DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date MAY - 7 1998

From Deputy Inspector General for Audit Services

Subject Report on the Financial Statement Audit of the Administration for Children and Families for Fiscal Year 1997 (CIN: A-17-97-00002)

To Olivia A. Golden
Assistant Secretary for Children and Families

The attached final report presents the results of audit of the Fiscal Year (FY) 1997 financial statements of the Administration for Children and Families (ACF). The firm Clifton Gunderson L.L.C. (CG) undertook the audit in support of the Departmentwide financial statement audit by the Office of Inspector General (OIG) and in accordance with the Government Management Reform Act of 1994. The OIG exercised technical oversight and quality control over the audit.

The audit objectives were to determine whether (1) the ACF statement of financial position as of September 30, 1997, and statement of operations and changes in net position for the FY then ended were fairly presented; (2) ACF internal controls provide reasonable assurance that transactions are properly recorded and accounted for to permit the preparation of reliable financial statements; and (3) ACF has complied with laws and regulations that could have a direct and material effect on the financial statements.

Except for the effects of the matters discussed below, the ACF financial statements present fairly, in all material respects, that entity's financial position at September 30, 1997, and the results of operations and changes in net position for the year then ended in accordance with the accounting principles described in note 1 to those financial statements.

- ***Fund Balance with Treasury.*** The ACF had not been able to reconcile the general ledger fund balance account with the balance reported by the Treasury Department. To reconcile, ACF decreased its general ledger balance by about $500 million. Documentation was not available to determine whether the adjustment was appropriate.

- ***Grant Expenses.*** In FY 1997, adjustments were made to reconcile the grant advance records in the Payment Management System with those in the ACF general ledger, and corresponding adjustments were made to grant expenses. Because management did not retroactively apply the effect of some of these adjustments, grant expenses in the current year could be overstated by as much as $454 million. However, due to problems with the available records, CG could not apply further auditing procedures to determine if an adjustment was necessary to correct the potential misstatement.

- ***Grant Expense Accrual.*** The ACF revised its method of estimating incurred but unreported grantee expenses. Using the revised method, ACF estimated yearend grant expenditures to be $6.4 billion. Based on subsequent grantee expenditure reports, CG was able to verify that at least $5.4 billion of the accrual was reasonable. The difference between the accrual and the amount claimed by grantees, $1 billion, is intended to represent an estimate of unreported grant expenses that had been incurred by grantees by yearend but not included on the expenditure reports. In the absence of historical trend data, it was not practical to extend audit procedures to enable CG to conclude on the reasonableness of the estimated unreported expenses.

- ***Nongrant Liability.*** The ACF had not maintained records to support nongrant advance liabilities of $353 million and nongrant assets of $78 million. These accounts typically arise from fund transfers between ACF and other agencies.

- ***Composition of Net Position Balances.*** The firm was not provided an analysis of the composition of net position balances in time to perform audit procedures. Errors, if any, in amounts reported in two components, unexpended appropriations and cumulative results of operations, could equally affect amounts reported as unexpended appropriations and cumulative results of operations in the statement of operation and changes in net position.

The report on internal controls notes three internal control weaknesses that CG considers to be material under standards established by the American Institute of Certified Public Accountants and Office of Management and Budget Bulletin 93-06.

1. The ACF, in conjunction with the accounting service provided by the Program Support Center, did not have a fully functioning, integrated financial reporting system capable of producing complete and reliable financial statements in a timely manner.

2. Although significant progress had been made in resolving grant accounting issues, additional effort is needed to satisfactorily support estimates of unreported yearend grant expenses and to ensure that Payment Management System advance balances reconcile with ACF records.

3. The ACF general ledger fund balance account and Treasury records were not reconciled in a timely manner.

The firm has incorporated comments to the draft report where appropriate. Officials in your office have concurred with the recommendations and are in the process of taking corrective action. We would like to thank you and your staff for the outstanding cooperation and assistance in working with us and CG on these most complex and challenging problems.

We would appreciate your views and information on the status of any action taken or contemplated on the recommendations within the next 60 days. If you have any questions, please contact me or have your staff contact Joseph E. Vengrin, Assistant Inspector General for Audit Operations and Financial Statement Activities, at (202) 619-1157.

To facilitate identification, please refer to Common Identification Number A-17-97-00002 in all correspondence relating to this report.

Thomas D. Roslewicz

Attachment

cc:
George Strader
Deputy Chief Financial Officer
Department of Health and Human Services

Betty James
Chief Financial Officer
Administration for Children and Families
Department of Health and Human Services

Thomas F. Greene
Director, Division of Fiscal Services, Program Support Center
Department of Health and Human Services

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REPORT ON THE FINANCIAL STATEMENT AUDIT OF THE ADMINISTRATION FOR CHILDREN AND FAMILIES FOR FISCAL YEAR 1997

JUNE GIBBS BROWN
Inspector General

MAY 1998
A-17-97-00002

DEPARTMENT OF HEALTH AND HUMAN SERVICES, ADMINISTRATION FOR CHILDREN AND FAMILIES

INDEPENDENT AUDITOR'S REPORTS AND CONSOLIDATED FINANCIAL STATEMENTS

September 30, 1997

**DEPARTMENT OF HEALTH AND HUMAN SERVICES,
ADMINISTRATION FOR CHILDREN AND FAMILIES**

**INDEPENDENT AUDITOR'S REPORTS
September 30, 1997**

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Independent Auditor's Report

To the Inspector General of the
Department of Health and Human Services, and
The Administration for Children and Families

We have audited the accompanying consolidated statement of financial position of the Administration for Children and Families (ACF), a division of the Department of Health and Human Services (HHS), as of September 30, 1997, and the consolidated statement of operations and changes in net position for the year then ended (collectively the Financial Statements). These Financial Statements are the responsibility of ACF management. Our responsibility is to express an opinion on these Financial Statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit for the year ended September 30, 1997 in accordance with generally accepted auditing standards, the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin 93-06, "Audit Requirements for Federal Financial Statements." These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Financial Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

ACF has been unable to completely reconcile Fund Balances With U.S. Treasury reflected in its general ledger to that reported by The Department of Treasury at September 30, 1997, but has adjusted its general ledger by approximately $500 million to agree with amounts reported by the Department of Treasury. ACF records were not available to determine whether this adjustment was appropriate, and we were unable to satisfy ourselves as to this balance by other auditing procedures.

At September 30, 1996, ACF had not reconciled the amount of grant advances reported in the general ledger system to the amount reported by the Division of Payment Management (DPM), the subsidiary record. During 1997, DPM created a new report to summarize actual grantee advance balances at the appropriation level. The new report reflected amounts different from those previously reported by DPM. In reconstructing grant expense for 1997, it appears that the adjustment to advances could have resulted in an overstatement of grant expenses reflected in the 1997 Statement of Operations by $454 million. ACF records are not available to permit the application of other auditing procedures to determine the adjustment needed, if any, to correct this potential overstatement.

As described in Note 4 to the Financial Statements, in 1997, ACF changed its method of accruing expenses incurred by grantees, but not yet reported to the Division of Payment Management (DPM) as of September 30, 1997. At September 30, 1997, the grant advance liability of approximately $106 million reflected on the Statement of Financial Position, is net of an accrual estimate for these expenses of approximately $6.4 billion. Actual disbursements reported to DPM by grantees were approximately $5.4 billion. Revisions to this accrual estimate may be needed as additional historical experience becomes available. ACF records are not currently available to permit the application of other auditing procedures to determine the adjustment needed to the grant accrual, if any, and the resulting impact on the 1997 grant expense.

ACF transfers funds to other governmental agencies for the purpose of funding various programs monitored at other agencies for which ACF has an interest. Correspondingly, ACF also receives funds from other governmental agencies in anticipation of assisting ACF in funding certain programs that they monitor, for which the other agency has an interest. At September 30, 1997, the non-grant advance liability of approximately $275 million shown on the Statement of Financial Position represents non-grant advance liabilities aggregating approximately $353 million less non-grant assets aggregating approximately $78 million. ACF has not maintained adequate documentation to support these balances, and we were unable to satisfy ourselves as to this balance by other auditing procedures.

Analyses of the composition of net position balances at September 30, 1997 reported in the Consolidated Statement of Financial Position and Note 6 to the Financial Statements was not provided in time to permit the application of auditing procedures to those accounts. Errors in amounts reported as Unexpended Appropriations and Cumulative Results From Operations, if any, could equally impact the amount of Appropriated Capital Used revenue and the amount of Non-operating Change reported for the year ended September 30, 1997. ACF records are not available to permit the application of other auditing procedures to determine if any adjustment is needed to these accounts, and we were unable to satisfy ourselves as to these balances by other auditing procedures.

As required by OMB Bulletin 94-01, Form and Content for Agency Financial Statements, Note 1 to the Financial Statements describes the accounting policies used by ACF to prepare the financial statements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

As discussed in Note 1 to the Financial Statements, ACF changed its method of accounting for pensions and other health and life insurance benefits. Such change had the effect of increasing imputed financing source revenue, with a corresponding offset to imputed financing cost by $13 million.

In our opinion, except for the effect of such adjustments on the Financial Statements, if any, to the amounts recorded for fund balances with U.S. Treasury, grant advance liability, net non-grant advance liability, grant expense, appropriated capital used, non-operating changes and the composition of net position as a result of the matters noted in the preceding paragraphs, the Financial Statements referred to above present fairly, in all material respects, the consolidated financial position of ACF at September 30, 1997, and the results of its operations for the year then ended in accordance with the accounting policies described in Note 1 to the Financial Statements.

Our audit was conducted for the purpose of forming an opinion on the Financial Statements taken as a whole. The information in the Overview of ACF is not a required part of the Financial Statements, but is supplementary information required by Office of Management and Budget Bulletin 94-01, Form and Content of Agency Financial Statements. We assessed whether this information, and the manner of its presentation, is materially inconsistent with the information, and the manner of its presentation, in ACF's financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the Financial Statements, and accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have issued our reports dated February 18, 1998, on our consideration of ACF internal controls and on its compliance with applicable laws and regulations.

This report is intended for the information of the management of ACF, HHS, the HHS Office of the Inspector General, and OMB. However, this report is a matter of public record, and its distribution is not limited.

Clifton Gunderson L.L.C.

Greenbelt, Maryland
February 18, 1998

Independent Auditor's Report on Compliance with Laws and Regulations

To the Office of Inspector General,
Department of Health and Human Services, and
The Administration for Children and Families

We have audited the accompanying Financial Statements of the Administration for Children and Families (ACF), a division of the United States Department of Health and Human Services (HHS), as of and for the year ended September 30, 1997, and have issued our report thereon dated February 18, 1998. The report includes explanatory paragraphs describing certain matters relating to scope limitations on our opinion on the Financial Statements of ACF at September 30, 1997.

Except for the matters discussed in the third through seventh paragraphs of our report on the Financial Statements, we conducted our audit in accordance with: generally accepted auditing standards; 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. 93-06, "Audit Requirements for Federal Financial Statements."

The management of ACF is responsible for complying with laws and regulations applicable to ACF. As part of obtaining reasonable assurance about whether ACF's Financial Statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material affect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 93-06, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Manager's Financial Integrity Act (FMFIA) and compared the material weaknesses reported in ACF's FMFIA report that relate to the financial statements under audit to the material weaknesses and other reportable conditions found during the evaluation we conducted of ACF's internal controls. In evaluating ACF's internal controls and conducting substantive audit procedures, we identified certain reportable conditions, including three material weaknesses, that were not included in ACF's most recent FMFIA report dated December 2, 1997.

Except for the noncompliance with FFMIA as discussed in the following paragraphs, the results of our tests of compliance disclosed no other instances of noncompliance with laws and regulations discussed in the preceding paragraph that are required to be reported under *Government Auditing Standards* and OMB Bulletin 93-06.

At the request of the Office of Inspector General, Department of Health and Human Services, we performed tests of compliance to determine whether ACF's financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997. Our tests with respect to ACF's Year 2000 planning were limited to obtaining and reading the applicable Year 2000 Progress Reports submitted to the Department of Health and Human Services.

An audit of Financial Statements conducted in accordance with generally accepted auditing standards; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin 93-06 is not designed to determine ACF's readiness for Year 2000. Further, we have no responsibility with regard to ACF's efforts to make its systems, or any other systems, such as those of ACF's vendors, service providers, or any other third parties, Year 2000 ready or provide assurance on whether ACF has addressed or will be able to address all of the affected systems on a timely basis. These are responsibilities of the ACF management.

The results of our tests disclosed instances where ACF's financial management systems did not substantially comply with certain of the requirements discussed in the second preceding paragraph. The Report of Independent Auditors on Internal Control identifies those matters that relate to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, our recommendations related to the specific issues presented, and relevant comments from ACF management responsible for the noncompliance, including management's proposed action plan.

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

This report is intended for the information of the management of ACF, HHS, the HHS Office of the Inspector General, and OMB. However, this report is a matter of public record, and its distribution is not limited.

Clifton Gunderson L.L.C.

Greenbelt, Maryland
February 18, 1998

Independent Auditor's Report on Internal Controls

To the Office of Inspector General,
Department of Health and Human Services, and
The Administration for Children and Families

We have audited the accompanying Financial Statements of the Administration for Children and Families (ACF), a division of the United States Department of Health and Human Services, as of and for the year ended September 30, 1997, and have issued our report thereon dated February 18, 1998. The report includes explanatory paragraphs describing certain matters relating to scope limitations on our opinion on the Financial Statements of ACF at September 30, 1997.

Except for the matters discussed in the third through seventh paragraphs of our report on the Financial Statements, we conducted our audit in accordance with generally accepted auditing standards, the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Bulletin 93-06, *Audit Requirements for Federal Financial Statements.* These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements referred to above are free of material misstatement.

In planning and performing our audit of the Financial Statements of ACF, as of and for the year ended September 30, 1997, we obtained an understanding of internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and to determine whether the internal controls meet the objectives identified in the following paragraph. Our consideration included obtaining an understanding of the significant internal control policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and for those significant internal control policies and procedures that have been properly designed and placed in operation, performing sufficient tests to assess more fully whether the controls are effective and working as designed to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

The management of ACF is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs on internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the basis of accounting described in Note 1 to the Financial Statements and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Our evaluation of the controls for performance information was limited to those controls that ensure the existence and completeness of the information. Because of inherent limitations in any internal control, errors and irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control which might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that we also considered to be material weaknesses as defined above. We have described the reportable conditions below; items #1 to 1F, 2 and 3 are considered material weaknesses as defined above.

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MATERIAL WEAKNESSES

1. FINANCIAL REPORTING

Existing Condition: The CFO Act of 1990 assigned responsibility for developing and operating financial management systems to each Federal agency. OMB Bulletin No. 94-01 was issued which defined the form and content of financial statements to be prepared by each agency to assist them in fulfilling this responsibility. Accordingly, to accomplish the objective of complying with the CFO Act, the agency must develop a system to prepare a complete set of financial statements in accordance with accounting principles generally accepted for Federal Agencies.

The HHS Program Support Center's Division of Financial Operations (DFO) has two branches (Audit Liaison Staff and Reports & Control Branch) that support the CFO Act reporting requirements, as well as perform tasks associated with financial reporting throughout the year. DFO's process for preparing the annual financial statements in the Core Accounting

System (CORE) includes downloading necessary data from CORE, and using microcomputer software to process adjusting entries and to prepare annual financial statements. The generation of a complete set of financial statements as of September 30, 1997 was not done in a timely manner. During the audit of several accounts, we noted that year-end closing and prior year audit adjustments were not always recorded in the general ledger. In addition, several adjustments to amounts reflected in such preliminary financial statements were identified during the audit. We also noted significant differences in amounts reported to the Department of Treasury via the Federal Agencies' Centralized Trial-Balance System (FACTS) and amounts reflected in ACF's pre-audited and, ultimately, audited financial statements.

In addition, as indicated in other sections of this report, certain reconciliation procedures were not being performed during the year and at September 30, 1997, and certain accounting transactions were not adequately supported by reliable and conclusive documentation. Also, detailed financial account analysis of ACF's financial statements was not being performed.

We also noted several other weaknesses in internal control that could have a material impact on ACF's ability to produce reliable financial statements in an efficient and timely manner and to comply with the intent of the CFO Act. **Such matters reflected as # 1A through 1 F, along with the matters described above, collectively are considered a material weakness.**

Also, as indicated in a separate Independent Accountant's Report dated February 18, 1998 entitled "Agreed Upon Procedures on the Division of Financial Operations' Financial Management Systems," ACF's financial management systems did not substantially comply with certain of the requirements relating to Federal financial management systems, applicable accounting standards, and the United States Standard General Ledger at the transaction level.

Accordingly, we do not believe that ACF's accounting resources are sufficient to identify and resolve reporting and accounting issues which should be addressed during the year. In light of the above, it does not appear that the CFO oversight function is meeting the responsibilities of the Government Management Reform Act of 1994.

Recommendation: We understand that the "CFO Act learning process", and the scarcity of personnel resources at DFO and ACF's CFO office, may have affected their ability to effectively carry out the intention of the CFO Act; however, we believe that a stronger CFO oversight function is needed immediately to avoid future problems in preparing timely and accurate financial statements. Therefore we recommend the following:

a) Reorganize and reemphasize duties and responsibilities within DFO and ACF's CFO office to address CFO Act reporting requirements on a more timely basis.

b) In order to meet Federal Government reporting deadlines, formal closings should be performed at an interim date (i.e. June 30) to reduce the level of accounting activity and analysis required at year end to meet those deadlines.

c) Consider obtaining financial statement preparation software compatible with CORE, or modifying CORE so that it is capable of generating accrual based financial statements.

d) Financial account analysis should be performed at least on a quarterly basis to access the reasonableness of the current period reported amounts and to identify account categories out of line with expectations. Management should investigate unusual changes from year to year and obtain explanations from appropriate division managers for significant deviations. In addition, consideration should be given to performing similar analysis with budgeted amounts.

Auditee Response: Our response is as follows:

a) Staffing adjustments will be made as a result of an analysis of staffing and functions currently being performed by DFO's two branches and their impact on the financial statement process.

b & d) We agree that procedures should be performed on a quarterly basis to test reports that support the audit, ensure necessary accounting entries are performed (i.e. reversal entries) and to get a start on the upcoming audits.

c) The actual preparation of the financial statements is achieved by downloading accounting data to a microcomputer database package (ACCESS). We are currently reviewing two software packages to prepare Financial Statements as an improvement to the current "ACCESS" software. The major thrust of this endeavor, however, is to relieve the stress on the CORE accounting system of having to support both financial operations and financial statements under audit. The impact of the audit of ACF's financial statements adversely affects the effort to support our normal operations of paying bills, recording obligations, and producing financial management reports.

1A. RECONCILIATION OF PAYROLL EXPENSE TO SUBSIDIARY REPORTS

Existing Condition: Even though prepared for the audit as of September 30, 1997, cumulative reconciliations had not been performed periodically during the year between the payroll disbursement amounts produced by Central Personnel and the Payroll System (Data Flowback Reports), and the payroll expense and related liability accounts in the general ledger system. We understand that management applies certain reconciliation procedures on payroll accounts on a monthly basis; however, none of these reconciliations are done cumulatively at a point in time. Even though the cumulative reconciliation did not identify any material discrepancies at September 30, 1997, the policies and procedures in place do not assure that this will be the case in the future.

Recommendation: We recommend that a cumulative payroll reconciliation be performed, at least semiannually, similar to the one eventually prepared at September 30, 1997, to identify errors in payroll processing and amounts in the general ledger that the monthly procedures may not have identified.

Auditee Response: We believe that our monthly control procedures are adequate. Such procedures are summarized as follows:

a) Every month a reconciliation is completed for "Fund Balance with Treasury" for each appropriation symbol. This reconciliation process compares the Fund Balance at Treasury with the balances recorded in the general ledger. It includes all cash activity for the entity, including payroll. Any disbursements that differed from the original obligation would have adjusted the expense amount in the general ledger and, therefore, been reconciled during this monthly process. It is important to understand that the data flow back reports are processed and reconciled through the agency accounting system.

b) In addition, before we closed for FY 1997, Administrative Officers reconciled their payroll obligations in the general ledger to their biweekly payroll reports (AFP). Since payroll expenses are recorded in the general ledger from the same transactions that records the obligation, the expenses are being reconciled.

c) For the past year, compensating procedures were established whereby a system staff employee has been given the responsibility of monitoring payroll on a monthly basis to ensure that the payroll tapes generated by AFP are entered into CORE. This includes all payroll obligations, accruals and disbursement transactions.

However, we will supplement these procedures with the reconciliation analysis semi-annually that the auditors suggest .

1B. RECONCILIATION OF RECORDED DIVISION OF PAYMENT MANAGEMENT (DPM) GRANT ADVANCE BALANCE (Repeat Condition)

Existing Condition: Due to lack of reconciliation procedures performed at September 30, 1996, management was unable to explain why grant advances (gross of an expense accrual) reported by the Division of Payment Management (DPM) exceeded the corresponding amount in the general ledger by $3.6 billion. During 1997, DPM researched this matter for all HHS operating divisions, including ACF, and determined that there were errors in amounts reported previously by DPM to ACF in 1997 and prior years. Consequently, DPM created a new report to summarize actual grantee advance balances at the appropriation level. The new report reflected amounts different from those previously reported by DPM. The correction of these resulting errors in reported amounts served to substantially reduce the difference between DPM and the general ledger. However, management did not retroactively apply these adjustments to amounts reported by DPM at September 30, 1996. At September 30, 1997, the amount reported in the general ledger exceeded the amount in the DPM subsidiary report by approximately $56 million. Management was unable to specifically identify the reasons for the remaining differences at September 30, 1997. The financial statements at September 30, 1997 reflect the DPM balance for which auditing procedures were applied thereon.

Recommendation: Even though we are satisfied with grant advance amounts reflected in the DPM subsidiary report at September 30, 1997, we recommend the following:

a) Formal procedures be developed at the Department level to document the process of reconciling the advance balance reported to ACF by DPM. Such procedures should include responsibilities of both DPM and ACF.

b) The subsidiary detail of the grant advance balance should be prepared/provided at a grant (or at least grantee level) summarized by appropriation.

c) The advance accounts reported in the general ledger be reconciled to those amounts reported by DPM at the grant level summarized by appropriation at least on a quarterly basis.

d) Obtain and review the most recent "Report on Department of Health and Human Services, Program Support Center, Division of Payment Management's Policies and Procedures in Operation and Tests of Operating Effectiveness." Particular attention should be given to the user control section of the report and the impact on the reconciliation process. User controls are defined in the report as being "internal control structure policies and procedures that should be in operation at user organizations to complement the control structure policies and procedures at HHS." A listing of certain key user controls is provided in the report. These key user controls should be established and/or enforced to reduce the risk of error and facilitate the reconciliation process.

Auditee Response: We concur with the recommendations. New procedures and processes are being refined to address these recommendations. The synchronization process identifies discrepant items. Additionally, this process is being expanded to ensure all financial data from the subsidiary will be reconciled to the general ledger each month. Further, we have resolved to have the same files DPM uses to compile the SF-224 (advance transactions) transmitted to the Core accounting system. We also resolved to alter the expenditure process to the extent that the advance transactions will be liquidated by the relevant disbursement transaction prepared by DPM as part of their PMS-272 posting process. Both of these files contain the detail necessary to provide grant document level reports summarized at the appropriation level.

1C. GENERAL LEDGER ACTIVITY IN NET POSITION ACCOUNTS (Repeat Condition)

Existing Condition: As indicated in the prior year report, ACF has still not been reconciling its net position accounts with revenue and expense (operating) activity ledger and non-operating activity in its general ledger during the year. Management did provide us with a reconciliation as of September 30, 1997; however, since it was provided so late in the audit we were unable to perform audit procedures on the reconciliation. Therefore, we were unable to determine whether ACF has maintained adequate documentation to support the composition of net position balances at September 30, 1997 or the related amount of non-operating changes or appropriated capital used for the year then ended. Accordingly, we have included a scope limitation in our audit report on the 1997 financial statements due to this matter.

At September 30,1997, Net Position was comprised of the following accounts (amounts in thousands):

Unexpended Appropriations	$21,863,521
Invested Capital	473
Cumulative Results of Operations	325,364
Future Funding Requirements	(13,921)
Total	$22,175,437

Non-operating changes were $8,705,384 for the year ended September 30, 1997.

Recommendation: We continue to recommend that ACF reconcile its operating and non-operating activity in the general ledger to the change in net position accounts, to ensure that the financial statements properly reflect net position activity for the year. In addition, appropriate analysis and support for the composition of net position at September 30, and non-operating changes for the year then ended should be maintained. In order to avoid problems with this analysis at the end of the year, we recommend that the analysis be done at least one other time during the year.

We also recommend that all audit and year end closing adjustments be recorded in the CORE Accounting System to avoid reconciliation problems in net position accounts in future years.

Auditee Response: We concur that a preliminary review of net position accounts should take place and we intend to do this. In addition, we would also like to note the following::

a) By its nature, the net position analysis sought by the auditors must be the last reconciliation performed on the financial statements. All other accounts (assets, liabilities, revenues, and expenses) must be reconciled first. Any changes to any of these accounts will flow through the Net Position accounts. One time delays occurred in completing the reconciliation during this audit due to the time devoted to defining acceptable reconciliation methods and formats. Such delays should not be part of the future process.

b) We agree that all audit adjustments that are correcting errors found in the accounting system should be recorded in the general ledger.

1D. ACCOUNTS PAYABLE AND UNDELIVERED ORDERS REPORTS AND RECONCILIATION (Repeat Condition)

Existing Condition: ACF was unable to provide a detailed listing of accounts payable and undelivered orders (referred to as an Open Document Listing - ODL) as of September 30, 1997 until mid-December 1997. The current system was not programmed to generate such a report, therefore, a special computer program had to be developed to ultimately generate this ODL. The reconciliation prepared by DFO between the ODL and the amount of accounts payable recorded in the general ledger at September 30, 1997, indicated that the ODL included documents over five years that should have been excluded. Similar ODL reports were not generated during the year, which effectively indicates that there was no valid support for accounts payable or undelivered orders balances at points during the year. Accordingly, the basic internal control of reconciling general ledger accounts to subsidiary records was not performed during the year.

Recommendation: We recommend that the ODL report format be revised to accurately reflect what should be in the general ledger for accounts payable and undelivered orders at the end of each month. In addition, reconciliations should be performed between this report and the balances in the general ledger in a timely manner after month end.

Auditee Response: With respect to the basic internal control of reconciling general ledgers to the subsidiary records, we believe that reconciliation functions are being performed in other processes. Historically, accounts payable and undelivered orders reports were made available monthly for reconciliation and by design supported the ACF appropriation and budgetary process. In order to meet the requirements of financial statement reporting, these previous versions of these subsidiary reports were modified in CORE and provided to the auditors to meet their need of reflecting nonfunded transactions that were not previously tracked in the budgetary process.

Besides the monthly manual reconciliations performed on open documents, CORE has an automated reconciliation of subsidiary files to the general ledger accounts. Through the usage of standard general ledger transactions and CORE's data base logic (which produces reconciliation reports), CORE ensures that subsidiary and general ledger files are updated on a transaction by transaction basis to prevent out of balance conditions.

We recognize that that these accounts payable and undelivered orders reports were provided to the auditors later in the audit process; however, believe that it was only a programming problem versus an internal control weakness.

1E. NON-ENTITY TRANSACTIONS

Existing Condition: ACF receives funds from the Internal Revenue Service in order to then forward such funds to the States for Child Support payments. These transfers from the IRS range between $5 and $15 million monthly. At September 30, 1997, approximately

$10 million was held by the Department of Treasury (Treasury) on behalf of ACF for the purpose of distributing such funds to the States in the future. For financial statement reporting purposes, this "non-entity" asset was completely offset by a corresponding "non-entity" liability. During our review of activity in this account we noted that the general ledger balance for both the asset and liability were always adjusted to the balance reported by Treasury without reconciliation or research as to why balances in the general ledger would be different.

Recommendation: We recommend that the balances in these accounts be reconciled monthly to that reported by Treasury, and that adjustments to general ledger amounts only be made once such reconciliation is complete.

Auditee Response: These Non-Entity funds are received from the Internal Revenue Service for Child Support payments collected on behalf of the States. Since the IRS is not a disbursing agency, it must pass these funds to the States through another federal agency (namely, ACF) on a current monthly basis. The journal voucher to adjust the general ledger balance in FY 1997 to agree with Treasury's balance is a one-time adjustment. Reconciling activity within this account is being conducted on a monthly basis.

1F. ACCOUNTING FOR CERTAIN NON-GRANT ADVANCES (ASSET AND LIABILITY)

***Existing Condition*:** ACF transfers funds to other governmental agencies for the purpose of funding various programs monitored at other agencies for which ACF has an interest. Correspondingly, ACF also receives funds from other governmental agencies in anticipation of assisting ACF in funding certain programs that they monitor, for which the other agency has an interest. In addition, ACF also transfers funds between its various appropriations (i.e. within ACF accounts) establishing assets and liabilities that theoretically should eliminate. These transactions are recorded in the general ledger system as non-grant advance assets or non-grant advance liabilities. At September 30, 1997, non-grant advance assets aggregated approximately $78 million and non-grant advance liabilities aggregated approximately $353 million. During our review of 1997 activity in this account and balances outstanding at September 30, 1997, we noted that several transactions were recorded in error. In addition, due to lack of conclusive documentation, it could not be determined whether certain balances at September 30, 1997 were valid or should be liquidated. Accordingly, we have included a scope limitation in our audit report on the 1997 financial statements due to this matter.

Recommendation: The HHS Accounting Manual requires that advance accounts be analyzed monthly. Accordingly, we recommend the following:

a) Perform a detailed review and reconciliation of the non-grant advance accounts (both asset and liability) currently outstanding at September 30, 1997 and make appropriate adjustments accordingly.

b) Implement adequate policies and procedures, with training as needed, to ensure the proper recording, monitoring and liquidation of non-grantee advances in accordance with federal and non-federal guidelines.

Auditee Response: The situation documented above relates to the treatment of Non-expenditure transfers. We concur with this recommendation.

2. GRANT ACCRUAL (Repeat Condition)

Existing Condition: In response to a matter disclosed in the 1996 report, the Assistant Secretary for Management and Budget (ASMB) formed a task force to develop a methodology to estimate grant expenses incurred by the grantee but not reported for relevant quarters. This estimation process was not finalized until late in the audit process and analytical testing of the results (i.e., cut-off testing at March 30 and June 30 and other historical analysis) was not adequately performed. During our review of the methodology and the mechanics of the calculation, we noted adjustments aggregating approximately $4.5 billion were needed to the initial accrual calculation. One such adjustment to the calculation related to the accounting for expired grants. In addition, we also noted that journal entries initially prepared by DFO to record this accrual were in error (i.e. net grant advance was overstated by $4.3 billion). The general ledger was adjusted accordingly.

The accrual estimate is based on a formula which calculates an average daily spending rate for each non-block grant program. This calculation assumes that the grantees expend their funds equally over the life of the grant. This spending rate is then used to calculate the estimated portion of the grant unexpended at September 30, 1997. For block grant programs, the accrual represents actual disbursements made by DPM through September 30, 1997, not yet recorded in the general ledger as liquidated advances due to timing. At September 30, 1997, the grant advance liability reflected on the Statement of Financial Position of $106 million is net of the final accrual for the aforementioned expenses of $6.4 billion. However, actual disbursements reported to DPM by grantees (principally SF-272 reports) were approximately $5.4 billion, the difference of $1 billion supposedly representing expenditures by the grantee not yet reported to DPM relevant to fiscal 1997 (i.e. "incurred but not reported" by grantees). Revisions to this accrual estimate may be needed as additional historical experience becomes available.

Recommendation: We commend ACF for the progress made during 1997 in developing a methodology to estimate grantee expenses incurred but not reported; however, further improvement is needed and, accordingly, we recommend the following:

a) The accrual estimate needs to be more thoroughly supported and compared to more extensive historical data of amounts incurred but not reported, and refinements should be made to the calculation accordingly, if necessary.

b) The grant accrual methodology and calculation should be refined for changes identified during the audit process.

c) Advances should be promptly liquidated and classified pursuant to federal, non-federal guidelines during the year.

d) Training should be provided to all individuals involved in the process for adequate understanding of the calculation, responsibilities and recording of the accrual estimate in the accounting system.

Auditee Response: We concur with the recommendations to support accruals with additional data analysis and historical data, and has refined the grant accrual methodology and calculation as identified in the audit process. However, we support the fact that the accrual is logically greater than the 272 Report amount, which is a cash based report that does not include expenditures for which there are no cash disbursements. Accordingly, we believe that the accrual estimate is reasonable.

3. FUND BALANCE WITH TREASURY

Existing Condition: ACF had not completed reconciliations between Fund Balance amounts reported by the Department of Treasury (Treasury) to those reported in its general ledger during the year. In connection with their attempt to reconcile Fund Balances at September 30, 1997, documentation for resolution of a difference of approximately $500,000,000 was not available from management. Based on research performed on other differences between the two amounts, ACF concluded that it was likely that the Treasury balance was correct and, accordingly, adjusted their general ledger balance to that reported by Treasury. Adjusting general ledger balances to that reported by Treasury without adequate documentation is not in accordance with Government accounting principles. Accordingly, we have included a scope limitation in our audit report on the 1997 financial statements due to this matter.

Recommendation: We recommend that HHS policy be followed for the complete and timely reconciliation of Fund Balances with US Treasury on a monthly basis, that variances be resolved in a timely manner, and that adjustments only be made to the general ledger when documentation supporting such adjustments is available.

Auditee Response: The difference discussed in this finding can be attributed to activities occurring prior to FY 93. The supporting documentation for these older activities would be the TFS-6654's for that period; however they could not be located. We currently have a senior accountant assigned specifically to perform the reconciliation process.

REPORTABLE CONDITIONS ARE AS FOLLOWS:

4. ACCOUNTING FOR TREASURY JUDGEMENT FUND TRANSACTIONS

Existing Condition: ACF has certain claims and lawsuits pending against it that could result in future payments when the claim is settled. The Federal Accounting Standards Advisory Board (FASAB) issued an interpretation (#2) of Statement Of Federal Financial Accounting Standards (SFFAS) #4 & 5, that requires management to determine whether it is probable that a legal claim against it will end in a loss, and if it is estimable should recognize an expense and liability for the full amount of the expected loss. The expense and liability should be adjusted periodically as necessary, based on changes in the estimated loss. Once the claim is either settled, or a court judgment is assessed against the Federal entity and either paid by the entity or the Treasury Judgment Fund, the liability should be removed. For claims paid by the Judgment Fund, Other Financing Source revenue is recorded upon payment. Even though a liability was not needed for ACF at September 30, 1997, we noted that management had not performed an assessment of the need for this accounting.

Recommendation: We recommend that ACF monitor legal claim activity with legal counsel and follow Departmental guidance on the FASAB and related interpretations to account for the estimated future liability, if any.

Auditee Response: We will work with the Office of General Counsel (OGC) in setting up an accrual semiannually to reflect a reasonable estimate of claims and settlements.

5. CONTROLS OVER MONITORING OF GRANT REPORTING PROCESS (Repeat Condition)

Existing Condition: ACF utilizes the reports generated under the single audit review process as their primary tool for monitoring its grant programs. A significant internal control over grants is provided by audits required by the OMB Circular A-133 "Audits of States, Local Governments, and Non-profit Organizations." In evaluating ACF's financial oversight of grants, we considered a number of issues related to the effectiveness of single audits as a key to ACF's internal control system.

The single audit review process period is not compatible with the financial statement period. Most of the fiscal 1997 expenditures will be reviewed at a date subsequent to the issuance of the financial statements. As a result, later reviews may identify disallowances of fiscal 1997 expenditures after the financial statements have been issued. Even though the periods are not compatible, it should be noted that the audit disallowances processed in fiscal 1997 were not material. The disallowances for ACF processed in fiscal 1997 were approximately $21 million or .06 percent of the $34 billion in grants' awards that were obligated in the same year. These disallowances have been sent to the operating divisions for resolution, therefore, the amount does not account for non-concurrences or other changes that could affect the amount disallowed.

There is no system in place to ensure that all audit grantee reporting requirements are being complied with pursuant to the provisions of OMB Circulars A-133 that the resultant reports have in fact been received. To compensate for this weakness, HHS's OIG conducted additional procedures regarding the actual receipt of single audit reports. While these procedures indicated that a substantial number of single audit reports had in fact been received, there is no assurance that in future years extended audit procedures such as those performed by the OIG in 1997 will be sufficient to establish proper accountability for grant expenditures.

ACF does not have a system to ensure that grantee audit reports are received; however, it is participating in a Department wide study to develop plans for controls over the single audit process. One of the purposes of this review is to identify the grantees who were audited in fiscal year 1995 by matching data from both the Payment Management System and the OIG. The Agencies have summarized and stratified the entities for which there either was no match between the Payment Management System and the OIG audit report inventory or no audit report was received. Letters had been sent to all organizations for whom an audit report had not been received. A questionnaire was also attached asking questions such as whether an audit had been completed during fiscal years 1995 and 1996 and whether the audit report was sent to NEAR in Kansas City. Questionnaires have been received and reviews of these questionnaires have commenced. HHS's OIG has provided information regarding the actual receipt of single audit reports.

The above monitoring system may also be affected by the impact of the revised Circular regarding the Single Audit Act amendments of 1996. One of the major changes raised the threshold for requiring an audit from $25,000 to $300,000. Therefore, future years will see a decline in the number of grantees subject to audit which may impact on the effectiveness of the single audit process as the key internal control in the grant monitoring system.

Recommendation: We have been informed that the Department has issued a policy statement in December, 1997 to address these matters; however, such statement was issued after our audit was complete and, therefore we have not reviewed such statement. We recommend that ACF continue to work with HHS to implement improvements in the monitoring system developed for the entire Department.

Auditee Response: We concur with this recommendation. This problem is inherent in the nature of the Federal grant process and is recognized in the statutory requirements of the Single Audit Act. The timing of the expenditure of Federal funds is inherently out of phase with the State, local, tribal, university and non-profit organization's use and the accounting for these funds.

Regarding the reference to a Department-wide study, it should be noted that the Departmental Audit follow-up Work Group is not a study, but part of the ongoing system that last year identified every grantee in the Department required to submit an audit, that had not done so. All non-compliant grantees were notified and the exact dollar amounts at risk were known OPDIV by OPDIV. Although the Department had not codified a policy prior to the end of the fiscal year in question, policies and procedures were subsequently promulgated by the Assistant Secretary for Management and Budget consistent with the action of the Work Group.

We believe the Policy Statement issued in December 1997 addresses all the matters raised in the auditors finding. Accordingly, we will follow the new procedures outlined in the Statement.

6. ELECTRONIC DATA PROCESSING

Existing Condition: During our review of Electronic Data Processing controls, we identified several weaknesses in internal EDP controls that collectively are considered a Reportable Condition. Such matters, summarized below, are explained in more detail in a separate Independent Accountant's Report dated February 18, 1998 entitled "Agreed Upon Procedures on the Division of Financial Operations' (DFO) Financial Management Systems":

- Computer Verification and Adjusting Procedures
- Computer Access Controls
- Accounting System Maintenance Policy & Interfaces
- Change Control Procedures and Separation of Duties

Recommendation: Develop and\or revise existing procedures to address the weaknesses noted in the aforementioned report.

Auditee Response: We concur with the auditors concern in this area and have reviewed the recommendations in the aforementioned auditor report. We will take those matters into consideration and develop procedures to compensate for those weaknesses accordingly.

****

We have reviewed our findings and recommendations with management of ACF and have incorporated their comments and action plans as appropriate.

In addition to the reportable conditions described above, we noted certain matters involving internal control and its operations that we will report to the management of ACF in a separate letter dated February 18, 1998.

This report is intended for the information of the management of ACF, HHS, the HHS Office of the Inspector General, and OMB. However, this report is a matter of public record, and its distribution is not limited.

Clifton Gunderson L.L.C.

Greenbelt, Maryland
February 18, 1998

DEPARTMENT OF HEALTH AND HUMAN SERVICES, ADMINISTRATION FOR CHILDREN AND FAMILIES

CONSOLIDATED FINANCIAL STATEMENTS
September 30, 1997

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DEPARTMENT OF HEALTH AND HUMAN SERVICES
ADMINISTRATION FOR CHILDREN AND FAMILIES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As of September 30, 1997
(Dollars in Thousands)

ASSETS	
ENTITY ASSETS	
Intragovernmental assets:	
Fund balances with U.S. Treasury (Note 2)	$ 22,584,876
Accounts receivable, net	2,738
Governmental assets:	
Accounts receivable, net	2,143
Advances and prepayments	134
Equipment, net of accumulated depreciation of $94	473
Total Entity Assets	22,590,364
TOTAL ASSETS	$ 22,590,364
LIABILITIES AND NET POSITION	
LIABILITIES	
Liabilities Covered By Budgetary Resources:	
Intragovernmental liabilities:	
Accounts payable	$ 1,374
Advances (Note 3)	274,983
Governmental liabilities:	
Accounts payable	12,824
Accrued payroll and benefits	5,810
Grant advance liability (Note 4)	106,015
Total liabilities covered by budgetary resources	401,006
Liabilities Not Covered By Budgetary Resources:	
Governmental liabilities:	
Worker's compensation (Note 5)	3,166
Accrued leave	10,755
Total liabilities not covered by budgetary resources	13,921
Total Liabilities	414,927
NET POSITION (Note 6)	
Balances:	
Unexpended appropriations	21,863,521
Invested capital	473
Cumulative results of operations	325,364
Future funding requirements	(13,921)
Total Net Position	22,175,437
TOTAL LIABILITIES AND NET POSITION	$ 22,590,364

These consolidated financial statements should only be read in connection with the accompanying notes to consolidated financial statements.

DEPARTMENT OF HEALTH AND HUMAN SERVICES
ADMINISTRATION FOR CHILDREN AND FAMILIES
CONSOLIDATED STATEMENT OF OPERATIONS
Year Ended September 30, 1997
(Dollars in Thousands)

REVENUES AND FINANCING SOURCES	
Appropriated capital used	$31,227,649
Revenues from sales of goods and services-to the public	12,667
- intragovernmental	8,174
Other revenues and financing sources	383
Imputed financing sources (Note 1)	13,044
Total revenues and financing sources	31,261,917
EXPENSES	
Operating expenses by object classification (Note 7):	
Personal services and benefits	116,883
Travel and transportation	4,591
Rental, communication and utilities	16,230
Printing and reproduction	539
Contractual services	457,647
Supplies and materials	586
Equipment not capitalized	3,049
Grants, subsidies and contributions (Note 4)	30,628,519
Insurance claims and indemnities	119
Imputed personnel costs (Note 1)	13,044
Total operating expenses	31,241,207
Provision for bad debts	2,000
Depreciation	46
Total expenses	31,243,253
EXCESS OF REVENUES AND FINANCING SOURCES OVER TOTAL EXPENSES	$ 18,664

These consolidated financial statements should only be read in connection with the accompanying notes to consolidated financial statements.

DEPARTMENT OF HEALTH AND HUMAN SERVICES
ADMINISTRATION FOR CHILDREN AND FAMILIES
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
Year Ended September 30,1997
(Dollars in thousands)

NET POSITION AT BEGINNING OF YEAR, As Originally Reported	$20,739,093
Prior Period Adjustment - Overstatement of Grant Advances at September 30, 1996 (Note 9)	(7,287,704)
NET POSITION AT BEGINNING OF YEAR, Restated	13,451,389
Excess of Revenues and Financing Sources Over Total Expenses	18,664
Non-operating Changes	8,705,384
NET POSITION AT END OF YEAR	$22,175,437

These consolidated financial statements should only be read
in connection with the accompanying notes to
consolidated financial statements.

DEPARTMENT OF HEALTH AND HUMAN SERVICES
ADMINISTRATION FOR CHILDREN AND FAMILIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30,1997
(Dollars in thousands)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

ACF was established in 1991 by an administrative decision of the Secretary to merge two major operating divisions of the Department of Health and Human Services (DHHS): the Family Support Administration and the Office of Human Development Services. The purpose of the merger was to bring under one agency all service and assistance payments that support children and families.

ACF is an operating division of the Department of Health and Human Services (HHS) which is a Cabinet agency of the Executive Branch of the United States Government. ACF provides national leadership and direction to plan, manage and coordinate the nationwide administration of comprehensive and supportive programs for vulnerable children and families, Native Americans, persons with developmental disabilities, refugees and legalized aliens to help them achieve stability, economic security, responsibility and self sufficiency.

HHS's CFO office provides department-wide accounting policy oversight. The Program Support Center's (PSC) Division of Financial Operations (DFO) provides accounting services (including financial statement preparation) to ACF on a fee for service basis, and is considered part of the management of ACF.

The majority of ACF's appropriated funds are used to support authorized entitlement and discretionary grant programs. Such programs are carried out by state, county, city and tribal governments as well as public and private local agencies. In accordance with OMB Bulletin 97-01, ACF is presenting consolidated financial statements consisting of the appropriated funds listed below. Also included is the related appropriation account symbol and period of fund availability.

Annual Appropriations

75 1500	Program Administration
75 1501	Family Support Payments to State
75 1502	Low Income Home Energy Assistance
75 1503	Refugee and Entrant Assistance
75 1504	Community Services Block Grant
75 1508	Interim Assistance to States for Legalization
75 1509	Payment to States for AFDC Work Programs
75 1511	Refugee Resettlement Assistance

(Dollars in thousands)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

75 1512	Family Preservation and Support
75 1515	Payments to States for Child Care Assistance
75 1522	Contingency Fund for State Welfare
75 1534	Social Services Block Grant
75 1536	Children and Families Services Programs
75 1545	Payment to States for Foster Care and Adoption Assistance
75 1550	Child Care Entitlement
75 1551	Federal Loan for State Welfare
75 1552	Temporary Assistance for Needy Families
75 1553	Children's Research & Technical Assistance
75 3107	Child Support Receipt Account
75 8605	Violent Crime Reduction Trust Fund

Indefinite Appropriations

75 X 1501	Family Support Payments to States
75 X 1504	Community Services Block Grant
75 X 1534	Social Services Block Grant
75 X 1553	Children's Research & Technical Assistance
75 X 1536	Children and Families Services Programs
75 X 6234	Collections for Past Due Support from Federal Tax Refunds
75 X 6288	Payment to States from Receipts for Child Support

Multi-Year Appropriations

75 1503 (4/6, 5/7)	Refugee and Entrant Assistance
75 1508 (8/4, 8/5, 9/5, 0/5, 1/5, 3/5, 4/5)	Interim Assistance to States for Legalization
75 2/3 1536	Children and Families Services Programs

Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Administration for Children and Families (ACF), as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. They have been prepared from the books and records of ACF in accordance with the form and content

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

for entity financial statements specified by the Office of Management and Budget (OMB) Bulletin 94-01, certain provisions of OMB Bulletin 97-01, the Federal Accounting Standards Advisory Board's (FASAB) Statements of Federal Financial Accounting Standards and ACF's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared by ACF pursuant to OMB directives, that are used to monitor and control ACF's use of budgetary resources. ACF has received a waiver from OMB of the requirement to present a statement of cash flows and a statement of budget and actual expenses.

Budgets and Budgetary Accounting

Financing sources are provided through congressional appropriations on an annual, multi-year and no-year basis. Appropriations are used to finance operating expenses and purchase property and equipment as specified by law. *Annual* appropriations are available for incurring obligations only during a specified year. *Multiple*-year appropriations are available for a definite period of time in excess of one fiscal year. *No-year*, or "X-year", appropriations are available for an indefinite period.

Basis of Accounting

Transactions are recorded using the accrual basis of accounting and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fund Balances With the Treasury

ACF does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The Fund Balances with the U.S. Treasury are available to pay current liabilities and finance authorized purchase commitments. There are no cash balances

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

held outside the U.S. Treasury. "Fund Balances with Treasury" are reconciled with balances reported by the Department of Treasury.

Equipment

Equipment consists of administrative, and automated data processing equipment. Equipment is capitalized at cost if the initial acquisition cost is $25 or more. Prior, to 1997, such capitalization threshold was $5.

Depreciation on equipment is computed using the straight line method based on the useful life of the assets with one-half year's depreciation taken in year of acquisition. Equipment is depreciated over useful lives ranging from 5 to 15 years. Useful lives are determined using the Veterans Affairs Federal Supply Catalog classification system.

Non-entity Transactions

"Non-entity assets" consists of funds transferred from the Internal Revenue Service to ACF which are to be forwarded to States for Child Support payments. Because the non-entity assets are not considered as financing sources (revenue) available to offset operating expenses, an offsetting liability is maintained in ACF's subsidiary records.

The presentation of non-entity assets and liabilities in a separate, self-balancing set of subsidiary accounts ensures the net position of the Administration presents only those resources which will be consumed in current or future operating cycles, while the non-entity categories contain resources relating to the ACF's custodial/fiduciary activities. For financial statement presentation purposes, the asset and liability amount of $9,867 are netted to $0.

Annual, Sick and Other Leave

Annual leave is accrued as it is earned and reduced as taken. The balance in the accrued annual leave account is adjusted to reflect current pay rates of cumulative annual leave earned but not taken. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick and other types of nonvested leave are expensed as taken.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Non-operating Changes

Non-operating changes represent the change in unexpended appropriations between fiscal year 1997 and 1996 and the equity portion of canceled appropriations.

Retirement Plans

ACF employees participate in two different retirement plans. Civil service employees participate in the Civil Service Retirement System (CSRS), or the Federal Employees Retirement System (FERS) (for most employees hired after December 31, 1983). ACF does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management.

The Federal Accounting Standards Advisory Board (FASAB) issued Statement of Federal Financial Accounting Standards Number 5 (SSFAS-5) - "Accounting for Liabilities of the Federal Government." SSFAS-5 requires that employing agencies recognize the full cost of pensions and other health and life insurance benefits during their employees' active years of service. SSFAS-5 requires that the Office of Personnel Management, as administrator of the Civil Service and Federal Employees Retirement Systems, the Federal Employees Health Benefits Program, and the Federal Employees Group Life Insurance Program provide the "cost factors" that adjust the agency contribution rate to the full cost for the applicable benefit programs. ACF implemented these new standards in 1997. Accordingly, an imputed financing source, and a corresponding imputed personnel cost of $13,044, is reflected in the Statement of Operations. This adjustment did not change ACF's net position.

Payroll Processing

The HHS centralized payroll system (Accounting for Pay System) computes employee benefits and is also used to process commissioned officer payroll data.

Obligations Related to Canceled Appropriations

ACF reported to OMB and Treasury $591,581 of obligational write-offs.

(Dollars in thousands)

NOTE 2 - FUND BALANCES WITH U.S. TREASURY

Balances By Account Symbol and Type:

Annual Appropriations

75 1500	Program Administration	$ -
75 1501	Family Support Payments to State	-
75 1502	Low Income Home Energy Assistance	352,125
75 1503	Refugee and Entrant Assistance	453,454
75 1504	Community Services Block Grant	39,928
75 1508	Interim Assistance to States for Legalization	18,830
75 1509	Payment to States for AFDC Work Programs	1,735,459
75 1511	Refugee Resettlement Assistance	6,986
75 1512	Family Preservation and Support	293,582
75 1515	Payments to States for Child Care Assistance	516,421
75 1522	Contingency Fund for State Welfare	-
75 1534	Social Services Block Grant	286,205
75 1536	Children and Families Services Programs	3,595,293
75 1545	Payment to States for Foster Care and Adoption Assistance	2,202,502
75 1550	Child Care Entitlement	569,461
75 1551	Federal Loan for State Welfare	-
75 1552	Temporary Assistance for Needy Families	6,906,210
75 1553	Children's Research & Technical Assistance	40,129
75 3107	Child Support Receipt Account	-
75 8605	Violent Crime Reduction Trust Fund	29,451
		17,046,036

Indefinite Appropriations

75 X 1501	Family Support Payments to States	4,648,280
75 X 1504	Community Services Block Grant	200
75 X 1534	Social Services Block Grant	862,830
75 X 1536	Children and Families Services Programs	9,661
75 X 1553	Children's Research & Technical Assistance	17,869
		5,538,840
	Total Fund Balance with U.S. Treasury	$ 22,584,876

NOTE 3 - ADVANCES LIABILITY - INTRAGOVERNMENTAL

ACF transfers funds to other governmental agencies for the purpose of funding various programs monitored at other agencies for which ACF has an interest. Correspondingly, ACF also receives funds from other governmental agencies in anticipation of assisting ACF in funding certain programs that they monitor, for which the other agency has an interest. In addition, ACF also transfers funds between its various appropriations (i.e. within ACF accounts) establishing assets and liabilities that theoretically should eliminate. These transactions are recorded in the general ledger system as non-grant advance assets or non-grant advance liabilities. At September 30, 1997, non-grant advance assets aggregated approximately $78 million and non-grant advance liabilities aggregated approximately $353 million.

NOTE 4 - GRANT ADVANCE LIABILITY - GOVERNMENTAL

Governmental advances relate to grant programs such as the Maternal and Child Health Services, Community Services, Preventive Health and Health Services and Primary Care. Recipients are paid through the Division of Payment Management (DPM) of the Program Support Center (PSC). The advances are recorded in the Health Accounting System (HAS) monthly, based on actual advance disbursements and an allocation of HHS net disbursements reported to Treasury. The allocated portion considers the impact of multiple grants provided by several HHS agencies. In 1997, HHS implemented a new process for allocating pooled advances to OPDIV appropriations. The new process resulted in a one-time adjustment that redistributed the cash outlays recorded in Treasury records in order to agree with cash outlays computed through the new charging process and recorded in the Payment Management System records. Adjustments were made to ACF's accounting records for canceled appropriations, thereby having no effect on the advance balance reported in the general ledger. Such adjustments received approval from both OMB and Treasury.

Advances are liquidated upon the grantee's reporting of expenditures on the quarterly 272 Report, which in many cases are received several months after the grantee actually incurs the expense reported thereon. In 1997, ACF adopted a Department wide accrual methodology to refine the method used to estimate and accrue amounts due grantees for their expenditures made through September 30, 1997, for which expenditure reports (principally SF-272 Reports) have not been received from such grantees as of September 30, 1997. Accrual amounts were determined by PSC's Division of Payment Management (DPM), the manager of HHS's central grants payment system.

The accrual estimate is based on a formula which calculates an average daily spending rate for each non-block grant program. This calculation assumes that the grantees expend their funds

NOTE 4 - GRANT ADVANCE LIABILITY - GOVERNMENTAL (CONTINUED)

equally over the life of the grant. This rate is then used to calculate the estimated portion of the grant unexpended at September 30, 1997. For block grant programs, the accrual represents actual disbursements made by DPM through September 30, 1997, not yet recorded in the general ledger as liquidated advances due to timing.

At September 30, 1997, the grant advance liability reflected on the Statement of Financial Position of $106,015 is net of the accrual for the aforementioned expenses of $6,422,000. Actual disbursements reported by grantees on SF-272 reports were approximately $5,375,000. Management believes that, even though the actual disbursements are less than the accrual estimate, the estimate is reasonable. However, HHS will continue to refine the accrual methodology as additional information becomes available.

NOTE 5 - WORKER'S COMPENSATION

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work related occupational disease, and beneficiaries of employees whose death is attributable to a job related injury or occupational disease. Claims incurred for benefits for ACF's employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by ACF. These future workers' compensation estimates were generated by DOL from an application of actuarial procedures developed to estimate the liability for FECA benefits. This DOL estimated actuarial liability for FECA benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability was determined using the paid losses extrapolation method calculated over the next 23 year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using the discount rate of 7% in year one and thereafter. Based on information provided by the Department of Labor the liability of ACF as of September 30, 1997 was determined to be $3,166.

(Dollars in thousands)

NOTE 6 - NET POSITION

Unexpended appropriations:		
Unobligated, available	$	7,954,960
Undelivered orders		13,908,561
Subtotal		21,863,521
Cumulative results of operations		325,364
Invested capital		473
Future funding requirements		(13,921)
Total Net Position	$	22,175,437

NOTE 7 - OPERATING EXPENSES BY ACTIVITY

Operating expenses by activity are not available.

NOTE 8 - GRANT AWARDS

The Single Audit Act of 1984, as revised, provides that recipients of Federal financial assistance funds, such as those provided by ACF, have an annual audit of its activities performed by an independent Non-federal auditor. The results of these audits provide information to Federal awarding agencies about the validity of Federal financial assistance awards expenditures, adequacy of internal controls over Federal assistance and the extent of compliance with grant rules and regulations. Disallowed costs identified pursuant to these audits are used to reduce future years' grant awards or returned to the awarding agency. Such reduction or returned awards are reported in the year such determination is made.

The single audit review process period is not compatible with the financial statement period. Most of the fiscal year 1997 expenditures will be reviewed at a date subsequent to the issuance of the financial statements. As a result, later review may identify disallowances for fiscal year 1997 expenditures after the financial statement have been issued. Even though the periods are not compatible, it should be noted that the fiscal year 1997 audit disallowances were not material. The disallowances for ACF amount to $21,143 or 0.06 percent of the $30,600,000 in grants.

NOTE 9 - PRIOR PERIOD ADJUSTMENT

At September 30, 1996, ACF had not reconciled the amount of grant advances reported in the general ledger system to the amount reported by the Division of Payment Management (DPM), the subsidiary record. During 1997, in connection with the reconciliation of general ledger and DPM balances at September 30, 1997, it was determined that the grant advance asset amount reported in the financial statements at September 30, 1996 was overstated by $7,287,704. The correction of this error resulted in a reduction of Net Position of $7,287,704 at September 30, 1996.