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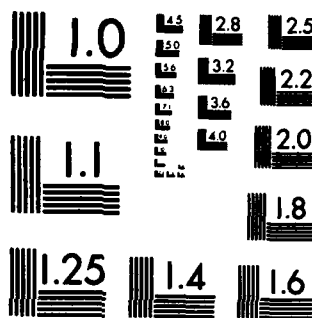
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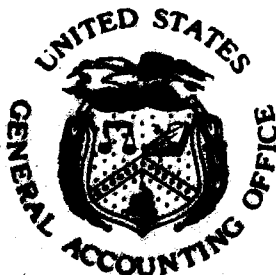
## Report To The Secretary Of Health And Human Services

### The Department Of Health And Human Services' First-Year Implementation Of The Federal Managers' Financial Integrity Act

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through annual agency self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Department of Health and Human Services in its first year of experience with this new act. The report focuses on the evaluation of internal controls, review of accounting systems, and improvements being made by the Department as a result of identified problems. GAO proposed, and the Department agreed to take, several actions for further improvement.

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

HUMAN RESOURCES  
DIVISION

B-202205

The Honorable Margaret M. Heckler  
The Secretary of Health and  
Human Services

Dear Madam Secretary:

This report presents the results of our review of HHS' first-year efforts to implement the Federal Managers' Financial Integrity Act of 1982. Our review was made to assess the adequacy of the Department's implementation efforts, and to identify possible improvements needed for subsequent years' efforts.

We identified several areas where we believe the Department needs to refine its assessment, evaluation, and reporting procedures. In a draft of this report, we proposed that you take several actions to enhance the Department's efforts to implement the act. The Department concurred with our proposals and agreed to take action. Accordingly, we are not making recommendations to you in this report, but we plan to track the Department's progress in taking the action promised.

As pointed out in your January 24, 1984, reports to the President and the Congress, the Department has not yet completed a full assessment of its internal control or accounting systems. Accordingly, it has not necessarily identified all significant weaknesses. As the Department progresses further in its evaluation processes, corrects material weaknesses in internal control and accounting systems, and makes the improvements it has agreed to, we believe you should have a more meaningful basis for concluding whether your internal control and accounting systems are operating as called for in the act.

We are sending copies of this report to the Assistant Secretaries for Health, Human Development Services, and Management and Budget; the Inspector General; the Acting Commissioner, Social Security Administration; the Administrator, Health Care

**Financing Administration; and the Director, Office of Management and Budget. Copies are also being sent to the Chairmen of the Senate Committees on Appropriations and Governmental Affairs and the House Committees on Appropriations and Government Operations.**

Sincerely yours,

Richard Trogel

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GENERAL ACCOUNTING OFFICE  
REPORT TO THE SECRETARY OF  
HEALTH AND HUMAN SERVICES

THE DEPARTMENT OF HEALTH  
AND HUMAN SERVICES'  
FIRST-YEAR IMPLEMENTATION  
OF THE FEDERAL MANAGERS'  
FINANCIAL INTEGRITY ACT

D I G E S T

The Department of Health and Human Services (HHS) has made progress in its first-year efforts to implement the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512). Under the act, heads of executive agencies must report annually to the President and the Congress on whether their agencies' systems of internal accounting and administrative control comply with the statutory internal control objectives and with standards prescribed by the Comptroller General. Reports on internal controls must be based on evaluations conducted in accordance with guidelines established by the Office of Management and Budget (OMB). A separate report must be prepared on whether the agency's accounting systems conform to the Comptroller General's accounting principles and standards. Although OMB is not required to provide evaluation guidelines for reviewing accounting systems, it intends to do so.

GAO recognizes that these were the Department's first-year efforts of a difficult, complex, and long-term undertaking. GAO believes its findings should be viewed in light of the Department's efforts to implement the act before evaluation guidelines were available and with the recognition that problems are to be expected during the start of any new major initiative.

POSITIVE STEPS TAKEN

To implement its internal control evaluation and improvement effort, HHS essentially followed the sequence of steps established by OMB, including (1) organizing to implement the act by taking such actions as assigning responsibility at high levels; (2) segmenting itself into internal control areas, which are established for each significant function

performed by each organizational unit; (3) assessing the vulnerability of its internal control areas to loss, unauthorized use of resources, or illegal acts; (4) conducting internal control reviews to determine whether adequate control measures exist and are working effectively; (5) tracking control weaknesses identified and corrective actions taken or planned; and (6) reporting on the status of its internal control systems and any material internal control weaknesses. In addition, for performing accounting systems reviews, HHS assigned responsibilities and developed policies and procedures. HHS conducted reviews of 10 of the 22 systems it identified, and reported the results.

HHS' GUIDANCE ON SEGMENTATION  
NEEDS TO BE REFINED

OMB guidelines provide that agencies segment themselves into internal control areas to provide complete coverage of all program and administrative activities so that vulnerability assessments of each area can be made. HHS' segmentation process identified 16 functions--such as travel, grants, and procurement and purchasing--which it believed covered all of the significant activities performed in that agency (see p. 41). About 6,200 internal control areas were then identified. However, some internal control areas which should have been included were missed. This occurred for essentially three reasons.

- First, HHS' list of 16 functions was not complete. For example, because the list did not contain a separate functional area for research, the National Institutes of Health did not identify internal control areas for research conducted in-house.
- Second, HHS' instructions to its component agencies on segmenting do not clearly define significant responsibility for purposes of establishing internal control areas. For example, because of this lack of clarity, the Social Security Administration (SSA) excluded the functions of

travel and personnel from its inventory of internal control areas for all headquarters and field organizational units except for one office, even though many units had significant responsibility for these activities.

- Third, descriptions of many internal control areas were so general that the scope of activities to be assessed for vulnerability were not clear or could not be determined either by persons performing such assessments or by GAO. One of the Health Care Financing Administration's (HCFA's) major responsibilities--monitoring the propriety of Medicare and Medicaid payments--was so generally described as part of an internal control area that the person who was responsible for performing the assessment of the area did not consider it. (See p. 13.)

CHANGES ARE NEEDED IN  
HHS' VULNERABILITY  
ASSESSMENT PROCESS

HHS developed guidelines and assessment forms for performing vulnerability assessments of its internal control areas. However, the resulting assessments were not a reliable basis for scheduling and guiding subsequent internal control reviews. This occurred for a number of reasons:

- HHS' assessment forms did not include all the factors OMB considers necessary for making adequate vulnerability assessments. Excluded were such factors as program size and a preliminary evaluation of existing safeguards. (See p. 19.)
- The scoring system used by HHS on its standard assessment form was biased against achieving highly vulnerable ratings. There was no provision for weighting the factors according to their relative importance to the internal control area being assessed, and many assessors rated items that were



not applicable as having low vulnerability. This skewed overall ratings in several cases toward low or moderate vulnerability. (See p. 20.)

- Some assessment forms were inaccurately completed. For example, in some cases the results of GAO or Inspector General audits were not reflected on HHS' standard assessment form. In addition, the SSA internal control officer discounted the 309 highly vulnerable ratings reported on an abbreviated assessment form used by SSA because of variances in how the forms were prepared. (See pp. 19, 22, and 23.)
- Some preparers of vulnerability assessments received little or no training and said they would have rated their areas differently had they known more about the process. (See p. 23.)

In addition to correcting these problems, GAO believes HHS can further improve its vulnerability assessment process by requiring that preparers describe the basis for scores and ratings assigned, even though this is not specifically provided for by OMB. This would provide needed information to reviewers for conducting internal control reviews and to management for taking other appropriate actions. (See p. 21.)

GAO also believes that HHS' vulnerability assessment process should include a systematic approach for identifying known weaknesses contained in GAO, Inspector General, and other reports and for entering these weaknesses in its tracking system for possible inclusion in its year-end report. (See p. 22.)

HHS' INTERNAL CONTROL  
AND ACCOUNTING SYSTEMS  
REVIEW METHODOLOGY NEEDS  
TO BE IMPROVED

Although HHS conducted 1,135 internal control reviews during the first year, these reviews did not always result in adequate evaluations of internal controls. This is due to the

fact that about 870 of these were ongoing efforts at SSA which were substituted for new reviews and as such were not intended to accomplish all of the objectives of new reviews. For example, SSA did not evaluate the general control environment. In addition, HHS' guidelines for conducting new internal control reviews did not require performance of all steps prescribed in OMB guidelines.

Many of the internal control reviews GAO examined missed important evaluation factors included in OMB guidelines--such as an evaluation of the appropriateness of controls and such general control environment factors as management attitude and budgeting and reporting practices--and did not adequately document the review procedures performed. Some reviews were too limited in scope because they missed evaluating internal controls over important functional activities within an internal control area. For example, at SSA, controls over receipts for services provided to other agencies which amounted to \$5.2 million in fiscal year 1982, were not included in the review of the sales function at headquarters. (See p. 25.)

HHS' written procedures for evaluating its accounting systems appeared reasonable. However, HHS' evaluations did not fully comply with its procedures, and consequently were inadequate to properly determine whether the 10 systems evaluated complied with the Comptroller General's principles and standards. Very little testing was done for six, and testing for the other four involved a limited examination of a few transactions and did not cover all of the Comptroller General's principles and standards. In addition, no documentation was available for reviews of six systems to show methods used or to explain instances of noncompliance, and incomplete information was available for four systems on the testing done and/or basis for the conclusions reached. (See p. 37.)

BETTER COVERAGE OF AUTOMATIC  
DATA PROCESSING ACTIVITIES  
IS NEEDED

HHS essentially excluded automatic data processing (ADP) activities from its vulnerability assessment and internal control review processes. Instead, it relied on the results of its ongoing ADP security review program conducted under OMB Circular A-71 (Transmittal No. 1, Security of Federal Automated Information Systems) to accomplish the objectives of the Financial Integrity Act. The procedures HHS followed under its ADP security review program, however, did not address many of the factors considered necessary by OMB's internal control guidelines, such as the preliminary evaluation of safeguards and the consideration of the general control environment; and the evaluations GAO reviewed were generally limited to the physical security of ADP. They did not generally include controls over ADP systems to produce accurate, complete, and timely output, as provided for in OMB's guidelines. (See p. 32.)

OTHER ASPECTS OF  
THE EVALUATION PROCESS  
NEED IMPROVEMENT

HHS could further improve its implementation efforts by providing (1) additional monitoring of the validity of the segmentation, vulnerability assessment, and internal control and accounting system review processes and (2) additional training on the objectives of and procedures for doing these processes. Systematic, department-wide monitoring efforts were limited and did not fully cover all important aspects of the Department's implementation efforts. (See p. 30.) Training that was provided was not always adequate to provide a full understanding of the objectives of the evaluation process or how to perform assessment or review procedures. (See p. 31.)

YEAR-END REPORTS  
SHOULD BE MORE COMPLETE

The Secretary reported on January 24, 1984, that she had reasonable assurance that the Department's internal controls in effect during calendar year 1983, taken as a whole, were operating as called for by the act and that the Department's eight general ledger and two payroll systems operating during 1983, also taken as a whole, conformed in all material respects to the appropriate principles and standards.

A total of 200 material weaknesses in internal controls, such as inadequate controls to prevent grantees from maintaining excessive cash balances, disclosed during HHS' evaluation were reported by the Secretary. She also reported that corrective actions have been taken for 78 of the weaknesses and a goal was established to correct the others by December 31, 1984. In the accounting systems area, 23 instances of nonconformance were reported for which corrective action plans were developed and being implemented.

The Department took the position that its year-end reports only had to contain those material internal control weaknesses which were specifically identified in its internal control reviews. HHS took a similar position with respect to its accounting systems report. Therefore, other internal controls or accounting systems problems identified in previous GAO, Inspector General, and agency contractor reports were not included.

GAO believes that some of these weaknesses which remain uncorrected are more material than many of those reported by HHS and should have been included in its year-end report. For example, HHS did not report weaknesses in internal controls over benefit payments at HCFA that resulted in the agency's paying for medically unnecessary services provided to beneficiaries or that internal controls are inadequate at SSA to prevent erroneous wage data from getting into its wage data base.

However, HHS did report that, in one regional office, small equipment which was open to theft was not marked with identifying numbers.

#### GAO PROPOSALS AND AGENCY COMMENTS

In a draft of this report, GAO proposed that the Secretary take several actions to improve the Department's internal control and accounting systems evaluations and reporting. These proposals included:

- Refining guidance and instructions on identifying and describing internal control areas to attain more complete coverage of agency functions. (See p. 16.)
- Developing new vulnerability assessment forms which will result in more accurate and meaningful assessments and will include a written explanation of the reasons for the ratings given. (See p. 24.)
- Requiring that all internal control reviews (or approved substitutes) be performed in accordance with OMB guidelines and that accounting systems reviews include adequate testing of the systems and documentation of the results of the reviews. (See p. 29.)
- Providing for adequate assessments and reviews of ADP activities. (See p. 35.)
- Providing more training on the objectives of the segmentation, vulnerability assessment, and internal control review processes and procedures to be followed and additional monitoring of the internal control evaluation and improvement effort. (See p. 35.)
- Requiring that internal control and accounting systems weaknesses identified by GAO, the Inspector General, and others outside the internal control or accounting system evaluation processes be given recognition in the vulnerability assessment process and year-end reports. (See pp. 24 and 39.)

In commenting on the draft report (see app. VI.), the Department agreed to take the corrective actions GAO proposed. Accordingly, GAO is not making recommendations to the Department but plans to track HHS' progress in taking the promised corrective actions.

In March 1984, HHS announced a reorganization within the Office of the Secretary. As part of this effort HHS plans to reduce the role of the Office of the Assistant Secretary for Management and Budget in providing technical assistance, policy development, and monitoring relative to the Financial Integrity Act. HHS plans for the Office of Inspector General to assume principal responsibility for monitoring the Department's efforts under the act.

The full effects of this reorganization are not yet apparent. GAO will track the effect of this change during its review of HHS' second-year efforts under the act. GAO will look closely at the number of staff available, their expertise, and the nature of the relationship between the Secretary's Office and the Office of Inspector General, especially as it relates to the smooth development and implementation of consistent policies and procedures throughout the Department.

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### ABBREVIATIONS

ADP	automatic data processing
ASMB	Office of the Assistant Secretary for Management and Budget
CDC	Centers for Disease Control
GAO	General Accounting Office
HCFA	Health Care Financing Administration
HHS	Department of Health and Human Services
ICO	internal control officer
ICR	internal control review
N/A	not applicable
OCS	Office of Community Services
OHDS	Office of Human Development Services
OIG	Office of Inspector General
OMB	Office of Management and Budget
PHS	Public Health Service
RASC	Regional Administrative Support Center
SSA	Social Security Administration
VA	vulnerability assessment

## CHAPTER 1

### INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls, the Congress in August 1982 passed the Federal Managers' Financial Integrity Act (31 U.S.C. 3512(b) and (c)). The law was enacted to strengthen the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control in order to provide effective control over, and accountability for, all funds, property, and other assets for which the agency is responsible (31 U.S.C. 3512(a)(3)).

We believe that full implementation of the Financial Integrity Act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agencies. To achieve these ends the act requires

- each executive agency to establish and maintain its internal controls in accordance with the standards prescribed by the Comptroller General, so as to reasonably assure that: (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- each executive agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify the material weaknesses involved and describe the plans for corrective action.
- each executive agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards, and related requirements prescribed by the Comptroller General.

--the Office of Management and Budget (OMB) to issue guidelines for each executive agency to use in evaluating its internal control systems. These guidelines were issued in December 1982.

--the Comptroller General to prescribe standards for federal agencies' internal control systems. The Comptroller General issued these standards covering both program and financial management in June 1983.

The Financial Integrity Act requires that each executive agency use the guidelines established by OMB to evaluate and determine the compliance of its systems of internal control with standards prescribed by the Comptroller General. The OMB guidelines provide agencies with a basic systematic approach for evaluating, improving, and reporting on their internal controls comprising seven phases:

--Organizing the process. This includes the assignment of responsibilities for planning, directing, and controlling the process and the development of an information system that provides for tracking the status of evaluations and corrective actions.

--Segmenting the agency into organizational components and then identifying the programs and administrative functions conducted in each component.

--Assessing each program or function identified in the segmenting phase for vulnerability to waste, loss, unauthorized use, or misappropriation of funds, property, or other assets and then deciding which programs or functions are the most vulnerable.

--Developing plans and schedules for the performance of internal control reviews (ICRs) and other actions.

--Reviewing the internal controls to determine whether adequate control measures exist and are functioning as intended.

--Determining, scheduling, and taking necessary corrective actions.

--Preparing the annual statement to the President and the Congress on the status of the agency's system of internal control.

The Department of Health and Human Services (HHS) is 1 of 22 federal agencies we evaluated to assess the processes used to implement the act during the first year.

## OVERVIEW OF HHS' FIRST-YEAR EFFORTS

The Department's efforts under the Financial Integrity Act are made up of two initiatives. The first is directed at evaluating, improving, and reporting on the Department's systems of internal control and is intended to meet the requirements of section 2 of the act--financial and accounting controls. The second initiative is directed at determining and reporting on whether its accounting systems are in compliance with the Comptroller General's accounting principles and standards and is intended to meet the requirements of section 4 of the act--accounting systems.

### Internal control systems

HHS began its internal control improvement efforts in response to OMB Circular A-123, which was issued in October 1981. Many of HHS' policies and procedures for its internal control programs were established before the issuance of OMB's December 1982 internal control guidelines. Although there are differences between HHS' policies and procedures and OMB's guidelines, the phases of HHS' internal control evaluation and improvement process generally parallel those set forth in OMB's guidelines. Following is a description of the steps taken and progress made by HHS to implement its internal control improvement program.

### Organizing

On March 8, 1982, the then Secretary of HHS expressed his support for a concerted effort to identify, evaluate, and monitor existing internal controls. He designated the Assistant Secretary for Management and Budget as the Internal Control Manager for the Department. The Assistant Secretary was delegated authority to issue directives, monitor and evaluate performance, and advise the Secretary on the status of internal controls.

The Assistant Secretary appointed an Internal Control Steering Committee composed of representatives from the Office of the Assistant Secretary for Management and Budget (ASMB), the Office of Inspector General (OIG), and the Office of the Assistant Secretary for Personnel Administration. The purpose of the committee is twofold: (1) to determine the overall department-wide approach for implementing the internal control aspects of OMB Circular A-123 and subsequently of the Financial Integrity Act and (2) to provide advice and detailed technical assistance. In addition, ASMB assigned staff to (1) provide technical expertise in developing the Department's overall approach, (2) provide quality control through monitoring and evaluation, and (3) initiate the development of a computerized tracking system.

The Secretary also assigned to the head of each operating and staff division (see app. I) the responsibility for assuring that internal controls are employed in all aspects of his or her organization. Each operating and staff division head appointed an internal control officer (ICO) to assure that directives issued by ASMB were properly implemented.

In addition to providing technical assistance through the Internal Control Steering Committee, the OIG monitored the Department's efforts to implement the Financial Integrity Act. As a part of its monitoring activities, the OIG evaluated a sample of completed internal control reviews and accounting systems evaluations. In his December 12, 1983, report to the Assistant Secretary for Management and Budget, the Inspector General indicated that the Department had taken aggressive action to implement both the internal control and accounting system aspects of the act and identified a number of problems that required attention.

In November 1983, the Assistant Secretary for Personnel Administration indicated that members of the Senior Executive Service and employees covered by merit pay who have significant management responsibility should have performance agreements that require fulfillment of their internal control responsibilities. Guidelines were issued on how to accomplish this task.

In March 1984, HHS announced a reorganization within the Office of the Secretary, including a "streamlining" of ASMB. As part of this streamlining effort, HHS plans to reduce ASMB's technical assistance, policy development, and monitoring roles relative to the Financial Integrity Act. HHS' plan calls for OIG to assume the principal monitoring responsibility for the Department's efforts under the act. However, the full effects of the HHS streamlining plan on the management and operation of the Department's Financial Integrity Act effort were not clear as of April 1984. We intend to track this during our review of HHS' second-year efforts under the act.

#### Segmenting

The Secretary determined that due to the large size (i.e., fiscal year 1983 budget of about \$274 billion and approximately 142,000 employees at 2,830 locations) and extreme complexity of HHS, the most effective manner of segmenting the Department was to separate it into major organizational components and have each component segment its operations, assuming 16 functions are performed in the Department (see app. II). If ICOs identified additional functions, they could add them to the Department's list of 16. However, no additional functions were identified.

The basic segmentation methodology was to identify all organizational components down to a specified level which have significant responsibility for 1 or more of the 16 functions. An "internal control area" was to be established for each significant function performed by each organizational component. This process resulted in the identification of 6,238 internal control areas. For example, 13 internal control areas were established at the National Cancer Institute. One was established for each of the functions of general policy and direction, inventories, budget planning and formulation, receivables, budget execution, travel, and records systems. Two internal control areas were established for each of the functions of procurement and purchasing, personnel, and grants.

Each internal control area was described on an inventory sheet which shows the function covered, the organizational component, and the name of the official who is responsible for assuring that internal controls are in place and working properly. The inventory sheet is also to contain a description of the scope of the organization covered, including quantifiable factors, such as dollars and/or volume.

#### Vulnerability assessments

HHS defines a vulnerability assessment (VA) as a review of the susceptibility of an internal control area to loss or unauthorized use of resources, errors in reports and information, illegal or unethical acts, and/or adverse or unfavorable public opinion. Two methodologies were used to perform the assessments. ASMB developed a standard HHS methodology and VA form (see app. III) which was used throughout HHS to perform approximately 2,100 VAs. In addition, the Social Security Administration (SSA) developed, and ASMB approved, an abbreviated methodology and form (see app. IV) which was used to perform approximately 4,100 VAs at SSA field offices (district offices, branch offices, and teleservice centers).

Completed VAs were to be reviewed and approved by the appropriate ICOs. If in the professional judgment of the ICO there were conditions or circumstances that made internal control areas highly vulnerable, but they were not originally rated as such, he/she could "override" the ratings assigned. Of HHS' 6,238 VAs, 419, or about 7 percent, were rated highly vulnerable; 1,651, or 26 percent, moderately vulnerable; and 4,168, or 67 percent, were rated as having low vulnerability. According to HHS, ICOs overrode assessments initially rated as low or moderate in about 100, or about 1.6 percent, of the cases.

### Internal control reviews

HHS defines an ICR as a detailed examination of an internal control area to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks. HHS' policy requires that all areas assessed as highly vulnerable (including overrides) be reviewed during the first year of its internal control improvement program and that all areas must be reviewed within 5 years.

HHS' instructions state that an ICR should identify the internal controls in place to accomplish the control objectives and test whether the controls are functioning as intended. Supporting documentation is to be maintained and must be readily available for review. The instructions also state that the degree of review of controls should be proportionate to the dollar value associated with the functional area. A report containing findings, conclusions, and recommendations is prepared for each completed ICR.

HHS has developed a suggested approach that can be used by HHS components for conducting new ICRs. For each functional area, except automatic data processing (ADP), HHS has developed a set of internal control objectives and a questionnaire. The questionnaire is to be completed by the manager for the area under review or jointly by the manager and the reviewer. The questionnaires address internal control techniques and system documentation. HHS' guidance suggests the circumstances in which the reviewer should verify management's opinions on the adequacy of controls and suggests that verification may be done by testing, interviewing, and observing.

HHS' guidance provides that reviews, such as those performed by GAO, OIG, and those ongoing by management, may be substituted for ICRs, provided they meet ICR requirements or could do so with minimum modifications. ICOs are responsible for determining whether substitutes referred to by HHS as "ongoing efforts" are acceptable. New ICRs and reviews being substituted for ICRs are submitted to individuals having day-to-day responsibility for the areas reviewed for their concurrence and development of proposed corrective actions. ICOs are responsible for reviewing, approving, and monitoring corrective actions.

During the first year's operation, HHS reported conducting 1,135 ICRs. About 870 of these were ongoing efforts at SSA.

### Automated internal control tracking system

HHS has developed an automated internal control tracking system which records and provides information on the Department's 6,238 internal control areas. This information includes (1) organizational component name, (2) function covered, (3) assessment rating, and (4) the results of ICRs. ICR data include weaknesses identified, corrective actions taken or scheduled, and the internal control standards not met.

### Reporting to the President and the Congress

On January 24, 1984, the Secretary reported to the President and the Congress on the status of HHS' system of internal accounting and administrative control. The report indicates that based on (1) evaluations performed in accordance with OMB guidelines (tailored to the Department's organizational and operational environment), (2) assurances given by appropriate HHS officials, and (3) other information provided, the HHS system of internal accounting and administrative control in effect during the year ended December 31, 1983, taken as a whole, provides reasonable assurance that:

- obligations and costs are in compliance with applicable law;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures applicable to HHS' operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The Secretary reported that ICRs conducted by HHS in 1983 identified 200 material weaknesses.<sup>1</sup> Of these, 78 had been corrected, and action plans have been developed with the goal of correcting the remaining 122 by December 31, 1984. In addition, the Secretary reported that over 1,000 nonmaterial weaknesses

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<sup>1</sup>OMB defines a material weakness which should be reported as a situation in which the designed procedures or the degree of operational compliance therewith does not provide reasonable assurance that the objectives of internal control specified in the act are being accomplished, and which would be of significance to the President and the Congress.



had been identified that had been corrected or that were scheduled to be corrected in 1984. The Secretary's report also provides an analysis of the 200 material weaknesses by HHS function and Comptroller General internal control standard.

Two examples of the 200 material weaknesses identified at HHS are:

--Insufficient assurance existed at Saint Elizabeths Hospital that resources have been safeguarded; funds expended in a manner consistent with relevant laws, regulations, and policies; and resources managed economically and efficiently. Recommended corrective actions included engaging an independent accounting firm to conduct an annual audit. This action is scheduled to be taken by September 1984.

--Under the Departmental Federal Assistance Financing System, funds drawn by grantees were not being matched to grantees' immediate needs. As a result, the Department of the Treasury has incurred additional interest estimated at \$14 million annually. HHS has been working with Treasury, OMB, and the states to establish improved funding methods.

Additional examples of material weaknesses reported by HHS are contained in appendix V.

The Secretary also stated that the Department planned to reassess its first-year implementation of the Financial Integrity Act early in 1984 and will change its policies, procedures, and methodologies, as appropriate, after it evaluates recommendations from GAO, OMB, OIG, and its own operating staff.

#### Accounting systems

The Financial Integrity Act requires each executive agency to annually make a determination as to whether its accounting systems are in compliance with the Comptroller General's accounting principles and standards and to report the results of its determination to the President and the Congress. The act does not require OMB to issue guidelines for implementing this requirement, but OMB intends to do so. HHS, however, developed its own approach for evaluating and reporting on its accounting systems. As part of this approach, HHS

--assigned responsibility to senior level staff for managing and carrying out accounting systems reviews and ensuring appropriate corrective actions.

- initiated efforts to develop an inventory of the Department's accounting systems.
- developed a checklist of the Comptroller General's accounting principles and standards to be used by reviewers in assessing conformance and required that (1) assertions of conformance by agency staffs be verified through statistical sampling techniques, interviews, and on-site observations and (2) the results of each review be fully documented. Due to time constraints, the use of statistical sampling techniques was encouraged.
- established a policy calling for an evaluation of each accounting system within 5 years.
- reviewed 10 systems in 1983--8 general ledger systems and 2 payroll systems.
- required year-end reports from heads of component agencies on the status of their accounting systems.

On January 24, 1984, the Secretary issued her report to the President and the Congress stating that the Department had reviewed its general ledger and payroll systems and that, taken as a whole, the systems conformed in all material respects to the principles, standards, and related requirements prescribed by the Comptroller General. The Secretary reported 23 areas of nonconformance for which corrective action plans had been developed and were being implemented. For example, the Secretary said that the accounting system for the Office of the Secretary, Division of Accounting Operations, does not assure that real and personal property are properly recorded, accounted for, and depreciated. The system is being replaced by a prototype Standard Accounting System which will have an automated property accounting module which should correct this deficiency.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate HHS' progress in implementing the Financial Integrity Act and reporting on the status of the Department's internal control and accounting systems. Because our first-year review was limited to an evaluation of the implementation process, we did not independently determine the status of the Department's internal control systems or the extent to which the Department's accounting systems comply with the Comptroller General's principles and standards. Our review was performed in accordance with generally accepted government audit standards.

Accounting and  
administrative controls

With respect to section 2 of the act--accounting and administrative controls--we reviewed the HHS and OMB instructions and guidelines and their application at HHS' five operating divisions (see app. I), at HHS headquarters for Regional Administrative Support Center (RASC) activities, and at the Denver RASC. We also reviewed the activities of ASMB and OIG as they pertained to (1) development of guidelines and instructions, (2) monitoring the implementation of guidelines and instructions including quality control, and (3) reporting on the results of the Department's internal control initiative. Our review did not include most activities of the Health Resources and Services Administration--a component of the Public Health Service (PHS)--because of its recent reorganization.

Our review was performed at HHS headquarters, Office of Community Services (OCS), and Office of Human Development Services (OHDS) headquarters in Washington, D.C.; SSA and HCFA headquarters in Baltimore, Maryland; PHS headquarters in Rockville, Maryland; National Institutes of Health headquarters in Bethesda, Maryland; and Centers for Disease Control (CDC) headquarters in Atlanta, Georgia. Regional components of these agencies were reviewed as follows:

<u>HHS region</u>	<u>HHS components</u>			
	<u>SSA</u>	<u>HCFA</u>	<u>PHS</u>	<u>RASC</u>
III Philadelphia	X	X		
IV Atlanta	X	X	X	
VI Dallas	X			
VII Kansas City	X			
VIII Denver		X	X	X
IX San Francisco	X			

In addition to visiting the above regional offices, in regions III and IX we also visited SSA district offices, branch offices, teleservice centers, data operations centers, and program service centers.

Our review also included an examination of VAs and ICRs (which included discussions with most of the preparers of these documents), as shown below.

Vulnerability Assessments and  
Internal Control Reviews  
Performed by HHS and Examined by GAO

	<u>VAs</u> <u>performed</u>	<u>VAs</u> <u>examined</u>	<u>ICRs</u> <u>performed</u>	<u>ICRs</u> <u>examined</u>
SSA:				
VA--HHS model	351	37		
VA--abbreviated form	4,122	240		
ICR--new			2	2
ICR--ongoing effort			871	120
HCFA	135	17	15	15
PHS	984	351	128	45
OHDS	24	5	4	1
RASC	160	4	33	1
OCS	32	0 <sup>a</sup>	0	0
VAs and ICRs per- formed at other HHS components	<u>430</u>	<u>0</u>	<u>82</u>	<u>0</u>
Total	<u>6,238</u>	<u>654</u>	<u>1,135</u>	<u>184</u>

<sup>a</sup>At OCS we reviewed 31 assessment forms; however, we could not interview personnel who performed the assessments because they are no longer employed by the agency.

These VAs and ICRs were selected judgmentally so that we could examine these documents for a cross-section of organizational units and functional areas.

We also reviewed HHS' implementation of the Department's ADP security program which is required by OMB Circular A-71.<sup>2</sup> As discussed on page 32, HHS directed that this effort be substituted for all ADP requirements in the internal control assessment and review process. Our review of the Department's security program was performed principally at SSA and HCFA and included interviews with HHS ADP security program staff and reviews of reports and other documentation resulting from the Department's program.

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<sup>2</sup>Security of Federal Automated Information Systems.

### Accounting systems

For our review of the Department's actions to comply with the reporting requirements of section 4 of the act--accounting systems--we reviewed the Department's instructions and their implementation to evaluate the eight general ledger and two payroll systems' compliance with the Comptroller General's principles and standards and related requirements. Our review covered systems at the following locations:

- Office of the Secretary;
- SSA;
- HCFA;
- PHS:
  - CDC,
  - Food and Drug Administration,
  - National Institutes of Health, and
  - Health Resources and Services Administration;
- Office of the Assistant Secretary for Personnel Administration (civilian and uniformed service payroll systems); and
- ASMB (Regional Accounting System).

Additionally, we evaluated ASMB's and OIG's efforts relative to implementing section 4 of the act. ASMB was responsible for developing and overseeing HHS' approach to evaluating and reporting on its accounting systems. OIG evaluated the Department's first-year efforts.

Our review included discussions with appropriate personnel, examination of their analyses and supporting workpapers for their examination of 10 accounting systems, reviews of prior GAO and OIG reports on HHS' accounting systems, and component agency and departmental reports on their first-year efforts to implement section 4 of the act.

## CHAPTER 2

### ADDITIONAL GUIDANCE NEEDED ON

#### IDENTIFICATION OF INTERNAL CONTROL AREAS

All of HHS' significant activities were not inventoried for purposes of determining their vulnerability to fraud, waste, or abuse. This happened because HHS' guidance did not provide a complete list of department-wide functions for use by its components and because the components did not always recognize all of the important functions performed by each of their organizational units. As mentioned on page 5, an internal control area was to be established for each significant function at each organizational unit. These internal control areas or activities were then to be assessed for vulnerability. Consequently, an incomplete inventory of internal control areas results in a lack of assessments of the vulnerability of certain significant HHS activities.

Further, in some cases component descriptions of established internal control areas were so general that the scope of activities to be assessed for vulnerability could not be determined. These problems could have been reduced if HHS guidance had included (1) a more comprehensive list of its functions, (2) a more complete explanation to its components on what constitutes important or "significant" responsibilities of organizational units, and (3) a requirement for clear descriptions of the scope of activities associated with internal control areas. In addition, we noted one internal control area that appeared to be too large to allow a meaningful VA to be conducted.

#### ALL SIGNIFICANT HHS ACTIVITIES WERE NOT INVENTORIED

OMB guidelines provide that agencies develop an inventory of internal control areas, each of which is to be the subject of a VA. Further, OMB guidelines state that the inventory should cover all program and administrative functions.

HHS' instructions to component agencies on how to divide themselves into internal control areas for conducting VAs were not adequate and were not always followed. HHS' instructions include a list of 16 functional areas, such as procurement, grants, and cash, which HHS believed encompassed all of its operations. HHS directed its component agencies to identify and inventory an internal control area for each function for which

each organizational unit<sup>1</sup> had "significant responsibility." In addition, HHS' instructions required that each component determine if the 16 functions covered its entire range of activities and, if not, add the missing functions.

HHS' list of 16 functions did not include all of the Department's important functions. Missing functions include in-house research, health care services delivery, drug regulation, and disease surveillance and prevention. However, none of the components identified any additional functions that they performed. For example, the National Institutes of Health excluded in-house research, health care services delivery, and other programmatic functions because they were not specifically identified in HHS' list of functions. CDC excluded many of its programmatic functions for similar reasons. In December 1983, HHS' Inspector General reported similar omissions for Indian Health Service hospital operations and Food and Drug Administration district office laboratory operations.

We also found that in several instances organizational units appeared to have significant responsibility for 1 or more of the 16 functions, but did not identify internal control areas for all of them. For example,

--SSA excluded the functions of travel and personnel from its inventory of internal control areas for all headquarters and field locations except the Office of Management, Budget and Personnel. This was done because SSA felt that the organizational unit that controlled policy and procedures for these functions was the only one that had "significant responsibility" for the functions. The Office of Management, Budget and Personnel establishes policy and procedures for both functions. However, the bulk of supervisory control over travel, and time and attendance takes place in certain SSA headquarters units and throughout its field offices. It is in these locations that decisions of appropriateness and necessity for travel and overtime, for example, are made. In contrast, HCFA assigned separate internal control areas for both functions at 16 different units including headquarters and regions.

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<sup>1</sup>HHS' instructions call for identifying all organizational components down to a minimum of three organizational levels below the operating division head and two organizational levels below the staff division head which have significant responsibility for 1 or more of the 16 functions.

--OHDS excluded the programmatic functions of its 10 regional offices because it incorrectly believed another HHS organization was responsible for covering them.

HHS' instructions to component agencies state that internal control areas are to be organizational components with "significant responsibility" for 1 or more of 16 internal control functions. Although the HHS instructions provide guidance on the number of organizational levels down to which internal control areas with significant responsibility will be identified, they do not explain what constitutes "significant responsibility." We believe that this contributed to considerable variation in interpretation. HHS' instructions do not provide the necessary guidance for a consistent approach to identifying internal control areas and do not assure that a complete inventory of its important activities in each organizational unit will be developed.

#### INTERNAL CONTROL AREA DESCRIPTIONS WERE TOO GENERAL

HHS' instructions require component agencies to prepare an inventory of internal control areas that includes a brief description of the function covered in each area in quantifiable terms, such as dollars and/or volume. However, the instructions do not elaborate on the specific types of information that should be included and provide no model description. Consequently, many of the descriptions we reviewed were so general that neither we nor others reviewing the inventory could determine what specific activities should be assessed for vulnerability. For example:

--ICO staff at HCFA informed us that they included monitoring benefit payments (which totaled \$73 billion in fiscal year 1983) in the internal control area for the Bureau of Program Operations' "procurement and purchasing" function. However, the narrative description of the area was unclear as to whether benefit payment monitoring activities should have been assessed. The person performing the VA for this internal control area said he did not cover benefit payments in his assessment because he did not know they were included. He assessed the area's vulnerability for administrative purchases of certain supplies and furniture.

--A number of narrative descriptions prepared by components of PHS did not contain detailed descriptions of activities to be included in the internal control areas. To illustrate, the internal control area of "cash" at CDC



did not identify the amount of cash involved or the number or location of organizational units that handle cash. As a result, the person performing the ICR for cash omitted the agency's largest imprest cash fund (\$55,000) from the review. Similarly, the descriptions of internal control areas for the "receivables, loans, and advances" function at the Food and Drug Administration did not include information on the total amount of receivables covered by the internal control area. As a result, we could not determine whether all accounts were covered in the inventory.

NEED TO REEVALUATE SIZE  
OF INTERNAL CONTROL AREA COVERING  
TWO SIGNIFICANT PROGRAMS

OMB guidelines state that internal control areas should be of an appropriate size and nature to allow meaningful VAs to be conducted. HCFA placed responsibility for monitoring the appropriateness of payments under the Medicaid and Medicare programs into one internal control area--the Bureau of Program Operations' procurement and purchasing function. We believe that this internal control area may be too large for a meaningful VA for several reasons.

First, the Medicare and Medicaid programs are very large--totaling over \$70 billion annually. Second, the two programs are administered differently--Medicare essentially through contractors and Medicaid through grants to states. Third, in addition to covering monitoring activities, the procurement and purchasing function covers such activities as negotiating Medicare contracts and coordinating Medicaid grant awards. Vulnerabilities for these activities may be different than those for monitoring. Finally, in addition to the Bureau of Program Operations, another bureau and all 10 of its regional offices have roles in operating HCFA's more than 30 monitoring systems for Medicare and Medicaid payments, and vulnerabilities may differ among organizations and monitoring systems.

We discussed our concern about the size of this internal control area with HCFA ICO staff. They acknowledged the problem and said that they had considered covering Medicare and Medicaid differently but decided to do what they had done because they viewed monitoring as one of several activities falling under the procurement and purchasing function.

PROPOSED CORRECTIVE ACTIONS  
AND HHS' RESPONSE

In a draft of this report, we proposed that HHS improve its instructions for the segmentation process by

- revising its list of agency functions to include all significant functions,
- providing additional guidance on what constitutes a "significant responsibility" so that a more consistent interpretation can be applied by the component agencies, and
- requiring more specific descriptions of its internal control areas so that the scope of activities included will be clearly stated for purposes of performing VAs and ICRs.

In addition, we proposed that the Department reevaluate its segmentation process for purposes of effectively assessing the vulnerability of the Medicare and Medicaid programs.

In commenting on the draft report, HHS agreed to take the actions we proposed. HHS said that it

- was reviewing its list of internal control functions to determine how to expand it to include additional significant functions,
- would provide necessary additional guidance on the term "significant responsibility,"
- would assure that the scope of activities for each function provides a clear and comprehensive description of the functional area, and
- would review the segmentation process for the Medicare and Medicaid programs.

Because HHS agreed to take action on these proposals, as well as those we made in subsequent chapters relative to other aspects of HHS' internal control and accounting systems evaluation and improvement process, we are not making recommendations to the Department in this report. However, we plan to track HHS' progress in taking the promised corrective actions. (See app. VI for HHS' comments on our draft report.)

### CHAPTER 3

#### VULNERABILITY ASSESSMENT PROCESS

##### NEEDS IMPROVEMENT

The HHS VA process did not produce results that could be used for reliably identifying highly vulnerable areas, scheduling ICRs, or taking other appropriate action. In addition, the HHS VA process did not identify known systemic weaknesses for purposes of listing them in the Department's year-end report.

No highly vulnerable ratings were produced by the preparers of HHS' model VA form in any of the five operating divisions. Also, for purposes of scheduling ICRs, SSA's ICO discounted the highly vulnerable ratings produced by SSA field staff using an abbreviated VA form because of variances in how the forms were completed. The results of HHS' VA process were distorted because (1) the assessments did not consider all factors necessary to accurately determine vulnerability, (2) the scoring system used for the HHS model VA form was biased toward low and moderate ratings, and (3) the HHS model form was, in some cases, inaccurately completed.

Limited documentation accompanying vulnerability ratings also hampered the usefulness of HHS' VA process. VA forms do not generally contain the rationale for the ratings given nor do they record internal control weaknesses, such as those previously reported in GAO or OIG reports, which are noted during the assessment process. Although OMB guidelines do not specifically provide for rating rationale to be recorded, we believe it would be helpful for (1) determining the most appropriate action to be taken as a result of the assessment, (2) preparing the Secretary's annual report on internal controls, and (3) evaluating the validity of the VA results.

ASMB officials stated that HHS had not emphasized the VA process because they believe HHS' requirement to conduct ICRs on all internal control areas within 5 years greatly reduces the importance of VAs in scheduling ICRs. The purpose of a VA is to make an initial identification of the most vulnerable areas so that resources can be directed to identifying and correcting or preventing the most significant problems first. Unreliable VAs can result in high vulnerability going undetected and uncorrected for years.

HHS' GUIDANCE DOES NOT PROVIDE  
FOR COMPREHENSIVE ASSESSMENTS

HHS developed a model form for conducting VAs which does not consider several of the factors that are necessary for comprehensive assessments, such as program size and complexity, and the effectiveness of existing safeguards. This form was used throughout HHS, except for SSA's field office assessments. SSA developed an abbreviated form for use in its 1,374 field offices due to the large number of offices involved.

Preparers of the SSA form were instructed to use their judgment in assigning general ratings of high, moderate, or low vulnerability. No consideration of any specific factors was required. Without an assessment approach that requires the systematic consideration of all relevant factors, we believe it is impossible to determine if the results of the assessments are reliable.

Of the 4,122 assessments prepared using the SSA form, 2,485 were rated low, 1,328 moderate, and 309 high. However, SSA did not use the high ratings to schedule ICRs. SSA's ICO stated that the preparers who used the abbreviated form considered inherent program vulnerabilities, rather than the vulnerability of specific locations, and therefore, the resulting assessments did not provide an appropriate basis for scheduling ICRs. The ICO called for any ongoing efforts covering field offices that could be used as substitutes for ICRs. He accepted substituted reviews until enough were received to satisfy HHS' first-year requirement on the number of ICRs to be performed.

Preparers of the HHS model form were instructed to consider 10 specific ranking factors<sup>1</sup> in completing their assessments (see app. III). These factors did not lead to comprehensive assessments. OMB guidelines issued after HHS completed its first-year assessments contain additional factors which we believe should be considered in the Department's second-year effort. The OMB guidelines prescribe a three-step process, and factors that should be considered in each step.

--First, an analysis of the general control environment including an evaluation of eight factors. HHS requires consideration of only some part of three: personnel, policies and procedures, and organizational checks and balances. HHS omits the consideration of such factors as management attitude and budgeting and reporting practices.

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<sup>1</sup>The form allows for the adding of other factors, but no assessment we reviewed had any added factors.

--Second, an analysis of inherent risks, including an evaluation of eight additional factors. HHS requires the evaluation of only some part of three: impact outside the agency, prior reviews, and age and life expectancy of the program. HHS does not require consideration of such important factors as purpose and characteristics, budget level, and management responsiveness.

--Third, a preliminary evaluation of safeguards, which HHS does not require.

THE SCORING SYSTEM IS BIASED  
AGAINST ACHIEVING A HIGHLY  
VULNERABLE RATING

None of the assessments for HHS' operating divisions received a mathematical rating of high vulnerability where the HHS model form was used. We believe this occurred primarily because of the scoring system incorporated into the form. The system provides that each applicable factor be scored 1, 2, or 3, indicating low, moderate, or high vulnerability. The scores are to be totaled and divided by the number of factors used to arrive at an overall average score for each area. A rating scale on the form is used to translate the average score into an overall rating of low, moderate, or high vulnerability. A major problem is that the factors do not have the same relative importance to all internal control areas, but the system does not provide for preparers to weight the factors to emphasize the most important one(s) for each area.

Although there are cases where scoring one factor as high should appropriately result in the entire area being rated highly vulnerable, where 10 ranking factors are used the VA form requires that at least 4 of them must be scored high in order to arrive at a mathematical rating of highly vulnerable. This assumes that all of the other six factors are scored as moderately vulnerable. If some are low, more than four factors will have to be ranked high to result in an overall (or average) rating of highly vulnerable. For example, 1 of HCFA's 135 assessments was given the highest point value for five ranking factors. However, each of the other five factors was given the lowest possible point value, resulting in a mathematical rating equivalent to moderately vulnerable. In another case an official at PHS said he knew a unit he assessed was highly vulnerable. However, even after several attempts, the highest mathematical rating he could assign the unit was equivalent to moderately vulnerable.

Two additional situations skewed the overall ratings toward low or moderate vulnerability. First, HHS requirements are conflicting for scoring the factors "Access to Cash/Negotiable

Instruments" and "Physical Security" if the unit does not handle cash and has no particular need for special security arrangements. Instructions for assessing each of these factors state that they should be rated "1" if cash and security are not applicable to the function. The overall instructions for completing all factors state that if a factor is not applicable, it should be rated "N/A," and documentation should be kept to justify this rating. If a unit does not handle cash or need special security arrangements, the assessor could score those factors either "1" or "N/A." If he chose the former, the overall vulnerability score for the unit would be lower than if the assessor used the "N/A" designation. In HCFA 103 of its total of 135 assessments showed a score of 1 for one or both of these factors even though they could have been scored "N/A."

Second, HHS' instructions on scoring the two factors relating to audits can contribute to lowering the overall rating of vulnerability. "Results of Audits" is to be scored high in the event of a negative audit. However, the factor "Interval Since Most Recent Audit" is to be scored low if the audit was completed in the most recent year. Consequently, the net effect of a recently completed negative audit is diluted for purposes of determining the overall vulnerability.

In the absence of high vulnerability ratings, ICOs were left with finding other bases for scheduling ICRs. HCFA's ICO used his override authority to rate some units highly vulnerable. However, the majority of these overrides were based on judgments of the vulnerability of entire functions, rather than of individual areas.

#### EXPLANATIONS OF SCORES ARE NOT REQUIRED

HHS does not require that VAs report the basis for scores and ratings given. It requires only the reporting of numeric assessment scores and overall ratings. The scores and ratings, if reliable, should be useful in determining which areas to review first. They are not very useful for (1) identifying specific problems to be considered in designing ICRs, (2) tracking and correcting weaknesses noted in the process, or (3) explaining assessment rationale to persons who use VAs.

SSA's ICO recognized the need for an explanation of scoring rationale in a September 1982 memorandum which instructs SSA staff completing the HHS model VA form to provide such rationale when feasible. The ICO stated:

"The rationale can be helpful in setting our priorities for subsequent internal control reviews, can provide a basis for tying in previously identified vulnerabilities and audits, and can pinpoint specific areas of concern."

About 45 percent of SSA's ratings prepared on the HHS model form contained statements, but they were generally inadequate to explain scoring rationale. We noted no such statements on assessments prepared in any other HHS components.

WEAKNESSES IDENTIFIED IN  
EXTERNAL REPORTS WERE  
SOMETIMES OVERLOOKED IN  
VULNERABILITY ASSESSMENTS

Internal control problems identified by congressional committees, GAO, OIG, and an agency contractor were not always adequately considered in the VA process. For 15 of 21 internal control areas that we were able to associate with weaknesses identified in GAO and OIG reports, no consideration was given to the weaknesses. For example, over the past few years GAO reported on weaknesses in controls over SSA's supplemental security income program (HRD-81-4, Feb. 4, 1981), and its system for assuring the propriety of earnings records (HRD-82-18, Apr. 28, 1982). Corrective actions have not been taken on these controls. For the internal control areas which are responsible for controlling these operations, assessors marked the factor "Results of Audits" with "N/A." Other weaknesses, which GAO or the OIG identified in the past several years that were generally not addressed in VAs, involved benefit payments under Medicare and Medicaid.

HHS DOES NOT RECORD  
WEAKNESSES IDENTIFIED IN  
THE ASSESSMENT PROCESS

HHS does not have a procedure for recording weaknesses identified in the VA process. HHS' instructions merely state that weaknesses requiring immediate corrective action be brought to the attention of appropriate officials. They do not provide for documenting weaknesses identified in the VA process, entering them into the Department's system for tracking internal control weaknesses, or considering them in the Secretary's assurance letter required by the act.

OTHER CONDITIONS RAISE  
QUESTIONS ABOUT THE VALIDITY  
OF ASSESSMENT RESULTS

Sufficient time and training may not have been provided to individual preparers of assessments to perform an adequate analysis of vulnerability. Of the HCFA and SSA preparers we interviewed at the regional and field office levels, most said they were working under tight time constraints to complete the VAs. One SSA area director told us that he performed the assessments for 60 internal control areas in less than an hour.

HHS provided guidance in its technical memorandum on how to conduct VAs. In addition, HHS and its components provided guidance to some of the individuals involved in the VA process. Several preparers said they should have had more background information, guidance, or training for the VA process. For example, at SSA

- a regional official, who assessed the wrong activities in preparing one VA we reviewed, said that the instructional material did not provide an adequate guide for conducting a VA;
- another regional official said he would not have taken the exercise so lightly and probably would have rated an assessment we reviewed higher had he received a proper explanation of the goals of the act and how to complete the HHS model assessment form;
- an area director in the field said he would have been able to provide a better response had he received training on the exercise; and
- several preparers questioned the value of the VA effort because of the limited amount of background information provided and the short time frames allowed.

HHS' instructions recognize the dependence of the assessment process on the professional judgment of managers responsible for the internal controls. However, the VAs we reviewed generally were performed by someone other than the responsible area managers. For example, a CDC central office official assessed six areas without consulting area managers. In fact, managers of 90 of CDC's 107 internal control areas were not even informed of the Financial Integrity Act requirements.



PROPOSED CORRECTIVE ACTIONS  
AND HHS' RESPONSE

In our draft report, we proposed that the Department:

- Develop assessment instruments for conducting VAs which include all factors OMB considers necessary to determine the relative vulnerability of each internal control area.
- Require a written explanation of the rationale for VA scores. The explanation should be sufficient to enable an independent party to arrive at a similar rating as did the assessor. It should include weaknesses identified as well as other information necessary for assuring that concerns of the assessor are communicated to preparers of ICRs or other appropriate personnel.
- More fully consider in the VA process weaknesses identified in GAO reports and reports from other external sources.
- Require that weaknesses identified during the VA process be documented and entered into the HHS system for tracking internal control weaknesses, followed up, and considered for inclusion in the annual report to the President and the Congress.
- Provide VA preparers the necessary background information, training, and time to complete meaningful assessments.

In commenting on our draft report, HHS concurred with our proposals and said that it

- was reviewing its VA policies and procedures with the goal of revising them to reflect all significant factors OMB considers necessary,
- believed a written explanation of VA rating rationale would be beneficial and will determine what steps need to be taken to assure that internal control weaknesses identified during the VA process are addressed,
- will determine the feasibility of documenting weaknesses identified during the VA process, entering them into its Internal Control Tracking System, and evaluating the extent to which such weaknesses should be included in its annual report, and
- will determine what steps could be taken to provide VA preparers with additional training and background information.

## CHAPTER 4

### IMPROVEMENTS ARE NEEDED IN HHS'

#### INTERNAL CONTROL REVIEWS

HHS' ICRs did not fully evaluate internal controls to determine if they were adequate and if they were implemented to prevent or detect the occurrence of potential risks. Many of the ICRs we reviewed missed important evaluation factors, did not evaluate all of the controls associated with each internal control area, and were not adequately documented. ICRs were incomplete because HHS did not require component agencies to perform all the steps OMB considers necessary in its guidelines, and documentation was incomplete because component agencies did not always follow HHS' instructions.

#### ICRS DID NOT EVALUATE ALL IMPORTANT FACTORS

The ICRs and the ongoing efforts approved as ICRs which we reviewed generally did not include (1) a comprehensive evaluation of the general control environment, (2) documentation of event cycles, or (3) evaluation of the appropriateness of control techniques and objectives. In addition, many of the ICRs did not include actual testing of controls to determine whether their operation was effective and in compliance with established policies and procedures.

OMB's internal control guidelines provide that an adequate review of internal controls should include

- identification and documentation of event cycles which are processes used to (1) initiate and perform related activities, (2) create the necessary documentation, and (3) gather and report related data. We believe this is necessary because a reviewer cannot appreciate the objectives of a control unless the role of the control in the entire sequence of events is known. For example, a reviewer cannot determine the effectiveness of a computerized edit check for medical necessity until he/she knows that only eligible individuals are allowed to submit claims into the payment system and that a manual check of the claim will be made only if the computer fails to process the claim.
- an analysis of the general control environment which would include factors, such as management attitude, organizational structure, personnel, budgeting and reporting practices, policies and procedures, and organizational checks and balances. We believe such an analysis

is necessary because it reveals the capability of specific controls to accomplish their objectives considering their environment. For example, if management is not committed to the objective of payment accuracy, but instead is more interested in making payments in a timely manner, it may choose to bypass computerized accuracy edits or circumvent manual payment accuracy checks which tend to slow down claims processing.

--evaluation and testing the internal controls within the event cycle. We believe this is necessary in order to determine if the controls required by existing policies and procedures are in place, if they are adequate to accomplish their objective, and if they are providing the level of control anticipated.

--reporting of results. We believe this is necessary in order to inform management about which controls are adequate and which are inadequate and need to be improved.

The HHS guidelines do not require the kind of comprehensive and systematic analysis contemplated by the OMB guidelines. They do not require the identification or documentation of event cycles or an analysis of the general control environment. Instead, they suggest only the evaluation and testing of controls in place and the reporting of results. Without this type of analysis it is difficult to evaluate the ability of existing internal controls to effectively accomplish appropriate objectives.

Most of the ICRs we reviewed were inadequate for the purpose of determining the effectiveness of the controls in place because they did not include all the elements of review needed to fully evaluate the internal controls. In some cases the elements were not considered at all, and in other cases, the elements were only minimally addressed with little evidence of analysis. The following chart shows the various ICR elements discussed in the paragraphs above which we believe were not adequately included in the ICRs we reviewed at each listed component agency.

<u>ICR elements</u>	<u>HHS components</u>			
	<u>HCFA</u>	<u>SSA</u>	<u>PHS</u>	<u>OHDS</u>
Identification and documentation of event cycles	x		x	
Analysis of general control environment				
Management attitude	x	x	x	x
Organization structure	x	x		x
Budgeting and reporting practices	x	x	x	
Policies and procedures	x		x	
Delegation and communication of authority	x	x	x	x
Evaluation and testing of internal control objectives	x	x	x	

HHS' ICR guidelines recommend that the components substitute ongoing efforts in lieu of conducting new ICRs wherever possible. Acceptable substitutes may be reviews performed by GAO, OIG, management, or other control agencies which meet the objectives of an ICR. For 1983, SSA substituted 871 ongoing efforts for ICRs and completed two new ICRs. It elected to do this in order to meet HHS' short time frames and to avoid a large dedication of staff time to conduct new ICRs. SSA's substitutes represent about 77 percent of HHS' ICR efforts.

We reviewed a sample of 120 approved ongoing efforts at various SSA offices and concluded that these efforts were compliance reviews, essentially examining the units' adherence to existing policies and procedures. These efforts did not comply with OMB guidelines because they did not consider the general control environment, identify event cycles, determine the need for, or appropriateness of, additional control techniques, or evaluate control objectives.

SSA is drafting revised procedures which will require field office operations and controls to be routinely reviewed. SSA plans to use these reviews as ICR substitutes for all of its field offices. As currently drafted, this guide will produce incomplete ICRs because it does not require all the steps provided for in OMB's guidelines, such as an evaluation of the appropriateness of controls and of the general control environment.

**SOME ICRS DID NOT EVALUATE  
ALL CONTROLS INCLUDED IN THE  
INTERNAL CONTROL AREA**

HHS' guidance states that ICRs are intended to assess all controls associated with the full range of activities for a

specific function within an internal control area. At SSA, however, the ICR performed on the "sales" function at headquarters evaluated only controls over the sale of such resources as waste paper and silver. Reimbursable services amounting to \$5.2 million in fiscal year 1982 were not included in this evaluation because the individual who performed the ICR did not believe that he was supposed to review the internal controls over these services.

One of the ICRs performed at CDC was on the accounts receivable function within its Financial Management Office. However, the reviewer did not evaluate all controls over intergovernmental receivables (moneys paid by other government agencies for services performed by CDC) during the ICR. We believe this happened because intergovernmental receivables were inadvertently omitted from the internal control area for this function in the Financial Management Office during the agency's segmentation process. Although we did not attempt to identify all of the ICR's omissions, a CDC official stated that controls over two programs totaling about \$70 million were not reviewed by the ICR team. We recognize that this problem is attributable to a faulty segmentation process, but the result is an inadequate ICR of accounts receivable because of a limitation in its scope.

It should be noted that, had this ICR been performed according to OMB guidelines, the event cycles would have been identified. Thus, the reviewers should have recognized that intergovernmental receivables were missing from the total receivables handled by the Financial Management Office, and this oversight may have been avoided.

Our findings regarding the inadequacy of HHS' ICR efforts are consistent with those reported by the HHS OIG. That office has reported that, based on the ICRs and ongoing efforts it reviewed, many of the ICRs and most of the ongoing efforts were inadequate in scope.

#### NEED FOR BETTER DOCUMENTATION OF ICRS

HHS' guidelines and instructions stress the need to document the ICR process. They specifically assign responsibility to the individual performing an ICR to obtain sufficient evidential matter through inspections, observations, and inquiries of officials to afford a reasonable basis for an opinion regarding the adequacy of internal controls for a specific internal control area. That individual is also responsible for preparing working papers to permanently document the review. Working papers would include such items as review procedures, the key factors considered, and narrative explanations in sufficient

detail to fully explain the review process. These documentation guidelines appear to be adequate, but were not always followed.

The ICRs we reviewed at PHS did not generally contain adequate documentation that either the appropriateness of internal controls in place had been evaluated or control procedures had been tested. PHS officials stated that reviewers were allowed to forego documentation of the ICRs in the interest of meeting tight time frames.

One of the two ICRs performed by SSA did not adequately document the appropriateness of the controls in place or the testing of control procedures. The reviewer did not realize that these activities had to be documented. Also, many of the ongoing efforts we reviewed did not document the testing of control procedures. This was due to the fact that ongoing efforts were not required to be documented for their original purposes, and HHS guidelines are not clear whether they require that ongoing efforts meet the documentation requirements for new ICRs.

Complete documentation is important because without it neither we nor others have a sufficient basis for judging the adequacy of the ICRs. HHS' OIG also reported inadequate ICR documentation for PHS, SSA, and HHS' regional offices.

#### PROPOSED CORRECTIVE ACTIONS AND HHS' RESPONSE

In our draft report, we proposed that HHS

- revise departmental instructions to require ICRs that either include all the steps contained in OMB's guidelines for ICRs or meet the objectives of those steps;
- monitor review documentation of all component agencies to determine compliance with HHS requirements; and
- emphasize to all component agencies, through such means as training or monitoring, the importance of adequately documenting review efforts.

In responding to our draft report, HHS concurred with our proposed actions. HHS said it would review its policies and procedures for ICRs with the goal of revising them to include all steps and objectives contained in OMB's guidelines. Also, HHS said that it recognized the importance of adequately documenting ICRs. An ASMB official told us that responsibility for some activities, such as monitoring, could shift when the Department's recent directive on streamlining the Office of the Secretary (see p. 4) takes effect, but it is unclear what impact this shift will have on the nature of the monitoring done.

## CHAPTER 5

### OTHER IMPROVEMENTS NEEDED IN

#### HHS' INTERNAL CONTROL EFFORTS

Although HHS tried to make implementation of the act an integral part of its management structures and processes, there are certain aspects of its first-year effort that need to be improved. More specifically, for all phases of its internal control evaluation and improvement effort, HHS needs to provide for (1) a systematic monitoring effort, (2) additional training to assure that staff understand objectives and procedures, and (3) adequate coverage of ADP activities. In addition, we believe that the Secretary's annual report on the Department's system of internal control should include all known material weaknesses rather than just weaknesses specifically identified during its ICR process.

#### MONITORING EFFORTS NEED TO BE IMPROVED

Although OMB guidelines provide that agencies should establish monitoring systems to ensure that VAs and ICRs are performed adequately, an ASMB official involved in the evaluation effort said that sufficient staff time was not made available to assure the quality of much of the work done under the internal control evaluation and improvement effort. Additional monitoring efforts by HHS could have identified many of the problems we and OIG noted and resulted in more immediate corrective action.

In his March 8, 1982, directive, the Secretary made the Assistant Secretary for Management and Budget responsible for monitoring department-wide performance under the internal control evaluation and improvement program. He stated that the Assistant Secretary would, in coordination with OIG, periodically test the validity of information component agencies submitted to the Office of the Secretary. In addition, he directed that component agencies monitor their own performance under the program. OIG evaluated ICRs and selected aspects of the segmentation and VA processes. However, neither OIG nor ASMB made a systematic, overall evaluation of the segmentation and VA processes, and the amount and nature of monitoring by component agencies varied.

At the departmental level, ASMB generally limited its monitoring efforts to determining whether component agencies completed required process steps as opposed to evaluating the quality of those steps. An ASMB official attributed limited monitoring efforts to resource constraints. He said that the

full-time and part-time staff assigned to the effort did not have enough time to develop policies and procedures, respond to questions, provide overall direction, prepare reports, assure that components met established schedules, and meet other responsibilities outside of the internal control effort as well as to review the quality of work done.

Monitoring efforts at the component level varied considerably, depending on the level of staffing made available for such efforts. For example, at SSA the staff handling the internal control effort did some monitoring but did not have enough time to systematically review the quality of the work done as well as to manage and direct the internal control effort and perform their responsibilities in other areas. PHS, on the other hand, assigned staff specifically to evaluate the segmentation process, and VA and ICR results. Eleven task forces made up of staff selected from the various PHS agencies reviewed the results of the segmentation process. Similarly, officials in the Office of the Assistant Secretary for Health examined each of the more than 900 VAs and 128 ICRs prepared by PHS components.

In March 1984, HHS announced a reorganization plan for the Office of the Secretary which will shift the principal monitoring responsibility for the Department's efforts under the Financial Integrity Act from ASMB to OIG. As of April 1984 it was not clear how this shift will affect the nature of HHS' monitoring, but we plan to follow this as part of our review of HHS' second-year efforts under the act. We plan to look closely at the number of staff available, their expertise, and the nature of the relationship between the Secretary's Office and OIG, especially as it relates to the smooth development and implementation of consistent policies and procedures throughout the Department.

#### ADDITIONAL TRAINING COULD IMPROVE IMPLEMENTATION OF THE ACT

HHS provided guidance in its technical memorandums on how to conduct its internal control evaluation effort. Also, HHS and its components provided guidance to some persons involved in the effort. The guidance provided was often not sufficient to ensure that staff understood the objectives of the effort and correctly implemented segmentation, VA, and ICR procedures. OMB guidelines state that training should be provided to explain the objectives and procedures for implementing the act.

We believe that additional training, along with other improvements we are recommending, could help overcome the problems we identified with the segmentation, VA, and ICR phases of HHS' implementation effort. For example, additional training on the



objectives of the segmentation process and more explanation of internal control functional areas and the term "significant responsibility" could, along with revised instructions, help prevent the misunderstandings that resulted in exclusion of various HHS activities from the Department's inventory of internal control areas.

In addition, revised instructions and additional training on the objectives and methodology for doing VAs could help prevent problems like those experienced by SSA field staff. Some of these staff said they may have rated their vulnerabilities differently, and some staff said they did not understand the objectives of the process. (See p. 23.) Additional training should also help staff at CDC who said they had no previous training or adequate instructions for conducting ICRs and did not understand what they needed to do to perform ICRs that fully complied with HHS' instructions.

#### ADP ACTIVITIES WERE NOT ADEQUATELY CONSIDERED AND EVALUATED

To avoid duplication of effort, HHS directed its component agencies to exclude ADP activities from much of the internal control evaluation and improvement process. It has relied on the Department's ADP security program established in response to OMB Circular A-71 (Transmittal #1, Security of Federal Automated Information Systems) to evaluate the internal controls associated with its ADP function. We believe HHS' desire to avoid duplication of effort was an appropriate attempt to conserve resources. However, neither the scope of activities, the administrative procedures, nor the degree of management emphasis associated with the Department's ADP security program were adequate to meet the provisions in OMB's internal control guidelines.

HHS' component agencies did not perform new VAs or ICRs for ADP activities for purposes of the Financial Integrity Act. Instead, HHS substituted assessments and analyses done under its ADP security program. However, the scope of HHS' efforts under its ADP security program was generally limited to the physical security of ADP facilities, equipment, and operations. HHS did not generally evaluate other important types of controls over ADP systems that are discussed in OMB's guidelines, such as controls to produce accurate, complete, and timely output.

Besides the limitations on the scope of efforts mentioned above, the ADP security assessments substituted for VAs were inadequate because they did not address all the factors considered necessary in OMB's internal control guidelines. Specifically, the ADP security assessments did not include a preliminary evaluation of safeguards and covered relatively few of the elements

of inherent risk or the general control environment. In addition, we believe that all five ADP security analyses we evaluated at HCFA and SSA were not adequate ADP ICRs. For example, one addressed physical security controls only and did not address other aspects of internal controls cited in OMB's guidelines.

It appears that HHS management has given only limited emphasis to considering and evaluating ADP activities as part of the process prescribed by the OMB guidelines. For example:

- Although OMB guidelines call for adequate documentation and monitoring, HHS did not prescribe what documentation should be maintained for its ADP internal control evaluations and did not establish an effective monitoring program for its ADP Financial Integrity Act efforts.
- HHS designated systems security officers to oversee its ADP efforts who did not have the authority to direct resources to fulfill the requirements of HHS' internal control evaluation and improvement program.
- Of 200 ADP application systems identified at SSA and HCFA, the systems security officers reported completing reviews of 14 as of September 30, 1983, and planned to complete 8 more in fiscal year 1984. In order to accomplish HHS' requirement that all systems be evaluated within 5 years, the systems security officers will have to direct an average of 46 evaluations a year for the next 4 years.
- As a result of HHS' policy to separate ADP from the other 15 HHS functions, staff conducting VAs and ICRs of the other functions did not consider the results of ADP security program assessments or reviews. Such consideration is important because ADP is integral to carrying out many of the activities included in other functions, such as payroll and entitlement program payments. Problems with ADP could significantly affect the vulnerability rating for each function, and the results of ICRs could be misleading if the ADP controls are not evaluated.

HHS has recognized the need to improve its coverage of ADP under its internal control evaluation program and to better integrate its ADP assessments and reviews with those conducted for the other internal control functions. In her January 24, 1984, report to the President and the Congress on HHS' first-year internal control evaluation effort, the Secretary said HHS was developing policies and procedures to address this issue.

HHS' YEAR-END REPORT  
SHOULD BE IMPROVED

In her report on HHS' first-year implementation of the act, the Secretary described the Department's internal control evaluation process and progress, reported material weaknesses together with corrective actions taken or planned, and said she had reasonable assurance the Department's internal controls were operating as called for in the act (see p. 7). The Secretary also reported that nonmaterial weaknesses were identified during the evaluation process (although they were not specified) and mentioned HHS' efforts to improve its operations in some "cross-cutting" functions. These functions include debt, cash, and personnel management; audit resolution; prompt payments; and systems enhancements.

In preparing its first-year report on the adequacy of its internal controls, HHS decided to report only those internal control weaknesses specifically identified by its ICRs or their substitutes. This decision was not consistent with instructions included in a July 29, 1983, memorandum from OMB's Deputy Director to the Secretary of HHS. OMB stated that each department and agency needed to identify, analyze, and record known material internal control weaknesses from all sources for use in preparing its year-end statement on the status of controls.

During the last few years, we and OIG have reported a number of significant problems to HHS relating to internal control weaknesses that were not discussed in HHS' report. We believe that some of these control weaknesses are more material than many of those identified by HHS during its first-year evaluation effort and should have been included in HHS' report. HHS reported, for example, that small equipment which was open to theft in one of its regional offices was not marked with identifying numbers. In contrast, some of the problems we identified but which HHS did not report and which remain uncorrected follow.

HCFA programs have experienced overpayments because medically unnecessary services were sometimes paid for on behalf of beneficiaries. In February 1983 (HRD-83-16), we reported that these overpayments were attributable to weaknesses in the internal controls. More specifically, HCFA's guidelines for Medicare paying agents did not require sufficient computer edits to identify claims for potentially medically unnecessary services. In addition, HCFA's policies governing payment for such services were not sufficient to assure that paying agents would appropriately deny payment for all such services after manual review. HCFA also did not direct its evaluations of paid claims in ways that would adequately assure that payments for medically unnecessary services were identified and recouped.

Although HHS has experienced a number of significant problems in the area of entitlements and benefit payments, the Secretary's annual report indicates that ICRs of the function "subsidies, entitlements and benefit payments" did not disclose any material weaknesses. On the basis of past GAO work, we believe that material weaknesses exist in SSA's entitlement and benefit payment programs. For example, we have reported on internal control weaknesses in the social security wage reporting system (HRD-82-19, Dec. 10, 1981) which we believe have given SSA continued problems with maintaining accurate wage data.

Specifically, controls are inadequate to prevent erroneous wage data submitted by employers from getting into SSA's wage data base. In addition, SSA does not have adequate procedures for acquiring needed wage and employee information for posting large volumes of unposted wages to appropriate accounts. Further, SSA has inadequate procedures to assure that beneficiary post-retirement wages are posted accurately and in a timely manner in order to recompute benefit amounts.

We have reported on several other internal control problems at SSA. For example, we reported (HRD-82-18, Apr. 28, 1982), that SSA identified about 2.1 million records where two or more people have the same social security number. This problem affects the timeliness and accuracy of processing claims for benefit payments. With respect to SSA's Supplemental Security Income program, we have reported on operating and internal control weaknesses that resulted in over \$125 million in erroneous benefit payments (HRD-81-4, Feb. 4, 1981).

We believe that HHS should record and track control weaknesses identified by all sources and, where they are considered to be material, include them in its year-end report.

#### PROPOSED CORRECTIVE ACTIONS AND HHS' RESPONSE

In our draft report, we proposed that HHS (1) provide for additional training on and monitoring of the segmentation, VA, and ICR processes and (2) revise its ADP security program to require the assessments and reviews included in OMB guidelines for implementing the Financial Integrity Act. In addition, we proposed that the Secretary require that internal control weaknesses identified by OIG, GAO, and others outside the internal control evaluation process be recorded, tracked, and if considered material, included in annual reports to the President and the Congress.

HHS concurred with our proposals, stating that it was a strong advocate of providing additional training on and monitoring of all aspects of its internal control initiative. It believes its efforts to combine the ADP security program with Financial Integrity Act requirements will be successful. Further, HHS said its position is to correct all internal control weaknesses regardless of who identifies them and that it will review procedures for recording, tracking, and reporting material weaknesses.

## CHAPTER 6

### IMPROVEMENTS ARE NEEDED IN HHS'

#### REVIEWS OF ACCOUNTING SYSTEMS

HHS' written procedures for evaluating its accounting systems generally appeared reasonable for the first year. However, component agencies did not adequately follow the established review procedures. They neither properly tested accounting systems to determine whether they operated in accordance with the Comptroller General's principles and standards nor adequately documented the results of their reviews. These problems appear to stem from a number of reasons, including the newness of the effort and the relatively short time available the first year, given the substantial amount of work required to adequately test accounting systems. HHS could improve its subsequent years' efforts by monitoring the adequacy of efforts undertaken and considering for inclusion in its annual reports on accounting systems all instances of nonconformance known to it from sources other than its own evaluations, such as GAO and OIG reports.

#### MORE AND BETTER TESTING OF ACCOUNTING SYSTEMS IS NEEDED

HHS did not adequately test any of the 10 accounting systems it reviewed during its first-year effort.<sup>1</sup> Six of the 10 systems received little, if any, testing. The remaining four were tested by a limited examination of a few system transactions, and did not cover all of the Comptroller General's principles and standards. None of the testing was done on a statistical sampling basis as called for by HHS' procedures, nor were ADP systems controls tested. A PHS official, for example, attributed insufficient testing to time and resource constraints.

#### BETTER DOCUMENTATION OF ACCOUNTING SYSTEM REVIEWS NEEDED

HHS' instructions for accounting system reviews state that the results of each review must be fully documented and the files permanently retained. Specifically, the instructions state that all "no" and "N/A" answers to standardized questions on the checklist for reviewing compliance with GAO's accounting

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<sup>1</sup>HHS reported that it has a total of 22 accounting systems. However, we recently completed a survey of its financial management systems and are working with the Department to reach agreement on the number of systems it should classify as accounting systems.

principles and standards must be fully explained in writing and permanently retained. The instructions further state that "yes" answers must be verified ". . . through statistical sampling techniques, interviews, and on-site observations" and the results ". . . must be recorded in writing and filed with the permanent workpapers."

HHS did not adequately document any of the 10 accounting system reviews it performed. For 6 of the 10 systems, no documentation was available showing methods used to obtain information or explaining instances of noncompliance with the Comptroller General's principles and standards. The other four system reviews had some workpaper documentation, but it was not complete regarding testing that was done and/or the basis for conclusions reached.

#### MONITORING NEEDED

HHS' policies and procedures for evaluating its accounting systems did not provide for a monitoring program. In the absence of OMB guidelines for accounting system reviews, we believe that all departments and agencies should monitor to test compliance with departmental or agency requirements. This is necessary for the same reasons OMB included monitoring under the internal control evaluation and improvement program. This function could be performed by either HHS program or administrative staff or the OIG.

ASMB officials responsible for HHS' accounting system review effort told us that there was insufficient time for their staff to monitor the results of the work done during the first year. The OIG, as a part of its review of HHS' implementation of the Financial Integrity Act, evaluated 3 of HHS' 10 system reviews and noted deficiencies with the Department's testing and documentation procedures similar to the problems we identified. However, we believe that monitoring of more system reviews is necessary to adequately ascertain compliance on a routine basis.

#### ALL SIGNIFICANT KNOWN PROBLEMS SHOULD BE REPORTED

HHS' first-year work did not include a systematic effort to inventory all known problems with the Department's accounting systems from such sources as reports and studies by GAO, OIG, and others. One such problem we previously reported on (HRD-81-4) is the lack of appropriate controls to prevent improper payments under SSA's disbursement systems. This problem was not identified in the Secretary's report but remained uncorrected. We believe that all known instances of deviations from the Comptroller General's principles and standards should be

identified and those that are considered to be material should be reported in the Secretary's future annual reports along with corrective actions planned, underway, or completed. Such action should also facilitate efforts to follow up on accounting systems problems to ensure that appropriate corrective actions are taken.

PROPOSED CORRECTIVE ACTIONS  
AND HHS' RESPONSE

In our draft report, we proposed that HHS take steps to ensure that future reviews of accounting systems include adequate testing and documentation of review procedures and suggested that it perform additional monitoring of review procedures to determine the adequacy of the testing, verification, and documentation of results. In addition, we proposed that HHS evaluate all instances of nonconformance with the Comptroller General's accounting principles and standards that the Department is aware of and include those that are considered material in future annual reports.

HHS concurred with our proposals. The Department said, however, that it would prefer to obtain official accounting system review procedures before it issues additional instructions to component agencies. In addition, HHS said that it intends to revise its procedures to assure that all instances of nonconformance with the Comptroller General's principles and standards are evaluated and, where appropriate, included in future annual reports. Although the act requires neither GAO nor OMB to issue guidelines for accounting systems reviews, OMB has assumed responsibility for issuing such guidelines. OMB has consulted with us on their development and expects to issue them in the near future.



DEPARTMENT OF  
HEALTH AND HUMAN SERVICES'  
OPERATING AND STAFF DIVISIONS

Operating Divisions:

- Public Health Service
- Social Security Administration
- Health Care Financing Administration
- Office of Human Development Services
- Office of Community Services

Staff Divisions:

- Office of the Assistant Secretary for Legislation
- Office of the Assistant Secretary for Planning and Evaluation
- Office of the Assistant Secretary for Personnel Administration
- Office of the General Counsel
- Office of the Inspector General
- Office of Civil Rights
- Office of the Under Secretary for Intragovernmental Affairs
- Office of the Assistant Secretary for Public Welfare
- Office of the Assistant Secretary for Management and Budget
- Immediate Office of the Secretary

DEPARTMENT OF  
HEALTH AND HUMAN SERVICES'

16 INTERNAL CONTROL FUNCTIONAL AREAS

General Policy and Direction - This function encompasses the communication by management of its programmatic objectives and responsibilities, as well as the policies and procedures to be employed in obtaining the desired results. This includes management's formal plan of organization.

Budget Planning and Formulation - This function encompasses budget planning and formulation for an organization. This includes policies and procedures used in the planning, formulation, and review of the budget of an organization.

Cash - This function covers all actions associated with cash transactions, such as receipt, safeguarding, and depositing of cash, checks, money orders, and negotiable securities. It also covers all actions associated with imprest funds, including advances and disbursements.

Receivables, Loans, and Advances - This function encompasses all policies, procedures, and operations of an organization for controlling, monitoring, collecting, and accounting for all receivables, loans, and advances due from both the public and private sectors.

Inventories - This function encompasses all policies, procedures, and operations for controlling and managing all materials, supplies, work-in-process, and finished goods used in achieving an organization's purpose or mission. This includes the taking of physical inventories, physical security over stores and supplies, and the maintenance of the appropriate accounting records.

Property, Plant, and Equipment - This function includes all policies, procedures, and operations for the acquisition, maintenance, storage, disposition, and physical security of all property, plant, and equipment of an organization. This also includes the maintenance of the appropriate accounting records.

Payables - This function encompasses all aspects of handling and accounting for the various types of liabilities incurred by an organization to both the public and private sectors. This area includes vendor billings, voucher packages, purchase orders, receiving reports, etc.

Budget Execution, Fund Control, and Government Equity - This function encompasses all procedures regarding budget execution, fund control, and government equity. This would include the use of budgetary accounts (appropriations, apportionments, allotments), fund control accounts (obligations, commitments), and government equity accounts (expended funds, earned and estimated reimbursements) as they impact on an organization.

Sales - This function encompasses all policies and procedures for the sale of an organization's resources. This includes all aspects of sales, such as customer orders, billings, shipping documents, and the overall accounting treatment of the proceeds from different types of sales.

Procurement and Purchasing - This function covers all actions associated with the process employed in acquiring goods and services from both the private sector as well as from government entities. The span of control covers the entire cycle from the point where the initial request for goods or services is made until the final action is taken and payment is authorized.

Personnel - This function encompasses the entire federal personnel system as it impacts on the organization. This includes three discrete areas: (1) personnel administration which is performed by servicing personnel offices, or staff offices that issue policies and procedures to direct servicing personnel offices; (2) personnel management which is performed by various levels of the management chain of command; and (3) time, attendance, and payroll functions that are performed within the organization.

Travel - This function includes all travel policies and procedures of an organization and also covers all travel performed by members of an organization. Travel procedures encompass the use of travel orders, travel advances, vouchers, and liquidation of outstanding travel advances.

Grants (discretionary and formula) - This function includes the entire grants process, from the development of policies and procedures to all operational aspects of grantee selection, award, administration, management, evaluation, and the processes associated with grant closure and/or accountability.

Subsidies, Entitlements, and Benefit Payments - This function encompasses all policies, procedures, and operations for controlling and accounting for subsidies, entitlements, and benefit payments administered by an organization. This includes the

entire process from the time an applicant applies for benefits until the time that payment to the applicant is initiated or other final disposition of the application.

Automatic Data Processing - This function encompasses all aspects of automatic data processing (ADP) for an organization. This area includes physical controls over computer hardware and software, as well as all policies and procedures for operating ADP systems. This also includes systems documentation, operating logs and controls, file protection and retention, input controls, output controls, and program controls.

Records Systems - This function encompasses records systems, such as the Earnings Records System maintained by the Social Security Administration. This area includes all records systems where information is queried to determine applicant eligibility for program assistance or of a nature restricted by the Privacy Act.

DEPARTMENT OF HEALTH AND HUMAN SERVICESVULNERABILITY ASSESSMENT MODEL

Internal Control Function: \_\_\_\_\_

OPDIV/STAFFDIV: \_\_\_\_\_

Organizational Component: \_\_\_\_\_

Organizational Level \_\_\_\_\_ Organizational Code \_\_\_\_\_

Organizational Name \_\_\_\_\_

<u>RANKING FACTORS</u>	<u>POINT VALUE</u>
A. <u>Results of Audits</u>	
1. Favorable	
2. Advisory	
3. Negative	_____
B. <u>Interval Since Most Recent Audit</u>	
1. Less than 1 year	
2. One to Three Years	
3. More than Three Years	_____
C. <u>Impact of Recent Errors or Irregularities</u>	
1. None	
2. Personal Harm/Embarrassment	
3. Monetary Loss/Policy Change	_____
D. <u>Access to Cash/Negotiable Instruments</u>	
1. No Access	
2. Limited Access	
3. Extensive Access	_____
E. <u>Existence of Internal Control Procedures</u>	
1. Extensive	
2. Moderate	
3. None	_____
F. <u>Physical Security</u>	
1. None Required	
2. Required by Program	
3. Required by Regulation/Law	_____
G. <u>Risks From Internal Influences</u>	
1. No Potential Risk	
2. Moderate Potential Risk	
3. Extensive Potential Risk	_____

## APPENDIX III

## APPENDIX III

<u>RANKING FACTORS</u>	<u>POINT VALUE</u>
H. <u>Risks from External Influences</u>	
1. No Potential Risk	
2. Moderate Potential Risk	
3. Extensive Potential Risk	_____
I. <u>Policy Direction</u>	
1. Usually Written	
2. Occasionally Written	
3. Rarely Written	_____
J. <u>Recent Changes in Program Control or Resource Level</u>	
1. Less than 10% increase or decrease	
2. 10 to 25% increase or decrease	
3. More than 25% increase or decrease (include new program or phase out)	_____
K. <u>Other</u>	
	_____
TOTAL POINT VALUE	=====

Total Point Value \_\_\_\_\_ ÷ Number of Rating Factors Used \_\_\_\_\_ = Point Value Average \_\_\_\_\_

Vulnerability Assessment Rating

<u>Point Value Average Scale</u>	<u>Degree of Vulnerability</u>
2.4 - 3.0	Highly Vulnerable <input type="checkbox"/>
1.7 - 2.3	Moderately Vulnerable <input type="checkbox"/>
1.0 - 1.6	Low Vulnerability <input type="checkbox"/>
Override	Highly Vulnerable <input type="checkbox"/>

PREPARED BY:

NAME: \_\_\_\_\_

TITLE: \_\_\_\_\_

PHONE #: \_\_\_\_\_

DATE: \_\_\_\_\_

APPROVED BY ICO:

NAME: \_\_\_\_\_

DATE: \_\_\_\_\_

### ACCOUNTABILITY MATINGS FOR DISTRICT/BRANCH OFFICES AND TSC'S

[illegible]

**RESPONSIBLE  
MINE DIRECTOR**

NAME  
ADDRESS  
PHONE  
DATE OF BIRTH  
ADO ORNL. CODE

H = High Vulnerability;  
M = Moderate Vulnerability;  
L = Low Vulnerability

EXAMPLES OF MATERIAL WEAKNESSES AND  
CORRECTIVE MEASURES REPORTED BY HHS

FUNCTION: General Policy and Direction

Total number of internal control reviews conducted: 10

Total number of material weaknesses: 11

Examples of material weaknesses:

- The HHS General Administration Manual chapters on controlling paperwork burden are out-of-date and need to be revised to incorporate new procedures and terminology. The Office of the Assistant Secretary for Management and Budget is drafting revised chapters.
- In HHS' Philadelphia regional office, supervisory staff in the Office of Inspector General, Office of Audit, approved and signed travel vouchers and time cards without delegated authorization to do so. Corrective action was scheduled to make appropriate delegations of authority.

FUNCTION: Budget Execution, Fund Control, and Government Equity

Total number of internal control reviews conducted: 5

Total number of material weaknesses: 1

Material weakness:

- The OIG, Office of Investigations, in HHS' Philadelphia regional office had not filed with the Administrative Services Division the designation of who can sign purchase requisitions. Corrective action was scheduled.

FUNCTION: Cash

Total number of internal control reviews conducted: 337

Total number of material weaknesses: 32

Examples of material weaknesses:

- The Public Health Service, Health Resources and Services Administration, made duplicate, over-, and improper payments to providers of health care to Cuban and Haitian



refugees. Completion of corrective action is scheduled by April 1, 1984.

- Financial management procedures at the Office of Human Development Services permitted grantees to maintain excessive cash balances. As a result, the federal government incurred unnecessary interest costs. A new cash management system has significantly improved cash management procedures. The system requires grantees to submit timely, complete, and accurate cash transaction reports, upon penalty of withholding cash advances if they do not, and to indicate their current cash needs.
- Federal interest costs for fiscal years 1981 and 1982 could have been reduced at least \$1.6 million if all eligible grantees were funded through letters of credit rather than periodic Treasury checks. To correct this situation, ASMB lifted a moratorium on new letters of credit in fiscal year 1983.

FUNCTION: Records Systems

Total number of internal control reviews conducted: 6

Total number of material weaknesses: 1

Material weakness:

- In the OIG, Office of Investigations, Philadelphia regional office, open and closed case files contained notes which should not be in the file folder itself, but placed in a related envelope. Corrective action was scheduled.

FUNCTION: Receivables, Loans, and Advances

Total number of internal control reviews conducted: 117

Total number of material weaknesses: 68

Examples of material weaknesses:

- A Public Health Service regional office had no system in place to assure review of the credit worthiness of applicants for National Health Service Corps loans. An official in each region will be designated to assure that appropriate reviews are made.

--Public Health Service, National Health Service Corps Site Loans did not contain any reference to interest or penalty for late payments. Procedures were issued to require such references.

--In the Public Health Service, Health Resources and Services Administration, the same person who approved loans had authority to waive interest and principal payments. The person's authority to waive interest and principal payments will be rescinded to conform with appropriate separation of duties.

FUNCTION: Travel

Total number of internal control reviews conducted: 8

Total number of material weaknesses: 2

Material weaknesses:

--In HHS' Boston regional office, the OIG, Office of Health Financing Integrity, processed Blanket Travel Orders without meeting requirements for an established length of travel or number of trips per month for each staff. Corrective action was taken to adhere to the established criteria.

--In HHS' Boston regional office, no daily travel log was kept to maintain adequate control over four General Services Administration cars assigned to the OIG, Office of Investigations. To correct this weakness, a formal directive was issued which requires all special agents to use locator cards, and to contact the office daily when on travel.

FUNCTION: Procurement and Purchasing

Total number of internal control reviews conducted: 262

Total number of material weaknesses: 12

Examples of material weaknesses:

--At St. Elizabeths Hospital, several audits led to the withdrawal of negotiated procurement authority in January 1983. The hospital's procurement section was insufficiently staffed to carry out the procurement and purchasing workload. Steps have been taken to insure that staffing is consistent with the workload.

--In the OIG, Office of Health Financing Integrity, New York regional office, telephone toll-call listings were not being received and reviewed timely by management to insure the validity of toll calls. A listing had not been received for at least 6 months. Corrective action was scheduled.

--In the OIG, Office of Audit, New York regional office, the "GSA charge plate" was maintained in an unlocked desk drawer. Corrective action was scheduled to secure the charge plate in a locked desk or cabinet when not in use.

FUNCTION: Payables

Total number of internal control reviews conducted: 2

Total number of material weaknesses: 1

Material weakness:

--In HHS' New York regional office, there was no standard procedure to confirm that voucher examiners had completed all required audit steps (e.g., checking extensions, quantities, distribution of charges) prior to submission of vouchers for payment. To correct this deficiency, a stamped, standard legend will be established and used by all voucher examiners to indicate completion of audit processes.

FUNCTION: Grants

Total number of internal control reviews conducted: 2

Total number of material weaknesses: 8

Examples of material weaknesses:

--A policy of withholding payments to grantees delinquent in submitting their financial reports should be adopted. Under revised procedures, ASMB implemented a policy of withholding payments to grantees when their financial reports are delinquent.

--The Office of Human Development Services did not include its regional offices in the inventory of internal control areas in the functional area of "discretionary grants." It was assumed that this would be covered by the Deputy Under Secretary for Intragovernmental Affairs.

Corrective action will be taken to include the regional offices in the inventory and to perform vulnerability assessments in 1984.

FUNCTION: Personnel

Total number of internal control reviews conducted: 46

Total number of material weaknesses: 39

Examples of material weaknesses:

- At the Health Care Financing Administration timecards were returned to the timekeepers after supervisory review. Some timekeepers prepared their own timecards. A majority of supervisors immediately took corrective action.
- Office of the General Counsel supervisory personnel and managers did not know which employees were entitled to overtime under the Fair Labor Standards Act. Action was taken to inform the supervisors of those who are eligible for overtime.
- In the OIG, Office of Audit, Philadelphia regional office, undistributed payroll checks were kept in an unlocked file cabinet. Corrective action was scheduled.

FUNCTION: Property, Plant, and Equipment

Total number of internal control reviews conducted: 11

Total number of material weaknesses: 10

Examples of material weaknesses:

- In HHS' Dallas regional office, a clear separation of duties was not made between receiving personal property items, recording property transactions, and procuring property items. Corrective actions were underway to clearly define and assign to different individuals the separate duties of receiving, recording, and procuring personal property items.
- In HHS' Philadelphia regional office, small easily concealed equipment which is open to pilferage was not marked with identifying numbers. Corrective action was scheduled to mark the equipment and record the numbers in an office inventory record.

FUNCTION: Automatic Data Processing (ADP)

Total number of internal control reviews conducted: 7

Total number of material weaknesses: 19

Examples of material weaknesses:

--The Social Security Administration does not have a backup arrangement should its principal data center facility be destroyed or otherwise become inoperative for an extended period of time. Efforts are proceeding to develop such backup capacity.

--One of the Health Care Financing Administration's ADP facilities is located in a building that has insufficient space and power supply to handle a large ADP operation. As a result, there is frequent downtime. In addition, there are no security personnel on duty at the building. Thus, during working hours the general public can gain access to the building. Corrective action calls for moving the facility to another building which is designed to accommodate an ADP operation. There may not be sufficient funds to provide the extent of guard coverage that is desired.



DEPARTMENT OF HEALTH &amp; HUMAN SERVICES

Office of Inspector General

APR 12 1984

Mr. Richard L. Fogel  
Director, Human Resources  
Division  
United States General  
Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

The Secretary asked that I respond to your request for the Department's comments on your draft of a proposed report, "The Department of Health and Human Services' First-Year Implementation of the Federal Managers' Financial Integrity Act." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

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

Sincerely yours,

*Byron Mitchell*  
for Richard P. Kusserow  
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES ON THE  
GENERAL ACCOUNTING OFFICE'S DRAFT REPORT, "THE DEPARTMENT OF  
HEALTH AND HUMAN SERVICES. FIRST-YEAR IMPLEMENTATION OF THE  
FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT"

General Comment

We reviewed the subject report and found that, taken as a whole, it represents the actions taken and/or planned to be taken by the Department to implement the Integrity Act.

We note that the General Accounting Office (GAO) recognized that many of the actions pertaining to internal controls taken to date by the Department were either completed or the system was put in operation prior to the issuance of the Office of Management and Budget (OMB) guidelines. The recommendations made by GAO basically stem from a comparison of the Department's system to the OMB guidelines and, where the two are at variance, GAO recommends that we amend our system to more fully comply with the guidelines. This in essence has the effect of placing the guidelines on the same level as standards. The Department's position and the OMB's position (as stated in OMB's draft question and answer booklet on internal control systems) continue to be that guidelines are permissive in nature thus providing management a high degree of flexibility.

The report also recognizes that the OMB and the GAO still have not issued guidelines pertaining to Section 4 of the Act, Accounting Systems Reviews. GAO notes that the Department took the initiative by developing its own policies and procedures for meeting its legal obligations and used them in reviewing all eight general ledger systems and both payroll systems.

We have been working under the premise that any new system should be re-evaluated after it has been in operation for a year or two. Accordingly, our plans called for evaluating the internal controls system during the first calendar quarter of 1984. This objective was accomplished in March with a two day workshop of the Department's Internal Control Steering Committee and Internal Control Officers from the operating divisions and major staff divisions of the Department. The workshop addressed the issues raised by the General Accounting Office and the Office of Management and Budget as well as by HHS's Office of Inspector General.

The workshop participants concluded that the system should be modified to assure that the intent of the recommendations made by all three independent audit groups are accomplished. The Assistant Secretary for Management and Budget, the Department's Internal Control Manager, concurs with these conclusions and has instructed the Committee Chairman to analyze how to best implement the recommendations and develop a time phased action plan for doing so. Some of the recommendations can be implemented in the very near future. However, some of the recommendations are very complex and may require long lead time extending into the next cycle.

Following is the Department's response to each recommendation contained in the GAO report.

1. GAO RECOMMENDATION

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to improve HHS' instructions for the segmentation process by revising its list of agency functions to include all significant functions.

DEPARTMENT COMMENT

We concur. A complete and comprehensive inventory of all significant internal control functions is central to the Department's internal control initiative. The existing list of the Department's internal control functions is currently under review to determine in what ways it can be expanded to include any additional significant functions. We intend to assure that all functions identified in the GAO report as well as the A-76 program, will be included in the Department's revised list of internal control functional areas as required by OMB in a recent directive to the Heads of Departments.

2. GAO RECOMMENDATION

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to improve HHS' instructions for the segmentation process by providing additional guidance on what constitutes a "significant responsibility" so that a more consistent interpretation can be applied by the component agencies.

DEPARTMENT COMMENT

We concur. The complexity and organizational structure of the Department requires that a large measure of flexibility be given to the component agencies in determining which areas of their organizations should be classified as having "significant responsibility" for internal controls. The Department designed the existing policies in order to provide that large measure of flexibility to the Department's component agencies. In order to assure that the term "significant responsibility" is applied on a more consistent basis throughout the Department, we intend to provide our component agencies with the necessary additional guidance in order to meet this objective.



3. GAO RECOMMENDATION

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to improve HHS' instructions for the segmentation process by requiring more specific descriptions of its internal control areas so that the scope of activities included will be clearly stated for purposes of performing VAs and ICRs.

DEPARTMENT COMMENT

We concur. The Department intends to review in detail the descriptions of its internal control functional areas with the objective of assuring that the scope of the activities within each function provides a clear and comprehensive description of each functional area. Revising the description of the Department's list of internal control functions will assist the Department's component agencies in obtaining full coverage of their operations for purposes of performing VAs and ICRs.

4. GAO RECOMMENDATION

We also recommend that the Secretary direct the Assistant Secretary for Management and Budget to work with HCFA ICO staff to reevaluate its segmentation process for purposes of effectively assessing the vulnerability of the Medicare and Medicaid programs.

DEPARTMENT COMMENT

We concur. The Medicare and Medicaid programs administered by HCFA are important HHS programs over which strict internal controls must be maintained. The segmentation process for purposes of effectively assessing the vulnerability of the Medicare and Medicaid programs will be reviewed in great detail to determine what type of further segmentation is warranted.

5. GAO RECOMMENDATION

We recommend that the Secretary require the Assistant Secretary for Management and Budget to develop assessment instruments for conducting VAs which include all factors OMB considers necessary to determine the relative vulnerability of each internal control area.

DEPARTMENT COMMENT

We concur. The assessment of vulnerability for each internal control area is critical in terms of scheduling ICRs based upon relative vulnerability and in terms of identifying weaknesses which require immediate corrective actions. It is important to recognize that all of HHS' VAs were conducted using an assessment instrument developed prior to the issuance of the OMB Guidelines.

The Department is currently reviewing the existing vulnerability assessment policies and procedures with the goal of revising them in such a manner which would reflect all significant factors OMB considers necessary to determine the relative vulnerability of each internal control area. This goal may be accomplished by revisions to the existing vulnerability assessment instrument or by development of a new assessment instrument more closely aligned with the OMB Guidelines.

**6. GAO RECOMMENDATION**

We recommend that the Secretary require the Assistant Secretary for Management and Budget to require a written explanation of the rationale for VA scores. The explanation should be sufficient to enable an independent party to arrive at a similar rating as did the assessor. It should include weaknesses identified as well as other information necessary for assuring that concerns of the assessor are communicated to preparers of ICRs or other appropriate personnel.

**DEPARTMENT COMMENT**

We concur. In order to assist an independent party in arriving at a similar rating as did the assessor, we believe it would be beneficial to provide a written explanation of the rationale for VA scores. The methodology for conducting VAs placed the responsibility for the assessments with the manager most closely associated with the internal control area being assessed. As such, the assessment rating accurately reflects the relative vulnerability of each internal control area. In addition, the ICO at each of the Department's component agencies exercises authority over the final assessment to insure correctness, reliability and accuracy. Nonetheless, it is recognized that written explanations of the rationale for VA scores would assist independent parties in understanding how the results of the ratings were obtained.

**7. GAO RECOMMENDATION**

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to more fully consider in the VA process weaknesses identified in GAO reports and reports from other external sources.

**DEPARTMENT COMMENT**

We concur. The Department's internal control initiative encompasses the correction of all internal control weaknesses whether identified through VAs, ICRs, GAO reports or reports from other external sources. We intend to review our existing VA policies and procedures to determine the appropriate steps which must be taken to assure that the VA process specifically includes and addresses weaknesses identified in GAO reports and reports from other external sources. While weaknesses identified in such reports are certainly considered in the existing VA process, focusing additional attention on such weaknesses can only serve to strengthen the Department's overall internal control initiative.

**8. GAO RECOMMENDATION**

We recommend that the Secretary require the Assistant Secretary for Management and Budget to require that weaknesses identified during the VA process be documented and entered into the HMS system for tracking internal control weaknesses, followed up, and considered for inclusion in the annual report to the President and the Congress.

**DEPARTMENT COMMENT**

We concur. The Department is currently evaluating the entire VA process focusing on ways to streamline the process while making it more comprehensive. Departmental procedures already require that weaknesses identified during the VA process which require immediate corrective actions be brought to the attention of management. We intend to review our existing VA policies and procedures to determine feasibility of documenting identified weaknesses, entering such weaknesses into the Internal Control Tracking System (ICTS). We also intend to evaluate to what extent weaknesses identified in the VA process should be included in the annual report to the President and Congress.

**9. GAO RECOMMENDATION**

We recommend that the Secretary require the Assistant Secretary for Management and Budget to provide VA preparers the necessary background information, training, and time to complete meaningful assessments.

**DEPARTMENT COMMENT**

We concur. From the inception of the internal control initiative, the Department has gone to great lengths to assure that VA preparers have the necessary background information, training and time to complete meaningful assessments. While the Department has minimal control over the timing of the assessments (currently required to be conducted biennially by OMB Circular A-123), we are currently in the process of reviewing the VA policies and procedures to determine what steps can be taken in terms of providing additional training and background information.

Generally, all of the Department's component agencies have responsibility for training their own VA preparers.

**10. GAO RECOMMENDATION**

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to revise departmental instructions to require ICRs that either include all the steps contained in OMB's guidelines for ICRs or meet the objectives of those steps.

**DEPARTMENT COMMENT**

We concur. It has always been the Department's intent to comply with the OMB Guidelines in such a manner that would include all the steps contained in OMB Guidelines for ICRs as well as meet the objectives of those steps.

The existing policies and procedures for conducting ICRs will be reviewed and evaluated in great detail with the goal of revising such policies and procedures to incorporate all the steps and objectives for ICRs as contained in the OMB Guidelines.

11. GAO RECOMMENDATION

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to monitor review documentation of all component agencies to determine compliance with HHS requirements.

DEPARTMENT RESPONSE

We concur. Compliance with the Department's requirements for conducting ICRs is central as well as critical to the review process. The existing policies and procedures place significant responsibility on the ICOs at the Department's component agencies to assure that adequate review documentation is developed and maintained for each ICR. The Department has acted in an oversight role.

12. GAO RECOMMENDATION

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to emphasize to all component agencies, through such means as training or monitoring, the importance of adequately documenting review efforts.

DEPARTMENT COMMENT

We concur. The importance of adequately documenting review efforts is recognized by the Department as one of the most important procedures in the entire internal control review process.

13. GAO RECOMMENDATION

We recommend that the Secretary require the Assistant Secretary for Management and Budget to (1) provide for additional training on and monitoring of the segmentation, VA, and ICR processes, and (2) revise its ADP security program to meet the requirements for assessments and reviews under OMB guidelines for implementing the Financial Integrity Act.

DEPARTMENT COMMENT

We concur. The Department is a strong advocate of providing additional training on and monitoring of all aspects of the internal control initiative.

The Department has already drafted policies and procedures in an attempt to dovetail the ADP Security program with the requirements of the Integrity Act. This process is a highly technical one involving many complex policies and procedures as well as complicated and confusing terminology. However, we believe that the Department's efforts to combine the ADP security program with the requirements of the Integrity Act will prove to be a successful undertaking.

**14. GAO RECOMMENDATION**

In addition, we recommend that the Secretary require that internal control weaknesses identified by OIG, GAO, and others outside the internal control evaluation process be recorded, tracked, and if considered material, included in annual report to the President and the Congress.

**DEPARTMENT COMMENT**

We concur. As indicated before, it is the Department's position that all internal control weaknesses be corrected regardless of whether such weaknesses were identified by OIG, GAO or other external sources. We intend to review our existing procedures for recording, tracking and reporting material weaknesses. It may well be that a coordination effort with the OIG would help a great deal in terms of identifying tracking and reporting internal control weaknesses from sources outside the internal control process.

**15. GAO RECOMMENDATION**

We recommend that the Secretary direct the Assistant Secretary for Management and Budget to take steps necessary to ensure that future reviews of accounting systems include adequate testing and documentation of review procedures. Steps which could be taken include (1) publishing additional instructions on the degree, types, and completeness of testing and documentation required, (2) providing training to personnel performing accounting systems reviews to make sure they understand what is expected of them regarding testing and documentation, and (3) performing additional monitoring of the procedures used during accounting systems reviews to determine the adequacy of the testing, verification, and documentation of results.

**DEPARTMENT COMMENT**

We concur. In terms of publishing additional policies and procedures, it should be recognized that neither OMB nor GAO have as yet issued their guidelines for conducting accounting systems reviews. The existing procedures for reviewing accounting systems were developed by the Department and implemented in an effort to meet the requirements of the Integrity Act. It is significant to note that eight other Departments and Agencies used HHS's procedures (with little or no modification). HHS would prefer to obtain the official review procedures prior to issuing any additional instructions to its component agencies.

**16. GAO RECOMMENDATION**

In addition, we recommend that the Secretary direct the Assistant Secretary for Management and Budget to evaluate all instances of nonconformance with the Comptroller General's accounting principles and standards that the Department is aware of and include those that are considered material in future annual reports.

**DEPARTMENT COMMENT**

We concur. The Department is strongly committed to identifying and correcting all instances of nonconformance with the Comptroller General's principles and standards. We intend to revise existing procedures to assure that all such instances of nonconformance are evaluated and, where appropriate, included in future annual reports to the President and Congress.

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