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Report of Independent Auditors

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

Report on the Financial Statements

We have audited the accompanying consolidated balance sheets of the U.S. Department of Health and Human Services (HHS) as of September 30, 2017 and 2016, and the related consolidated statement of net cost and changes in net position, and the combined statement of budgetary resources for the fiscal years then ended, and the related notes to the principal financial statements. We were also engaged to audit the sustainability financial statements, which comprise the statement of social insurance as of January 1, 2017, 2016, 2015, 2014, and 2013, the related statement of changes in social insurance amounts for the periods ended January 1, 2017 and 2016, and the related notes to the sustainability financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. Except as discussed in the Basis for Disclaimer of Opinion paragraphs with respect to the accompanying statement of social insurance as of January 1, 2017, 2016, 2015, 2014, and 2013, the related statement of changes in social insurance amounts for the periods ended January 1, 2017 and 2016, and the related notes to these financial statements, we conducted our audits in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to HHS's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing

an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statement of net cost and changes in net position, and the combined statement of budgetary resources for the fiscal years then ended, and the related notes to the principal financial statements.

Basis for Disclaimer of Opinion on the Statement of Social Insurance and the Related Changes in the Social Insurance Program

As discussed in Note 24 to the principal financial statements, the statement of social insurance presents the actuarial present value of the Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) trust funds' estimated future income to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants during a projection period sufficient to illustrate long-term sustainability of the social insurance program. The sustainability financial statements are intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statements of social insurance and changes in social insurance amounts are based on income and benefit formulas in current law and assume that scheduled benefits will continue after any related trust funds are exhausted. The sustainability financial statements are not forecasts or predictions. The sustainability financial statements are not intended to imply that current policy or law is sustainable. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. Because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material. Projections of Medicare costs are sensitive to assumptions about future decisions by policymakers and about the behavioral responses of consumers, employers, and health care providers as policies, incentives, and the health care sector change over time. In addition to the inherent variability that underlies the expenditure projections prepared for all parts of Medicare, and as discussed below, significant additional variability and issues regarding the sustainability of the underlying assumptions under current law were introduced by the passage of the *Patient Protection and Affordable Care Act (ACA)* and the *Medicare Access and CHIP Reauthorization Act (MACRA)*.

As further described in Note 25 to the principal financial statements, with respect to the estimates for the social insurance program presented as of January 1, 2017, 2016, 2015, 2014, and 2013, management has assumed in the projections of the program that the various cost-reduction measures will occur as the ACA and the specified physician updates established by MACRA require. Management has developed an illustrative alternative scenario and projections intended to quantify the

potential understatement of projected Medicare costs to the extent that certain payment provisions were not fully implemented in all future years. The range of the social insurance liability estimates in the scenarios is significant. As described in Note 25, the ability of health care providers to sustain these price reductions will be challenging, as the best available evidence indicates that most providers cannot improve their productivity to this degree for a prolonged period given the labor-intensive nature of these services. As a result, actual Medicare expenditures are highly uncertain for reasons apart from the inherent difficulty in projecting health care cost growth over time. Absent an unprecedented change in health care delivery systems and payment mechanisms, the prices paid by Medicare for most health services will fall increasingly short of the costs of providing these services. For example, overriding the scheduled physician payment updates or the productivity adjustments for most providers, as was done repeatedly with the sustainable growth rate formula in the period leading up to passage of MACRA and may be necessary in the future if cost rates prove inadequate, would lead to substantially higher costs for Medicare in the long range than those projected in this report. As a result of these limitations, we were unable to obtain sufficient audit evidence for the amounts presented in the statements of social insurance as of January 1, 2017, 2016, 2015, 2014, and 2013, and the related statements of changes in social insurance amounts for the periods ended January 1, 2017 and 2016.

Disclaimer of Opinion on the Statement of Social Insurance and the Related Changes in the Social Insurance Program

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial condition of the HHS social insurance program as of January 1, 2017, 2016, 2015, 2014, and 2013, and the related changes in the social insurance program for the periods ended January 1, 2017 and 2016.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of HHS as of September 30, 2017 and 2016, and its consolidated net cost, changes in net position, and budgetary resources for the years then ended in conformity with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information as identified on HHS's Agency Financial Report Table of Contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, which considers it to be an essential part of financial reporting for placing the basic financial statements

in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Financial Information and Other Information

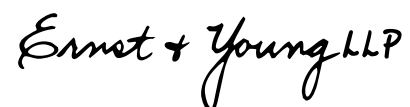
Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise HHS's basic financial statements. The Other Financial Information, as identified on HHS's Agency Financial Report Table of Contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Other Financial Information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the Other Financial Information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Except for the Other Financial Information described above, the Other Information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 14, 2017, on our consideration of HHS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering HHS's internal control over financial reporting and compliance.



November 14, 2017



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Report of Independent Auditors on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the U.S. Department of Health and Human Services (HHS or the Department), which comprise the consolidated balance sheet as of September 30, 2017, and the related consolidated statement of net cost and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and the related notes to the principal financial statements, and we were also engaged to audit the sustainability financial statements, which comprise the statement of social insurance as of January 1, 2017, and the related statement of changes in social insurance amounts for the period ended January 1, 2017, and have issued our report thereon dated November 14, 2017. That report states that because of the matters described in the Basis for Disclaimer of Opinion paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statement of social insurance as of January 1, 2017, and the related statement of changes in social insurance amounts for the period ended January 1, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered HHS' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of HHS's internal control. Accordingly, we do not express an opinion on the effectiveness of HHS' internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 17-03. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*, such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and

corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit, we did identify certain deficiencies related to Financial Information Systems, described below, to be a material weakness. We also identified certain deficiencies related to NIH and CMS Financial Systems, Analysis and Reporting, described below, to be a significant deficiency.

Material Weakness

Financial Information Systems

The Department continued to make strides during fiscal year (FY) 2017 to improve the information technology (IT) controls within its financial systems. The IT Material Weakness Working Group (MWWG) has the leadership role in monitoring remediation of the most significant deficiencies reported in prior years across IT systems in scope of the consolidated Financial Statement Audit and Federal Information Security Modernization Act of 2014 (FISMA). The MWWG has had a positive impact on the enterprise-wide focus on corrective actions that has led to the remediation of number of prior year (PY) control deficiencies. The following summarizes some of the improvements achieved that resulted from this increased attention:

- Differential investments in key financial systems (i.e. Unified Financial Management System (UFMS) access control / segregation of duties redesign) have provided a more mature controls baseline that allows for reliance on the application; and
- HHS MWWG has continued their enterprise-wide focus on corrective actions that has led to the remediation of a subset of high risk PY control deficiencies.

Remediating deficiencies is inherently an iterative process, which frequently takes multiple years to come to complete resolution. The MWWG has overseen the implementation of specific action plans to decrease the number and severity of the deficiencies in the most critical financial systems. However, some of those plans did not reach completion during the fiscal year and others, while reporting as complete during the year, did not reach completion in time to cover the majority of the fiscal year activity. Accordingly, those findings remain for the current year. In particular, the differential investments made in UFMS/CFRS have led to the strengthening of those very important systems' control maturity. However, our findings in regards to other major systems, including Center for Information Technology (CIT) and National Institutes of Health Business System (NBS), actually increased over previous years partially offsetting the impact of the

improvements in our overall conclusions. We also observed a combined number of remaining deficiencies that in aggregate continue to constitute an IT material weakness in internal control.

The IT material weakness determination is driven by four (4) overarching factors, which are listed below:

- Incomplete remediation of PY control deficiencies in Access Control, Segregation of Duties and Configuration Management;
- Identification of new high risk control deficiencies on non-CMS systems focused on access controls, configuration management and segregation of duties;
- Consideration that the areas of weakness identified exist across multiple physical layers of systems; and
- A conclusion that ineffective centralized oversight / monitoring of IT controls allowed new deficiencies to occur without timely detection.

The following is a summary of the deficiencies that we considered most critical at the application layer. When assessed in aggregate, we continue to conclude they could have a material effect on the financial statements and, as a result, they forms the basis for our conclusion of an IT material weakness:

- Access controls – We identified access controls exceptions across six (6) of the eight (8) applications in scope of our review, which spanned non-CMS systems Specifically, we noted (1) inactive users are identified with active application-level access, (2) unauthorized changes to user access are not proactively monitored, (3) inconsistent monitoring of the removal of terminated users to ensure the timely removal of access, (4) a system generated listing of system administrators does not exist, (5) inconsistent monitoring of user activity for powerful elevated access user accounts, and (6) inconsistent recertification of user access. Similarly, CMS did not perform or adequately perform management reviews of user access and system parameters for key financially significant applications. In addition, procedures for adding users were not consistently followed.
- Configuration management – We identified configuration management exceptions in five (5) of the eight (8) applications in scope of our review, which spanned non-CMS systems Specifically, we noted (1) application level baseline configurations were not documented, or changes made monitored for two (2) applications in scope, (2) inconsistent documentation supporting the monitoring of all database and development changes, (3) no formal process in place to periodically monitor for unauthorized changes or activity performed by individuals with access to both development and production environments, (4) we were not able to validate the full population of changes made to an application in

order to verify that only changes that went through the change management and approval process were put into production, and (5) changes made to the Oracle front-end application configurable settings were not monitored. CMS continues to experience deficiencies in the implementation and monitoring of compliance with its defined computer security policies at both the Medicare fee-for-service contractors and the Central Office. Several vulnerabilities related to system configurations were identified with the Central Office and Medicare fee-for-service information systems.

- Segregation of duties – We identified segregation of duties exceptions across five (5) of our eight (8) applications in scope of our review, which spanned non-CMS systems. Specifically, we noted (1) restricted roles are assigned to several user accounts that have been identified as prohibited combinations of roles, per the Segregation of Duties policy, (2) users possess security administrator role while also having separate business user accounts with the ability to input and/or approve transactions, (3) administrators have the ability to modify the workflow of a grant to avoid required approvals, (4) business justification is not consistently documented for all users with access to roles with SOD conflicts, (5) users with SOD conflicts did not have SOD waiver in place nor could we determine if monitoring of user activities was taking place, and (6) users with excessive access to the application, identified during the user recertification process, did not have their access removed in a timely manner. CMS did not monitor the use of privileged access for key applications.

During this year's audit, we also identified a number of high-risk findings on the supporting infrastructure that four (4) non-CMS systems in scope of the audit reside on. The issues identified also span the three (3) control domains of Access Controls, Configuration Management and Segregation of Duties. When assessed in aggregate, we noted that the findings, identified at the infrastructure layer, also contributed to the IT Material Weakness:

- Login to the root account on the UNIX servers was not restricted to the console
- User accounts set to be deleted continued to have active access to the infrastructure
- Baseline configurations for UNIX Hosting Servers have not defined a listing of restrictive permissions
- Inconsistent review / monitoring of multiple critical system level reports by UNIX administrators
- Excessive access granted to a privileged access management utility

Recommendations

HHS should continue the focus achieved in FY 2018 to remediate the remaining deficiencies contributing to material weakness. The following are some specific considerations:

- Department and HHS MWWG should work to strengthen overarching governance / oversight to improve sustainability of remediation activities limiting the identification of new , high risk observations in access controls, configuration management, and segregation of duties during the audit;
- HHS MWWG should continue to focus on high priority remediation activities ultimately strengthening the controls maturity; and
- A focused effort should be made to decommission systems that are being planned to retire and in which the Department is no longer making a differential investment in remediating the issues identified within the system.

We have performed a separate financial statement audit of CMS for FY 2017 and in conjunction with our reports on that audit have provided recommendations specific to CMS on our IT internal control findings. Those findings and recommendations were considered in our overall HHS conclusions.

Significant Deficiency

NIH and CMS Financial Systems, Analysis, and Reporting

During FY 2017, HHS made significant progress in addressing certain issues that have impaired its ability to overcome its significant deficiencies in the past. Improvements included:

- Resolving issues related to its grant accruals,
- Continued development of policies and procedures over financial processes,
- Implementation of processes and controls related to requirements under the DATA Act,
- Implementation of certain processes to strengthen controls around NIH's manual journal entries,
- Execution of analyses to remediate certain data quality issues allowing for data cleanup activities, and
- Continued reduction of the number of manual journal entries through improved approval controls and updates to financial systems.

Although progress in certain areas has been identified, our review of internal control disclosed a series of deficiencies at NIH and CMS in financial systems and processes for producing financial statements, including lack of integrated financial management systems, antiquated processes that impacted journal entries to their financial and budgetary amounts, and/or insufficient analysis and oversight of certain significant accounts or programs. We identified the following items in the current year's audit that indicate additional improvements in the financial reporting systems and processes are required.

National Institutes of Health

During FY 2017, NIH continued its efforts in resolving deficiencies in its financial systems and processes. HHS and NIH took a series of steps to overcome certain deficiencies in internal controls, including: executing additional analyses in its efforts to improve data quality; developing policies and procedures; combining its financial and budgeting systems; and updating and establishing processes surrounding manual journal entries. However, NIH management, the Department, along with the results of our audit, continue to identify deficiencies that require additional focus in FY 2018 and beyond. For example:

- *Manual Entries* –HHS posts a significant number of manual journal vouchers, with the majority of the entries being generated by NIH. During FY 2017, although NIH's annual total budgetary resources was \$38 billion, NIH was required to process approximately 11,000 manual entries totaling an absolute value of more than \$ 670 billion to its National Institutes of Health Business System (NBS). These entries consist of nonstandard postings to record both the proprietary and budgetary effects of certain financial activities for which either the financial system is not configured properly to post automatically or to post differences identified during the various reconciliations or analyses performed by NIH personnel. Although necessary to ensure balances are accurate, the volume and dollar value of manual entries is significant compared to the NIH's overall activity.

Additionally, although a system for tracking, approving and recording manual entries was implemented during FY 2017, we continue to observe certain weaknesses in the manual journal entry process, including:

- Improper or lack of approvals to both routine and non-routine manual journal entries;
- Posting of certain entries that were in error and required reversal;
- Untimely identification and recording of certain manual entries to resolve issues noted; and
- Limited descriptions and insufficient documentation to support the purpose of certain non-routine entries recorded prior to the implementation of new processes to track and record routine entries.

NIH management indicated that the reason for the large number of manual entries is due to clean-up efforts to improve data quality and system and resource limitations. Additionally, management indicated that further training would reduce the number of mistakes and provide for more consistency in manual entry processing.

- *NIH's Grant Accrual* – Quarterly, NIH recorded an estimated grant accrual to its financial data to ensure that reported financial statement balances were correct. NIH recorded its estimate to only one institute's appropriation, although the grant accrual supports all 27 institutes and centers. NIH corrected its process later in the fiscal year by posting accrual estimates to each of its approximately 200 appropriations rather than the one. At September 30, 2017, the estimated grant accrual totaled \$2.1 billion. While the process of recording this type of entry has been mostly automated in FY 2017, it is still a manually intensive process and could lead to mistakes during the posting in the current month and the reversal during the future period.
- *Policies and Procedures* – Although NIH initiated the development of documented financial policies and procedures, NIH should continue to refine NIH-specific desk procedures for its financial processes and period-end closing procedures to ensure all entries are recorded appropriately and completely, and that the volume of entries is reduced

Centers for Medicare & Medicaid Services

We performed a separate audit of the financial statements of CMS and reported on the results of our audit, including a report on its internal controls, dated November 3, 2017. In that report, we outlined details of deficiencies noted and made recommendations for improvement in its financial management controls. Consistent with our findings in the previous year, we concluded that the aggregation of these deficiencies to be a significant deficiency for the CMS internal control over financial reporting. The most significant of those deficiencies fell within the oversight of the Medicaid program and the coordination between CMS actuaries and the CMS Office of Financial Management, which is further discussed below.

Medicaid Oversight

The Medicaid program is the primary source of medical assistance for low-income Americans. Medicaid operates as a partnership between the states and the Federal government. The Federal government establishes the minimum requirements and provides oversight for the program and the states design, implement, administer and oversee their own Medicaid programs within the Federal parameters. Beginning January 1, 2014, the Affordable Care Act expanded eligibility for Medicaid to certain low-income adults and increased the Federal medical assistance percentage to 100 percent for those qualifying claims for the first three years, and gradually decreasing to 90 percent by FY 2020 and beyond, for states that elected to participate in the program (Medicaid Expansion). During our FY 2017 audit, we noted the following deficiencies related to the Medicaid Program:

- While there have been improvements, we continue to see delays receiving certain quarterly expenditure report certifications which results in a backlog of uncertified claims as well as delays in grant finalizations as the regional offices and Centers for Medicaid and CHIP Services (CMCS) reviews are not completed.
- We noted that CMCS should continue to enhance its financial management systems and its related data analyses capability to develop robust analytical procedures and measures against benchmarks to monitor and identify risks associated with the Medicaid program, including outliers and unusual or unexpected results that may identify abnormalities in state-related Medicaid expenditures.
- During the FY 2017 audit, we observed that while progress has been made CMS management has not updated its quantification of prior year recovery estimates. Discussions were held with management to understand the steps taken to gather additional data necessary to quantify the recoveries for more recent periods, however, due to limitations on the data available, no further quantification was feasible. We believe that the efforts to collect information from the individual states and evaluate the necessary recovery efforts should be augmented. As this process further develops, we expect that management will be able to record estimates related to these recoveries.
- CMS does not perform a claims-level detailed look-back analysis for the Medicaid Entitlement Benefits Due and Payable (EBDP) to determine the reasonableness of the various state calculations of incurred (unpaid claims) but not reported liability. CMS has indicated that it currently does not have timely access to the states' claim data nor the ability to accumulate the detailed claim data by state to perform the analysis described above. Additionally, CMS is not able to validate its methodology by using a claims-based approach due to the lack of individual claims-level detail and continues to rely on its estimation process to record the Medicaid EBDP without the ability to confirm the reasonableness of its methodology.

Coordination between the Office of the Actuary and OFM

In September 2017, CMS made advance prospective payments related to October 2017 for the Medicare Part D Program which were appropriately recorded within other assets; however, CMS also included the advance payments as a component of its Part D accrual estimate, resulting in an overstatement of accounts receivable. This was not identified through the normal financial statement close process because there was a gap in communication between the Office of the Actuary and OFM regarding a change in methodology.

Recommendations

We recommend that NIH and CMS continue to develop and refine their financial management systems and processes to improve their accounting, analysis, and oversight of financial management activity. This will require focused efforts and continued prioritization of issues related to controls within and surrounding their financial information management systems. Specifically, we recommend the following:

For NIH, we recommend:

- Continue to focus on automating and reducing the number of manual journal vouchers by determining the cause and the ability to upgrade systems to allow for automated posting of high-volume routine transactions and to ensure financial data is accurate. Additionally, we believe that NIH should continue to strengthen controls surrounding review and approval functions around manual journal vouchers and reconciliations to provide for timely identification of errors and remediation of differences. As a new process was implemented during FY 2017, we recommend NIH monitor the new process to determine if further improvements are warranted.
- Enhance its internal control processes including the continued development of NIH-specific procedures and training to ensure its policy is consistently applied.
- Continue to strengthen the newly implemented process in allocating NIH's grant accruals to each of its 27 institutes to allow for accurate Government-wide Treasury Account Symbols and Adjusting Trial Balances System (GTAS) reporting.

Additionally, we recommend that CMS continue to develop and refine its financial management controls as a means to improve its accounting, analysis, and oversight of financial management activity, primarily relating to the oversight of the Medicaid program. Further, when considering changes to established methodologies, we recommend that the Office of the Actuary work with CMS' Office of Financial Management prior to implementation of such changes within their calculations so that all relevant accounting consequences have been considered. More detailed recommendations related to our specific findings on these topics are included in our CMS Report on Internal Control.

Status of Prior Year Findings

In the reports on the results of the FY 2016 audit of the HHS financial statements, a number of issues were raised relating to internal control over financial reporting. The chart below summarizes the current status of the prior year items:

Material Weakness		
Issue Area	Summary Control Issue	FY 2017 Status
Financial Information Systems	<ul style="list-style-type: none"> • Access Controls • Configuration Management • Segregation of Duties • FISMA Compliance 	Certain progress noted; certain issues need continued focus. Modified Repeat Condition
Significant Deficiencies		
Financial Reporting Systems, Analyses, and Oversight	<ul style="list-style-type: none"> • Lack of Integrated Financial Management System • Financial Analysis and Oversight 	Progress noted with OPDIV financial reporting processes. This significant deficiency is combined with the NIH Financial Management Systems Review Process significant deficiency discussed below. Our concern regarding information technology controls within the Commissioned Corps process continues to exist; however balances have been deemed insignificant for purposes of this report.
NIH Financial Management Systems and Review Processes	NIH Financial Reporting Processes—deficiencies noted related to NIH’s manual journal entries, grant accruals, policy and procedure documentation and security controls for IT System’s infrastructure.	Progress noted. This significant deficiency is combined with the Financial Reporting Systems, Analyses, and Oversight significant deficiency, discussed above.

HHS’s Response to Findings

HHS’s response to the findings identified in our audit and examination are included in the accompanying letter dated November 14, 2017. HHS’s response was not subjected to either the auditing procedures applied in the audit of the financial statements or the attest procedures applied in the examination of internal control, and, accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 14, 2017



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Report of Independent Auditors on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the Department of Health and Human Services (HHS or the Department), which comprise the consolidated balance sheet as of September 30, 2017, and the related consolidated statement of net cost and changes in net position and the combined statement of budgetary resources for the fiscal year then ended, and the related notes to the principal financial statements, and we were also engaged to audit the sustainability financial statements, which comprise the statement of social insurance as of January 1, 2017, and the related statement of changes in social insurance amounts for the period ended January 1, 2017, and have issued our report thereon dated November 14, 2017. That report states that because of the matters described in the Basis for Disclaimer of Opinion paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statement of social insurance as of January 1, 2017, and the related statement of changes in social insurance amounts for the period ended January 1, 2017.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether HHS's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 17-03, including the requirements referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA) (P.L.104-208). However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to HHS.

The results of our tests of compliance with the laws and regulations described in the second paragraph of this report disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 17-03, as described below.

During fiscal year (FY) 2017, HHS's management determined that it may have potential violations of the Anti-Deficiency Act (P.L. 101-508 and OMB Circular A-11) related to an obligation of funds for conference spending at FDA and certain contract obligations serviced by the PSC occurring between FY 2006 and FY 2011. Additionally, HHS's management determined that its Medicare appeals process did not adjudicate appeals within the statutory decisional time frames required by the *Social Security Act*.

The *Improper Payments Information Act of 2002* (IPIA) (P.L. 107-300) as amended by the *Improper Payments Elimination and Recovery Act of 2010* (IPERA) (P.L. 111-204) and the *Improper Payments Elimination and Recovery Improvement Act of 2012* (P.L. 112-248) (hereinafter, the "Acts") require federal agencies to identify the program and activities that may be susceptible to significant improper payments and estimate the amount of the improper payments. While the Department continues to make progress, HHS currently is not in full compliance with the requirements of the Acts. For example, HHS has reported improper payment error rates for each of its high-risk programs, or components of such programs, except for the Temporary Assistance for Needy Families (TANF). HHS indicated that it is unable to compel states to collect the necessary information required to conduct an improper payment measurement for TANF due to Section 411 of the *Social Security Act*, which specifies the data elements that HHS may require states to report, and Section 417 of the same *Social Security Act*, which dictates that the federal government may only regulate the conduct of states where Congress has given them the express authority. Accordingly, HHS feels that it does not have the authority to collect data pertaining to case and payment accuracy for TANF since the information is not included under the *Social Security Act*. Additionally, we noted certain high-risk programs that did not meet their identified targets or exceeded the maximum 10% threshold stipulated by OMB. Also, HHS is not in full compliance with Section 6411 of the *Patient Protection and Affordable Care Act*, as HHS has not yet implemented recovery activities of the identified improper payments for the Medicare Advantage (Part C) program.

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

- During FY 2017, HHS recorded approximately \$750 billion in manual journal entries as these transactions are either corrections, reversals or transactions not currently configured correctly within the financial systems and are for the purpose of ensuring that balances within financial systems are correct to enable the development of periodic financial statements and other required reporting.
- Although progress was noted, reviews of general and application controls over financial management systems identified certain departures from requirements specified in OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. Additionally, the Office of Inspector General (OIG) identified certain issues, including access control deficiencies related to systems as part of its Federal Information Security Modernization Act and other OIG engagements. Finally, HHS management has identified certain weaknesses within its information technology general and application controls during its assessment of corrective action status and its OMB Circular A-123 processes.

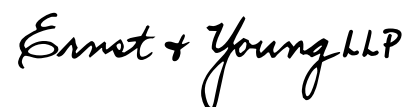
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HHS's Response to Findings

Our Report on Internal Control dated November 14, 2017, includes additional information related to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the noncompliance to FFMIA, and our recommendations related to the specific issues presented. It is our understanding that management generally concurs with the facts as presented and that relevant comments from HHS's management responsible for addressing the noncompliance are provided in its letter dated November 14, 2017. HHS's response was not subjected to either the auditing procedures applied in the audit of the financial statements or the attest procedures applied in the examination of internal control, and, accordingly, we express no opinion on it. Additionally, HHS is updating its Department-wide corrective action plan to address the financial management issues discussed above.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on HHS's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering HHS's compliance. Accordingly, this communication is not suitable for any other purpose.



November 14, 2017