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General Accounting Office
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Accounting and Information
Management Division

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October 2, 1998

The Honorable John Edward Porter
Chairman, Subcommittee on Labor, Health
and Human Services, Education, and Related
Agencies
Committee on Appropriations
House of Representatives

Subject: Financial Management: Comparison of the Arthur Andersen Study
and the Ernst and Young Financial Audit of the National Institutes of
Health

Dear Mr. Chairman:

This letter responds to a request your staff made during a July 27, 1998, briefing. We were asked to compare the results of the Arthur Andersen (AA) study of the National Institutes of Health's (NIH) operations and the Ernst and Young (E&Y) audit of NIH's fiscal year 1997 financial statements to determine if they contained any conflicting information.

We compared the two reports and found no conflicting information. Rather, the reports were complementary, discussing the need to improve management controls and making recommendations that, if properly implemented, could improve overall financial management of NIH's operations.

Although the reports did not have the same focus, some of the issues they discussed were similar. The AA study, which was much broader in scope, focused on 17 administrative functions of NIH and their respective costs. These functions included information technology, finance, procurement, property management, intramural and extramural research management, personnel, and budget. For each function, AA discussed in detail related issues, identified best practices, and made recommendations. The E&Y audit focused more on internal controls, compliance with laws and regulations, and issues that may impact NIH's financial statements. These issues included property, plant, and equipment; grant accrual; the decentralized accounting environment; physical access controls to systems; and grant monitoring. The following sections discuss similar issues we identified in the reports and other issues from the AA study which could improve financial management.

GAO/AIMD-99-9R Comparison of NIH's Operations Study and Financial Audit

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SIMILAR ISSUES

Both studies identified issues related to property management, physical security controls, and the Prompt Payment Act.¹

Property Management

The E&Y audit noted that NIH had not performed a complete physical inventory of capital nonexpendable assets in the past 4 years and that the results of periodic inventories are not reconciled to the Property Management Information System (PMIS). The AA study also discussed property management and how a lack of regular inventories and NIH's failure to reconcile subsidiary ledgers hinders compliance with the Chief Financial Officers (CFO) Act.² The AA study further links property management weaknesses with NIH's lack of an integrated property management system. Both AA and E&Y recommended that the Property Management Division (PMD) help the Office of Financial Management (OFM) reconcile the general ledger with PMIS and set the inventory schedule for NIH. AA also recommended that NIH elevate the CFO function to give the CFO management control over the major systems, including PMIS, that affect the quality and content of the financial information for which the CFO is responsible. In addition, the AA study noted that if the CFO's function is elevated, the CFO can ensure that OFM and PMD work together to improve NIH property management.

Physical Security Controls

E&Y reported deficiencies in the physical security controls over systems at NIH's Division of Computer Research and Technology (DCRT). These deficiencies included windows with no alarms and the lack of procedures to control monitoring and administration of computer machine room access privileges. These deficiencies could ultimately affect the accuracy of data processed by the data center. While the AA study did not discuss DCRT security issues, its section on facilities and support functions discussed the need for increased overall security on the NIH campus. This security should include

¹The Prompt Payment Act of 1982, as amended, generally requires agencies to pay interest penalties when payments are late and to take discounts only when payments are made on or before the discount date.

²The Department of Health and Human Services (HHS) is one of 24 departments and major agencies that has a statutory CFO and must comply with the CFO Act, as expanded. As the third largest component of HHS based on net outlays, NIH is important to HHS' efforts to satisfy the CFO Act and has an administratively established CFO.

guard and badge requirements and collection of keys and badges from personnel terminating employment at NIH.

Prompt Payment

The AA study noted that failure to pay invoices on time is a persistent and serious problem. According to the study, numerous staff stated that vendors for scientific supplies had occasionally suspended business with NIH due to payment problems. Also, E&Y reported that NIH needed to improve controls over the processing of invoices to ensure compliance with the Prompt Payment Act. The act generally requires federal entities to pay interest when contract payments are late. Thus, the failure to pay invoices promptly can not only affect the vendors' operations but also result in NIH incurring unnecessary interest costs.

OTHER ISSUES

The AA study reported other issues affecting NIH's financial operations and made recommendations that, if implemented, could improve financial management. These issues are as follows.

- **Budget:** The AA study mentioned that the dissatisfaction expressed by members of NIH's scientific community regarding the timeliness and quality of budget information indicates that the role of the CFO needs strengthening. The study further recommended that a CFO liaison be established for each institute, center, and division (ICD) to (1) provide consultative services to ICD administrators and scientists on financial management issues, (2) oversee the internal controls and processing of ICD financial activities, and (3) serve as a contact person for government improvement initiatives, including the CFO Act and the Government Performance and Results Act (GPRA).
- **Grants Management:** AA's reporting on grants management had a different focus than E&Y's. The AA study focused more on the grant application process, the automation of the process, and reducing the cycle time from receipt of a grant application to award. Grants management was a key issue in the E&Y audit and one of the reasons the fiscal year 1997 opinion was qualified. The E&Y audit focused more on the financial reporting of grant accrual and monitoring. For example, E&Y reported that NIH did not have a system to track grantees' submission of Single Audit Act reports and identify those which were delinquent or noncompliant. Under the Single Audit Act, a grantee's auditor is required to assess the internal controls, identify reportable conditions, and issue an internal control report covering each major grant program for the grantee.

- **Finance:** The AA study stated that in order to be effective, a CFO should have management control over the major systems that affect the content and quality of financial information. The study further stated that the NIH CFO position was too low in the hierarchy to exercise responsibilities effectively. According to the study, the CFO is the director of OFM and therefore has management control over only budget and finance, not the property management function. As a result, AA recommended that NIH elevate the CFO position so that it oversees finance, procurement, and logistics (property management). AA stated that elevating the CFO position will facilitate integrated solutions to long-standing problems in these areas. In March 1998, the CFO position was elevated to include overseeing finance, procurement, and logistics.

- **Information Technology:** The AA study noted that NIH's organization of information technology (IT) is fragmented and that NIH does not have an IT strategic plan across all of its ICDs to identify the need for long-term changes in organization, resource allocations, computing requirements, and technologies. AA recommended that NIH establish an effective chief information officer (CIO) position and structure its IT organization around the CIO. According to the study, an effective organization for IT would consist of the CIO's heading a structure comprising DCRT, the Office of Information Resources Management (OIRM), and telecommunications. An NIH CIO was appointed in March 1998.³ The CIO is the Director of the Center for Information Technology (CIT), which resulted from merging DCRT, OIRM, and the Telecommunications Branch.

AGENCY COMMENTS

We obtained oral comments on a draft of this letter from the NIH CFO, who generally agreed with its contents and described how NIH is addressing the issues raised in the E&Y and AA reports. For example, the CFO stated that NIH has (1) conducted a physical inventory and is reconciling the inventory records to the central accounting system, (2) enhanced the security associated with ADP facilities, and (3) provided additional staffing to those finance areas involved in the CFO activities.

We are sending copies of this letter to the Director of NIH and other interested parties. Copies will also be made available to others upon request.

³The Clinger-Cohen Act of 1996 requires 24 executive agencies to appoint a CIO to provide the expertise to implement needed reforms. Although NIH is not one of the 24 executive agencies required to appoint a CIO by the Clinger-Cohen Act, it is the third largest component of the HHS, which is one of the 24 executive agencies.

If you have any questions about the contents of this letter or if you would like to discuss these issues in more detail, please contact me at (202) 512-4476. The major contributors to this letter were Chinero Thomas and Rosa Ricks Harris.

Sincerely yours,

A handwritten signature in black ink that reads "Gloria L. Jarmon". The signature is written in a cursive style with a large initial "G".

Gloria L. Jarmon
Director, Health, Education, and Human Services
Accounting and Financial Management

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