law. In HHS, the largest entitlement programs, which comprise the bulk of HHS entitlement spending, are Medicare and Medicaid (HCFA). Changes in Entitlement Benefits Payable balance in relation to the changes in total liabilities are illustrated in the accompanying graph.

**Changes in HHS Total Liabilities and Entitlement Benefits Payable (in billions)**



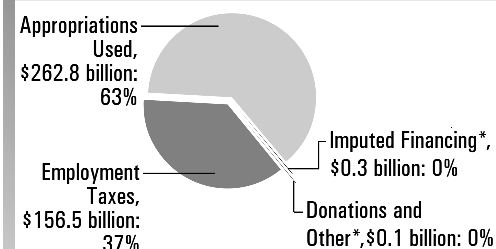
# Analysis of Net Position: Balance Sheet and Statement of Changes

- **Net Position** is the difference between total assets and total liabilities shown on the balance sheet. Starting with FY 1998 reporting, net position was broken down into two categories: unexpended appropriations and cumulative results of operations.
- **Unexpended Appropriations** is the amount of authority granted by Congress that has not been expended or used. It is mostly attributed to ACF, NIH, and HCFA.
- **Cumulative Results of Operations** are the net results of operations since inception, plus the cumulative amount of prior period adjustments. Most of the balance in the account is attributable to HCFA.

The Department's Net Position was nearly $265.7 billion as of September 30, 2000, a $41.5 billion (19%) increase from the $224.2 billion balance at September 30, 1999.

The Statement of Changes in Net Position reports the net results of operations as the difference between the Department's financing sources for nonexchange revenues and the total net cost of operations. In FY 2000, appropriations used totaled almost $262.8 billion, which comprised 63% of the Department's total revenues and financing sources.

**HHS FY 2000 Non-Exchange Financing Sources**




Note: The HHS FY 2000 Statement of Changes in Net Position reveals that general appropriations and taxes are the largest source of non-exchange financing.

* Imputed Financing, Donations, and Other Financing Sources were far less than .1% of the total.

# Analysis of Net Cost of Operations

The principal Statement of Net Cost presents the net cost of each HHS component in aggregate and the supplemental schedule provides figures by major budget function.

The FY 2000 GPRA annual performance plans identified major programs. Those programs are shown on the HHS components' respective FY 2000 statements. Due to the number of HHS component programs, presentation and analysis of cost by program will be at the HHS component level. The HHS component financial statements will be available on their respective Internet Web sites. For reporting at the Departmental level, these programs have been rolled up by major budget functions. HHS' largest budget function is Medicare.

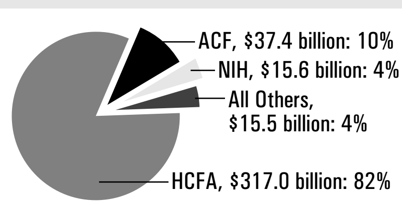
In addition, the Statement of Net Cost will allow for linking program performance under GPRA reporting to the costs of programs reflected on the HHS components' respective statements. The concept of linking resources to results will finally be achieved by the display of total program costs.

The format of the HHS-level Statement of Net Cost is quite similar to the schedule of HHS FY 2000 net outlays by major budget function and HHS component (see Budgetary Highlights in Section VI). The difference between the two is that the Statement of Net Cost represents expenses computed using accrual accounting techniques which recognize costs when incurred, regardless of the year the money was appropriated during the budget process. The net outlays chart in Section VI identifies only the outlay (issuance of checks, disbursement of cash, or electronic transfer of funds) of those funds 'tagged' during the budget process as FY 2000 funds net of receipts.

The Department's total net cost of operations for the year ended September 30, 2000, after intra-HHS Eliminations, was $385.5 billion. HCFA with $317.0 billion of net costs, ACF with $37.4 billion of net costs, and NIH with $15.6 billion of net costs, comprise 96% of the total net cost of operations.

Net costs by HHS components are shown the accompanying chart.

**HHS FY 2000 Net Cost of Operations by HHS Component**



# Analysis of the Statement of Budgetary Resources

The Statement of Budgetary Resources illustrates to financial statement readers how the budgetary resources were made available and the status at the end of the period. It presents the relationship between budget authority to budget outlays and reconciles obligations to total outlays. This is a fundamental change in financial statement reporting in that the budget process became a part of the financial statement audit process when this statement was first required for FY 1998.

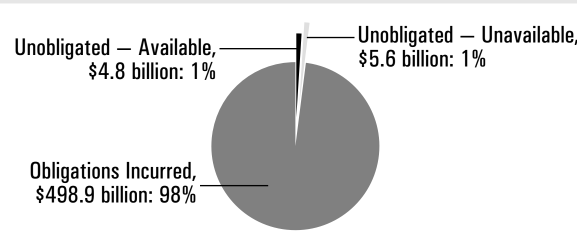
The purpose of the statement is to explain the sources of appropriated dollars and to provide the status (obligated or not) of those appropriated dollars. The total resources and the total status of budgetary resources equal the same amount. Thus, we have a type of budgetary "balance sheet." The statement shows that of the total $509.3 billion in FY 2000 HHS budgetary resources, they are largely derived from budget authority.

The status section of the report reveals that most ($498.9 billion) of the resources budgeted for FY 2000 have either already been spent or have already been marked for specific things although there is an unobligated available year-end balance of $4.8 billion.

The Statement of Budgetary Resources also provides information on total outlays for the year. Total FY 2000 outlays in the Statement of Budgetary Resources amounted to almost $481.0 billion. This amount excludes intra-budgetary transactions and proprietary receipts from the public such as those for Medicare's SMI (Part B) insurance premiums. When those amounts are included (as is practice for several budget execution reports) the figure becomes a total net outlays amount of $382.6 billion, a figure which is also used in this report (particularly in the section on budgetary highlights).

Most of the budgetary resources available to HHS during FY 2000 were categorized as incurred obligations at year end.

**Status of Budgetary Resources at End of FY 2000**



# Analysis of the Statement of Financing

The Statement of Financing is designed to provide the bridge between accrual based (i.e. financial accounting) information in the Statement of Net Cost and obligation based (i.e. budgetary accounting) information in the Statement of Budgetary Resources by reporting on the differences and reconciling the two statements. This reconciliation is needed to insure that there is a proper relationship between proprietary and budgetary accounts in the financial management system. In addition to the information it will provide, this statement will provide additional assurance about the reliability of the system that produces the accounting and budgetary information.

Historically, federal program managers have had little need to be familiar with financial accounting since the formulation and execution of their budgets centered on the budgetary measures as defined by OMB. Alternately, the accounting offices focused attention on the proprietary accounts while ensuring that corresponding budgetary entries were being recorded to ensure the proper control of funds. Recent financial management initiatives, starting with the CFO Act of 1990, emphasize that employees of the various disciplines should no longer be unaware of the relationships between financial and budgetary measures. The Statement of Financing assists those who work with the budget to understand the financial statements and the cost information they provide. Therefore, this statement serves as a bridge between the two different bases of accounting. There are certain differences, such as timing differences, between budget numbers and financial statement numbers that will never change. The Statement of Financing will also serve to define and supply this information.

The Statement of Financing begins with the amount of budgetary obligations incurred ($498.9 billion) from the status section of the Statement of Budgetary Resources. The statement then provides a series of reconciling items in order to work toward the bottom line — the net cost of operations of $385.5 billion. This amount does not equal the Consolidated Net Cost of Operations appearing on the Consolidated Statement of Net Cost because the Statement of Financing does not include the eliminating entries that are included in the Consolidated Statement of Net Cost.