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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, 2015 and 2014, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended, and the related notes to the financial statements. We were engaged to audit the statements of social insurance as of January 1, 2015, 2014, 2013, 2012, and 2011, the related statements of changes in social insurance amounts for the periods ended January 1, 2015 and 2014, and the related notes to these 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 statements of social insurance as of January 1, 2015, 2014, 2013, 2012, and 2011, the related statements of changes in social insurance amounts for the periods ended January 1, 2015 and 2014, 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 Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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, 2015 and 2014, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended, and the related notes to these financial statements.

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

As discussed in Note 24 to the financial statements, the statement of social insurance presents the actuarial present value of the Hospital Insurance and Supplementary Medical Insurance trust funds' estimated future income to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants during a projection period sufficient to illustrate long-term sustainability of the social insurance program. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. 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 financial statements, with respect to the estimates for the social insurance program presented as of January 1, 2015, 2014, 2013, 2012, and 2011, 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 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 the 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, 2015, 2014, 2013, 2012, and 2011, and the related statements of changes in social insurance amounts for the periods ended January 1, 2015 and 2014.

Disclaimer of Opinion on the Statements 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, 2015, 2014, 2013, 2012, and 2011, and the related changes in the social insurance program for the periods ended January 1, 2015 and 2014.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of HHS as of September 30, 2015 and 2014, and its net cost, changes in net position, and budgetary resources for the years then ended in conformity with U.S. generally accepted accounting principles.

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 audit 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 audit was 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 audit 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.

The Other Information has not been subjected to the auditing procedures applied in the audit 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 13, 2015, 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.

/Ernst & Young LLP/

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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. 15-02, *Audit Requirements for Federal Financial Statements*, the 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, 2015, 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 financial statements, and we were engaged to audit the statement of social insurance as of January 1, 2015, and the related statement of changes in social insurance amounts for the period ended January 1, 2015, and have issued our report thereon dated November 13, 2015. 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, 2015, and the related statement of changes in social insurance amounts for the period ended January 1, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered HHS's 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's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 15-02. 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 and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit, we did identify certain deficiencies related to Financial Information Management Systems, described below, which we concluded to be a material weakness. We also identified certain deficiencies related to Financial Reporting Systems, Analyses, and Oversight, and Financial Management Close and Review Processes described below, which we concluded to be significant deficiencies.

Material Weakness

Financial Information Management Systems

The Department continued to make strides during fiscal year (FY) 2015 to improve the controls within its supporting information technology (IT) infrastructure and financial application systems. Senior leadership has established a Material Weakness Working Group (MWWG) tasked with monitoring remediation activities across all IT systems in scope of the Financial Statement Audit and Federal Information Security Management Act (FISMA). The MWWG has established an enterprise-wide focus on corrective actions that has led to the remediation of a number of deficiencies identified during past audits. The following summarizes some of the improvements achieved that resulted from this increased attention.

- Review and update of critical entity-wide governance documentation, such as System Security Plans, Configuration Management Plans and security documentation in support of system-level authority to operate

- Update of application-level contingency plans, backup policies, and procedures and the performance of testing to improve redundancy and availability of the supporting IT infrastructure and financial application systems.

While the MWWG has implemented specific action plans to decrease the number and severity of the deficiencies remaining in the significant financial systems, remediating the root cause of the deficiencies is an iterative process. A focused effort is still necessary to more completely remediate the long outstanding deficiencies in access controls, configuration management, and segregation of duties. The remaining deficiencies continue to constitute a material weakness in internal control. We grouped the deficiencies into topics and categories.

- Access controls
  - Inconsistently performing user access reviews, to monitor for access anomalies and suspicious activities

  - Use of generic IDs, some with administrative access, that are not proactively monitored
  - Users maintaining multiple user IDs to the application and/or users with excessive access to applications that are not commensurate with their job roles and responsibilities
- Configuration management
  - Verification that no changes were made that did not go through the change approval and management process to include proactive monitoring of changes in support of those reviews
  - Lack of automated mechanisms to support change management activities
  - Inconsistent maintenance of the application-level or database-level baseline configuration
- Segregation of duties:
  - Lack of role-based security and established policies and procedures supporting role-based security
  - Inconsistent implementation of least privileged access considerations for all users and lack of documentation for business justifications for necessary conflicts

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

- Access controls – Access controls exceptions were identified across the Unified Financial Management System (UFMS); HHS Consolidated Acquisition Solution (HCAS); Grants Administration Tracking and Evaluation System (GATES); GrantSolutions; Enterprise Human Resources & Payroll (EHRP); Information for Management, Planning, Analysis, and Coordination (IMPACII); National Institutes of Health Business System (NBS); and Consolidated Financial Reporting System (CFRS) systems. Specifically, UFMS and HCAS use Oracle Grid Control audit logs to monitor user access and activity; however, the audit logs are not reviewed/monitored on a consistent basis. Additionally, UFMS has a user that has multiple user IDs within the application that is not required to accomplish organizational missions / business functions, providing them access that is not commensurate with their job roles and responsibilities. EHRP and NBS user activity is not consistently reviewed for suspicious or malicious activity. Also, we noted that UFMS, HCAS, and GATES leverage the use of shared user IDs, some with privileged access, without monitoring user activity performed when using shared IDs. Additionally, we noted UFMS has a large number of generic IDs that are active, without a business need for the generic ID. EHRP had users with excessive access within the application that did not map back to the access provision on their user access request form on file, while GATES does not have detailed user access procedures in place for program administrators governing the new user access provisioning process. Similarly, CMS did not have sufficient evidence of regular management reviews of user access at both the Medicare contractors and the Central Office for appropriateness. In addition, procedures for adding or removing users were not consistently followed.

- Configuration management – Configuration management exceptions were identified across the GATES, EHRP, HCAS, and UFMS systems. For EHRP, we noted that the configuration management process is currently being revamped and that configuration management plans, change control charters, and release management standard operating procedures were not developed or implemented across the span of the audit. Additionally, for EHRP and GATES, we noted that there is no automated and consistent process in place to monitor configuration changes made to the production environment. Furthermore, the EHRP and GATES applications do not maintain updated baseline configurations for all aspects of the application, to include back-end databases. Lastly, for EHRP, we found that users have access to the production environment as well as development access giving them the capability to develop and subsequently migrate code. 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. One significant CMS application did not have adequate segregation of duties as it relates to implementing new program code. Secure access configuration settings were not consistently implemented or reviewed. Several vulnerabilities related to system configurations were identified with the Central Office and Medicare fee-for-service information systems. Evidence supporting testing of claims processing software changes was not always retained.

- Segregation of duties – Segregation of duties (SOD) exceptions were identified across the UFMS, EHRP, and IMPACII systems. For EHRP, there is no entity-wide governance in place to establish segregation of duties for user access. Additionally, for EHRP, segregation of duties is not adequately enforced among the EHRP environments and the SOD matrix does not document the conflicting roles between the developer and system administrator roles, which would provide individuals the ability to develop code and migrate it into production. For UFMS, a listing of all users with SOD conflicts and their respective business justifications is not proactively maintained. For IMPACII, a listing of system-generated individuals and their corresponding roles in the IMPACII development, test, and production environments could not be provided by management, which could lead to excessive access for users across the different environments. CMS continues to experience difficulties in implementing its policy of least privilege access, preventing and monitoring for inconsistencies in access rights to various systems, and mitigating the potential impact on adequate segregation of duties. We found several deficiencies that may result in a potential lack of segregation of duties at both the Medicare fee-for-service contractors and across the enterprise.

- FISMA compliance – The security management program, as required by FISMA of 2002, and amended by the Federal Information Security Modernization Act of 2014, provides a framework to help identify security threats, assess risks continuously, determine that control objectives are appropriately designed and formulated, support the development and implementation of relevant control techniques, and apply consistent managerial oversight to support the overall effectiveness of security measures. Without a fully integrated security management program, the design and implementation of security

controls may be inadequate; user roles and responsibilities may be unclear; and management, operational, and technical controls may be inconsistently implemented. Such conditions will lead to insufficient protection of sensitive or critical resources. As part of our FY 2015 FISMA assessment, we performed our procedures at the following OpDivs: (1) Indian Health Service (IHS), (2) Administration for Children and Families, (3) National Institutes of Health (NIH), (4) Centers for Medicare & Medicaid Services (CMS), and the (5) HHS Office of the Secretary. We noted progress since the prior year procedures at some of the OpDivs; however, our procedures identified the following deficiencies across the OpDivs reviewed:

- Incident response and reporting – The Department's HHS Computer Security Incident Response Center is either not documenting or reporting to US-CERT within the one-hour time frame required by OMB.

- Continuous monitoring – The Department does not have an effective process for managing and identifying unauthorized software on devices in the HHS environment.

- Patch management – The Department does not have an effective process for timely implementation of critical system patches.

- Contingency planning – The Department does not have an effective process for managing contingency plan documentation and performing a timely review. Additionally, the Department does not have sufficient oversight over testing of contingency plans.

- Plan of action and milestones (POA&M) – The Department's security management has not fully implemented an effective POA&M process to ensure that all fields for each POA&M record are entered and updated on a timely basis and that all POA&M records are resolved and closed in a timely manner. Additionally, POA&M records extracted from the HHS Data Warehouse are not reconciled to OpDiv-level data.

Recommendations

HHS should continue the focus achieved in FY 2015 to remediate the remaining deficiencies. The following are some specific considerations:

- Continue to identify, assess, modify, and monitor access controls, configuration management, and segregation of duties to further enhance the security posture of all applications. Specific recommendations for the non-CMS OpDiv applications include the following:

  - For UFMS/HCAS/EHRP/NBS, monitor user activity, leveraging automated tools or mechanisms, on a consistent basis for suspicious activity

- For UFMS/HCAS/GATES, remove all generic IDs that do not have a business need or are no longer needed to be active within the system. For generic IDs that are needed to run the application, proactively monitor user activity performed when using shared generic IDs

- For UFMS, management should leverage their analysis to identify users with multiple UFMS user IDs and remove any instances of multiple user IDs that exist without documented and valid business justification

- For GATES, develop and implement detailed user access provisioning procedures so that leadership can leverage documented procedures when approving new user access, while attempting to prevent unauthorized or excessive access

- For EHRP, develop and finalize all entity-wide configuration management plans and charters to efficiently manage the application's configuration management process

- For EHRP/GATES, develop and implement processes to monitor the production environment to detect configuration changes made to the system and verify if these changes were implemented in accordance with the established configuration management policies and procedures

- For EHRP/GATES, define and document baseline security configurations and ensure the system configuration settings are finalized and mirror the current operational environment

- For EHRP, remove excessive access allowing users with the ability to develop code and subsequently migrate that code into the production environment

- For EHRP, system ownership should collaborate with the individual HR Centers and security and administration resources to further refine the SOD Matrix (i.e., document functional roles, system roles, and conflicting access and functions) based on all applicable roles within the system

- For UFMS, implement standardized and centralized segregation of duties policies across all the OpDivs, perform and monitor mitigation testing, and monitor the SOD reviews for each of the OpDivs to ensure that they are being performed and all SOD conflicts are resolved or justified

- For EHRP, management should develop and document procedures to implement controls for identifying, documenting, and monitoring segregation of duties conflicts within the change management process

• Throughout the course of this year's audit, we noted that GATES is going to be retired in the near future and replaced by other internal systems or other Governmental centers of

excellence. However, a focused effort should still be made to remediate weaknesses identified across all systems currently in operation, including systems that will be retired in the coming years, so as to mitigate risk and exposure to exploitation.

- We have performed a separate financial statement audit of CMS for FY 2015 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 Deficiencies

Financial Reporting Systems, Analysis, and Oversight

Although progress in certain areas has been identified, HHS and its OpDivs' internal reviews and the results of our testing of internal control continued to identify internal control deficiencies in financial systems and processes for producing financial statements, including lack of integrated financial management systems and insufficient analysis of certain significant accounts. In many cases, processes continued to be developed throughout FY 2015 and will require additional refinements in FY 2016 and beyond. Within the context of the approximately $1 trillion in departmental net outlays, the ultimate resolution of our specific 2015 findings was not material to the financial statements taken as a whole. However, these matters are indicative of systemic issues that should continue to be resolved.

Lack of Integrated Financial Management System

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires Federal agencies to have an integrated financial management system that provides effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems and compliance with the United States Standard General Ledger at the transaction level and applicable federal accounting standards. Over the past 18 years, HHS has continued its efforts to overcome certain issues that have affected its ability to become compliant with the FFMIA, including the following long-standing issues, for which HHS and the audit continue to identify:

- The recording of billions of dollars in manual journal entries to ensure balances within financial systems are correct

- Departures from requirements specified in OMB A-123 Appendix D, *Management's Responsibility for Internal Control in Federal Agencies*, and OMB A-130, *Management of Federal Information Resources*, related to access and change management controls within financial systems, as discussed above

- The lack of sufficient integration within the various financial systems which are not complemented with sufficient manual preventative and detective-type controls, including

CMS' durable medical equipment (DME) Medicare Administrative Contractors (MACs) who have not fully implemented CMS' Healthcare Integrated General Ledger Accounting System and the NIH Business System which continues to have certain transactions which are captured inconsistently to the Treasury United States Standard General Ledger at the transaction level and requires adjustments to the accounting records

- Inconsistencies across the various accounting centers and financial systems on how accounting transactions are captured and which standard general ledger accounts are utilized.

Resource limitations and other priorities have consistently been identified as the causes for delays in upgrading certain system and financial internal control processes limiting HHS's ability to comply with requirements under FFMIA.

With the passage of new laws, including the Digital Accountability and Transparency Act (the DATA Act), the continued implementation of Treasury requirements, and upgrades to its financial management systems, HHS has made progress in addressing its compliance with the FFMIA. During FY 2015, the Department has moved forward in its planning and implementation of upgrades to its financial systems, expected to be completed by FY 2016; prioritized and centralized additional resources in addressing certain issues related to controls within its financial information management systems; updated various sections of departmental financial management policies; and continued to automate the manual journal entry processes required to ensure financial data is accurate.

As it continues its pursuit in resolving these long-standing issues, HHS needs to be vigilant in developing, maintaining, and implementing consistent policies and procedures, monitoring the implementation of its upgrades, providing extensive training throughout the Department to ensure consistent application, and enhancing its monitoring program to ensure continued compliance.

Financial Analysis and Oversight

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

Department/Operating Division Periodic Analysis and Reconciliation

As deficiencies exist in financial systems, management compensates by implementing and strengthening other manual controls to ensure that errors and irregularities are prevented or detected in a timely manner. These manual and compensating controls may include monitoring of budgets, reconciliations of accounts, analyses of fluctuations, aging of accounts, and manual and supervisory reviews. During our audit, we found that certain controls still required further improvements. The following represent specific areas that need enhanced periodic reconciliation and analysis:

- *Departmental Review of OpDivs Financial Statements and Other Financial Activity* – The Department performs periodic reviews of OpDivs' financial activity as part of the financial reporting process and for external inquiry purposes. However, we noted that further improvements are necessary at the OpDiv level in performing analysis of its financial data and amounts and communication of newly adopted, unique and/or complex financial management activities to the Department. We observed significant improvements from prior years with the identification by the Department's Office of Finance of significant discrepancies through its implementation of new analysis tools. However, NIH and CMS failed to communicate certain significant or complex activities that were material to the Department in a timely fashion.

- *Fund Balance with Treasury* – Every month, HHS is responsible for reconciling approximately 500 Treasury appropriation symbols. As of September 30, 2015, the general ledger and Treasury's records differed by more than an approximate absolute value of $1.4 billion. This primarily relates to differences that were either timing differences or differences that were not adequately researched and cleared from the suspense accounts. Additionally, differences in HHS suspense account reconciliations were not properly cleared within the 60 days required time frame. For example, based on the support provided, the Out of Balance report for NIH which supports its Fund Balance with Treasury reconciliation had outstanding items from FY 2008 to FY 2015, which indicated that differences are not being resolved in a timely manner (i.e., within the required 60 days). Many of the stale differences presented on the Out of Balance report were carried over from the previous financial systems upgrade. As of June 2015, there was a net difference of $0.9 billion with an absolute variance of $1.8 billion. Finally, we identified several Fund Balance with Treasury reconciliations prepared in the Indian Health Service area offices, which were either not reviewed or were improperly prepared.

- *Property, Plant, and Equipment* – We found that sufficient documentation was not readily available to support certain amounts and disclosures related to property, plant, and equipment. For example, the following:

  – Certain assets at the Indian Health Service were purchased in prior years and put into service, but were not recorded to accounting records until FY 2015.

  - For two of six NIH selected samples, we were not able to agree invoices to the amounts identified in NIH's property subsidiary ledger. We were informed that adjustments to amounts had recently been requested.

- *Commissioned Corp* – During January 2014, HHS transferred the Commissioned Corp retiree, annuitant and surviving payroll processes from a commercial financial shared service center to the US Coast Guard. During FY 2015, we determined that reviews of the respective Coast Guard internal control systems had not sufficiently taken place during the fiscal year nor had sufficient communications taken place to ensure timely access of Commission Corp data or documentation for audit purposes. We have been informed that the active processes will also be transferred from the commercial financial shared service center to Coast Guard in January 2016. In preparation for the move, improvements in the agreements between the two agencies are necessary to ensure a system's assessment would be available in FY 2016 and that documentation to support Commissioned Corp payroll – at the individual level – would be available more timely.

Policies and Procedures

During FYs 2014 and 2015, the Department initiated a plan to upgrade its policies and procedures, including hiring of new personnel to oversee the process, setting up formal prioritized processes from initiation to implementation, defining required levels of approvers, and holding meetings and review periods with OpDivs to ensure input and collaboration into the finalization and implementation of the policy. Many proposed policies were implemented during FY 2015. With certain policies requiring updating, laws being passed and requiring implementation, and as internal control processes change, the Department has not completed its updating of procedural manuals to ensure that sufficient knowledge of financial management systems/processes or consistency and adequacy of internal control exist. For example, HHS management indicated that, while certain policies within its procedural manuals have been drafted awaiting final approval, including sections within its accounting treatment manual, others continue to be on a listing waiting to be updated or approved.

Further, as part of the accounting centers' monthly processes, the Department has instituted a policy whereby the accounting centers certify the status of completing required periodic reconciliations. For each required reconciliation, the preparers and approvers are required to sign off and provide a date of completion. On a monthly basis, the document is forwarded to the Department. Other than the detailed data submitted through CFRS, no supporting documentation is required to be provided as part of the submission. We observed in FY 2015 that follow-up requests from the Department to the OpDivs took place when discrepancies were identified; however, our review of the OpDivs' submissions and the supporting documentation maintained at the OpDivs identified inconsistencies in the procedures performed, the reports utilized, and the results provided among the various OpDivs. Additionally, we noted that although the financial statements are submitted to OMB on the 21st day after the end of the quarter, the Department's policy did not require reconciliations to be completed and certified until the end of the month.

Financial Management Controls at CMS

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 9, 2015. 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 and those related to business partner risk management, noted elsewhere in this report, to be a significant deficiency for the CMS internal control over financial reporting.

Our observations related to financial management controls included a recommendation that as CMS continues to enhance its data analyses capability, further improvement can be made by developing robust analytical procedures or measures against benchmarks to monitor and mitigate risks associated with the decentralized nature of CMS operations. To the extent more robust analysis occurs within Centers and Offices, identifying, evaluating, and reviewing such analysis would assist in ensuring that a perspective that incorporates a financial reporting point of view is captured and considered. It may be beneficial for CMS to identify a cross-functional working group to perform such analysis.

Business Partner Risk Management at CMS

CMS relies heavily on third-party contractors as it outsources substantially all the day-to-day operations for its information technology systems, the payment of Medicare fee-for-service and Medicaid claims and certain services related to the Medicare Part C and Part D programs. We identified areas where improvements could be made in the control environment related to the oversight of third-party contractors.

The contracts between CMS and its Medicare fee-for-service contractors include provisions that require the MACs to develop and follow objectives established by CMS. Through the established procedures, CMS monitors the MACs' compliance with its policies and procedures, established internal controls and the completeness and accuracy of financial reporting. While this approach to financial integrity supports monitoring of the MACs' financial controls, the oversight/monitoring process historically has not been fully effective in identifying and resolving financial recording and reporting issues or ensuring that the issues are timely remediated by the MACs.

As noted in the prior year, we identified deficiencies where actions are required but have not been taken or resolved in the following circumstances: (1) the Medicare Summary Notices, which are returned to the MACs but are not investigated as to why they are returned; (2) the claims outstanding greater than one year – periodic review, track or monitor those aged claims other than those identified as bankruptcy, fraud or abuse; and (3) the provider records – reconcile, review or monitor provider records and provider eligibility status on a periodic basis to verify that all changes were timely, accurately, and completely processed.

Recommendations

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

- Continue to move forward in its planning and implementation to upgrade its financial systems; prioritize and centralize additional resources in addressing certain issues related to controls within its financial information management systems; and continue to automate the manual journal entry processes required to ensure financial data is accurate.

- Continue to focus on reducing the number of manual journal vouchers by determining the cause and the ability to upgrade systems to allow for automated posting of certain high-volume routine transactions.

- Continue to update and implement the Department-wide policies and procedures and other guidance to enable the collection of consistent financial data and consistency in the processing of financial activity among its accounting centers and headquarters. As policies and procedures are developed, training should be developed and delivered across all OpDivs to determine consistent application of the new policies. Additionally, ongoing monitoring processes should be enhanced to ensure appropriateness and consistency over the long-term and continued compliance.

- Develop increased communication protocols with all OpDivs, especially CMS and NIH, to enhance notification and awareness of newly adopted, unique and/or complex financial management activity for purposes that may impact the Department's required financial reporting.

- Strengthen policy and controls surrounding the property, plant, and equipment and related processes to ensure that documentation is maintained and that balances are accurate and supportable.

- Strengthen the agreement between HHS and the Coast Guard to provide for a system's assessment in FY 2016 and that documentation to support Commissioned Corp payroll – at the individual level – would be available more timely.

- Strengthen controls surrounding Fund Balance with Treasury reconciliations to ensure differences are remediated properly and timely. HHS should develop and monitor processes to ensure suspense account transactions are cleared properly on a timely basis.

- Establish a policy individual or group to analyze the accounting and reporting of unique, newly implemented, non-routine, or significant transactions; enhance the financial reporting process; and address or identify transactions that required cross-functional input. Enhancement of this process may assist to develop, document, and validate the new critical accounting matters that are identified or implemented during the year and

improve the timeliness and completeness of the white papers. In addition, prepare the required presentations and disclosures to ensure adequate time for analysis and feedback from key stakeholders.

Additionally, we recommend that CMS continue to develop and refine its financial management controls and business partner risk management as a means to improve its accounting, analysis, and oversight of financial management activity. More detailed recommendations related to our specific findings on these topics are included in our CMS Report on Internal Control.

Financial Management Close and Review Processes

In FY 2015, the NIH upgraded its General Ledger system to Oracle R12; partially implemented of the HHS Accounting Treatment Manual, performed additional analysis of its balances and transactions in order to report budgetary activity through the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS); and underwent a significant change in financial accounting personnel. The convergence of these events caused NIH to find a series of general ledger balances related to Treasury and budgetary activity from current and prior years that did not agree with the corresponding GTAS balances. The process to correct these balances included a series of large dollar balance journal entries. Our analysis of those entries did not cause us to change our opinion on the FY 2015 financial statements of HHS taken as a whole. However, we did find that the research of the differences was inadequate, the supporting documentation underlying the journal entries was insufficient, and the HHS journal entry approval processes were not followed.

Recommendation

The analyses prepared for the audit should be formalized and made a part of the accounting records of NIH. In addition, the analysis and adjustment processes related to balances at NIH should be revised to assure differences are thoroughly researched and adjustments are properly documented and approved. Finally, HHS should continue to perform intensified analyses of balances at all other OpDivs while undergoing the Oracle R12 upgrades.

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Status of Prior Year Findings

In the reports on the results of the FY 2014 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 2015 Status**
Financial Management Information Systems	• Segregation of Duties • Change Management • Access Controls • FISMA Compliance	Certain progress noted; certain issues need continued focus Modified Repeat Condition
Significant Deficiency		
Financial Reporting Systems, Analyses, and Oversight	• Lack of Integrated Financial Management System • Financial Analysis and Oversight	Progress noted; however, certain issues identified require continued focus. Modified Repeat Condition

HHS's Response to Findings

HHS's response to the findings identified in our audit is included in its letter dated November 13, 2015, which has been included at the end of this report. HHS's response was not subjected to the auditing procedures applied in the audit of the financial statements 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 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 13, 2015

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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. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Department of Health and Human Services (HHS), which comprise the consolidated balance sheet as of September 30, 2015, 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 financial statements, and we were engaged to audit the statement of social insurance as of January 1, 2015, and the related statement of changes in social insurance amounts for the period ended January 1, 2015, and have issued our report thereon dated November 13, 2015. 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, 2015, and the related statement of changes in social insurance amounts for the period ended January 1, 2015.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether HHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, non-compliance 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. 15-02, 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 those provisions 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.

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The results of our tests of compliance with the laws and regulations described in the second paragraph of this report disclosed instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 15-02, and which are described below.

During fiscal year (FY) 2015, 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 FY 2014 and FY 2015 obligation of funds for conference spending and a potential violation related to the appointment of a Presidentially nominated official without the required confirmation.

The Improper Payments Information Act of 2002 (P.L. 107-300) as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010 (P.L. 111-204) and the Improper Payments Elimination and Recovery Improvement Act of 2014 (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 it continues to make progress, HHS is currently not in full compliance with the requirements of the Acts. For example, HHS has reported error rates for each of its high-risk 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's position is 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 the Acts. 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. To date, HHS posted a Request for Quote in June 2014; however, no responses were received but HHS anticipates executing a contract in FY 2016.

Under FFMIA, 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 FFMIA 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 non-compliance related to FFMIA:

- During FY 2015, thousands of manual journal vouchers were required to be recorded in the Unified Financial Management System (UFMS)/National Institutes of Health Business System (NBS) to post certain types of transactions not currently configured

correctly within UFMS/NBS and for the purpose of ensuring that balances within financial systems are correct to enable the development of periodic financial statements.

- Although progress was noted, reviews of general and application controls over financial management systems identified certain departures from requirements specified in OMB A-130, *Management of Federal Information Resources*, and OMB A-123 Appendix D, *Management's Responsibility for Internal Control in Federal Agencies*. Additionally, the Office of Inspector General (OIG) identified certain issues, including access control deficiencies related to systems as part of its Federal Information Security Management Act and other OIG engagements. Finally, HHS management has identified certain weaknesses within its information technology general and application controls during its assessment of corrective action status and its OMB A-123 processes.

- The lack of sufficient integration within the various financial systems are not complemented with sufficient manual preventative and detective type controls, including Centers for Medicare & Medicaid Services' (CMS') durable medical equipment Medicare Administrative Contractors who have not fully implemented CMS' Healthcare Integrated General Ledger Accounting System and the NBS which continues to have certain transactions which are recorded incorrectly at the entry point as compared to the Treasury Standard General Ledger at the transaction level and require adjustments to the accounting records.

- Inconsistencies were identified across the various accounting centers and financial systems on how accounting transactions are captured and which standard general ledger accounts are utilized.

* * * * *

HHS's Response to Findings

Our Report on Internal Control dated November 13, 2015, includes additional information related to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the non-compliance to FFMIA, and our recommendations related to the specific issues presented. It is our understanding that management agrees with the facts as presented and that relevant comments from HHS's management responsible for addressing the non-compliance are provided in its letter dated November 13, 2015. We did not audit management's comments, and accordingly, we express no opinion on them. Additionally, HHS is updating its Department-wide corrective action plan to address FFMIA and other financial management issues.

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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.

/Ernst & Young LLP/

November 13, 2015