

**Memorandum**

Date AUG 27 1993

From Bryan B. Mitchell *Bryan Mitchell*
Principal Deputy Inspector General

Subject Review of the Health Care Financing Administration's Health Maintenance
Organization Loan and Loan Guarantee Fund for Fiscal Year 1991

To (A-14-91-03002)

Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of the final report entitled, "Review of the Health Care Financing Administration's Health Maintenance Organization Loan and Loan Guarantee Fund for Fiscal Year 1991." The objective of our review was to determine whether the Health Maintenance Organization (HMO) loan fund financial transactions were accurately recorded and reported. We also reviewed internal control policies and procedures for recording and documenting payments, monitoring HMO loans, and writing off delinquent HMO loans.

We reviewed the records supporting the loan fund and the internal controls pertaining to that operation. Except for the items noted below, the fund balances were reported correctly and no material internal control deficiencies were identified. We found that internal controls need improvement to ensure that all HMO loan payments and liabilities are accurately and properly reported and that written procedures are established to document the Health Care Financing Administration's (HCFA) deviations from Department of the Treasury (Treasury) reporting procedures. We also found that internal controls need improvement to ensure that the general ledger balance for loans payable is reconciled to the Office of Prepaid Health Care's (OPHC) supporting records. These deficiencies caused the HMO loans payable account to be overstated. For example, by not reconciling the HMO loans payable account to OPHC's supporting records resulted in the HMO loans payable account being overstated by \$821,606 at September 30, 1991.

Accordingly, we recommend that HCFA improve internal controls to ensure that:

- o the HMO loan payments and liabilities are accurately recorded;
- o the general ledger balance for the loans payable account is accurately recorded and is reconciled to OPHC's supporting records, such as, the Loan and Loan Guarantee Revolving Fund Summary of Transaction Report;
- o material events are adequately disclosed and properly reported;
- o deviations from Treasury instructions are properly approved; and
- o written procedures are established that document deviations from Treasury reporting procedures which document the process for recording and reporting transactions and preparing financial reports.

The Acting HCFA Administrator responded to our draft report in a memorandum dated May 10, 1993. The HCFA believes that several of our findings were not relevant or consequential when assessing their materiality and impact on the overall financial control and reporting of the HMO loan account. As a result, we met with HCFA officials who provided us with additional pertinent information which has resulted in modifications made to the "Findings and Recommendations" section of our final report.

After our review of HCFA's comments, we continue to recommend that HCFA improve their internal controls to correct identified deficiencies with internal controls. Our detailed comments are included after the Recommendations section of the report. The HCFA's comments are included in their entirety as an Appendix to this report.

We would appreciate your views and the status of any further action taken or contemplated on our recommendations within the next 60 days. If you have any questions, please call me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 966-7104. Copies of this report are being sent to other interested Department officials.

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To facilitate identification, please refer to Common Identification Number A-14-91-03002 in all correspondence relating to this report.

Attachments

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE
HEALTH CARE FINANCING ADMINISTRATION'S
HEALTH MAINTENANCE ORGANIZATION LOAN
AND LOAN GUARANTEE FUND
FOR FISCAL YEAR 1991**



AUGUST 1993 A-14-91-03002

SUMMARY

The overall objective of our review was to determine whether the Health Maintenance Organization (HMO) loan fund financial transactions were accurately recorded and reported for the period ended September 30, 1991. We examined internal control policies and procedures for recording and documenting payments, monitoring HMO loans, and writing off delinquent HMO loans. Presently there are 60 outstanding HMO loans valued at a gross principal of \$56.6 million.

To achieve our objective, we reviewed the internal control policies and procedures used to report loans receivable, allowance for uncollectibles, debts issued under borrowing authority (loans payable), financing sources, expenses, the fund account balances reported at September 30, 1991, and other supporting documentation.

Our review of the internal controls showed that with the exception of the items noted below, the fund balances were reported correctly and no material internal control deficiencies were identified. We found that internal controls need improvement to ensure that all HMO loan payments and liabilities are accurately and properly reported and that written procedures are established to document the Health Care Financing Administration's (HCFA) deviations from Department of the Treasury (Treasury) reporting procedures which document the process for recording and reporting transactions and preparing financial reports. We found that general ledger account balances were reconciled except for the HMO loans payable account which was not reconciled to the Office of Prepaid Health Care's (OPHC) supporting records. Therefore, internal controls need improvement to ensure that the general ledger balance for loans payable is reconciled to OPHC's supporting records. For example, as a result of the general ledger not being reconciled to OPHC's supporting records, the HMO loans payable amount of \$66.9 million was overstated by \$821,606 at September 30, 1991.

We believe that the HCFA needs to improve internal controls to ensure that:

- o the HMO loan payments and liabilities are accurately recorded;
- o the general ledger balance for the loans payable account is accurately recorded and is reconciled to OPHC's supporting records, such as, the Loan and Loan Guarantee Revolving Fund Summary of Transaction Report;

- o material events are adequately disclosed and properly reported;
- o deviations from Treasury instructions are properly approved; and
- o written procedures are established that document deviations from Treasury reporting procedures which document the process for recording and reporting transactions and preparing financial reports.

We received written comments from HCFA that addressed our findings and recommendations. The HCFA did not concur with our recommendations and had objections to the audit report. The HCFA believes that several of our findings were not relevant or consequential when assessing their materiality and impact on the overall financial control and reporting of the HMO loan account. However, we met with HCFA officials who provided us with additional pertinent information which has resulted in modifications made to the "Findings and Recommendations" section of our final report.

After our review of HCFA's comments, we continue to recommend that HCFA improve their internal controls. We believe our recommendations are relevant to correct deficiencies with internal controls. Our detailed comments are included after the Recommendations section of the report. The HCFA's comments are included in their entirety as an Appendix to this report.

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INTRODUCTION

BACKGROUND

The HMO loan fund was established in 1975 as a revolving fund under title XIII of the Public Health Service (PHS) Act with an initial appropriation of \$35 million. The purpose of the HMO loan fund is to assist HMOs with direct loans for planning, initial development and operations, and expansion of their business. Since 1975, 110 HMOs have received loan assistance totaling approximately \$219 million. The HMO loan fund's latest loan commitments were made in Fiscal Year (FY) 1983. By law, no commitments could be made after September 30, 1986.

In the 1980's, the Department of Health and Human Services (HHS) borrowed money from the Federal Financing Bank (FFB) and several commercial banks using the initial HMO loans as collateral, in order to provide a continuous source of capital for making additional direct loans to HMOs. These HHS loans from the FFB were made to replenish the loan portfolio because of loan defaults in the early years of the program. The contractual agreement between HHS and the FFB required that HHS retain custody of the notes and act as the agent for the FFB and repay the principal and interest on the debt through recovery of payments from the HMOs. The HMO loans were guaranteed, meaning that in the event of a default, HHS would accept responsibility for repayment of the specific loan.

The HCFA has responsibility for monitoring HMO compliance with the terms and conditions of the loan agreement and analyzing the HMOs' financial condition to help ensure that they meet these terms and conditions. As part of the contractual agreement, the HMOs are required to submit annual audited financial statements to HCFA. Within 30 days after receiving the HMOs' audited financial statements, HCFA reviews the statements, and prepares a loan monitoring summary. This summary provides an evaluation of each HMO's financial position through the use of ratio analysis techniques and includes a statement on whether or not the loan is in danger of default.

Furthermore, HCFA is responsible for receiving and recording all loan repayments and, in turn, repaying the FFB. The HMOs are required to make their payments through electronic wire transfer on January 1 and July 1 of each year. The HCFA is also responsible for submitting payments to the FFB for principal on January 1 of each year and for interest on January 1 and

July 1 of each year. The HCFA used Treasury Standard Form (SF) 220, Report on Financial Position to report the assets, liabilities, and equity for the HMO loan fund at September 30, 1991. The HCFA also used the SF 221, Report on Operations, to report financing sources, expenses, and net results of the HMO loan fund.

The HMO loan fund reported \$57.6 million in total assets, of which the 60 outstanding HMO loans accounted for \$56.6 million in principal, \$4.2 million in accrued interest, and \$11.3 million in allowance for uncollectible receivables and accrued interest. The fund balance was \$8.1 million at September 30, 1991. Liabilities amounted to \$66.9 million of which \$66 million was owed by HHS to the FFB for money borrowed using the loans receivable as collateral (i.e., assignment). Also included in the liabilities was approximately a \$869,179 debt owed for loans assigned to a commercial bank. The assigned loans pertained to HMOs which had defaulted and the HMO loan fund had assumed payment.

The HMO loan fund reported revenue for the year ended September 30, 1991 at approximately \$12.6 million which included loan interest payments (see page 3 for Report on Operations). The total financing sources also included a deficit value for accrued expenditures (expended appropriations) of \$4.7 million.

**Report on
Financial Position
for the Period Ended
September 30, 1991
(in millions)**

<u>Assets</u>	<u>Dollar Amount</u>	<u>% of Total</u>
Fund Balance	\$ 8.1	14.0%
Accrued Interest	4.2	3.5%
Accrued Interest Allowance (1)	(2.2)	
Loans Receivable	56.6	82.5%
Loans Receivable Allowance (1)	(9.1)	
Total	<u>\$ 57.6</u>	<u>100.0%</u>
<u>Liabilities & Equity</u>		
Loans Payable (2)	\$66.9	116.1%
Equity	(9.3)	(16.1%)
Total	<u>\$57.6</u>	<u>100.0%</u>

1 The allowance accounts are included in the percentage calculation. Due to rounding, the allowance accounts increased to \$11.3 million.

2 This account includes \$66 million owed to the FFB and \$869,179 owed to the commercial bank.

Source: Treasury SF 220 Report

Also, the fund reported approximately \$7.9 million in interest expense, of which payments to the FFB accounted for about \$7.7 million.

To cover the current shortfall of the HMO loan fund and to liquidate the mounting debt owed to the FFB due to accruing prepayment penalties and interest payments, HCFA requested \$13.8 million in the FY 1993 budget. The HCFA plans to use the requested funds to pay the FFB during FY 1993.

SCOPE

Our audit was conducted in accordance with generally accepted government auditing standards. To achieve our objectives, we tested the loans receivable, allowance for losses, loans payable, and fund account balances reported at September 30, 1991. The financing sources and expenses account balances were also tested.

An understanding of the relevant internal control policies and procedures was obtained by interviewing officials, reviewing documentation, testing procedures, and assessing control risk. Based on our results, we concluded that it would be more efficient to evaluate the internal control environment, accounting systems, and control procedures by expanding substantive audit tests, instead of performing a detailed assessment of the internal control structure.

Report on Operations for the Period Ended September 30, 1991 (In millions)

Financing Sources

Accrued Expenditures	\$ (4.7)
Revenue	<u>12.6</u>
Total	<u>\$ 7.9</u>

Operating Expenses

Interest Expense, Funded	<u>\$ 7.9</u>
Total	<u>\$ 7.9</u>

Net Results

Net Results before Adjustments	\$ 0.0
Less: Adjustments	<u>0.0</u>
Net Results	<u>\$ 0.0</u>

Source: Treasury SF 221 Report

Accordingly, we performed the following steps at HCFA headquarters:

- o reviewed applicable laws and regulations,¹ General Accounting Office (GAO) accounting principles,² the Treasury financial manual, the HHS accounting manual,³ and HCFA's administration manual;
- o reviewed the HMO loan fund Report on Financial Position, Report on Operations, Report on Cash Flow, Report on Reconciliation, and general ledger for FY 1991;
- o reviewed the subsidiary ledger of the outstanding loans receivables and loans payables;
- o mailed 46 positive and 14 negative confirmation statements to independent third parties to verify the HMO loans receivable account balance and 2 positive confirmation statements to verify the loans payable account balances;
- o interviewed HCFA officials to identify whether HCFA had written policies and procedures for recording and documenting HMO loan payments and writing off delinquent HMO loans;
- o traced balances from source documents (i.e., electronic transfer receipts, logs, etc.) to the Cash Activity Report, Report on Financial Position, and Report on Operations to review the collection procedures and verify the accuracy of financing sources and fund balance;

¹The Social Security Act, as amended; the PHS Act, section 1308; and the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

²This includes GAO Policy and Procedures Manual for Guidance of Federal Agencies Title 2 (Title 2) which outlines the accounting principles and standards for financial statement presentation, and requires the accrual basis of accounting.

³The HHS accounting manual incorporates the principles, standards, and related requirements of GAO Title 2.

- o reconciled the general ledger, subsidiary ledger, and OPHC's source documents (i.e., Summary of Transaction Report and Monthly Appropriation Schedule) to the Report on Financial Position, Report on Operations, Report on Cash Flow, and Report on Reconciliation;
- o reviewed the HMO loan files to verify that HCFA was performing their loan monitoring function in accordance with established laws, regulations, and procedures; and
- o reviewed HCFA's FY 1989 Management Control Plan and the management control review performed on the OPHC/Office of Compliance (OC).

Field work was performed from October 1991 to June 1992. Our field work was performed at HCFA headquarters in Baltimore, Maryland and Washington, D.C.

FINDINGS AND RECOMMENDATIONS

As a result of our review, we identified internal control weaknesses pertaining to the HMO loan fund. These weaknesses need to be addressed to ensure that all financial reports contained complete and accurate information. Furthermore, the general ledger account balance for the HMO loans payable amount needs to be reconciled with OPHC's supporting records.

We also found that HCFA had deviated from reporting procedures established by Treasury. When such situations occur, HCFA needs to document their process for recording and reporting transactions and preparing financial reports.

INTERNAL CONTROLS NEED IMPROVEMENT

Agencies are required to prepare annual financial reports for reporting entities. The financial reports are to be based upon summarized financial data from the official accounting records and are supplemented by footnotes to provide full disclosure of the current financial status of the entity. During our review, we noted several matters involving the internal controls over the HMO loan fund that should be addressed.

The HCFA is responsible for establishing and maintaining an internal control structure in accordance with the Accounting and Budgeting Act of 1950 and the FMFIA. The FMFIA of 1982 also requires agencies to review internal controls and financial management systems and report material weaknesses and material nonconformances to the President and the Congress. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures.

The objective of an internal control structure is to provide management with reasonable, but not absolute, assurance that: (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded to maintain accountability and to permit the preparation of accounts and reliable financial and statistical reports.

The purpose of the auditor's assessment of internal controls is to identify and communicate reportable conditions. Reportable conditions are significant deficiencies in the design or operation of the internal control structure, which could adversely affect HCFA's ability to meet the above stated objectives.

The HCFA needs to improve the internal controls to ensure: (1) HMO loan payments and liabilities are accurately recorded; (2) general ledger balances, specifically for the loans payable account, are accurately recorded; (3) material events are adequately disclosed and properly reported; (4) deviations from Treasury instructions are properly approved; and (5) written procedures exist to document modifications in the reporting process that deviate from Treasury instructions.

Loans Payable Account

We verified the loans payable amount reported at September 30, 1991 of \$66.9 million and the loans receivable amount of \$56.6 million, by confirming and comparing the account balances with the records of both the HMOs and the financial institutions, namely the FFB and the Texas Commerce Bank (TCB). We mailed 60 third-party confirmations to the HMOs which indicated that the loans receivable account balances were correct. However, the confirmation mailed to TCB indicated that the loans payable balance was overstated by \$821,606.

Through confirmations, we also found that in February 1992, HCFA overpaid \$11,900 to TCB. This was a payment on a loan which had been previously paid in full. Because HCFA was not aware that the debt had been paid as of January 1992, the monthly payments of about \$11,900 may have continued in the future.

Upon further review of HCFA's supporting records maintained by OPHC (i.e., Summary of Transaction Report and Monthly Appropriation Schedule), we found that a significant portion of the overstatement occurred within one loan. In this loan account, HHS made a lump sum payment of \$407,000 in principal and interest to TCB in 1983 when the accounting record was maintained by PHS. This account was subsequently transferred to HCFA's accounting records without this transaction recorded. We could not identify the cause of the remaining difference in the loans payable account. However, a HCFA official stated that the remaining difference was related to HCFA misapplying the TCB payment between principal and interest.

Additionally, based on our review of the HMO loan fund, we determined that due to a lack of internal controls requiring the reconciliation of general ledger balances with OPHC's supporting records, the loans payable account balance at September 30, 1991 was overstated by \$821,606. We found that the general ledger balances differed from the supporting record balances maintained by OPHC. We also found that there were no written policies and procedures requiring HCFA's general ledger to be reconciled to OPHC's supporting records.

The lack of internal controls requiring the reconciliation of the general ledger to OPHC's supporting records contributed to the noted deficiencies. If OPHC's supporting records had been reconciled annually with records maintained by OPHC, the differences in account balances would have been detected earlier and the correct amount would have been reported. We believe that the lack of written policies and procedures requiring periodic reconciliations between HCFA components contributed to the deficient internal controls.

Accrued Expenditures Account

The HCFA reported a \$4.7 million deficit in accrued expenditures under financing sources on the Report on Operations for the period ended September 30, 1991. Our initial review of the general ledger indicated accrued expenditures totaled \$7.9 million for the period ended September 30, 1991. However, through follow-up discussions with HCFA officials, we found that deviations were made from the Treasury instructions for the reporting of accrued expenditures amounts.

The HCFA officials agreed that the Report on Operations was not prepared according to Treasury instructions for accrued expenditures. According to HCFA officials, they deviated from Treasury instructions because they believed this approach would provide the users of the financial reports a clearer presentation of the accrued expenditures included on the Report on Operations. We believe, however, that when such situations occur HCFA should request approval from Treasury and establish written procedures to document their process for recording and reporting transactions and preparing financial reports that deviate from reporting procedures established by Treasury.

Unreported Financial Information

According to the Treasury manual, operating expenses should include all expenses incurred in conducting the ordinary activities of the entity and be recorded on the Report on Operations. Results of our review indicated that for the year ended September 30, 1991, HMO loan fund reported expenses of \$11.3 million in the general ledger that were not reported on the Report on Operations.

Based on follow-up discussions with HCFA officials, they stated that bad debt expenses reported in the FY 1991 general ledger were for prior year expenses. Therefore, HCFA decided not to report these expenses on the FY 1991 Report on Operations because they were not current year expenses. We believe that the difference between the general ledger account balance and financial reports should be documented. In the future, when such situations occur, HCFA needs to document their process for recording and reporting transactions and preparing financial reports that deviate from reporting procedures established by Treasury.

Internal Controls Have Not Been Reviewed Under FMFIA

The FMFIA requires Federal agencies to establish a process for evaluating and improving their internal controls. Each agency is required to divide its organization into assessable units in a way that all areas with inherent risk are identified and included in the agencies' Management Control Plan (MCP).

The HCFA is currently divided into 84 Management Control Areas which are reviewed at least once every 5 years. One of the 84 areas is the OPHC/OC function, which was last reviewed in FY 1989. During the last internal control review, HCFA reviewed OPHC/OC activities pertaining to information acquisition, monitoring and analysis, and determinations and remedies to assure compliance with applicable statutory, regulatory, and contractual requirements.

Based on our review of HCFA's MCP and the FY 1989 internal control review of OPHC, we found that the HMO loan fund was not included as part of the internal control review process. As a result, the HMO loan fund internal controls have not been reviewed. We believe if the HMO loan fund had been reviewed, the internal control deficiencies found during this review may have been identified, brought to management's attention, corrected, and properly

disclosed. The HCFA agreed with us and has included the HMO loan fund in their scheduled management control reviews for FY 1994.

OTHER ISSUES

Footnote and Disclosure

We found that approximately \$3.8 million in checks, notes, and securities were collected subsequent to the issuance of the financial statements from an HMO whose loan had been categorized as uncollectible on the Report on Financial Position at September 30, 1991. Based on GAO Title 2, HHS, and Treasury accounting principles, subsequent events that have a material impact on the financial statements should be disclosed in the footnotes to the financial statements. The disclosure should identify the nature and impact of the event. We believe that the \$3.8 million in payments HCFA received from an HMO during the period from December 1, 1991 to January 8, 1992 should have been reported as a subsequent event on the financial reports because it had a material impact on information presented in the financial reports.

Additionally, disclosures related to two defaulted loans totalling \$1.9 million were not reported. The GAO Title 2 and HHS accounting principles state that loans and notes which are in default shall be disclosed in footnotes along with related allowances for estimated uncollectible amounts. These two loans were placed in receivership in 1989. Based on our review, we determined that HCFA's status regarding the collectibility of the two delinquent loans had not been finalized by the receivers as of September 30, 1991. However, additional information obtained in December 1991 and January 1992 indicated the loan payments would not be collected.

The information obtained from the receivers stated that HCFA's claims were evaluated based on creditor priority levels. The receivers determined that the delinquent loans would not be collectible. For instance, one of the receiver's responses stated that:

"...current assets of the Receivership (as of December 31, 1991) are \$332,117.50. The Receivership owes \$3,204,247.00 to subscribers and providers. This amount does not include \$1,127,778.00 owed to repay the HCFA loan and \$40,460.00 owed to general creditors. The Receivership has received permission from HCFA to pay the subscribers and providers before repaying HCFA the loan. Under these circumstances, the HCFA loan is not collectible."

Subsequent events are events or transactions that occur after the financial statement date but before those statements are issued, that have a material effect on the financial statements. The nature and amount of the event should be disclosed in the footnotes to the financial statements (Title 2).

The other receiver's response stated that:

"...this claim was evaluated and accepted at priority level 'e', in accordance with the Insurance Department Act. Unfortunately, there are only sufficient assets to pay claims in priority levels 'a' thru 'd', therefore there will be no payment from the Statutory Liquidator on this claim."

The total of loans and notes which are in default (e.g., principal and interest payments have not been made within a specified period of time or other events of default have occurred) shall be disclosed in footnotes, if material, along with total related allowances for estimated uncollectible amounts... (Title 2).

Based on GAO Title 2, HHS, and Treasury accounting principles, HCFA should have reported all material events on the financial reports in order for the reports to be adequately and fairly disclosed.

RECOMMENDATIONS

We recommend that HCFA improve internal controls to ensure that:

- o the HMO loan payments and liabilities are accurately recorded;
- o the general ledger balance for the loans payable account is accurately recorded and is reconciled to OPHC's supporting records, such as, the Loan and Loan Guarantee Revolving Fund Summary of Transaction Report;
- o material events are adequately disclosed and properly reported;
- o deviations from Treasury instructions are properly approved;
- o written procedures are established that document deviations from Treasury reporting procedures which document the process for recording and reporting transactions and preparing financial reports.

We reviewed HCFA's initial comments to our draft report and as a result, a follow-up meeting was held with HCFA officials to resolve all differences. The HCFA officials provided additional pertinent information which resulted in modifications made in the "Findings and Recommendations" section of our final report.

We continue to recommend that HCFA improve internal controls. We believe these recommendations are relevant to correct internal control deficiencies.

RESPONSE TO HCFA COMMENTS TO DRAFT REPORT

Recommendation

We recommend that HCFA ensure that payments and liabilities are accurately recorded and general ledger balances, specifically for the loans payable account, are accurately recorded and are reconciled to OPHC's supporting records, such as, the Loan and Loan Guarantee Revolving Fund Summary of Transaction Report.

HCFA'S Comments

The HCFA believes it has maintained strong internal controls over all accounting processes, including payments, collections, and report preparation. A major OIG finding relative to the reconciliation process was an overstatement of the HMO loan payable in the amount of \$821,606. Although HCFA does not want to diminish the nature of the error, the error was clearly an anomaly and not systemic in nature and, therefore, not a valid example to render an overall assessment as to the adequacy of their reconciliation process.

OIG'S Response

Our recommendation was intended to show that HCFA needs to reconcile their general ledger HMO loans payable amount to OPHC's supporting records. We agree that HCFA generally performs reconciliations of the general ledger with subsidiary reports and that the process includes reconciling external reports to the general ledger. However, our review showed that an internal control deficiency existed because there was no reconciliation between the general ledger for the HMO loans payable account and the OPHC's supporting records. We believe that controls should be established to ensure that the general ledger accounts pertaining to HMO loans payable are reconciled to OPHC's supporting records.

For example, our review showed that the loans payable account with TCB was misstated as a result of HCFA not reconciling this account to source documents, such as, the Summary of Transaction Report. The OPHC recorded on the Summary of Transaction Report a liability owed to TCB of \$35,062. However, the Division of Accounting (DA) reported a balance of \$869,000 as of September 30, 1991 for the TCB loans payable account. We found that a lump sum payment of \$407,000 made in 1983, was recorded by OPHC, however, DA did not have this payment recorded in their records resulting in an overstatement of \$821,606 on its accounting records. If DA and OPHC had reconciled their records, the error would have been discovered and the overpayment made in February 1992 would have been prevented.

Recommendation

We recommend that material events are adequately disclosed and properly reported.

HCFA'S Comments

The HCFA disagreed that it should have footnoted several transactions in its financial reports because the additional information would not have been significant to report users.

OIG'S Response

As a result of follow-up discussions, the HCFA agreed with our recommendation that material events should be adequately disclosed.

Recommendation

We recommend that HCFA establish written procedures that documents deviations from Treasury reporting procedures which documents the process for recording and reporting transactions and preparing financial reports.

HCFA'S Comments

The HCFA seriously objected to our recommendation to ensure that account balances from the general ledger are reconciled to the financial reports. The HCFA's comments to our draft report stated that the OIG has characterized the deficit in accrued expenditures as unusual and attributable to HCFA failing to reconcile the financial reports to the general ledger. Additionally, as a result of our follow-up discussions, HCFA stated that the bad debt expenses reported in the FY 1991 general ledger were for prior year expenses. Therefore, HCFA decided not to report these expenses on the FY 1991 Report on Operations because they were not current year expenses.

OIG'S Response

Information provided by HCFA showed that they deviated from Treasury instructions specifically for reporting the accrued expenditures and the bad debt expense accounts. Originally, we recommended for HCFA to ensure that these account balances were reconciled to the financial reports. However, based on follow-up discussions, HCFA demonstrated that the general ledger

accounts mentioned above were reconciled to the financial reports but were not reported in accordance with Treasury requirements. We believe HCFA needs to document those instances when they deviate from Treasury instructions.



DEPARTMENT OF HEALTH & HUMAN SERVICES

Memorandum

MAY 10 1993

DATE

FROM

William Toby, Jr.
William Toby, Jr.
Acting Administrator

SUBJECT

Office of Inspector General (OIG) Draft Audit Report: Review of the Health Care Financing Administration's (HCFA) Health Maintenance Organization (HMO) Loan and Loan Guarantee Fund for Fiscal Year (FY) 1991, (A-14-91-03002)

TO

Bryan B. Mitchell
Principal Deputy Inspector General

We have reviewed the draft audit report which describes the results of the OIG review of HCFA's HMO Loan and Loan Guarantee Fund for the year ended September 30, 1991.

The HMO loan fund was established in 1975 as a revolving fund to assist HMOs with direct loans for planning, initial development and operations, and expansion. Initially a Public Health Service program, it was inherited by HCFA in 1985. The last loan commitments were made in FY 1983.

OIG found deficiencies in HCFA's financial reporting controls for HMOs' loan payments, liabilities, and delinquent loans. OIG also found weak internal accounting controls in reconciling account balances for the period ending September 30, 1991.

To address their findings, OIG recommends that HCFA develop written policies and procedures on how HMO loan fund transactions are to be recorded, and resultant financial reports are to be developed in order to ensure that:

- o HMO loan payments, liabilities, financing sources, and delinquent loans are accurately recorded;
- o general ledger balances, specifically for the loans payable account, are accurately recorded and are reconciled to supporting records;

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- o all expenses and material events are reported and traceable to supporting records; and
- o account balances from the general ledger are reconciled to the financial reports.

Additionally, OIG recommends that HCFA perform an internal control review of the HMO loan fund to follow up on the deficiencies identified and incorporate and ensure periodic reviews in accordance with the Office of Management and Budget Circular A-123 and the Federal Managers' Financial Integrity Act.

HCFA has serious objections to the audit report. We find the conclusions of the audit report to be misleading given that several of OIG's major findings are not relevant or consequential when assessing their materiality and impact on the overall financial control and reporting of the HMO loan account. The report gives the reader the impression that HCFA has not exercised prudent stewardship of the HMO loan account when, in fact, the opposite is true. Our specific comments are attached for your consideration.

Thank you for the opportunity to review and comment on this report. Please advise us if you agree with our position on the report's recommendations at your earliest convenience.

Attachment

Comments of the Health Care Financing Administration (HCFA)
on the Office of Inspector General (OIG) Draft
Audit Report: Review of HCFA's
Health Maintenance Organization (HMO) Loan
and Loan Guarantee Fund for Fiscal Year (FY) 1991
(A-14-91-03002)

Recommendation 1

HCFA should develop written policies and procedures on how HMO loan fund transactions are to be recorded and resultant financial reports are to be developed. These policies and procedures on financial reporting and internal accounting controls need to ensure that:

- o HMO loan payments, liabilities, financing sources, and delinquent loans are accurately recorded;
- o general ledger balances, specifically for the loans payable account, are accurately recorded and are reconciled to supporting records;
- o all expenses and material events are reported and traceable to supporting records; and
- o account balances from the general ledger are reconciled to the financial reports.

HCFA Response

HCFA finds this recommendation to be inappropriate for several reasons. HCFA has always performed detailed reconciliations of the general ledger as well as all subsidiary reports. The reconciliation process includes reconciling all external reports to the general ledger. In addition, HCFA has maintained strong internal controls over all accounting processes, including payments, collections, and report preparation.

In an effort to further strengthen our reconciliation process, during 1991 HCFA documented its reconciliation process and developed a formalized reconciliation protocol for every appropriation and every general ledger account. The reconciliation protocol explains in detail the specific reconciliation process of each general ledger account, including an explanation of source documentation and subsidiary reports. Accounts are reconciled either quarterly or monthly depending on the significance of the account. For example, all cash accounts are reconciled each month. The reconciliation process includes the HMO loan account. We believe that our general ledger reconciliation process is as extensive as any in Government, and the OIG's implication that HCFA's reconciliation process is inadequate is incorrect.

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A major OIG finding relative to the reconciliation process was an overstatement of the HMO loans payable in the amount of \$821,606. Of this amount, \$407,000 was attributable to a prepayment made by the Public Health Service (PHS) to a loan holder in 1983. When responsibility for the loan fund was transferred from PHS to HCFA, PHS' supporting ledgers did not reflect this transaction. Consequently, HCFA's general ledger for the HMO loan account, which included all amounts that were transferred from PHS, was overstated. Although we do not want to diminish the nature of the error, this error is clearly an "anomaly." It is not "systemic" in nature and therefore not a valid example to render an overall assessment as to the adequacy of our reconciliation procedures. Reconciliations of the HMO loan account were continually performed. However, since the source documentation transferred from PHS was incorrect, reconciliations would not have discovered the error. The error was eventually discovered when the payee notified HCFA that the account was paid in full. When that occurred, HCFA immediately adjusted its accounts and notified the OIG. The audit report's implication that the OIG discovered this error and brought it to HCFA's attention is not factual.

We share OIG's concern about the remaining portion of this finding, i.e., a difference in the general ledger of \$414,606. We request that the OIG supply us with the details so that we can look into the issue. Moreover, we would like to emphasize that the fact that a difference exists does not necessarily mean that HCFA's accounting records are incorrect. It should also be noted that an exit conference for this audit was not held with the operating line manager. Such a meeting would have provided the opportunity for HCFA to have resolved this issue at an earlier date.

Recommendation 2

HCFA should perform an internal control review of the HMO loan account to follow up on the deficiencies that have been identified. Additionally, the HMO loan fund should be incorporated into HCFA's Management Control Plan to ensure periodic reviews in accordance with Office of Management and Budget Circular A-123 "Management Control Reviews."

HCFA Response

Since new loans are not being issued, accounting for the HMO loan account is now handled by the Division of Accounting, Office of Financial Management, Office of Budget and Administration. We have scheduled HCFA's core accounting system, the Financial Accounting Control System which includes the HMO loan fund, for a combined section 2/4 review during FY 1994, and will ensure that the HMO loan area is reviewed at that time.

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Although we fully support the Federal Managers' Financial Integrity Act program and intend to perform an internal control review of this activity as described above, we are concerned about the appropriateness of this recommendation. We do not believe that this type of generic recommendation properly flows from OIG's findings. The deficiencies noted by OIG were not reflective of HCFA's financial internal control system governing the HMO loan account.

A major OIG finding relative to internal controls related to the payable difference discussed above. As discussed above, we believe that this difference is an anomaly and not reflective of the overall accounting process. In any event, we fail to see how an internal control review would have prevented or necessarily identified this error.

On pages 2 and 7 of the report, OIG points out that the fund reported \$12.6 million in revenue for the year ended September 30, 1991, which included loan interest payments. The related financing sources included a deficit value for accrued expenditures (expended appropriations) of \$4.7 million. OIG has characterized the deficit in accrued expenditures as unusual and attributable to HCFA failing to reconcile the financial reports to the general ledger. In fact, all financial reports are prepared directly from the general ledger. Although we agree that the deficit value for accrued expenditures is unusual, it is caused because collections to the HMO loan account exceeded expenses. HCFA's payment of principal to the Federal Financing Bank is not considered an expense but is a nonexpenditure transfer. For the OIG to conclude that the deficit accrued expenditure amount is somehow related to poor internal controls is incorrect.

Beginning on page 8 of the report, OIG makes several statements regarding the adequacy of HCFA's financial reporting controls governing the preparation of full disclosure reports. OIG concluded that HCFA should have footnoted several transactions in our financial report. We disagree. It is interesting to note that one footnote proposed by the OIG supported actions already taken by HCFA. Based on available information, HCFA had correctly concluded that the funds in question were not going to be collected from the HMO. Thus, HCFA properly included the defaulted loan in the allowance for bad debts. Consequently, the footnote proposed by the OIG would not have provided additional information that would have been significant to report users. It is also important to note that for FY 1991 (the period audited) HCFA prepared the SF-220 series of year-end reports, which are forwarded to the Department of the Treasury to be used by them in preparing a "rolled up" governmentwide report. The suggested footnotes would have even less significance or materiality in the governmentwide report. In any event, we fail to see how the use of additional footnotes is related to internal controls.

On page 10 of the report, OIG found that HCFA had no written policies and procedures related to preparing financial statements. OIG concluded that the lack of such written policies and procedures contributed to a deficient financial reporting

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system of controls. We fail to understand OIG's logic in this regard. In the following paragraph, the OIG points out that HCFA relied on the Department of Health and Human Services (HHS) umbrella accounting manual, as well as the Department of the Treasury's governmentwide reporting procedures as guidance for recording and reporting transactions and preparing the financial reports. We believe that our reliance on HHS and Treasury manuals is highly appropriate and additional procedures are not needed. In fact, in view of the Government's attempt to implement a standard reporting process, there would be no utility in developing supplemental HCFA procedures.