G A O

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, D.C. 20548

June 23, 2005

Mr. Kerry Weems
Acting Chief Financial Officer
Department of Health and Human Services

Mr. Daniel R. Levinson
Acting Inspector General
Department of Health and Human Services

Subject: *Financial Audit: The Department of Health and Human Services's Fiscal Year 2004 Management Representation Letter on Its Financial Statements*

As you know, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required to annually prepare and submit audited financial statements of the U.S. government to the President and the Congress. We are required to audit these consolidated financial statements (CFS) and report on the results of our work.[1] In connection with fulfilling our requirement to audit the fiscal year 2004 CFS, we evaluated the Department of the Treasury's (Treasury) financial reporting procedures and related internal control over the process for compiling the CFS, including the management representation letter provided us by Treasury and OMB. Written representation letters from management, required by U.S. generally accepted government auditing standards, ordinarily confirm oral representations given to the auditor, indicate and document the continuing appropriateness of those representations, and reduce the possibility of a misunderstanding between management and the auditor.

In our report, which is included in the fiscal year 2004 *Financial Report of the United States Government*,[2] we reported a limitation on the scope of our work due to identified concerns with the adequacy of certain federal

[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. § 331 (e). The federal government has elected to include certain financial information on the legislative and judicial branches in the CFS as well.

[2]The fiscal year 2004 *Financial Report of the United States Government* was completed by the Department of the Treasury on December 15, 2004, and is available through both GAO's Web site at www.gao.gov and Treasury's Web site at www.fms.treas.gov/fr/index.html.

agencies' management representations on which Treasury and OMB depend to provide their representations to us regarding the CFS. Specifically, Treasury and OMB stated that their representation letter to us on the CFS was based primarily on the individual federal agency representation letters. Consequently, our audit considered the content of the individual federal agency letters, and the incompleteness of certain of these letters impaired our ability to obtain sufficient evidence in support of our audit of the CFS. This limitation contributed to our disclaimer of opinion on the CFS. We performed sufficient audit work to provide the disclaimer of opinion and issued our audit report, dated December 6, 2004, in accordance with U.S. generally accepted government auditing standards.

As part of our audit of the fiscal year 2004 CFS, we received and reviewed selected federal agencies' management representation letters to assess their adequacy in support of our audit of the CFS. As the federal government gets closer to an opinion on its financial statements, it becomes more important that the federal agencies' management representation letters be complete and reliably prepared.

The purpose of this report is to communicate our observations on the Department of Health and Human Services's (HHS) fiscal year 2004 management representation letter. Our objective is to help ensure that future management representation letters submitted by HHS are sufficient to help support Treasury and OMB's preparation of the CFS management representation letter and our ability to rely on the representations in that letter in combination with individual federal agency representation letters. We reviewed five key areas in each management representation letter: (1) signatures, (2) materiality thresholds, (3) representations, (4) summary of unadjusted misstatements, and (5) reliability of representations. In reviewing the management representation letters, we applied the American Institute of Certified Public Accountants' (AICPA) *Codification of Auditing Standards*, AU Section 333, *Management Representations*; OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*; and the GAO/President's Council on Integrity and Efficiency (PCIE) *Financial Audit Manual* (FAM) section 1001, entitled "Management Representations."[3]

[3]GAO, *GAO/PCIE: Financial Audit Manual: Update*, GAO-04-1015G (Washington, D.C.: July 30, 2004), an update to *Financial Audit Manual: Volumes 1 and 2*, GAO-01-765G (Washington, D.C.: Aug. 1, 2001).

Results in Brief

HHS's fiscal year 2004 management representation letter did not provide all the information necessary to support Treasury and OMB's preparation of the CFS management representation letter. This in turn impacted our ability to rely on the representations in the CFS management representation letter in combination with individual federal agency representation letters.

We identified some needed improvements in three of the five key areas we reviewed. First, HHS did not provide the materiality thresholds used to determine, for representation purposes, any matters that were individually or collectively material to its financial statements. Such individual federal agency thresholds are considered by Treasury and OMB in providing a materiality threshold for the CFS representation letter. Second, the letter included 27 of the 29 representations[4] from the FAM that were applicable to HHS. The other 2 representations were not fully included. Finally, HHS did not include a complete summary of unadjusted misstatements with its management representation letter and also did not distinguish between misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public.

We believe that these matters can be easily addressed. We are making three recommendations to HHS's Acting Chief Financial Officer targeted to specific changes needed. Also, we are recommending that the HHS Acting Inspector General, with the contracted independent public accountant, work with the department to help ensure that future management representation letters meet the key conditions noted as needing improvements in this report.

In commenting on a draft of this report, HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services raised some points regarding the three areas that we noted in our report as needing improvement, but stated that they will (1) work to ensure the fiscal year 2005 materiality thresholds are communicated to Treasury, OMB, and GAO;

[4]The FAM lists 27 representations that are ordinarily included, if applicable, in the management representation letter that an agency provides to the auditor. For 4 of the representations, the agency is required to address three separate components. As such, each agency is ordinarily expected to make a total of 35 representations. Six of the 35 representations are not applicable unless the agency received an opinion on its internal control. Since HHS did not receive an opinion on its internal control for fiscal year 2004, only 29 of the 35 representations were applicable to HHS's fiscal year 2004 management representation letter.

(2) ensure that their fiscal year 2005 management representation letter includes the FAM language for one of the representations not fully included; and (3) use the FAM language related to “known” and “likely” misstatements and carry-forward effect in their fiscal year 2005 summary of unadjusted misstatements. For the other representation not fully included, they noted that reference to stewardship property, plant, and equipment would not be included in the management representation letter. However, in order for there to be no misunderstandings, HHS’s future management representation letters should provide additional detail on its stewardship responsibilities. In addition, the HHS Deputy Assistant Secretary Finance’s and Deputy Inspector General for Audit Services’s comments did not address distinguishing between misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public on HHS’s summary of unadjusted misstatements. As stated in the report, this information is needed by us to prepare the governmentwide summary of unadjusted misstatements.

Background

In conducting agency financial statement audits, U.S. generally accepted government auditing standards incorporate financial auditing fieldwork and reporting standards issued by the AICPA. Such auditing standards (AU Section 333) require auditors to obtain certain representations from agency management. These representations are part of the evidential matter to be considered by the auditor in its audit of the agency’s financial statements. The representations obtained will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. AU Section 333 discusses specific representations that should be obtained from management, including a requirement to attach a schedule of unadjusted financial statement misstatements for entities with uncorrected misstatements.

In addition, OMB Bulletin 01-02 and FAM section 1001 contain guidance on preparing federal agencies’ management representation letters. According to the FAM, in addition to the representations included in AU Section 333, the auditor generally should consider the need to obtain representations on other matters based on the circumstances of the audited entity. FAM section 1001A lists 35 specific representations ordinarily included in the management representation letter and also includes a requirement to attach a schedule of unadjusted financial statement misstatements for entities with uncorrected misstatements. (See enc. I for these representations.) Representations listed in FAM section 1001A should be customized to the situation of the entity being audited or excluded if inapplicable. We perform our audit of the CFS in accordance with the FAM and related auditing standards.

Treasury and OMB are to receive management representation letters from certain federal agencies. This is important because U.S. generally accepted government auditing standards require that Treasury and OMB provide us, as principal auditor of the CFS, a management representation letter, and their letter depends on the information in such agencies' management representation letters. In their representation letter to us for the audit of the fiscal year 2004 CFS, Treasury and OMB stated that their representations are based primarily on the representations of those agencies covered by the Chief Financial Officers (CFO) Act and other selected agencies that were made in connection with the preparation of these entities' respective financial statements and provided to OMB and Treasury. For this reason, it is important that all federal agency representation letters be complete and reliable.

Objectives, Scope, and Methodology

In connection with our audit of the fiscal year 2004 CFS, we evaluated Treasury's financial reporting procedures and related internal control, including the CFS management representation letter. For the fiscal year 2004 CFS, 33 of the 35 "verifying agencies" submitted audited financial statements along with their management representation letters to Treasury.[5] In our review of these 33 management representation letters, our overall objective was to assess their adequacy as it relates to our audit of the CFS. Specifically, we reviewed each agency management representation letter to determine whether the following five key conditions were met:

- the management representation letter was signed by appropriate agency officials;

[5]See *Treasury Financial Manual*, vol. I, part 2, ch. 4700, for a list of the 35 agencies. These agencies, for fiscal year 2004, consisted of 23 CFO Act agencies and 12 material other agencies. The 33 agencies we reviewed did not include the U.S. Securities and Exchange Commission and the Smithsonian Institution because these audits were not complete before the fiscal year 2004 *Financial Report of the United States Government* was issued. The Department of Homeland Security (DHS) Financial Accountability Act, Pub. L. No. 108-330, 118 Stat. 1275 (Oct. 16, 2004), added DHS to the list of CFO Act agencies, increasing the number of CFO Act agencies again to 24 for fiscal year 2005.

- the management representation letter included designation as to the amounts above which matters were considered material (materiality thresholds);
- the management representation letter included applicable representations from the FAM;
- the management representation letter included a properly prepared summary of unadjusted misstatements for agencies with uncorrected misstatements; and
- the representations in the management representation letter were reliable based on a review of findings in the auditor's report.

This report is based on the audit work we performed for the audit of the fiscal year 2004 CFS, which was performed in accordance with U.S. generally accepted government auditing standards.

We requested comments on a draft of this report from HHS's Chief Financial Officer and Inspector General or their designees. Written comments from HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services are reprinted in enclosures II and III, respectively, and are also discussed in the Agency Comments and Our Evaluation section.

Identified Issues with HHS's Fiscal Year 2004 Management Representation Letter

With respect to HHS's fiscal year 2004 management representation letter, we identified the following three areas that need some improvement: (1) providing the materiality thresholds used, (2) fully including applicable representations from the FAM, and (3) including a summary of unadjusted misstatements. Details regarding these issues are as follows.

Providing the Materiality Thresholds Used

Management representations may be limited to matters that are considered individually or collectively material to the entity's financial statements, provided that management and the auditor have reached an understanding on the materiality thresholds to be used. Likewise, in preparing the overall management representation letter for the CFS, which is provided to us, Treasury and OMB limit the letter's representations to matters that are considered to be material. While an understanding between management and the auditor of materiality thresholds used is not explicitly required by auditing standards to be included in the management representation letter, Treasury and OMB use agency thresholds in providing a materiality threshold for the governmentwide management representation letter.

For fiscal year 2004, because the materiality thresholds used were not included in HHS's and a number of other federal agencies' management representation letters, or otherwise provided to Treasury and OMB, Treasury and OMB's ability to represent that all matters material to the CFS were properly considered and included in the overall management representation letter for the CFS was impaired.

Fully Including Applicable Representations from the FAM

Written representations from management ordinarily confirm oral representations made to the auditor during the audit, document the continuing appropriateness of those representations, and reduce the possibility of a misunderstanding. To meet auditing standards and OMB requirements, federal agencies' management and auditors need to ensure that management representation letters are complete and accurate.

We found that HHS's fiscal year 2004 management representation letter included 27 of the 29 representations from the FAM that were applicable to HHS. The 2 other representations were not fully included. For one of the incomplete representations, the HHS management representation letter included the following representation intended to cover the satisfactory title to all owned assets, including stewardship property, plant, and equipment representation called for by FAM 6. (See enc. I for this representation.)

> "Except for properties capitalized under capital leases, HHS has satisfactory title to all assets appearing in the balance sheet as of September 30, 2004, including assigned and unassigned loans; and there are no liens or encumbrances, nor have any assets been pledged. All assets to which the HHS has satisfactory title appear in the balance sheet."

While this representation addresses owned assets, it should also address stewardship property, plant, and equipment as called for by FAM 6.

For the other incomplete representation, the management representation letter included the following representation intended to cover the subsequent events representation called for by FAM 13. (See enc. I for this representation.)

> "No events or transactions have occurred since September 30, 2004 or are pending that would have a material effect on the financial statements at that date or for the period then

ended, or that are of such significance in relation to the HHS's affairs to require mention in a note to the financial statements in order to make them not misleading regarding the financial position, net cost, changes in net position, budgetary resources, and the reconciliation of net costs to budgetary obligations of the HHS."

While this representation addresses the financial statements and notes, it should also address stewardship information as called for by FAM 13.

When agencies include incomplete representations in their management representation letters, it impairs our ability to audit the CFS and Treasury and OMB's ability to make these types of representations in the CFS management representation letter.

Including a Complete Summary of Unadjusted Misstatements

U.S. generally accepted government auditing standards require that for each federal agency with uncorrected misstatements, a summary of unadjusted misstatements be attached to the agency's management representation letter. Treasury and OMB use the summaries of unadjusted misstatements to assess the impact of federal agencies' unadjusted misstatements on the CFS and make appropriate management representations to us at the governmentwide level. The summaries are also used by us, as principal auditor of the CFS, to develop an overall governmentwide summary of unadjusted misstatements, which is then attached to the CFS management representation letter prepared by Treasury and OMB.

Also, in a matter related to the compilation process for the CFS, in fiscal year 2004, Treasury required agencies to submit a summary of unadjusted misstatements as part of the closing package using the standardized format provided for in the *Treasury Financial Manual* (TFM). The TFM, however, required additional details to be added to this summary of unadjusted misstatements than those called for by the FAM. Specifically, agencies were to also (1) include a description of the misstatements and (2) distinguish between misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public. We need this additional information to develop the overall governmentwide summary of unadjusted misstatements. In order to avoid duplication of effort by the agencies in preparing two summaries of unadjusted misstatements, the additional information should also be included in the summary of unadjusted misstatements attached to the management representation letter. As such, we plan to work with PCIE to modify the FAM to call for these two additional disclosures to be included in the summary of unadjusted misstatements attached to the management representation letter.

HHS included a summary of unadjusted misstatements with its management representation letter, but the summary as called for by the FAM was incomplete. Specifically, HHS did not (1) separate "known" and "likely" misstatements and (2) separately identify the carry-forward effect of the prior year's unadjusted misstatements. In addition, HHS did not submit a summary of unadjusted misstatements as part of its closing package to Treasury as required by the TFM. As such, HHS also did not distinguish between misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public.

Without a complete summary of unadjusted misstatements from each of the verifying agencies with uncorrected misstatements, it is not possible for us, as principal auditor of the CFS, to reasonably determine the audit risk exposure for each of the line items in the CFS or to prepare an adequate summary of unadjusted misstatements at the governmentwide level.

Conclusions

In three of the five key areas we reviewed, HHS's fiscal year 2004 management representation letter did not provide all the information necessary to support Treasury and OMB's preparation of the CFS management representation letter and our ability to rely on the representations in that letter in combination with individual federal agency representation letters, including that of HHS. The additional information needed from HHS is straightforward and should be easy to address.

Recommendations for Executive Action

We recommend to HHS's Acting Chief Financial Officer that in the future the management representation letter

- include materiality thresholds or such thresholds be provided separately to Treasury and OMB;
- fully include all representations from the FAM that are applicable to HHS; and
- include a complete summary of unadjusted misstatements, if there are any uncorrected misstatements, that also distinguishes between

misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public.

We recommend that the HHS Acting Inspector General, with the contracted independent public accountant, work with the department to help ensure that future management representation letters meet the key conditions noted as needing improvements in this report.

Agency Comments and Our Evaluation

HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services, in separate letters that are reprinted in enclosures II and III, respectively, provided written comments on our draft report. Their specific comments and our evaluation of their comments for each of the issues in the report are discussed below.

HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that their offices believe that the points raised by us did not affect HHS's audit or our audit of the CFS. With respect to affecting HHS's audit, the purpose of our review was to assess the adequacy of selected agencies' management representation letters in supporting our audit of the CFS. We did not conclude on or report as to the specific effect of the issues we identified on the audit of any of the respective agencies' financial statements, as this was not a focus of our review. In regards to affecting our audit of the CFS, we disagree. As stated in our report, we reported a limitation on the scope of our work on the fiscal year 2004 CFS due to identified concerns with the adequacy of certain federal agencies' management representations on which Treasury and OMB depend to provide their representations to us regarding the CFS. Specifically, the incompleteness of certain of these federal agencies' letters, including HHS's letter, impaired our ability to obtain sufficient evidence in support of our audit of the CFS and contributed to our disclaimer of opinion on the CFS.

Providing the Materiality Thresholds Used

HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that they did not consider it proper to include a consolidated materiality threshold in HHS's management representation letter that is signed by all of the operating divisions. We are unclear as to why the signing of the letter by the operating divisions would impact the disclosure of materiality thresholds in the departmentwide management representation letter. However, we are pleased that, consistent with our recommendation, HHS stated it will ensure that the fiscal year 2005 materiality thresholds are communicated to Treasury, OMB, and GAO.

Fully Including Applicable Representations from the FAM

As it relates to FAM representation #6, HHS's Deputy Inspector General for Audit Services stated that reference to stewardship property, plant, and equipment would not be included in the management representation letter. He stated that given the nature of the heritage assets and Indian trust lands, pursuant to Public Law 86-121, the assets will be returned to the Department of the Interior's Bureau of Indian Affairs when no longer needed by HHS's Indian Health Service. He also noted that a separate paragraph regarding the stewardship reporting was included in HHS's fiscal year 2004 management representation letter. In addition, HHS's Deputy Assistant Secretary Finance noted that his office believes that HHS fully recognized its Indian Health Service's stewardship property, plant, and equipment in this separate paragraph.

The required supplementary stewardship information section of HHS's fiscal year 2004 Performance and Accountability Report discusses stewardship property, plant, and equipment. As such, HHS's management representation letter should include a representation related to these assets. The representation should clearly communicate HHS's responsibilities for the stewardship property, plant, and equipment, including whether or not HHS has title and if there are any encumbrances. Although HHS's management representation letter stated that the required supplementary stewardship information has been prepared and presented in conformity with the guidelines established by the Statements on Federal Financial Accounting Standards, it did not specifically discuss stewardship property, plant, and equipment. As a result, HHS's future management representation letters should provide additional detail on its stewardship responsibilities.

As it relates to FAM representation #13, HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that there were no significant subsequent events related to stewardship information. The Deputy Inspector General for Audit Services also stated that his office believes that the representations provided by management covered the significant portion of the required supplementary stewardship information by reference to the Centers for Medicare and Medicaid Services's representation letter. Nevertheless, the Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that their offices will ensure that HHS's fiscal year 2005 management representation letter includes the FAM language for this representation. Since (1) the FAM calls for a representation that there are no material subsequent events or transactions that have not been properly recorded in the stewardship information and (2) HHS reports stewardship information at the department level, FAM representation #13 in the HHS consolidated financial statements management representation letter should incorporate language related to stewardship information. We are pleased that HHS has agreed to incorporate the FAM language into this representation for fiscal year 2005.

Including a Complete Summary of Unadjusted Misstatements

HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that information contained in the summary of unadjusted misstatements would allow a reader to classify adjustments as "known" or "likely". Specifically, they stated that misstatements labeled "exposure" were classified as likely and all other adjustments were classified as known. In HHS's summary of unadjusted misstatements, the word "exposure" was noted for some of the misstatements. However, the term "known" was not noted on any of the misstatements. It was not clear during our review as to how this presentation provided the information called for by the FAM. In addition, HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that information contained in the summary of unadjusted misstatements would allow a reader to determine the carry-forward effect of the prior year's unadjusted misstatements. Specifically, they indicated that the carry-forward effect was included on the summary under the "turnaround effect" line. However, the turnaround effect on the summary only included one amount as to the effect on net income and did not show any effect on the related balance sheet line item(s). As a result, it was unclear that the "turnaround effect" was the carry-forward effect. Therefore, in order for there to be no misunderstandings, in future management representation letters, the language and presentation called for by the FAM should be used to prepare the summary of unadjusted misstatements. We are pleased that HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services stated that they will use the FAM language in their fiscal year 2005 management representation letter.

HHS's summary of unadjusted misstatements also did not distinguish between misstatements affecting intragovernmental accounts and misstatements affecting accounts with the public. HHS's Deputy Assistant Secretary Finance and Deputy Inspector General for Audit Services comments did not address this issue. As stated in the report, this information is also needed by us to prepare the governmentwide summary of unadjusted misstatements.

Within 60 days of the date of this report, we would appreciate receiving a written statement on actions taken to address these recommendations.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Homeland Security and Governmental Affairs; the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Government Reform; and the Subcommittee on Government Management, Finance, and Accountability, House Committee on Government Reform. In addition, we are sending copies to the Fiscal Assistant Secretary of the Treasury and the Controller of OMB. Copies will be made available to others upon request. This report is also available at no charge on GAO's Web site at www.gao.gov.

We appreciate the courtesy and cooperation extended to us by your staff throughout our work. We look forward to continuing to work with your offices to help improve financial management in the federal government. If you have any questions about the contents of this report, please contact me at (202) 512-3406.

Gary T. Engel

Gary T. Engel
Director
Financial Management and Assurance

Enclosures -- 3

Enclosure I: Representations in FAM 1001A

Guidance contained in FAM 1001 and FAM 1001A deals with the management representations that the auditor should obtain from current management as part of the audit. This guidance also acknowledges that judgment needs to be exercised to obtain representations that depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. Representations given in FAM section 1001A should be customized to the situation of the entity being audited, and additional representations may need to be obtained.

FAM 1001A lists 27 representations that are ordinarily included, if applicable, in the management representation letter that an agency provides to the auditor. For representations 3, 11, 16, and 18, the agency should address three separate components. As such, each agency is ordinarily expected to make a total of 35 representations. Representations 18, 19, 20, and 21 are not applicable unless the agency received an opinion on its internal control. In addition, representations 22, 23, and 24 address the three requirements of the Federal Financial Management Improvement Act of 1996 and are only applicable to the 24 CFO Act agencies. The 35 representations in FAM 1001A are as follows.

1. We are responsible for the fair presentation of the financial statements and stewardship information in conformity with U.S. generally accepted accounting principles.

2. The financial statements are fairly presented in conformity with U.S. generally accepted accounting principles.

3. We have made available to you all

   a. financial records and related data;

   b. where applicable, minutes of meetings of the Board of Directors [or other similar bodies, such as congressional oversight committees] or summaries of actions of recent meetings for which minutes have not been prepared; and

   c. communications from the Office of Management and Budget (OMB) concerning noncompliance with or deficiencies in financial reporting practices.

4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements or disclosed in the notes to the financial statements.

5. We believe that the effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. [If management believes that certain of the identified items are not misstatements, management's belief may be acknowledged by adding to the representation, for example, "We believe that items XX and XX do not constitute misstatements because [description of reason]."]

6. The [entity] has satisfactory title to all owned assets, including stewardship property, plant, and equipment; such assets have no liens or encumbrances; and no assets have been pledged.

7. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

8. Guarantees under which the [entity] is contingently liable have been properly reported or disclosed.

9. Related party transactions and related accounts receivable or payable, including assessments, loans, and guarantees, have been properly recorded and disclosed.

10. All intraentity transactions and balances have been appropriately identified and eliminated for financial reporting purposes, unless otherwise noted. All intragovernmental transactions and balances have been appropriately recorded, reported, and disclosed. We have reconciled intragovernmental transactions and balances with the appropriate trading partners for the four fiduciary transactions identified in Treasury's *Intra-governmental Fiduciary Transactions Accounting Guide*, and other intragovernmental asset, liability, and revenue amounts as required by the applicable OMB Bulletin.

11. There are no

    a. possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency,

    b. material liabilities or gain or loss contingencies that are required to be accrued or disclosed that have not been accrued or disclosed, or

    c. unasserted claims or assessments that are probable of assertion and must be disclosed that have not been disclosed.

12. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

13. No material events or transactions have occurred subsequent to September 30, 20X2 [or date of latest audited financial statements], that have not been properly recorded in the financial statements and stewardship information or disclosed in the notes.

14. We are responsible for establishing and maintaining internal control.

15. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud (intentional misstatements or omissions of amounts or disclosures in financial statements and misappropriation of assets that could have a material effect on the financial statements).

16. We have no knowledge of any fraud or suspected fraud affecting the [entity] involving:

    a. management,

    b. employees who have significant roles in internal control, or

    c. others where the fraud could have a material effect on the financial statements.

    [If there is knowledge of any such instances, they should be described.]

17. We have no knowledge of any allegations of fraud or suspected fraud affecting the [entity] received in communications from employees, former employees, or others. [If there is knowledge of any such allegations, they should be described.]

18. Pursuant to 31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act), we have assessed the effectiveness of the [entity's] internal control in achieving the following objectives:

    a. reliability of financial reporting—transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use or disposition;

    b. compliance with applicable laws and regulations—transactions are executed in accordance with (i) laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and (ii) any other laws, regulations, and governmentwide policies identified by OMB in its audit guidance; and

    c. reliability of performance reporting—transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

    [If the entity bases its internal control assessment on suitable criteria other than 31 U.S.C. 3512(c), (d), this item should cite the criteria used (for example, *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission).]

19. Those controls in place on September 30, 20X2 [or date of latest audited financial statements], and during the years ended 20X2 and 20X1, provided reasonable assurance that the foregoing objectives are met. [If there are material weaknesses, the foregoing representation should be modified to read:

    Those controls in place on September 30, 20X2, and during the years ended 20X2 and 20X1, provided reasonable assurance that the foregoing objectives are met except for the effects of the material weaknesses discussed below or in the attachment.

or: Internal controls are not effective.

or: Internal controls do not meet the foregoing objectives.]

20. We have disclosed to you all significant deficiencies in the design or operation of internal control that could adversely affect the entity's ability to meet the internal control objectives and identified those we believe to be material weaknesses.

21. There have been no changes to internal control subsequent to September 30, 20X2 [or date of latest audited financial statements], or other factors that might significantly affect it. [If there were changes, describe them, including any corrective actions taken with regard to any significant deficiencies or material weaknesses.]

22. We are responsible for implementing and maintaining financial management systems that substantially comply with federal financial management systems requirements, federal accounting standards (U.S. generally accepted accounting principles), and the U.S. Government Standard General Ledger at the transaction level.

23. We have assessed the financial management systems to determine whether they substantially comply with these federal financial management systems requirements. Our assessment was based on guidance issued by OMB.

24. The financial management systems substantially complied with federal financial management systems requirements, federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of [date of the latest financial statements].

    [If the financial management systems substantially comply with only one or two of the above elements, this representation should be modified as follows:

    As of [date of financial statements], the [entity's] financial management systems substantially comply with [specify which of the three elements for which there is substantial compliance (e.g., federal accounting standards and the SGL at the transaction level)],

> but did not substantially comply with [specify which of the elements for which there was a lack of substantial compliance (e.g., federal financial management systems requirements)], as described below (or in an attachment).]

[If the financial management systems do not substantially comply with any of the three elements, the following paragraph should be used instead:

> As of [date of financial statements], the [entity's] financial management systems do not substantially comply with the federal financial management systems requirements.]

[If there is a lack of substantial compliance with one or more of the three requirements, identify herein or in an attachment all the facts pertaining to the noncompliance, including the nature and extent of the noncompliance and the primary reason or cause of the noncompliance.]

25. We are responsible for the [entity's] compliance with applicable laws and regulations.

26. We have identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

27. We have disclosed to you all known instances of noncompliance with laws and regulations.

Enclosure II: Comments From the Office of the Chief Financial Officer at the Department of Health and Human Services

DEPARTMENT OF HEALTH & HUMAN SERVICES Office of the Secretary

Washington, D.C. 20201

JUN 10 2005

TO: Gary T. Engel
Director, Financial Management and Assurance
Government Accountability Office
Washington, DC 20548

FROM: George Strader
Deputy Assistant Secretary Finance

SUBJECT: Department of Health and Human Services, Office of Inspector General Comments on *GAO-05-588R HHS' Management Representation Letter* Draft Report

Thank you for the opportunity to comment on your draft report entitled *Financial Audit: The Department of Health and Human Services' Fiscal Year 2004 Management Representation Letter on Its Financial Statements.* I am responding on behalf of Kerry Weems, Acting Chief Financial Officer.

We agree that it is important to have a complete and accurately prepared Management Representation Letter that supports both the HHS and the Governmentwide consolidated financial statements. We have worked consistently with our OIG and our auditors Ernst and Young to produce such a letter. We believe our Management Representation Letter served that purpose and that the points raised by the GAO in no way affected our HHS audit or that of the CFS.

We know that our OIG has already commented in detail on your report. We totally agree with their comments and wish to make these additional remarks.

Providing the Materiality Thresholds. Our office and that of the OIG did not consider it proper to include a consolidated threshold that would be signed by all OPDIV managers. What might be of significant materiality at the HHS level would not be applicable at all OPDIVs, particularly the smaller organizations. We shall work with the OIG and E&Y to ensure materiality thresholds are separately conveyed to GAO, OMB and Treasury in FY 2005.

Fully Including Applicable Representations From the FAM. We believe we fully recognized the Indian Health Service's stewardship PP&E in the separate paragraph regarding stewardship reporting in the FY 2004 management representation letter. With reference to events or transactions occurring since September 30, 2004, there were none with respect to stewardship property. We shall, however, ensure that our FY 2005 management representation follows closely your recommendation for this disclosure.

Including Complete Summary of Unadjusted Misstatements. GAO has noted that our Management Representation Letter did not separately identify the unadjusted misstatements as "known" and "likely" misstatements as well as identity of the carry-forward effect of prior year's unadjusted misstatements. Our use of the term "exposure" meant the adjustments were "likely" and all others were classified as "known." Summarily, the use of the term "turnaround effect" for prior year's unadjusted misstatements is the same as GAO's term "carry-forward-effect." We shall use the preferred language in our FY 2005 management representation letter.

Again, we thank you for the opportunity to provide comments. We request that our comments be considered in the revision of the draft report or be incorporated in the final report. Should you wish to discuss the comments, please contact Paul Weinberger, at (202) 260-6572, or through e-mail at Paul.Weinberger@hhs.gov.

Enclosure III: Comments From the Office of the Inspector General at the Department of Health and Human Services

DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Washington, D.C. 20201

JUN 6 2005

TO: Gary T. Engel
Director, Financial Management and Assurance
Government Accountability Office
Washington, DC 20548

FROM: Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Department of Health and Human Services, Office of Inspector General Comments on *GAO-05-588R HHS' Management Representation Letter* Draft Report

Thank you for the opportunity to comment on your draft report entitled *Financial Audit: The Department of Health and Human Services' Fiscal Year 2004 Management Representation Letter on Its Financial Statements.*

We agree with the Government Accountability Office (GAO) that it is important that Federal agencies' management representation letters be complete and reliably prepared and that the letters should help support Treasury and Office of Management and Budget (OMB) preparation of the Governmentwide consolidated financial statement (CFS) management representation letter. However, we do not believe that the lack of information in the fiscal year (FY) 2004 Department of Health and Human Services (HHS) management representation letter affected GAO's ability to rely on the representations in the CFS management representation letter and individual Federal agency representation letters.

Furthermore, we believe that the areas that GAO identified as incomplete were not significant and would not limit the scope of audit work or impair GAO's ability to obtain sufficient evidence in support of its audit of the CFS. Our comments on the three areas that GAO cited as needing improvement follow.

Providing the Materiality Thresholds

On page 8 of the draft report, GAO stated, "While an understanding between management and the auditor of materiality thresholds used is not explicitly required by auditing standards to be included in the management representation letter, Treasury and OMB use agency thresholds in providing a materiality threshold for the government-wide management representation letter."

Page 2 - Gary T. Engel

We concur that auditing standards do not require that materiality thresholds be included in the management representation letter. Because of the nature and complexity of the HHS organization of operating divisions (OPDIV) and timing of the management representation letter, the Office of Inspector General (OIG) and the principal auditor determined that it was not appropriate to include a consolidated threshold in the HHS representation letter that is signed by all of the OPDIVs. Including a consolidated materiality threshold, as GAO suggests, would have little applicability over our smaller OPDIVs, such as the Food and Drug Administration. The FY 2004 HHS representation letter did, however, refer to the Center for Medicare & Medicaid Services (CMS) representation letter, which contained a threshold amount.

Thus, although we agree that materiality thresholds should be provided to GAO, we do not believe that the consolidated HHS threshold or the separate OPDIV thresholds should be, or are required to be, contained in the HHS management representation letter. OIG will work with auditors and management to ensure that the FY 2005 representation threshold(s) is properly communicated to GAO, OMB, and Treasury.

Fully Including Applicable Representations From the FAM

GAO indicated that the representation made below should also address stewardship property, plant, and equipment:

> Except for properties capitalized under capital leases, HHS has satisfactory title to all assets appearing in the balance sheet as of September 30, 2004, including assigned and unassigned loans; and there are no liens or encumbrances, nor have any assets been pledged. All assets to which the HHS has satisfactory title appear in the balance sheet.

Given the nature of the heritage assets and Indian trust land described in the HHS stewardship schedule (both types relate to the Indian Health Service OPDIV), pursuant to Public Law 86-121 the assets will be returned to the Department of the Interior's Bureau of Indian Affairs when no longer needed by the Indian Health Service in connection with its general PP&E. Therefore, HHS would not include reference to the stewardship information in this paragraph of the management representation letter. A separate paragraph regarding the stewardship reporting was included in the FY 2004 HHS management representation letter: "The required supplementary information, required supplementary stewardship information, and supplementary information included with the financial statements has been prepared and presented in conformity with the guidelines established by the SFFAS."

In addition, GAO indicated that the representation below should also address stewardship information:

No events or transactions have occurred since September 30, 2004 or are pending that would have a material effect on the financial statements at that date or for the period then ended, or that are of such significance in relation to the HHS's affairs to require mention in a note to the financial statements in order to make them not misleading regarding the financial position, net cost, changes in net position, budgetary resources, and the reconciliation of net costs to budgetary obligations of the HHS.

Although this paragraph does not reference stewardship information, we believe that the representations provided by management covered the significant portion of the required supplementary stewardship information by reference to the CMS management representation letter. The FY 2004 CMS representation letter included the following statement: "No material events or transactions have occurred subsequent to September 30, 2004, that have not been properly recorded in the consolidated financial statements and required supplementary stewardship information or disclosed in the notes thereto."

In addition, discussions with management have indicated that no significant subsequent events occurred as related to the HHS stewardship information. However, OIG will work with the auditors and management to ensure that the "required supplementary stewardship information" is referred to in the subsequent events paragraph to be included in the FY 2005 HHS management representation letter.

Including a Complete Summary of Unadjusted Misstatements

GAO noted that the summary of unadjusted misstatements submitted with the management representation letter was incomplete. Specifically, HHS did not (1) separate "known" and likely" misstatements or (2) separately identify the carry-forward effect of the prior year's unadjusted misstatements.

The summary of unadjusted misstatements attached to the FY 2004 management representation letter included a detailed description of the proposed transactions that would allow a reader to classify the adjustments as "known" and "likely." In summary, those items labeled "exposure" were classified as likely and all other adjustments were classified as known. However, OIG will work with the auditors and management to ensure that the summary of unadjusted misstatements attached to the FY 2005 management representation letter explicitly states whether the adjustments were known or likely.

The carry-forward effect of the prior year's unadjusted misstatements was included in the schedule of unadjusted misstatements attached to the FY 2004 management representation letter. The amount was reported on the "turnaround effect" line on page 2 of the schedule. OIG will work with the auditors and management to ensure that the

Page 4 – Gary T. Engel

schedule refers to the "turnaround effect" as the "carry-forward effect" on the summary of unadjusted misstatements attached to the FY 2005 management letter

Again, we thank you for the opportunity to provide comments. We request that our comments be considered in the revision of the draft report or be incorporated in the final report. Should you wish to discuss the comments, please contact David Long, Assistant Inspector General for ROIT Audits, at (202) 619-1157, or through e-mail at david.long@oig.hhs.gov.

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548