

Section II: Financial Section

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MESSAGE FROM THE CHIEF FINANCIAL OFFICER

As the Chief Financial Officer (CFO) of the Department of Health and Human Services (HHS), I recognize that our Department is accountable to our ultimate stakeholders -- the American Public. We are vigilant to use taxpayer resources wisely to carry out the Department's mission to enhance the health and well-being of Americans. With an annual budget in excess of \$700 billion in fiscal year (FY) 2008, we are one of the largest, most complex financial organizations in the world. Through collaboration, our CFO community manages financial accountability, compliance, and risk across HHS by maximizing resources to drive results.



Charles E. Johnson

For the second year, we have chosen to participate in the Office of Management and Budget (OMB) pilot approach to improving performance and accountability reporting. Pursuant to OMB Circular A-136, *Financial Reporting Requirements*, this *Agency Financial Report* represents our accountability report for FY 2008. The *FY 2008 Performance Report* and *Citizens' Report* will be available on January 15, 2009. As part of this pilot approach, we will also produce a *Budget, Performance, and Financial Snapshot* document, which will be available at www.hhs.gov on December 15, 2008. HHS anticipates that this approach will make information more transparent and useful to the President, Congress, and American people.

During FY 2008, the Department successfully sustained its standards for reporting and management controls. We have improved our reporting processes and successfully performed our third annual, more rigorous internal control assessment as required by OMB Circular A-123, *Management's Responsibility for Internal Control*. The Secretary's annual Statement of Assurance reflecting the results of our assessment is presented in Section I of this report.

This report also contains our audited annual financial statements. For the tenth year in a row, I am pleased to report that our independent auditors have issued an unqualified or "clean" opinion. The FY 2008 independent auditors' report identifies two internal control material weaknesses that must be corrected relating to: (1) financial reporting systems, analyses, and oversight, and (2) financial management information systems. Four material weaknesses were identified in the FY 2007 independent auditors' report. The Department recognizes the importance of effective internal control and is committed to resolving these material weaknesses promptly. During FY 2009, we plan to continue our collaborative efforts to improve our financial management and to further enhance information available through UFMS with the implementation of the consolidated reporting solution.

With respect to our financial reporting capabilities, the Department successfully executed implementation of our Unified Financial Management System (UFMS). The last Operating Division was successfully converted to UFMS during October 2007. The Department continues to convert Medicare contractor systems which will substantially comply with the *Federal Financial Management Improvement Act (FFMIA)* by the end of 2010. During FY 2008, our CFO executives throughout the Department worked together as a community to address the internal control issues identified during the FY 2007 financial statement audit. While much work remains, we made significant progress towards resolving long-standing issues and strengthening our internal control structure. Many of these improvements resulted from our strong commitment to accountability, transparency, and effective stewardship, along with effective use of information now available with our full implementation of UFMS.

Finally, I want to thank our employees and partners who work each day to achieve our Nation's noblest human aspirations for safety, compassion, and trust. This report -- and the accomplishments it describes -- is a reflection of their extraordinary dedication to our mission. Together we look forward to tackling our ambitious agenda for the future in 2009.

Charles E. Johnson

November 17, 2008

Audit Reports

November 13, 2008

TO: The Secretary
Through: DS _____
COS _____
ES _____

FROM: Inspector General

SUBJECT: Report on the Financial Statement Audit of the Department of Health and Human Services for Fiscal Year 2008 (A-17-08-00001)

This memorandum transmits the independent auditors' reports on the Department of Health and Human Services (HHS) fiscal year (FY) 2008 financial statements, conclusions about the effectiveness of internal controls, and compliance with laws and regulations. The Chief Financial Officers Act of 1990 (Public law 101-576), as amended, requires the Office of Inspector General (OIG) or an independent external auditor, as determined by OIG, to audit the HHS financial statements in accordance with applicable standards.

We contracted with the independent certified public accounting firm of Ernst & Young LLP (E&Y), to audit the HHS consolidated balance sheet as of September 30, 2008, and the related consolidated statements of net cost and changes in net position, the combined statement of budgetary resources for the year then ended, and the statement of social insurance as of January 1, 2008. The contract required that the audit be performed in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the "Government Auditing Standards," issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 07-04, Audit Requirements for Federal Financial Statements.

Results of Independent Audit

Based on its audit, E & Y found that the FY 2008 HHS financial statements were fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. However, E & Y noted two matters involving internal controls over financial reporting that were considered to be material weaknesses under standards established by the American Institute of Certified Public Accountants:

- *Financial Reporting Systems, Analyses, and Oversight.* Internal control weaknesses continued in HHS's financial management systems and financial analyses and oversight. HHS's lack of an integrated financial management system impaired its ability to support and analyze account balances. Manual intervention was required to

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correct transactions that did not post in accordance with standards and to transfer information between systems that did not interface electronically. In addition, certain reconciliations and account analyses were not adequately or timely performed to ensure that differences were identified and resolved and that invalid or old transactions were identified and closed. HHS's financial management systems did not substantially comply with Federal financial management systems requirements or the U.S. Government Standard General Ledger at the transaction level.

- *Financial Management Information Systems.* General control issues in both the design and the operation of key controls were noted in security management and access controls. In addition, weaknesses were noted in general controls, business process controls, interface controls, and data management system controls for specific financial applications.

Evaluation and Monitoring of Audit Performance

In accordance with the requirements of OMB Bulletin 07-04, we reviewed E & Y's audit of the HHS financial statements by:

- evaluating the independence, objectivity, and qualifications of the auditors and specialists;
- reviewing the approach and planning of the audit;
- attending key meetings with auditors and HHS officials;
- monitoring the progress of the audit;
- examining audit documentation related to the review of internal controls over financial reporting;
- reviewing the auditors' reports; and
- reviewing the HHS Management Discussion and Analysis, Financial Statements and Footnotes, and Supplementary Information.

E & Y is responsible for the attached reports dated November 13, 2008, and the conclusions expressed in those reports. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and accordingly we do not express, an opinion on HHS's financial statements, the effectiveness of internal controls, whether HHS's financial management systems substantially complied with the Federal Financial Management Improvement Act, or compliance with laws and regulations. However, our monitoring review, as limited to the procedures listed above, disclosed no instances in which E& Y did not comply in all material respects, with U.S. generally accepted government auditing standards.

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If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact Joseph E. Vengrin, Deputy Inspector General for Audit Services, at (202) 619-3155 or through e-mail at Joseph.Vengrin@oig.hhs.gov. Please refer to report number A-17-08-00001.

Daniel R. Levinson

Attachment

cc:

Charles E. Johnson
Assistant Secretary for Resources and Technology

Sheila Conley
Deputy Assistant Secretary, Finance

Report of Independent Auditors

To the Secretary and the Inspector General of the
U.S. Department of Health and Human Services

We have audited the accompanying consolidated balance sheet of the U.S. Department of Health and Human Services (DHHS) as of September 30, 2008, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and the statement of social insurance as of January 1, 2008. These financial statements are the responsibility of DHHS's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of DHHS as of and for the year ended September 30, 2007 were audited by other auditors whose report thereon dated November 14, 2007 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of DHHS's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of DHHS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2008 financial statements referred to above present fairly, in all material respects, the financial position of DHHS as of September 30, 2008, and its net cost, changes in net position, and budgetary resources for the year then ended, and the financial condition of its social insurance program as of January 1, 2008 in conformity with accounting principles generally accepted in the United States.

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As discussed in Note 27 to the financial statements, the statement of social insurance presents the actuarial present value of the CMS's Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) trust funds' estimated future income to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants during a projection period sufficient to illustrate long-term sustainability of the social insurance program. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material. In addition to the inherent variability that underlies the expenditure projections prepared for all parts of Medicare, the SMI Part D projections have an added uncertainty in that they were prepared using very little program data upon which to base the estimates.

Our audit was conducted for the purpose of forming an opinion on the 2008 basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136. The other accompanying information has not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we express no opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 13, 2008 on our consideration of DHHS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Ernst & Young LLP

November 13, 2008

Report on Internal Control

To the Inspector General and Secretary of the
U.S. Department of Health and Human Services

We have audited the financial statements of the Department of Health and Human Services (DHHS or the Department) as of and for the year ended September 30, 2008 and the statement of social insurance as of January 1, 2008, and have issued our report dated November 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the design effectiveness of the Department's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of the Department's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not to express an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DHHS's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purposes described in the preceding paragraphs and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

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A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described above and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we considered the following matters noted—Financial Reporting Systems, Analyses, and Oversight; and Financial Management Information Systems—to be material weaknesses.

MATERIAL WEAKNESSES

Financial Reporting Systems, Analyses and Oversight

Overview

OMB Circular No. A-127, *Financial Management Systems*, prescribes the policies and standards that each agency should follow in developing, operating, evaluating, and reporting on financial management systems. The agency's financial statements are the culmination and an integral part of the total financial management system that encompasses sufficient structure, effective internal controls and reliable data necessary for the agency to carry out its financial management functions, manage financial operations and report on the agency's financial status. DHHS and its Operating Division (OPDIV) management are responsible for establishing and maintaining effective internal controls and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA) and OMB Circular No. A-123, *Management's Responsibility for Internal Control*.

In fiscal year (FY) 2004, DHHS began its implementation of a commercial web-based off-the-shelf product modified to replace five legacy accounting systems and numerous subsidiary systems with one modern accounting system with three components. The three components include:

- Healthcare Integrated General Ledger Accounting System (HIGLAS) developed to support the financial activities of the Centers for Medicare & Medicaid Services (CMS) and its Medicare contractors. Although initiated in fiscal year (FY) 2005, full implementation is not expected until FY 2013.
- National Institutes of Health (NIH) Business System (NBS) developed to support the financial activities at NIH completed certain aspects of its implementation in FY 2007 with several ancillary systems expected to be implemented over the next few years.
- Unified Financial Management System (UFMS) developed to support the financial activities at the remaining operating divisions (OPDIVS) with full implementation occurring within FY 2008.

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These conversion efforts necessitated complex, extensive data cleanup, which were not always successfully completed in a timely manner. During FY 2008, DHHS management and its OPDIVs focused significant resources in developing and implementing corrective actions to address these issues and many other longstanding weaknesses identified in its OMB A-123 reports and other internal processes and OIG and GAO performance and financial audits. Management continued to implement internal controls, develop policies and procedures, and train its financial management personnel.

The Department created the Risk Management and Financial Oversight Board (the Board) in FY 2006 and is chaired by its Chief Financial Officer. The Board played a critical role in FY 2008 in focusing senior management's attention on those activities identified as weaknesses or vulnerabilities and ensuring that corrective action plans were developed and implemented to address the Department's deficiencies in an effective manner.

However, our testing of internal control continued to identify serious internal control weaknesses in its financial systems and processes for producing financial statements, including lack of integrated financial management systems and weaknesses in entity-wide internal control which impaired DHHS's ability to report accurate and timely financial information. Within the context of the approximately \$700 billion in departmental outlays, the ultimate resolution of such amounts is not material to the financial statements taken as a whole. However, these matters are indicative of serious systemic issues that must be resolved.

Lack of Integrated Financial Management System

DHHS's financial management systems are not compliant with the Federal Financial Management Improvement Act (FFMIA) of 1996. FFMIA requires agencies to implement and maintain financial management systems that comply with federal financial management systems requirements. More specifically, FFMIA requires federal agencies to have an integrated financial management system that provides effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems and compliance with the United States Standard General Ledger (USSGL) at the transaction level and applicable federal accounting standards. The lack of an integrated financial management system continues to impair DHHS's and its OPDIVs' abilities to adequately support and analyze account balances reported.

Although DHHS implemented a commercial off-the-shelf product, approved by the former Joint Financial Management Improvement Program (JFMIP), certain aspects of the accounting systems lack integration and do not conform to the requirements. DHHS's management continues to identify configuration issues that results in inappropriate transactional postings. Finally, the financial systems are not fully integrated and are not expected to have full integration until FY 2013. Specific weaknesses noted include the following:

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- CMS, the largest entity within DHHS processing 85% of total expenditure activity, continues its efforts to implement HIGLAS, which will integrate the CMS contractors' standard claims processing system and replace the CMS current mainframe-based financial system with a web-based accounting system. CMS relies on a decentralized organization/structure and complex financial management systems—not only within its central office and regional offices' processes but within many of the Medicare contractor organizations—to accumulate data for financial reporting. Currently, CMS's lack of a single integrated financial management system continues to impair its ability to efficiently and effectively support and analyze financial reports. The Medicare contractors that have not implemented HIGLAS continue to rely on a combination of claims processing systems, personal computer based software applications and other ad hoc systems to tabulate, summarize and prepare information that is reported to CMS on the 750—*Statement of Financial Position Reports*, the 751—*Status of Accounts Receivable Reports* and the reporting of funds expended, the 1522—*Monthly Contractor Financial Report*. The accuracy of these reports remains heavily dependent on inefficient, labor-intensive, manual processes that are also subject to an increased risk of inconsistent, incomplete, or inaccurate information being submitted to CMS.
- During FY 2008, thousands of manual journal vouchers totaling in excess of \$900 billion were required to be recorded in UFMS to post certain types of transactions—including transactions to record certain proprietary and budgetary entries, record accruals, perform adjustments between governmental and nongovernmental accounts, perform adjustments to agree budgetary to proprietary accounts, perform other reconciliation adjustments at period end, and correct errors identified related to configuration issues within UFMS. These entries are non-standard postings to the UFMS system to record both the proprietary and budgetary affects of certain financial activities for which the financial system is not configured properly to post automatically. Although these entries are required to be posted to the general ledger in order for the financial statements to be accurate, many of these entries should have been configured as routine systematic entries within UFMS. Although these entries are considered manual postings, they are in fact subject to automated edit checks such as cross validation rules and funds control. Additionally, we noted certain weaknesses with the use of manual entries including improper or lack of approvals and limited descriptions as to the purpose of the entry. During the third quarter of FY 2008, new policies and procedures related to manual entries were issued; however, the effective date of the policy is not until FY 2009.
- As discussed in further detail below, reviews of general and application controls over financial management systems identified certain departures from requirements specified in OMB Circulars A-127, *Financial Management Systems*, and A-130, *Management of Federal Information Resources*. Additionally, the OIG identified certain issues, including access control deficiencies related to systems as part of its Federal Information Security Management Act and other OIG engagements. Finally, DHHS management has identified financial information management systems as a material weakness as a result of its OMB Circular A-123 assessment.

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- As reported by other auditors last year, DHHS has not completed the development of management information reports from the UFMS system. Ad-hoc extracts from UFMS are used to support monthly reconciliations and audit requests. For example, DHHS could not readily provide standard reports to identify detailed balances to support their reported accounts receivable and accounts payable balances included in their financial statement balances.
- Although the OPDIVs are using UFMS to account for financial activities within the OPDIVs, the DHHS is utilizing the Automated Financial System (AFS) to compile the consolidated financial statements. AFS, a spreadsheet macro driven process, requires the OPDIVs to manually enter their trial balances and footnote disclosures for DHHS to compile the Department-level consolidated financial statements. The key entry process can be error-prone if effective detective controls are not in place. In our review of the initial financial statements provided on October 20, 2008, we noted several OPDIVs recording amounts on the incorrect line causing the financial statement disclosures to be incorrect. Additionally, we noted several adjustments totaling in excess of \$700 million were recorded within AFS to ensure proper balancing of statements. As a result, amounts within AFS did not consistently agree to balances within the OPDIV general ledger.
- Due to certain configuration issues within UFMS, certain financial statement balances on the Statement of Budgetary Resources (SBR) require analysis of other accounts to derive/estimate the amounts reported. For example, as other auditors reported in FY 2007, financial accounting and reporting standards require that DHHS record prior year recoveries in a separate general ledger account and report these amounts on the SF-133 and the SBR. These items are currently not being captured within UFMS. As a result, most OPDIVs are required to analyze transactions in other accounts to derive the balance.

Resource limitations and other priorities, including operational mission objectives, conversion of legacy systems to UFMS, the catch-up of reconciliations and “clean up” of data anomalies as a result of the conversion were noted as causes for delays in upgrading certain system and financial internal control processes limiting DHHS’s ability to comply with requirements under FFMIA.

Financial Analysis and Oversight

The U.S. Government Accountability Office (GAO)’s Standards for Internal Control in the Federal Government states that internal control activities help ensure that management’s directives are carried out. The control activities should be effective and efficient in accomplishing the organization’s control objectives. Examples of control activities include: top-level reviews, reviews by management at the functional or activity level, segregation of duties, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Because weaknesses exist in the financial management systems, management must compensate for the weaknesses by implementing and strengthening additional controls to ensure that errors and irregularities are detected in a timely manner. Our review of internal control disclosed a series of weaknesses that impact DHHS's ability to report accurate financial information on a timely basis. During FY 2008, we found that certain processes were not adequately performed to ensure differences were properly identified, researched, and resolved in a timely manner and that account balances were complete and accurate. We noted the following items in the current year audit that indicate additional improvements in the financial reporting systems and processes are required.

Department/Operating Division Periodic Analysis and Reconciliation

When weaknesses exist in financial systems, as discussed above, management must compensate by implementing and strengthening entity-wide controls to ensure that errors and irregularities are detected in a timely manner. These entity-wide controls would include monitoring of budgets, reconciliations of accounts, analyses of fluctuation, and aging of accounts. During our audit, we found that certain processes were not adequately performed to ensure that differences were properly identified, researched, and resolved in a timely manner and that account balances were complete and accurate. The following represent specific areas we noted that need enhanced periodic reconciliation and analysis procedures:

- Fund Balance With Treasury—Treasury regulations require that each federal entity ensure that it reconciles on a monthly basis its financial records with Treasury's records and that it promptly resolves differences. If this reconciliation is not adequately performed, loss, fraud, and irregularities could occur and not be promptly detected, and/or financial reports that are inaccurate may be prepared and used in decision-making. On a monthly basis, the DHHS is responsible for reconciling approximately 500 Treasury appropriation symbols. As of March 30, 2008, the general ledger and Treasury's records differed by more than an approximate absolute value of \$1.8 billion. The cause primarily centered on one OPDIV that converted to UFMS at the beginning of the year, falling behind several months on its fund balance with Treasury reconciliations. Other causes related to reconciling differences dating back to 2004 and resource limitations that limited certain OPDIVs to identifying the larger differences. During the third and fourth quarters, management focused additional efforts on its fund balance with Treasury reconciliations which resulted in progress in reducing differences at September 30, 2008 to an approximate \$218 million.
- OPDIV Financial Reconciliation Activity Certifications—As part of the accounting centers' monthly processes, the Department has instituted a policy whereby the accounting centers certify the status of completing required periodic reconciliations. For each required reconciliation, the preparer and approver sign off and provide a date of completion. On a monthly basis, the document is forwarded to the Department. No supporting documentation is required to be provided as part of the submission. Our review of the OPDIV submissions and the supporting documentation maintained at the OPDIV identified inconsistencies in the procedures performed, the reports utilized, and

the results provided among the various OPDIVS. Our review of certifications prepared identified that although certain reconciliations were signed off and dated, the reconciliation had not been completed as differences within the reconciliation had not been identified on a timely basis. For example, the OPDIV management certifies to the accuracy of their financial statements submitted through AFS; however, we noted over \$400 million in errors or omissions within the OPDIV level statements. Finally, we noted that although desk officers have been assigned the responsibility of reviewing specific OPDIV financial reporting, the desk officers do not consistently review the supporting documentation to ensure that the submissions are accurate.

- Accounts Payable—Our review of certain accounts payable reconciliations performed by the OPDIVs identified large differences between subsidiary files and the general ledger. For one OPDIV, we noted a \$126 million difference between its subsidiary and the general ledger. Further, we noted a number of old/stale accounts payable transactions that should have been researched and removed. Many of the items were several years old and had not shown activity for at least two years.
- Accounts Receivable—Although an aging of accounts receivable was provided, DHHS was unable to provide a subsidiary listing of accounts receivable balances that support the general ledger.
- Grant Monitoring—During our review of FY 2008 grant activity provided from the Payment Management System as of March 30, 2008, we noted approximately 70 grant obligations totaling \$11.8 million that were dated prior to FY 1999 that had not been closed out. Although progress was noted from prior years, we continue to note that these grants were already beyond a reasonable timeframe for close-out. In prior years, a lack of resources was noted as the cause of backlogs in closing out expired grants. In FY 2008 increased emphasis on close-out has provided needed progress in reducing the backlog and ensuring consistency between Payment Management System and the OPDIVs official subsidiary systems.
- Undelivered Orders—As reported in FY 2007, DHHS does not have adequate controls in place to monitor undelivered orders which represent remaining amounts of obligated funds that have not been delivered or appropriately deobligated. As of June 30, 2008, we noted over 25,000 transactions totaling \$256 million which were over two years old without activity. Many of these transactions represented travel, grants and contracts awaiting close-out. Our analysis at September 30, 2008 identified that DHHS had made significant progress in removing stale obligations with our differences decreasing to 22,700 transactions totaling \$150 million.
- Intragovernmental Transactions—Under OMB Circular A-136, *Financial Reporting Requirements*, government entities are required to reconcile intragovernmental transactions with their trading partners. For the June 30, 2008 material difference report, DHHS was unable to determine what made up a \$26.8 million difference between its subsidiary records and its trading partner's financial records. Additionally, we noted that for two entities, balances reported by DHHS had not been adjusted for three quarters.

- Budgetary Analyses—Within the federal government, the budget is a primary financial planning and control tool. OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, implements the requirements of budget formulation and execution including requirements related to apportionments, accounting systems to control spending, proper recording of obligations, and closing accounts. For internal control purposes, budgetary monitoring is a key management control that, if implemented correctly, identifies cost overruns and potential material misstatements in a timely fashion. Although we determined that reviews of the budget were being performed at the OPDIV level, our review of the budgetary status of funds report identified some negative balances whereby costs appeared to exceed obligations. In the past few years, DHHS has had one anti-deficiency act violation in one program activity and is currently investigating a potential violation for another program. To ensure these violations do not continue, enhanced budgetary monitoring processes are required.
- Available Documentation—We noted that certain documentation to support certain transactions was not readily available. Of our testing of 539 transactions, we identified 131 transactions where we received incomplete documentation that would be required by federal or DHHS guidelines. Examples of the types of documentation that were incomplete or omitted included unapproved invoices, purchase orders, treasury confirmations, payment registers, and supporting documentation for certain journal vouchers. In most cases, we were able to obtain other types of evidence to validate the samples.

Monitoring of Financial Operations Require Enhancements

The U.S. GAO's *Standards for Internal Control in the Federal Government* states that "information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities." Further, the standard indicates that financial statement information is needed not only on periodic basis for external reporting but also on a day-to-day basis to make operating decisions, monitor performance and allocate resources. Within a decentralized complex organization like DHHS, a single integrated financial system with strong internal controls is required for up-to-date accurate financial information needed for certain decision-making responsibilities. Currently, due to the number of manual correcting entries, evolving internal control, and outdated policies and procedures, accurate information needed for decision-making at all levels of the organization may not be readily available on a day-to-day or even monthly basis as required by FFMIA. Currently, except for the compilation of quarterly financial statements, there is limited available reporting of accurate financial activities at the program, contractor, regional office, OPDIV, and/or consolidated department level.

Updating of Policies and Procedures and Additional Training of Personnel are Needed

DHHS' formalized policies and procedures are out-of-date and may be inconsistent with actual processes taking place. During our internal control documentation and testing phases, we noted that although various internal control processes had been changed or updated, the Department

had not completed its updating of procedural manuals or provided sufficient formalized guidance/training to personnel to ensure sufficient knowledge of financial management system/processes or consistency, and adequacy of internal control. For example, we noted that certain policies and procedures, including certain accrual processes, had not been updated since the mid 1980s. Further, we noted additional training on the financial systems was needed to enable DHHS personnel in their ability to access needed information from the system to complete their day-to-day responsibilities—including the preparation of reconciliations, research of differences noted, and the ability to identify and clear older “stale” transactions dating back several years.

It is our understanding that the Department and its OPDIVs are currently updating their procedures and developing further training for their personnel in the use of Oracle and other financial related systems and processes. Further training is expected to include training on Government-wide (including OMB and Treasury), DHHS and OPDIV level policies and procedures, the use of UFMS and other subsidiary systems, the preparation of financial statements and related analysis and reconciliations, and system security.

Enhanced Coordination and Communication are Needed to Facilitate an Effective Financial Management System

DHHS lacks a coordinated end-to-end process among cross-functional teams of financial management, information technology, actuarial, general counsel, operations and other personnel who monitor business activities, identify those situations where accounting evaluation or decision-making may be required, ensure that policies are being implemented and adhered to among OPDIVs and document an accurate conclusion in a timely manner. The coordination and communication of critical financial information is inconsistent and does not ensure the appropriate level of involvement and participation among the cross-functional team. For example,

- DHHS lacks a legal contingency process at interim and annual periods to record legal accruals in accordance with Generally Accepted Accounting Principles (GAAP). For example, on its June 30, 2008 OMB submission of financial statements, DHHS management reported certain contingent liabilities and a few weeks later the Office of General Counsel reported the matters as remote eliminating the need for the accrual. At year-end the liability for the claims was removed.
- Significant last minute adjustments totaling \$1.7 billion to the financial statements were identified in the weeks following year-end resulting in delays in completing its AFR. Management completed all of its identified adjustments and disclosures on November 5, 2008.
- Critical accounting matters such as accruals and contingencies require a robust process on a quarterly basis including the documentation of these critical accounting matters through a series of white papers. For CMS, these white papers supporting the conclusions on several critical accounting matters had not been timely approved and available for the

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auditor's review. Critical financial management responsibilities such as, reconciliations of Medicare Advantage (Part C) and Prescription Drug (Part D) payments and monitoring of Medicaid expenditures are performed in various program Centers / Offices of CMS. The dispersed nature of the financial management environment leaves CMS vulnerable to program responsibilities taking precedence over financial management. The decentralized nature of the organization resulted in a significant number of controls being performed at the contractors, regional offices and other Centers / Offices outside CMS. Robust analytical procedures or measures against benchmarks can monitor and mitigate risks associated with the decentralized nature of CMS operations. The limited analytical procedures performed centrally and circulated within CMS management increases the likelihood that adjustments which are other than inconsequential to the financial statements may not be identified and corrected in a timely manner.

- CMS does not perform a claims-level detailed look-back analysis for the Medicaid Entitlement Benefits Due and Payable (EBDP) to determine the reasonableness of the various state calculations of unpaid claims. For example, CMS performs an analysis of changes in prior year to current year balances; however, this analysis should be enhanced and further supplemented by additional performance measures and analyses (e.g., actual expenditures on a monthly, quarterly or annual basis by program and by contractor compared to prior year periods and expectations, etc.). To the extent that such analyses are performed by the various program Centers / Offices, OFM should ensure that these analyses reconcile to the financial statements. CMS has incorporated the use of some analytical procedures into its monitoring controls as demonstrated by the Benefit Payment Validation (BPV) process which analyzes Part C and D program benefit payment expectations compared to the actual benefit payments. This is an excellent example of an overall detect control that allows program management to monitor and understand payment trends and investigate anomalies before the funds are disbursed.

CMS Business Partner Risk Management

CMS, as stewards of the Medicare and Medicaid programs' administrative and financial operations, has a fiduciary responsibility to ensure that the programs' funds are spent in the best interest of the beneficiaries and the American taxpayers. CMS administers an extensive internal control program to protect the Agency's resources from fraud, waste and mismanagement. CMS also relies heavily on third-party contractors as it outsources substantially all the day-to-day operations for its information technology systems, the payment of Medicare and Medicaid fee-for-service claims and the Medicare Advantage (Part C) and Part D Drug programs.

CMS has developed internal controls that help prevent fraud and waste from occurring such as edits in the claims processing systems that attempt to identify and filter inappropriate claims. CMS also has developed internal controls that will help detect fraud and waste that may have occurred. Any strong control environment will have a combination of both prevent and detect controls with a greater emphasis on prevent controls.

While we noted during the current year audit that CMS had a significant amount of both prevent and detect controls in operation, we noted several examples of areas where improvements could be made in the overall control environment. This is especially true of CMS's relationships with its third-party contractors. The following are examples of control deficiencies we noted:

- Reductions have been made to the amount of funds advanced to the Part D plans as compared to prior years. However, the Part D program has a funding mechanism that results in a substantial amount of cash being advanced to various plans in anticipation of future beneficiary prescription drug claims throughout the first three quarters of the year. This is especially important given the condition of the financial and credit markets and the increased risk that Part D plans could have financial difficulties.
- During 2007, CMS transferred a majority of the Medicare Secondary Payor recovery process to a single third-party contractor. This contractor is responsible for collecting several hundred million dollars of cash on an annual basis. We noted several instances where internal controls related to this third-party contractor, including CMS's oversight of the contractor, segregation of incompatible duties and the untimely application of cash receipts, were not designed or operating effectively.

The processes designed to prevent errors should also be supplemented by controls and analyses that highlight any material errors that may occur. In this regard, errors or abuses within the Medicare claim data, if material, should be detected in the annual Comprehensive Error Rate Testing (CERT) process, while for Medicaid, the Payment Error Rate Measurement (PERM) process can be useful in this regard. Processes to assess accuracy rates as applicable and monitor Part C and D plans, particularly prescription drug event data, are evolving, but such monitoring activities can also be useful management controls. To be fully effective in compensating for inherent risks in the programs, the monitoring activities must be well understood, susceptible to replication and highly credible. To provide context for this issue: the error rate on CERT was 3.6% with projected gross improper payments of \$10.4 billion in the current reporting period.

The OIG, through recent audit activities, has indicated that for certain select services comprising a small portion of the CMS programs the error rate calculation appears to have produced estimates that are at variance from experience in the programs, and were not readily replicated. Recent CMS activities to selectively retest CERT results over the entire spectrum of claims activity will be useful in assessing the reasons for differing results and ensuring the overall credibility of the process. Similarly, ensuring that a fully reconciled population of claims is susceptible to testing is an important starting point in the development of PERM error rates. The work performed by the OIG in reconciling such populations indicates that further focus on this area is needed.

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A common set of accounting and reporting standards, an integrated financial system, a sufficient number of properly trained personnel and a strong oversight function are all necessary to ultimately prevent, and/or to detect, and resolve errors and irregularities in a timely manner. A robust financial management system also captures and produces key financial data and analyses, including critical performance measures and anomalies that chief decision makers within the organization would monitor on a periodic basis to fulfill their fiduciary responsibility, deter fraud, waste and abuse of Federal government resources and facilitate efficient and effective delivery of designated programs.

Recommendation

We recommend that DHHS continue to develop and refine its financial management systems and processes to improve its accounting, analysis, and oversight of financial management activity. Specifically, we recommend that DHHS:

- Continue to strengthen controls related to its entity-wide structure for account reconciliation, analyses and oversight by providing more in-depth on-site quality reviews of OPDIV and headquarter financial functions, provide further guidance and training of new policies and procedures, periodically requesting the supporting documentation to compare to the results communicated, and to improve communication between the various parties so that issues may be identified and resolved in a more timely manner. Further, we recommend that the operating divisions allocate adequate resources to perform the required account reconciliations and analyses on a timely basis.
- Continue to improve its financial reporting and internal quality review procedures to reasonably assure that information presented in the interim financial statements and Annual Financial Report are accurate, fully supported, and completed timely and consistent with the requirements of OMB Circular A-136, Financial Reporting Requirements, including rigorous use of checklists and enhanced supervisory review processes.
- Continue to improve its procedures related to confirming intra-governmental balances with its trading partners so that differences identified through the OMB quarterly process do not exist.
- Continue to improve its process to timely close-out “stale” or old account balances, including undelivered orders, accounts payable and grants.
- Continue to devise short-term and long-term resolutions to systematic and integration issues that complicate use of the UFMS. DHHS should continue to assess whether systems used to prepare the financial statements are complete and have been sufficiently tested prior to year-end reporting dates.

- Continue to offer updated guidance and training to personnel to ensure specific guidelines are documented as to the source of data, required follow-up with timetables, and documentation retention policies. Further, training should be provided to OPDIV and headquarter personnel to ensure a complete understanding of the financial management system and reports that are available to perform certain tasks.
- Consider moving to a monthly close of financial data to provide for a more timely compilation of accurate data that may be needed for decision-makers at all levels.
- Improve internal control surrounding manual non-routine entries, including requiring a log of all manual entries and preparing documentation to support the entry and the approval by upper management. Management has issued new policies regarding journal entries that are effective as of October 1, 2008.
- Establish or revise policies and procedures addressing documentation of transactions that are consistent with GAO's internal control standards. The policies should enable DHHS to provide sufficient documentation in a timely fashion to support its financial statements.
- Ascertain whether the operating divisions, in conjunction with DHHS, properly implement corrective actions, pending full operation of HIGLAS, the NIH NBS, and the UFMS, to mitigate system deficiencies that impair the capability to support and report accurate financial information.

Additionally, in regards to CMS, we recommend that CMS continue to develop, enhance, refine and provide robust analyses over its financial reporting systems and processes. Specifically, CMS should:

- Establish specific policies, procedures and a protocol to address situations or transactions that require cross-functional involvement in order to ensure interim and year-end financial statements are accurate and complete. This includes policies and procedures to ensure changes to critical systems outputs are appropriately discussed and reviewed with all users. The financial management function should serve as the primary coordinator to facilitate the input and involvement of the other cross-functional units whose involvement and input are important factors to consider in formulating accounting treatment and financial reporting implications.
- Continue to enhance its process related to the development, documentation, and validation of critical accounting matters and the timeliness of its white papers.
- CMS should perform and circulate for review more analytical analyses as part of the monthly, quarterly and annual close process. To the extent that such analyses are performed by various program Centers / Offices, we would expect the information would be reviewed and analyzed by OFM and reconciled to CMS financial reports.

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- Establish a process to perform a claims-level detailed look back analysis on the Medicaid EBDP to determine the reasonableness of the methodology utilized to record the \$20.4 billion accrual. One potential method to verify the reasonableness of the Medicaid EBDP balance would be to use the detail claims data from the PERM process to calculate the average days outstanding.
- Continue the process of enhancing the integrity and improving the process of the CERT and PERM tools.
- Continue to implement an integrated financial management system for use by Medicare contractors and CMS to promote consistency and reliability in accounting and financial reporting.
- With respect to the Part D program, CMS should evaluate the timing of the “Reinsurance” payments and consider a payment process which matches the timing of the “Reinsurance” payments with the incurrence of the related claims. This will result in substantially less advances to Part D plans throughout the year.
- Implement controls and enhance CMS monitoring controls over the Medicare Secondary Payor recovery contractor. In addition, CMS should evaluate its overall directives to third-party contractors to ensure that adequate controls are in place and that appropriate documentation is maintained to support the conduct of those controls.

Finally, in light of the extraordinary financial crisis that exists in 2008, we believe that DHHS should evaluate its risks with respect to all its third-party contractors and grantees to ensure that the Agency is doing everything possible to ensure that its resources are protected.

Financial Management Information Systems

Many of the business processes that generate information for the financial statements are supported by DHHS information systems. Adequate internal controls over these systems are essential to the confidentiality, integrity and reliability of critical data while reducing the risk of errors, fraud and other illegal acts. As part of our assessment of internal controls, we have conducted general control reviews for systems that are relevant to the financial reporting process.

General control review categories are the department-wide security management, access controls (physical and logical), configuration management, segregation of duties (SoD) and contingency planning. These categories combined to safeguard data, protect business process application programs and ensure continued computer operations in case of unexpected interruptions. General controls are applied at the department-wide, systems and business process application levels. GAO draft FISCAM dated April 14, 2008 states, “the effectiveness of general controls is a significant factor in determining the effectiveness of business process application controls, which are applied at the business process application level. Without effective general controls, business process application controls can generally be rendered ineffective by circumvention or modification.”

Our audit included general controls testing for NIH Center for Information Technology (CIT) and Information Technology Support Center (ITSC). Our testing noted issues in both the design and the operations of key controls. We noted weaknesses in the following FISCAM review areas:

- Security Management
- Access Control

More broadly within DHHS, a topic of major concern is the lack of remediation of prior year audit findings, primarily with respect to FISMA, some dating back to FY 2006. In addition, the process by which these findings are identified and managed, Plan of Actions and Milestones (POA&M) does not function effectively. For example, many of the prior year audit findings were not recorded in the Security and Privacy Online Reporting Tool (ProSight FISMA).

Because of the pervasive nature of general controls, the cumulative effect of these significant deficiencies represents a material weakness in the overall design and operation of internal controls. DHHS should take a department-wide view in developing a top-down strategy implementing information security programs to drive information security control design and operations in accordance with standards established by DHHS and federal standards such as NIST and OMB. Detailed descriptions of control weaknesses may be found in the management letters issued on information technology general controls and audited applications. The following discusses the summary results by review area.

Security Management

These programs are intended to ensure that security threats are identified, risks are assessed, control objectives are appropriately designed and formulated, relevant control techniques are developed and implemented, and managerial oversight is consistently applied to ensure the overall effectiveness of security measures. Security programs typically include formal policies on how and which sensitive duties should be separated to avoid conflicts of interest. Similarly, policies on background checks during the hiring process are usually stipulated. Department-wide security programs afford management the opportunity to provide appropriate direction and oversight of the design, development and operation of critical systems controls. Inadequacies in these programs can result in inadequate access controls and software change controls affecting essential, systems-based operations.

“A department-wide information security management program is the foundation of a security control structure and a reflection of senior management’s commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the department-wide level. System and application-specific procedures and controls implement the department-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood or improperly implemented; and controls may be

inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources. Through FISMA, Congress requires each federal agency to establish an agency-wide information security program to provide information security for the information and information systems that support the operations and assets of the agency, including those managed by a contractor or other agency, as written in GAO draft FISCAM dated April 14, 2008. Our procedures identified the following issues:

- **Certification & Accreditation:** Inappropriate Authorization to Operate (ATO) memos were granted for financial applications and general support systems; system security plans were outdated; and some accreditation memos were not signed.
- **Plan of Actions and Milestones (POA&M):** A formal process of monitoring and reporting status of issues recorded in POA&M has not been established; POA&M is not complete and not recorded in the Security and Privacy Online Reporting Tool (ProSight FISMA).
- **Vulnerability Management:** Vulnerability assessments are performed; however, there is a lack of effective management of the identified vulnerabilities; some identified vulnerabilities are not tracked within the vulnerability tracking system.
- **Background Investigation:** Some personnel did not complete the necessary background investigation; one contractor did not obtain the appropriate level of background investigation.

Access Control

Access controls ensure that critical systems assets are physically safeguarded and that logical access to sensitive application, system utilities, and data is granted only when authorized and appropriate. Access controls over operating systems, network components and communications software are also closely related. These controls help to ensure that only authorized users and computer processes can access sensitive data in an appropriate manner. Weaknesses in such controls can compromise the integrity of sensitive program data and increase the risk that such data may be inappropriately used and/or disclosed. Our procedures identified the following issues:

- **Access Authorization:** For ITSC and CIT, the approval of access requests was not or was inadequately documented.
- **Access Revalidation:** For ITSC, the periodic revalidation of user accounts is either not performed or inadequately documented.
- **Access Assignment:** Access assignments were excessive for some systems and did not provide an adequate segregation of duties.
- **Access Removal:** For ITSC, users' access was not terminated upon termination of their role.

- **Remote Access:** A significant number of users access DHHS network using their own personal home computers that lack security controls; remote users do not use two factor authentication.
- **Local Admin Rights:** General DHHS users have local administration access rights to their individual computers.
- **Security Monitoring:** Various computer platform operating system (Windows, UNIX and mainframe) security logs are not monitored.

Financial Application Specific Concerns

GAO FISCAM states, “business process financial application level controls, commonly referred to as “application controls” are those controls over the completeness, accuracy, validity and confidentiality of transactions, and data during application processing. The effectiveness of application controls is dependent on the effectiveness of DHHS department-wide and general controls. Weaknesses in department-wide and general controls can result in unauthorized changes to business process applications and data that can circumvent or impair the effectiveness of financial application controls. Application controls are divided into the following four control categories:

Application general controls (AS) consist of general controls operating at the business process application level, including those related to security management, access controls, configuration management, segregation of duties and contingency planning.

Business Process controls (BP) are the automated and/or manual controls applied to business transaction flows. They relate to the completeness, accuracy, validity and confidentiality of transactions, and data during application processing. They typically cover the structure, policies and procedures that operate at a detailed business process (cycle or transaction) level, and operate over individual transactions or activities across business processes.

Interface controls (IN) consist of those controls over the a) timely, accurate and complete processing of information between applications, and other feeder and receiving systems on an on-going basis; and b) complete and accurate migration of clean data during conversion.

Data management system controls (DA) enforce user authentication/authorization, availability of system privileges, data access privileges, application processing hosted within the data management systems and segregation of duties. Technology includes database management systems, specialized data transport/communications software (often called middleware), data warehouse software and data extraction/reporting software.”

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As part of our assessment of internal controls, we performed procedures related to UFMS, NIH Business System (NBS); Grants Administration, Tracking and Evaluation System (GATES); Information for Management; Planning, Analysis, and Coordination (IMPACII); Central Accounting System (CAS); Accounting for Pay System (AFPS); Managing/Accounting Credit Card System (MACCS); Automated Financial Statements System (AFS); Commissioned Officer Personnel and Payroll System (COPPS); and Commissioned Corps Personnel and Payroll System (CCP). Our testing noted application controls issues in both the design and the operations of key controls. We noted weaknesses in all four (4) control categories with significant issues around application level general controls:

- **Application Level General Controls**

- ◆ **Access Authorization/Separation:** For some users, access to key financial systems such as AFS, CAS, GATES, IMPACII and UFMS were not appropriately granted, recertified or removed.
- ◆ **Financial System Security Plan:** Security plan documentation is not complete or contains inconsistent language for GATES, IMPACII and NBS.
- ◆ **Audit Log Monitoring:** For AFS, GATES, MACCS and UFMS systems, audit log monitoring procedures were not documented. Further, audit trails that were generated were not monitored.
- ◆ **Segregation of Duties:** Access assignments were excessive for NBS and UFMS systems and did not provide an adequate segregation of duties. Assignment conflicts represent instances whereby accesses assigned may have allowed users to perform all phases of transactions without intervention by other users or approvers. In addition, application developers had full access to both development and production system. Finally, general users can override payroll system transactions.
- ◆ **Outdated Technology:** COPPS application operates on an outdated technology that can not support the latest security requirements.
- ◆ **User IDs and Passwords:** The COPPS application users share system IDs which eliminates personal accountability. Additionally, a number of other system password configurations do not comply with DHHS standards.
- ◆ **Change Management:** Change management procedures for COPPS, GATES and UFMS were insufficient to ensure only properly authorized changes were implemented into production systems.

- **Business Process Controls**

- ◆ **Error Handling Activities:** Procedures do not exist that the Global Error Handler is monitored and that transactions held in error are reviewed and processed timely.

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- **Interface Controls**
 - ◆ **System Interfaces:** For COPPS, GATES and UFMS systems, consistent policies and procedures do not exist over these interfaces to ensure that necessary inputs are processed, control logs are monitored and reviewed with issues adequately followed up, and errors held in rejection files during processing are resolved.
- **Data Management System Control**
 - ◆ **Configuration Controls:** NBS and UFMS Oracle financial systems settings for the selected databases and operating systems are not optimized to provide a secure computing environment.
 - ◆ **Development System:** COPPS system does not maintain a development environment.
 - ◆ **Key Management Report:** Management does not regularly or consistently review output reports detailing the interface activity to the financial system.

CMS Specific Financial Management System

A substantial portion of CMS transactions and administration of CMS programs is performed by geographically diverse contractors. CMS relies on extensive information systems operations to counteract the risks of its enormous size and the decentralized nature of the organization. These systems, resident at its Central Office and Medicare contractor sites, are designed to assure consistency in administration of the Medicare program in addition to processing, accounting for, and reporting on Medicare expenditures. Internal controls over these operations are essential to ensure the integrity, confidentiality and reliability of the Medicare data and to reduce the risk of errors, fraud and other illegal acts.

Controls over information systems should be augmented by controls designed to detect errors that have occurred on a timely basis and mitigate the potential impact of imperfections in the prevent controls. Generally detect controls are accomplished by means of robust manual, financial reporting and periodic monitoring activities. As noted earlier, improvements are needed in the detect controls at CMS. This weakness increases the importance of a thorough and closely followed system of Information Technology (IT) security.

The contracts between CMS and its contractors that have IT responsibilities include provisions requiring the contractors to follow security standards described in a series of documents the cornerstone of which is the Business Partners Systems Security Manual (BPSSM), Version 9. The specific security standards followed at each location are to be documented by the contractors in their System Security Plan (SSP). Contractors are also required to periodically (at least annually) test and certify their systems for operation. In addition, in some cases CMS has contractually required contractors to obtain a Statement of Auditing Standards (SAS) No. 70 report to document compliance with the BPSSM and the contractor's SSP.

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While this approach to IT security supports continuous monitoring of the contractor's information security controls, CMS controls would be enhanced by additional interactions in approving the specific security approaches and settings used to process its data and defining with sufficient granularity the details intended for contractor compliance to be tested (either by the contractors themselves in the self-assessment process or through other monitoring activities).

I. Enhancement of CMS Oversight of Information Security

CMS has developed processes and policies for supporting its Information Security Management Program in accordance with NIST Special Publication (SP) 800-53, Recommended Security Controls for Federal Information Systems and NIST SP 800-37, Guide for the Security Certification and Accreditation of Federal Information Systems. These policies are documented in the CMS BPSSM, CMS Information Security (IS) Certification and Accreditation (C&A) Program Procedures, and System Security Plans (SSP) Methodology that present the CMS plan for information security.

CMS requires certain key contractors to obtain a third party SAS 70 report and penetration tests as part of the information security monitoring procedures. However, due to the timing of contractor transition, the SAS 70 reports were not required for most of the Medicare contractors during the fiscal year 2008. As part of our audit, we read the summary documentation of the CMS self-assessment of internal controls under OMB Circular A-123, *Management's Responsibility for Internal Control*, that touched on IT controls. We noted in that review that they did not assess compliance against configuration baselines at the level of detail necessary to help ensure that CMS systems are functioning consistent with NIST compliant baselines, or that such baselines exist.

During our audit activities as part of the CFO audit, we noted instances of potential weaknesses in information security, including:

- CMS Central Office did not have a security software or operating systems software baseline for the IBM mainframe computer that processes a significant portion of CMS's financial applications, including the general ledger system.
- Four of the eight (8) data centers and software maintainers tested did not have baseline security standards for the computer systems used to process Medicare data. Baseline security standards are a requirement of the CMS BPSSM and CMS SSP Methodology.
- One data center had a deficiency in controls over security of the Medicare data being transmitted through the Medicare Data Communication Network (used to transmit data amongst all Medicare contractors) nor was this condition identified during the CMS-mandated certification and accreditation process and recertification process.

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In addition, we noted that the system security plans that were reviewed as part of the audit did not have consistent content as to the baseline security settings. As a result, it was not possible to determine if the information security requirements accepted by CMS were the information security controls implemented or that such settings were contemplated to appropriately consider risks pursuant to NIST guidance.

CMS conducted follow-up oversight activities at its Medicare contractors to reinforce the importance of CMS requirements and they noted improvements in contractor compliance. Some of these controls were not implemented until the fourth quarter of fiscal year 2008.

As part of our assessment of internal controls over CMS financially significant applications, we reviewed Financial Accounting and Control System (FACS), Fiscal Intermediary Standard System (FISS), Common Working File (CWF), Medicare System (VMS) and Multi-Carrier System (MCS) applications. Based on our review, we identified the following weaknesses:

II. Access to Programs

Access controls ensure that critical system assets are physically protected from unauthorized access and logical controls provide assurance that only authorized personnel are granted access to data and programs maintained on systems; such controls include monitoring of security events for proper assessment and remediation.

Segregation of duties is not maintained between the business function and the information security administration function for the Office of Financial Management's (OFM's) Financial Accounting and Control System (FACS) general ledger-related application. The CMS OFM has certain assigned personnel who are able to grant access to the FACS general ledger application as a system administrator to potentially unauthorized employees and process transactions. The accounting employees also have user accounts for the FACS application and they are granted access to the accounting functions within FACS.

These security weaknesses could allow internal users to access and update sensitive systems, program parameters and data without proper authorization. The audit did not disclose any exploitation of critical systems tested.

III. Control over Application Configuration Management for Shared Systems

Configuration Management depends on the consistent application of change management processes and policies to automated computer systems in order to ensure the integrity and security of financial and claims data. CMS has contracted with software maintainers to support the software development and support of the shared systems used to process Medicare claims. The software maintainers have agreed in their contract with CMS to provide services that include system development production environment simulation, documentation, training and unit testing of software the contractor develops. During the audit, the following observations were made at software maintainers:

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- The Medicare system processes claims using standardized shared application systems. Application edits were tested at four (4) software maintainer sites; the software maintainer was not able to demonstrate the successful execution of eight (8) of the 100 edits tested.
- Automated Adjudication System (AAS) programs such as SuperOps and System Control Facility (SCF) are developed and processed independently of the shared system applications to process CMS claims rejected by the standard systems. It was determined that changes made by the software maintainer for SuperOps were not made using standard CMS change control processes.
- The role of the software maintainer in the application development and deployment process as described during the audit was not consistent with the CMS Statement of Work. One software maintainer lacked current documentation on the shared application system and another software maintainer lacked complete systems documentation. In addition, the software maintainers were unable to support the development of user documentation for training of employees on security administration.

CMS depends on the software maintainers' consistent adherence to the requirements as set forth in the contract to develop and deploy shared systems that will support claims processing that provides for the integrity of claims data. The contractors' ability to meet these objectives is an important component of the internal controls at CMS.

Recommendations

DHHS should provide a secure computing environment for critical applications throughout all the operating divisions, DHHS should:

- Establish an effective process for reviewing and granting system accreditations.
- Maintain complete POA&Ms for systems and programs to facilitate the timely remediation of corrective actions.
- Conduct appropriate background investigation for DHHS personnel.
- Develop and implement an effective vulnerability management process for general support systems and major financial applications.
- Develop and implement an action plan for ensuring that user access to DHHS financial management systems, including general support systems and major applications, is authorized based on need; that system logical security settings and updates are properly implemented for all interconnected networks, systems, and applications; and that proper oversight of system activities is performed.
- Revalidate access rights on a periodic basis to limit systems access to the least privilege required to perform job responsibilities.

- Maintain system security plans to provide security and controls commensurate with risk changes associated with systems.

For CMS specifically, their systems have undergone significant change, with efforts taken to remediate specific security weaknesses leading to improvements. CMS management should continue its efforts to appropriately organize and direct the information security program administered by Office of Information Services (OIS) for all of the affected information system processing activities. Such activities should include continuous monitoring of the information security program at the Central Office and contractor sites. Specifically, CMS should analyze the following for all contractors:

- Validation of the implementation of BPSSM requirements and embedded NIST standards by the contractor. Deviations from the defined requirements and standards should be evaluated and, if acceptable, be approved.
- Documentation of the actual security settings implemented on the computer systems that support CMS financial and claims processing.
- Documentation to support certification reports provided by the contractors.
- Documentation to support that the specific control objectives and processes being tested in self-assessments and SAS 70 reviews are sufficiently granular to demonstrate compliance on a detail basis with CMS information security requirements. Consultation between the contractors and CMS on whether specific security settings for particularly vulnerable systems and data should be agreed upon and specified for periodic monitoring should be considered.

To address the FACS deficiency, we recommend that CMS move the application security administration process and configuration management process from personnel within OFM to OIS. This would remediate the segregation of duties issues for the FACS. OIS has an established user security administration process as well as an established configuration management process. CMS would strengthen the internal controls by capitalizing on these OIS processes.

CMS management should also enhance their efforts to increase contractor compliance with the implementation of controls conforming to the published CMS and other related federal standards. Through oversight activities, proactively monitoring contractor compliance with security baselines and related directives for data access control and application program management can enhance the integrity of Medicare data and programs. Specifically, they should focus on the requirements set forth in the software maintainer contracts to ensure all changes follow the change control process and that contractors provide the services and activities required by their contracts in support of the overall protection of computer system processing integrity and security for CMS.

SIGNIFICANT DEFICIENCY

Statement of Social Insurance

The SOSI for CMS presents a long-term projection of the present value, of over a 75 year time horizon, of the benefits to be paid for the closed and open groups of existing and future participants of the Medicare social insurance programs, less the income to be received from or on behalf of those same individuals. The presentation assumes the programs will continue in their current form under current law, albeit with certain economic assumptions which serve to constrain growth of the programs and imply refinements in response to the burden of the programs on economic activity and observations in the related report of the Board of the Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds (the Trustees Report) that growth as projected will substantially strain the nation.

The presentation in the CMS annual report includes estimates not only of the payroll taxes, premiums and other contributions to be made directly by the participants but also estimates of general fund contributions on their behalf to help finance the programs for which this funding mechanism exists. In contrast, the presentation included in the consolidated annual financial statements of the U. S. Government excludes such intra-governmental transfers.

Starting in FY 2006, the SOSI was required to be presented as part of the basic financial statements rather than as Required Supplementary Stewardship Information (RSSI) as previously presented. As such, the process for preparing the SOSI must comply with appropriate financial reporting internal control requirements established by OMB.

The additional visibility provided to the projections highlights the need to periodically assess the level of investment made in further refining the models, transitioning them to a robust model platform with effective programmed controls, developing alternatives for critical economic modeling and involving outside experts and public members of the Board of Trustees in critically assessing the models and associated projections. We note that the two Public Trustee positions were vacant at issuance of the 2008 Trustees Report.

The models used as inputs to the Trustees Report and the SOSI consist largely of spreadsheets with myriad data inputs from internal and external sources, and extensive movement of data between such spreadsheets. No current plans exist to replace these spreadsheets which have been used for a number of years for their intended purpose. CMS has implemented policies, processes, controls and related documentation that will provide support for the related financial statement assertions, but the use of spreadsheets will continue to pose risks that errors that are other than inconsequential will not be detected. We noted improvements in the areas of change control and internal control documentation but certain modifications needed in preparing the 2008 SOSI presentation

highlights the need to improve the controls. The lack of robust automated controls over spreadsheet changes and inputs, and complexity of the models which greatly impact the ability to rely on output analysis as a principal control with sufficient granularity, may result in output that varies from management's intentions.

Recommendation

We recommend that CMS continue to develop and refine its SOSI financial reporting spreadsheet applications and processes. Specifically, CMS should:

- Implement automated controls to ensure that data moved between and within spreadsheets are moved correctly.
- Implement automated controls to prevent the possibility of overwriting critical spreadsheet data or formula cells.
- Implement automated controls to test, review and verify all formulae changes within and between spreadsheets (e.g., spreadsheet change logging capabilities).
- Continue to emphasize compliance with compensating controls developed to ensure spreadsheets are critically assessed as they are used each year through use of input/output controls such as reviews of output against expected results and systematic signoffs on changes as data is input and the spreadsheets changed.
- Continue to work with appropriate parties to engage Public Trustees, expert panels and other internal and external resources to continue to refine the models and explore alternatives to the existing spreadsheet applications and somewhat simplified economic models.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2007 audit of the DHHS financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Material Weaknesses		
Issue Area	Summary Control Issue	FY 2008 Status
Financial Reporting Systems and Processes	I.1 Coordination and Communication including: Prescription Drug Program Accrual and Obsolete Reports/Lack of Data I.2 Controls over Trust Fund Draws I.3 Lack of Integrated Financial Management System I.4 Financial Statement Preparation I.5 Incomplete and Untimely Completion of Reconciliations	Modified Repeat Condition and renamed Financial Reporting Systems, Analysis and Oversight
Budgetary Accounting	II.1 Undelivered Orders II.2 Recoveries of Prior Year Obligations II.3 Recording of Obligations II.4 Budgetary Reimbursable Accounting	Progress made; combined with Financial Reporting, Systems, Analyses, and Oversight Condition.
Financial Management Information Systems	III.1 Entity-wide Security Programs III.2 Access Controls III.3 Systems Software III.4 Application Software Development and Change Controls III.5 Application Specific Concerns—General Ledger System including: Access Control, Data Input and Data output.	Modified Repeat Condition
Medicare Claims Processing Controls	IV.1 Direct Update Access to Medicare Claims Data IV.2 Controls over Edit Settings in the FSS, VMS, and MCS Application Systems IV.3 Controls Governing the Use of Supplemental Software Used to Process Claims IV.4 Lack of CMS Oversight IV.5 Other Matters including: Logical Access Controls and Systems Software.	Progress made; combined with Financial Management Information Systems Weakness

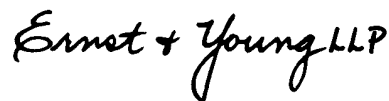
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Significant Deficiencies		
Issue Area	Summary Control Issue	FY 2008 Status
Inadequate Oversight of Managed Care Organizations	I.1 Monitoring Review Selection Methodology I.2 Monitoring Review Documentation including: Evidence of Review I.3 Corrective Actions I.4 Oversight Status Tracking	Sufficient progress made: eliminated as separate deficiency
Lack of Controls over Monitoring of Grant Closeout	II.1 Grant Closeouts II.2 Grant Documentation Retention II.3 Grant Monitoring	Progress made; combined with Financial Systems, Analyses, and Oversight Weakness.
Lack of Controls over Timely Invoice Payment	III. Lack of standardized policies and procedures for processing of invoices to ensure proper and timely payments	Progress made; combined with Financial Systems, Analyses, and Oversight Weakness.
Statement of Social Insurance (SOSI)	IV. Lack of robust automated controls over spreadsheet changes	Modified Repeat Condition

We have reviewed our findings and recommendations with DHHS management. Management generally concurs with our findings and recommendations and will provide a corrective action plan to address the findings identified in this report.

We also noted certain other matters involving internal control that we will report to DHHS management in a separate letter dated November 13, 2008.

This report is intended solely for the information and use of the management and the OIG of DHHS, OMB, GAO and Congress and is not intended to be and should not be used by anyone other than these specified parties.



November 13, 2008

Report on Compliance with Laws and Regulations

To the Secretary and the Inspector General
of the U.S. Department of Health and Human Services

We have audited the financial statements of the U.S. Department of Health and Human Services (DHHS) as of and for the year ended September 30, 2008 and the statement of social insurance as of January 1, 2008, and have issued our report thereon dated November 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of the DHHS is responsible for complying with laws and regulations applicable to DHHS. As part of obtaining reasonable assurance about whether DHHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in Office of Management and Budget (OMB) Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DHHS.

The results of our tests of compliance with the laws and regulations described in the second paragraph of this report disclosed instances of noncompliance with the following laws and regulations or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended. DHHS's management is currently investigating whether it violated certain provisions of the Anti-Deficiency Act (P.L. 101-508 and OMB Circular A-11).

Additionally, the Improper Payments Information Act (IPIA) of 2002 requires federal agencies to identify the program and activities that may be susceptible to significant improper payments and estimate the amount of the improper payments. While DHHS is not in full compliance with the requirements of IPIA, it has developed and reported error rates for each of its seven high risk programs, or components of such programs. DHHS continues its efforts to fully implement IPIA and OMB's implementing regulation.

Report on Laws and Regulations

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Under FFMIA, we are required to report whether DHHS's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of our tests disclosed instances in which DHHS's financial management systems did not substantially comply with certain requirements discussed in the preceding paragraph. We have identified the following instances of noncompliance.

- Certain subsidiary systems are not integrated with the Unified Financial Management System (UFMS) and are not complemented by sufficient manual preventative and detective type controls. For example, although operational at some of the Medicare Contractors, DHHS has not yet completed the implementation of the HIGLAS general ledger system. Additionally, manual key input continues to be required for each Operation Division (OPDIV) to upload trial balances into the Automated Financial System for consolidation in preparation of the departmental consolidated financial statements. Further, certain OPDIV-level reconciliations/analyses were not performed on a timely basis.
- During FY 2008, hundreds of manual journal vouchers were required to be recorded in UFMS to post certain types of transactions—including budgetary and proprietary, not currently configured correctly within UFMS and for the purpose of developing quarterly financial statements. Further, policies related to the posting of manual journal entries were not updated until the third quarter of 2008.
- Reviews of general and application controls over financial management systems identified certain departures from requirements specified in OMB Circulars A-127, *Financial Management Systems*, and A-130, *Management of Federal Information Resources*. Additionally, the OIG identified certain issues, including access control deficiencies related to systems as part of its Federal Information Security Management Act and other OIG engagements. Finally, DHHS management has identified certain weaknesses within its information technology general and application controls during its assessment of corrective action status and its OMB A-123 processes.
- DHHS was unable to provide extracted balances from its UFMS systems to support its reported accounts payable and accounts receivable.

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Our Report on Internal Control dated November 13, 2008, includes additional information related to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the noncompliance to FFMIA, and our recommendations related to the specific issues presented. It is our understanding that management agrees with the facts as presented and that relevant comments from DHHS's management responsible for addressing the noncompliance are provided as an attachment to its report. We did not audit management's comments and accordingly, we express no opinion on them. Additionally, DHHS is updating its agency-wide corrective action plan to address FFMIA and other financial management issues.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

This report is intended solely for the information and use of management and the Office of Inspector General of the U.S. Department of Health and Human Services, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 13, 2008

Mr. Daniel R. Levinson

Inspector General
Department of Health and Human Services
330 Independence Avenue, S.W., Room 5250
Washington, DC 20201

Dear Mr. Levinson:

This letter responds to the audit report submitted by the Office of the Inspector General in connection with the Department of Health and Human Services' fiscal year 2008 financial statement audit. We concur with the findings and recommendations presented to us.

We are pleased that, once again, your report reflects an unqualified or "clean," audit opinion for the Department. Through our joint efforts, the audit was completed on time.

We acknowledge that we have material weaknesses in internal control relating to financial reporting system analytics and oversight, and financial management information systems. The Department's plan to resolve these weaknesses is to continue our efforts to improve our financial management processes and oversight, and strengthen our information technology systems.

I would like to extend my appreciation to you and your staff for the professionalism that was demonstrated in working with us during the challenges we faced this year.

Sincerely,

Charles E. Johnson
Assistant Secretary for Resources and Technology
and Chief Financial Officer

FINANCIAL STATEMENTS

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
CONSOLIDATED BALANCE SHEET
As of September 30, 2008 and 2007
(In Millions)

	2008	2007
Assets (Note 2)		
Intragovernmental		
Fund Balance with Treasury (Note 3)	\$ 124,280	\$ 114,774
Investments, Net (Note 5)	385,397	365,875
Accounts Receivable, Net (Note 6)	880	1,164
Other (Note 9)	92	43
Total Intragovernmental	<u>510,649</u>	<u>481,856</u>
Accounts Receivable, Net (Note 6)	7,419	13,021
Cash and Other Monetary Assets (Note 4)	354	129
Inventory and Related Property, Net (Note 7)	4,603	3,161
General Property, Plant & Equipment, Net (Note 8)	5,011	5,064
Other (Note 9)	1,235	576
Total Assets	<u>\$ 529,271</u>	<u>\$ 503,807</u>
Stewardship PP&E (Note 1)		
Liabilities (Note 10)		
Intragovernmental		
Accounts Payable	\$ 406	\$ 533
Accrued Payroll and Benefits	105	86
Other (Note 14)	1,057	815
Total Intragovernmental	<u>1,568</u>	<u>1,434</u>
Accounts Payable	633	484
Entitlement Benefits Due and Payable (Note 11)	65,851	61,470
Accrued Grant Liability (Note 13)	3,878	3,941
Federal Employee & Veterans' Benefits (Note 12)	8,742	8,368
Contingencies & Commitments (Note 19)	3,782	4,337
Accrued Payroll & Benefits	784	718
Other (Note 14)	1,356	1,142
Total Liabilities	<u>86,594</u>	<u>81,894</u>
Net Position		
Unexpended Appropriations - Earmarked funds	12,172	8,887
Unexpended Appropriations - Other funds	81,350	78,830
Unexpended Appropriations, Total	<u>93,522</u>	<u>87,717</u>
Cumulative Results of Operations - Earmarked funds	346,287	332,966
Cumulative Results of Operations - Other funds	2,868	1,230
Cumulative Results of Operations, Total	<u>349,155</u>	<u>334,196</u>
Total Net Position	<u>442,677</u>	<u>421,913</u>
Total Liabilities & Net Position	<u>\$ 529,271</u>	<u>\$ 503,807</u>

The accompanying "Notes to the Financial Statements" are an integral part of these statements.

U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30, 2008 and 2007
(In Millions)

Responsibility Segments	2008	2007
Centers for Medicare & Medicaid Services (CMS)		
Gross Cost	\$ 657,910	\$ 612,411
Exchange Revenue (Note 16 & 17)	(54,071)	(50,304)
CMS Net Cost of Operations	<u>603,839</u>	<u>562,107</u>
Other Segments:		
Administration for Children & Families (ACF)	48,545	47,336
Administration on Aging (AoA)	1,398	1,373
Agency for Healthcare Research and Quality (AHRQ)	(59)	131
Centers for Disease Control and Prevention (CDC)	8,643	8,105
Food & Drug Administration (FDA)	2,127	1,913
Health Resources and Services Administration (HRSA)	7,053	6,897
Indian Health Service (IHS)	4,415	4,250
National Institutes of Health (NIH)	29,776	28,489
Office of the Secretary (OS)	2,234	2,169
Program Support Center (PSC)	1,086	1,414
Substance Abuse & Mental Health Services Administration (SAMHSA)	<u>3,163</u>	<u>3,320</u>
Other Segments Gross Cost of Operations	108,381	105,397
Exchange Revenue (Note 16 & 17)	(3,074)	(2,905)
Other Segments Net Cost of Operations	<u>105,307</u>	<u>102,492</u>
Net Cost of Operations	<u>\$ 709,146</u>	<u>\$ 664,599</u>

The accompanying "Notes to the Financial Statements" are an integral part of these statements.

**U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Year Ended September 30, 2008
(In Millions)**

	2008			Consolidated Total
	Earmarked Funds	All Other Funds	Eliminations	
Cumulative Results of Operations:				
Beginning Balances	\$ 332,966	\$ 1,230	\$ -	\$ 334,196
Budgetary Financing Sources:				
Appropriations Used	193,008	314,749	-	507,757
Nonexchange Revenue				
Non-exchange Revenue - Tax Revenue	197,426	-	-	197,426
Non-exchange Revenue - Investment Revenue	19,241	-	-	19,241
Non-exchange Revenue - Other	569	33	36	638
Donations and Forfeitures of Cash and Cash Equivalents	50	5	-	55
Transfers-in/out without Reimbursement	(2,663)	1,338	-	(1,325)
Other Financing Sources (Non-Exchange):				
Donations and forfeitures of property	-	4	-	4
Transfers-in/out without reimbursement (+/-)	(1)	5	(3)	1
Imputed financing	25	399	(126)	298
Other (+/-)	-	10	-	10
Total Financing Sources	407,655	316,543	(93)	724,105
Net Cost of Operations (+/-)	394,334	314,905	(93)	709,146
Net Change	13,321	1,638	-	14,959
Cumulative Results of Operations	346,287	2,868	-	349,155
Unexpended Appropriations				
Beginning Balances	8,887	78,830	-	87,717
Budgetary Financing Sources				
Appropriations Received	205,320	318,130	-	523,450
Appropriations transferred in/out	(4)	2,089	-	2,085
Other Adjustments	(9,023)	(2,950)	-	(11,973)
Appropriations Used	(193,008)	(314,749)	-	(507,757)
Total Budgetary Financing Sources	3,285	2,520	-	5,805
Total Unexpended Appropriations	12,172	81,350	-	93,522
Net Position	\$ 358,459	\$ 84,218	\$ -	\$ 442,677

The accompanying "Notes to the Financial Statements" are an integral part of these statements.

U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Year Ended September 30, 2007
(In Millions)

	2007			Consolidated Total
	Earmarked Funds	All Other Funds	Eliminations	
Cumulative Results of Operations:				
Beginning Balances	\$ 304,465	\$ 522	\$ -	\$ 304,987
Budgetary Financing Sources:				
Appropriations Used	190,742	296,631	-	487,373
Nonexchange Revenue				
Non-exchange Revenue - Tax Revenue	188,219	-	-	188,219
Non-exchange Revenue - Investment Revenue	18,474	-	-	18,474
Non-exchange Revenue - Other	242	36	115	393
Donations and Forfeitures of Cash and Cash Equivalents	44	3	-	47
Transfers-in/out without Reimbursement	(1,920)	911	-	(1,009)
Other budgetary financing sources	(4)	5	-	1
Other Financing Sources (Non-Exchange):				
Donations and forfeitures of property	-	3	-	3
Transfers-in/out without reimbursement (+/-)	(1)	(18)	1	(18)
Imputed financing	26	399	(112)	313
Other (+/-)	-	12	-	12
Total Financing Sources	395,822	297,982	4	693,808
Net Cost of Operations (+/-)	367,321	297,274	4	664,599
Net Change	28,501	708	-	29,209
Cumulative Results of Operations	332,966	1,230	-	334,196
Unexpended Appropriations				
Beginning Balances	27,665	102,832	-	130,497
Budgetary Financing Sources				
Appropriations Received	199,309	274,565	-	473,874
Appropriations transferred in/out	(98)	88	-	(10)
Other Adjustments	(27,247)	(2,024)	-	(29,271)
Appropriations Used	(190,742)	(296,631)	-	(487,373)
Total Budgetary Financing Sources	(18,778)	(24,002)	-	(42,780)
Total Unexpended Appropriations	8,887	78,830	-	87,717
Net Position	\$ 341,853	\$ 80,060	\$ -	\$ 421,913

The accompanying "Notes to the Financial Statements" are an integral part of these statements.

**U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2008 and 2007
(In Millions)**

	2008		2007	
	Budgetary	Non-Budgetary Credit Program Financing Accounts	Budgetary	Non-Budgetary Credit Program Financing Accounts
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1:	\$ 24,104	\$ 145	\$ 67,726	\$ 194
Recoveries of Prior Year Unpaid Obligations				
Actual	14,969	-	17,604	-
Budget Authority				
Appropriation	1,004,447	1	937,162	1
Spending Authority from Offsetting Collections				
Collected	12,192	51	6,104	28
Change in Receivables from Federal sources	(177)	-	650	-
Change in unfilled customer orders				
Advance received	(106)	-	13	-
Without advance from Federal sources	297	-	(1,406)	-
Expenditure Transfers from trust funds				
Actual	3,521	-	3,325	-
Change in Receivables from Trust Funds	179	-	290	-
Subtotal	1,020,353	52	946,138	29
Nonexpenditure transfers, net, anticipated and actual	2,259	-	(91)	-
Temporarily not available pursuant to Public Law	(16,416)	-	(20,607)	-
Permanently not available (-)	(12,141)	(45)	(29,619)	(29)
Total Budgetary Resources	\$ 1,033,128	\$ 152	\$ 981,151	\$ 194
Status of Budgetary Resources:				
Obligations Incurred				
Direct	\$ 991,979	\$ 56	\$ 949,517	\$ 49
Reimbursable	6,800	1	7,105	-
Subtotal	998,779	57	956,622	49
Unobligated Balances – Available				
Apportioned	25,893	63	17,155	58
Exempt from apportionment	427	-	126	-
Subtotal	26,320	63	17,281	58
Unobligated Balances - Not Available	8,029	32	7,248	87
Total Status of Budgetary Resources	\$ 1,033,128	\$ 152	\$ 981,151	\$ 194
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid obligations, brought forward, October 1	\$ 142,248	\$ -	\$ 142,161	\$ 3
Uncollected customer payments from Federal sources, brought forward, October 1	(6,893)	-	(7,327)	-
Total unpaid obligated balance, net	135,355	-	134,834	3
Obligations incurred net	998,779	57	956,622	49
Gross outlays	(980,841)	(57)	(938,981)	(52)
Obligated Balance Transferred, Net				
Actual transfers, unpaid obligations	5	-	18	-
Total Unpaid obligated balance transferred, net	5	-	18	-
Recoveries of prior year unpaid obligations, actual	(14,969)	-	(17,604)	-
Change in uncollected customer payments from Federal sources	(299)	-	466	-
Obligated Balance, Net, End of Period				
Unpaid Obligations	145,222	-	142,248	-
Uncollected customer payments from Federal sources	(7,192)	-	(6,893)	-
Total, unpaid obligated balance, net, end of period	138,030	-	135,355	-
Net Outlays				
Gross outlays	980,841	57	938,981	52
Offsetting collections	(15,607)	(51)	(9,442)	(28)
Distributed Offsetting receipts	(264,186)	(44)	(257,704)	-
Net Outlays	\$ 701,048	\$ (38)	\$ 671,835	\$ 24

The accompanying "Notes to the Financial Statements" are an integral part of these statements.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
STATEMENT OF SOCIAL INSURANCE
75-Year Projection as of January 1, 2008 and Prior Base Years
(In Billions)

	2008	Estimates from Prior Years			
		2007	2006	2005 unaudited	2004 unaudited
Actuarial present value for the 75-year projection period of estimated future income (excluding interest) received from or on behalf of: (Notes 27, 28, and 29)					
Current participants who, in the starting year of the projection period:					
Have not yet attained eligibility age					
HI	\$ 6,320	\$ 5,975	\$ 5,685	\$ 5,064	\$ 4,820
SMI Part B	14,932	12,112	12,446	11,477	10,505
SMI Part D	6,527	7,285	7,366	7,895	7,545
Have attained eligibility age (age 65 and over)					
HI	202	178	192	162	148
SMI Part B	1,785	1,648	1,606	1,436	1,310
SMI Part D	581	746	750	817	713
Those expected to become participants					
HI	5,361	4,870	4,767	4,209	4,009
SMI Part B	4,480	4,460	3,562	3,658	3,514
SMI Part D	2,856	2,735	2,134	2,522	2,511
All current and future participants:					
HI	11,883	11,023	10,644	9,435	8,976
SMI Part B	21,197	18,221	17,613	16,571	15,329
SMI Part D	9,964	10,766	10,250	11,233	10,770
Actuarial present value for the 75-year projection period of estimated future expenditures for or on behalf of: (Notes 27, 28, and 29)					
Current participants who, in the starting year of the projection period:					
Have not yet attained eligibility age					
HI	17,365	15,639	15,633	12,668	12,054
SMI Part B	14,949	12,130	12,433	11,541	10,577
SMI Part D	6,527	7,273	7,338	7,913	7,566
Have attained eligibility age (age 65 and over)					
HI	2,747	2,558	2,397	2,179	2,168
SMI Part B	1,986	1,834	1,773	1,622	1,475
SMI Part D	581	794	792	880	773
Those expected to become participants					
HI	4,506	5,118	3,904	3,417	3,246
SMI Part B	4,262	4,257	3,407	3,408	3,277
SMI Part D	2,856	2,699	2,121	2,440	2,431
All current and future participants:					
HI	24,619	23,315	21,934	18,264	17,468
SMI Part B	21,197	18,221	17,613	16,571	15,329
SMI Part D	9,964	10,766	10,250	11,233	10,770
Actuarial present values for the 75-year projection period of estimated future excess of income (excluding interest) over expenditures (Notes 27, 28 and 29)					
HI	\$ (12,737)	\$ (12,292)	\$ (11,290)	\$ (8,829)	\$ (8,492)
SMI Part B	-	-	-	-	-
SMI Part D	-	-	-	-	-
Additional Information					
Actuarial present values for the 75-year projection period of estimated future excess of income (excluding interest) over expenditures (Notes 27, 28, and 29)					
HI	\$ (12,737)	\$ (12,292)	\$ (11,290)	\$ (8,829)	\$ (8,492)
SMI Part B	-	-	-	-	-
SMI Part D	-	-	-	-	-
Trust fund assets at start of period					
HI	312	300	285	268	256
SMI Part B	53	38	23	19	24
SMI Part D	3	1	-	-	-
Actuarial present value for the 75-year projection of estimated future excess of income (excluding interest) and Trust Fund assets at start of period over expenditures (Note 27, 28, and 29)					
HI	\$ (12,425)	\$ (11,993)	\$ (11,006)	\$ (8,561)	\$ (8,236)
SMI Part B	53	38	23	19	24
SMI Part D	3	1	-	-	-

Note: Totals do not necessarily equal the sums of rounded components.

With the exception of the 2007 projections presented, current participants are assumed to be the "closed group" of individuals who are at least age 15 at the start of the projection period, and are participating in the program as either taxpayers, beneficiaries, or both. For the 2007 projections, the "closed group" are assumed to be individuals who are at least 18 at the start of the projection period, and are participating in the program as either taxpayers, beneficiaries, or both.

The accompanying "Notes to the Financial Statements" are an integral part of these statements.