U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
NOTES TO THE FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 1999

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Department of Health and Human Services consists of thirteen Operating Divisions (OPDIVs) which have diverse missions and programs. There are twelve financial reporting entities:

1. Administration for Children and Families (ACF)
2. Centers for Disease Control (CDC)/Agency for Toxic Substances and Disease Registry (ATSDR)
3. Food and Drug Administration (FDA)
4. Health Care Financing Administration (HCFA)
5. Health Resources and Services Administration (HRSA)
6. Indian Health Service (IHS)
7. National Institutes of Health (NIH)
8. Program Support Center (PSC)
9. Substance Abuse and Mental Health Services Administration (SAMHSA)
10. Administration on Aging (AoA)
11. Agency for Health Care Policy and Research (AHCPR)
12. Office of the Secretary (OS)

The Agency for Toxic Substances and Disease Registry is combined with the Centers for Disease Control for financial reporting purposes. In FY 1999, the first nine OPDIVs listed above received full scope audits, while the last three were reviewed as part of the Departmental consolidated audit. Each OPDIV is considered a responsibility segment for purposes of preparing the HHS-wide Statement of Net Cost.

Basis of Presentation

The financial statements have been prepared to report the financial position and results of operations of HHS as required by the Chief Financial Officers Act of 1990, and amended by the Government Management Reform Act of 1994. They have been prepared from Departmental records in accordance with the form and content guidance of OMB Bulletin 97-01, and generally accepted accounting principles. These statements are therefore different from financial reports prepared pursuant to other OMB directives that are primarily used to monitor and control HHS's use of budgetary resources.

The financial statements consolidate the balances of about one hundred and forty discrete appropriations and fund accounts, and a number of accounts used for suspense, collection of receipts and general governmental functions. Material intra-HHS balances have been eliminated in the consolidation of the account balances from the financial statements of HHS's twelve OPDIVs; each issued under separate cover. Intra-entity eliminations are presented on the Consolidating Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. The effects of intra-entity transactions <u>are not</u> eliminated in the presentation of the other principal statements. These other statements are labeled as combined/combining statements rather than consolidated/consolidating statements. Supplemental information is accumulated from the OPDIV reports, regulatory reports and other sources within HHS. Information is generally presented herein on a summary level, hence greater detail on OPDIV programs and activities is found in the annual reports prepared by the OPDIVs.

Basis of Accounting

For most HHS programs, transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to the receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

The cash basis is used by HCFA for Medicare benefit payments and Medicaid Program draws by States to cover current quarter expenses, and a number of other OPDIV programs. For these programs, an accrual method adjustment is made by recording year-end estimates of unpaid liabilities.

Entity and Non-Entity Assets

Entity assets are those assets which the reporting entity holds and has the authority to use in its operations. Non-entity assets are assets the entity holds but does not have the authority to use. An example of non-entity assets is income tax receivables, which the IRS collects for the U.S. Government but does not have authority to spend.

Fund Balance with Treasury

The Department maintains all cash accounts with the U.S. Treasury. The account, "Fund Balance with Treasury," represents appropriated, revolving, trust, and other funds available to pay current liabilities. The U.S. Treasury processes cash receipts and disbursements for HHS.

Investments

Trust fund balances in excess of current needs are invested in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States.

Accounts Receivable

Accounts receivable consists of amounts owed to the Department by other Federal agencies and the public. Amounts due from the public are presented net of an allowance for loss on uncollectable accounts. The allowance for loss is based on past collection experience and/or an analysis of the outstanding balances. Accounts receivable also includes interest due to the Department other than interest on direct loans and loan guarantees. HHS non-entity receivable balances represent amounts that cannot be used by HHS once collected. Such receipts are transferred to the General Fund of the Department of the Treasury.

Loans Receivable

Loans are accounted for as receivables after funds are disbursed. In accordance with credit reform legislation, for loans obligated prior to October 1, 1991, loan principal, interest, and other cost are reduced by an allowance for loss based on historical data and current market factors. For loans obligated on or after October 1, 1991, the amount of gross loans receivable is reduced by an allowance equal to the present value of the subsidy costs associated with these loans. Loans receivable also includes interest due to the Department for direct loans and defaulted loan guarantees.

Advances and Prepayments

Advances are cash outlays made by the Department to its grantees, employees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the Department receives. Prepayments are payments made to cover certain periodic expenses before they are incurred. Progress payments on work in process are not included in advances and prepayments. Advances to the public, primarily grant advances, are reported in Note 6, "Advances to the Public." Advances to other Federal agencies are reported in Note 10, "Other Assets."

Inventory and Related Property

Inventory and Related Property includes: Inventories Held for Sale; Operating Materials and Supplies, and Stockpile Materials. Inventories Held for Sale (Inventories) consists of small equipment and supplies held by the various OPDIV Service and Supply Funds for sale to HHS components and other Federal entities. Operating Materials and Supplies (OMS) consist of pharmaceuticals, biological products, vaccines, and other medical supplies, which are used, in providing medical services and conducting medical research in the various OPDIVs. Both Inventories and OMS are recorded as assets when purchased, and expensed when they are consumed or sold. Generally, these inventories are recorded at (1) historical cost (or a method which reasonably approximates historical cost), or (2) the lower of cost (using weighted-average cost method) or market. Stockpile materials represent supplies of biological materials and vaccines held for use in case of a national emergency.

General Property, Plant and Equipment

The basis for recording purchased General Property, Plant and Equipment (PP&E) is full cost, including all costs incurred to bring the PP&E to a form and location suitable for its intended use. The cost of PP&E acquired under a capital lease is the amount recognized as a liability for the capital lease at its inception. The cost of PP&E acquired through donation is the estimated fair value when acquired. The cost of PP&E transferred from other Federal entities is the net book value of the transferring entity. All PP&E with an initial acquisition cost of $25,000 or more and an estimated useful life of two (2) years or greater are capitalized. PP&E are depreciated on a straight-line basis over the estimated useful life of the item. Land and land rights, including permanent improvements, are not depreciated. Normal maintenance and repair costs are expensed as incurred.

Liabilities

Liabilities are recognized for amounts of probable future outflows or other sacrifices of resources as a result of past transactions or events. Since HHS is a component of the U.S. Government, a sovereign entity, its liabilities cannot be liquidated without legislation that provides resources to do so. Payments of all liabilities other than contracts can be abrogated by the sovereign entity. In accordance with Public Law and existing Federal accounting standards, no liability is recorded for any future payment to be made on behalf of current workers contributing to the Medicare Hospital Insurance (HI) Trust Fund.

Liabilities Covered by Budgetary Resources are those liabilities funded by available budgetary resources including: (1) new budget authority, (2) spending authority from offsetting collections, (3) recoveries of unexpired budget authority, (4) unobligated balances of budgetary resources at the beginning of the year, and (5) permanent indefinite appropriation or borrowing authority.

Liabilities Not Covered by Budgetary Resources are incurred when funding has not yet been made available through Congressional appropriations or current earnings. HHS recognizes such liabilities for employee annual leave earned but not taken, and amounts billed by the Department of Labor for Federal Employee's Compensation Act (disability) payments. For HHS revolving funds, all liabilities are funded as they occur.

Accounts Payable

Accounts Payable consists of amounts due for goods and services received, progress in contract performance, interest due on accounts payable, and other miscellaneous payables.

Entitlement Benefits Payable

Entitlement Benefits Payable represents benefits due and payable to the public from entitlement programs enacted by law. In HHS, the largest entitlement programs, which comprise the bulk of HHS entitlement spending, are Medicare and Medicaid (HCFA).

Accrued Grants

HHS grant programs are classified into two categories, block grants and non-block grants.

Block Grants: For most block grant programs, the OPDIVs record expenses as the grantees draw funds. Therefore the year-end accrual for block grants is equal to the amount of funds drawn that have not already been recorded as expenditures.

Non-Block Grants: For non-block programs, grantees draw funds (recorded as advances in OPDIV systems) commensurate with their immediate cash needs. When grantees pay bills they report this to HHS' Division of Payment Management (DPM), quarterly and DPM reports these grantee expenditures to the OPDIVs. The OPDIVs then record an expense and reduce the grantee advance balance accordingly.

In 1998, all OPDIVs except HCFA adopted a new process to estimate and accrue unreported grantee expenditures. Grantees report their expenses on a quarterly basis using the grantee expenditure report, SF 272. The new process divides unreported grantee expenditures into two components: 1) fourth quarter grantee expenditures incurred and expected to be reported on the September 30 SF 272, and 2) fourth quarter grantee expenditures incurred but not expected to be reported (IBNR) on the September 30 SF 272.

The estimate of the first component was based upon historical grantee data. Grantee advances have proven to be a reliable predictor of quarterly grantee expenditures. Based on this relationship a regression analysis, using historical grantee advance and expenditure data, was used to estimate fourth quarter grantee expenditures. The estimated Fourth quarter grantee expenditures were calculated by PMS, transmitted to the OPDIVs and are reported in the accompanying financial statements.

To estimate the second component, IBNR, HHS gathered information on spending patterns from four different groups of grantees to determine if they had unreported expenses at year-end and if so, in what amounts. As a result, HHS determined that grantees typically had year-end IBNR equal to approximately 2 weeks of annual expenditures. OMB has agreed that this accrual methodology appears reasonable. This two-week accrual of grantee IBNR expenses is reported in the accompanying financial statements.

Federal Employee and Veterans' Benefits

Federal Employee and Veterans' Benefits consist of the actuarial portions of future benefits earned by Federal employees and Veterans, but not yet due and payable. These costs include pensions, other retirement benefits, and other post-employment benefits. These benefits programs are normally administered by OPM and not by the Department of Health and Human Services, or any of the individual operating divisions of the Department. Therefore, HHS does not recognize any liability on the Balance Sheet for pensions, other retirement benefits, and other post-employment benefits. HHS does, however, recognize the imputed cost and imputed financing related to these benefits in the Statement of Net Cost and the Statement of Changes in Net Position, respectively.

The lone exception to this policy is the Public Health Service (PHS) Commissioned Corps Retirement System. The HHS-administered PHS Commissioned Corps Retirement System is discussed in Note 16, "Federal Employee and Veterans' Benefits."

<u>Pensions:</u> Pensions provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. Most HHS employees participate in the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). Under CSRS, HHS makes matching contributions equal to 8.51 percent of basic pay. For FERS employees, HHS contributes the employer's matching share for Social Security and contributes an amount equal to 1 percent of employee pay to a savings plan and matches up to an additional 4 percent of pay. Most employees hired after December 31, 1983 are covered by FERS. The Office of Personnel Management reports on CSRS and FERS assets, accumulated plan benefits, unfunded liabilities, if any, applicable to Federal employees.

<u>Other Retirement Benefits</u> (ORB): Retirement benefits other than pensions are all forms of benefits to retirees or their beneficiaries provided outside the pension plan. Examples include health and life insurance. Retirement health care benefits are the primary ORB expense.

<u>Other Post-employment Benefits</u> (OPEB): Post-employment benefits other than pensions include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. Inactive employees are those who are not currently rendering services to their employers and who have not been terminated, but who are not eligible for an immediate annuity, including those temporarily laid off or disabled. OPEB includes salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity.

Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent that current or prior year funding is not available to cover annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken. Any liability for sick leave that is accrued but not taken by a CSRS-covered employee is transferred to the Office of Personnel Management upon the retirement of that individual. No credit is given for sick leave balances upon the retirement of FERS-covered employees.

Obligations Related to Canceled Appropriations
Payments may be required of up to 1 percent of current year appropriations for valid obligations incurred against prior year appropriations that have been canceled. The total potential payments related to canceled appropriations is estimated to be $648 million as of September 30, 1999.

Revenues and Other Financing Sources
Funding for the Department/OPDIV is classified as revenue or other financing sources. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. Other Financing Sources include appropriations used, transfers of assets from other Government entities, and imputed financing.

Other Financing Sources: Congressional appropriations are the primary funding source for most of the Department's programs. For financial statement purposes, appropriations used are recognized as a financing source as expenses are incurred.

Imputed financing is an "other financing source" which reflects cost incurred by one Federal entity which is paid for by another Federal entity. These are also known as inter-entity costs. For financial statements covering fiscal years 1998 and 1999, OMB is limiting the inter-entity costs to be recognized by Federal agencies to the following: (1) employee's pension benefits, (2) the health, life insurance, and other benefits for retired employees, (3) other post-employment benefits for retired, terminated, and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and worker's compensation under the Federal Employees' Compensation Act, and (4) losses in litigation proceedings (FASAB Interpretation No. 2, Accounting for Treasury Judgement Fund transactions).[1]

Financing for the Public Health Service (PHS) Commissioned Corps Retirement System is provided through annual appropriations. The estimate for PHS Commissioned Corps employees is an intra-HHS elimination because the PSC recognizes the liability for their retirement plan.

Nonexchange Revenue: Nonexchange revenues include income taxes, excise taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable and the amount is measurable.

Medicare's Hospital Insurance program, also known as HI or Medicare Part A, is financed through the HI Trust fund, whose revenues come primarily through Medicare's portion of payroll and self-employment taxes collected under the Federal Insurance Contribution Act (FICA) and Self-Employment Contribution Act (SECA). The Medicare payroll tax rate was 2.9 percent of annual wages-employees and employers were each required to contribute 1.45 percent of employees' wages, with no limitation, to the HI Trust Fund. Self-employed individuals paid the full 2.9 percent themselves.

[1] Memorandum from G. Edward DeSeve, Controller, OMB, dated April 6, 1998, entitled *"Technical Guidance for the Implementation of Managerial Cost Accounting Standards for the Federal Government."*

Medicare's Supplemental Medical Insurance program, also known as SMI or Medicare Part B, is financed primarily by general fund appropriations (Payments to the Health Care Trust Funds) provided by Congress and by monthly premiums paid by beneficiaries. Premium payments from Medicare beneficiaries are matched approximately 3 to 1 by congressional appropriations. Interest revenue on investments is recognized as it is earned.

Exchange Revenue: Revolving funds recognize exchange revenue at the time goods or services are provided to the public or to another Government entity. Reimbursable service agreements between HHS activities and with other Federal agencies generally recognize these revenues when the related expenses are incurred. Various user fees are collected to offset the cost of providing services.

Contingencies

A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to the Department/OPDIV. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. With the exception of pending, threatened or potential litigation, a contingent liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is more likely than not, and the related future outflow or sacrifice of resources is measurable. For pending, threatened or potential litigation, a liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is likely to occur, and the related future outflow or sacrifice of resources is measurable.

Use of Estimates in Preparing Financial Statements

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

Intra-Governmental Relationships and Transactions

In the course of its operations, HHS has relationships and financial transactions with numerous Federal agencies. The more prominent of these are with the Social Security Administration (SSA) and the Department of the Treasury. The SSA determines eligibility for Medicare programs, and also allocates a portion of Social Security benefit payments to the Medicare Part B Trust Fund for Social Security beneficiaries who elect to enroll in the Medicare Part B program. The Treasury receives the cumulative excess of Medicare receipts and other financing over outlays, and issues interest-bearing securities in exchange for the use of those monies. At the Government-wide level, the assets related to the trust funds on HHS' financial statements and the corresponding liabilities on the Treasury's financial statements should be eliminated.

Comparative Data

OMB Bulletin 97-01, "Form and Content of Agency Financial Statements" provides that comparative financial statements are permitted but not required until reporting periods beginning after September 30, 1999 (FY 2000). Management has determined that, due to the implementation of new FASAB accounting standards and new financial statement formats and disclosures for FY 1999, it is not feasible nor prudent to attempt to restate FY 1998 amounts in the current statements. Therefore, comparative data will not be presented in the financial statements for FY 1999.

Accounting Changes
The following accounting changes were made in the 1999 financial statements:

On the Combined Statement of Budgetary Resources, adjustments are reported due to OMB's FY 1999 revision to Circular A-34, clarifying the reporting for "Adjustments" and "Unobligated balances – available" on the Statement of Budgetary Resources. The change required that "Adjustments" include the portion of receipts collected in the current fiscal year for trust funds that is precluded from obligation due to Public Law 101-508. In FY 1998, these receipts were reported as "Unobligated balances – available" (for obligation). In FY 1999, these receipts are reported as (negative) amounts on the "Adjustments" under HCFA's HI and SMI trust funds, and, additionally, HI and SMI must have no "Unobligated balances – available."

On the Consolidating Statement of Changes in Net Position, transfers made from HCFA's Payments to the Health Care Trust Funds to HI and SMI are reported as financing sources twice: (1) as "Appropriations Used" under HI and SMI and (2) as "Taxes and Other Non-Exchange Revenue (SMI)" and "Other Financing Sources" (HI). To avoid double reporting these financing sources, HCFA previously eliminated the "Appropriations Used" amounts. HCFA believes the proper elimination should be against the "Taxes and Other Non-Exchange Revenue" and "Other Financing Sources" line items, which will match the elimination of intragovernmental revenues with intragovernmental expenses within HCFA.

Unless otherwise stated, amounts are presented in millions of dollars.

NOTE 2. FUND BALANCE WITH TREASURY

HHS' undisbursed account balances are listed below by fund type. Other Funds include balances in deposit, suspense, clearing and related non-spending accounts.

	Entity Assets	Non-Entity Assets
Trust Funds	4,082	18
Revolving Funds	731	1
Appropriated Funds	68,259	(2)
Other	88	27
Total Fund Balance with Treasury	73,160	44

NOTE 3. INVESTMENTS, NET

HHS invests trust fund cash that is in excess of current needs in U.S. Treasury Securities. The U.S. Treasury Department is HHS' agent and advisor for investing.

	Cost	Unamortized (Premium) Discount	Investments, Net
Non-Marketable: Par Value	180,307	-	180,307
Non-Marketable: Market-Based	1,434	20	1,454
Subtotal	181,741	20	181.761
Accrued Interest	3,003		3,003
Total Investments, Net	184,744	20	184,764

HCFA invests in U.S. Treasury Special Issues exclusive to HI and SMI Trust Funds that are purchased and redeemed at face value. Certificates are short-term and pay 6 1/4 percent. Bond interest rates range from 5 7/8 to 10 3/8 percent. Bonds mature at various dates from June 1999 to June 2014. The accrued interest receivable on investments totaled approximately $3 billion as of September 30, 1999.

During FY 1999, a series of trust fund transactions related to investments in U.S. Treasury securities were posted incorrectly and not detected until FY 2000. These errors resulted in HI interest income being overstated by $154 million and SMI trust fund income being understated by $237 million. HCFA and HHS management are pursuing options to make each trust fund "whole" in FY 2000. HCFA has taken steps to prevent such errors in the future.

HRSA's Vaccine Injury Compensation Trust Fund invests in market-based (MK) special securities. Securities currently held are MK Bills and Notes maturing in fiscal years 1999, 2004, and 2008.

The NIH invests a portion of their trust fund cash in short-term U. S. Treasury Securities. The majority of HHS' investments in securities are held to maturity and no provision is made for unrealized gains and losses.

NOTE 4. ACCOUNTS RECEIVABLE, NET

HCFA recorded a $6 billion anticipated Congressional appropriation to cover liabilities incurred as of September 30 by the Medicaid program and the Payments to the Health Care Trust Funds appropriation. HCFA recorded a $5,735 million anticipated appropriation in FY 1999 for incurred but not reported claims that exceeded the available unexpended Medicaid appropriation. The Medicare SMI program is financed primarily by the general fund appropriation, Payments to the Health Care Trust Funds, and by monthly premiums paid by beneficiaries. The appropriated amount is an estimate calculated annually by HCFA's actuary and can be insufficient in any particular fiscal year. In FY 1999, the estimate was insufficient and the matching ceased prior to the close of the fiscal year. Subsequently, HCFA's actuary valued the unmatched amount as $295 million and HCFA reported the $295 million as revenues earned in FY 1999, although the actual transfer of funds will occur in FY 2000.

HCFA's Medicare receivables are primarily due to overpayments to providers, beneficiaries, physicians and suppliers. The Medicaid balance is the net realizable value of disallowances in dispute with the States.

HHS non-entity receivable balances represent amounts that cannot be used by HHS once collected. Such receipts are transferred to the General Fund of the Department of the Treasury.

The allowance for loss on accounts receivable is based upon analytical procedures on both individual and group basis. Individual analysis is based upon the debtor's ability to pay, the debtor's payment record and willingness to pay and the probable recovery of amounts from secondary sources, including liens garnishments, etc. To estimate allowance for loss by groups, HHS stratifies receivables into groups exhibiting similar characteristics. Estimated losses are then projected based upon statistical sampling or through historical loss experience. The allowance is periodically reviewed and adjustments are made as required.

~~Entity~~	Gross	Interest	Allowance	Combined Net	Intra-HHS Eliminations	Consolidated Net
Intragovernmental	7,075	-	(31)	7,044	(421)	6,623
From the Public						
Medicare	7,315	-	(3,092)	4,223	-	-
Medicaid	30	-	(7)	23	-	-
Other Public	104	-	(12)	92	-	-
Total, Public	7,449	-	(3,111)	4,338	-	4,338
~~Non-Entity~~						
Intragovermental	6	4	(8)	2	-	2
From Public	245	-	(185)	60	-	60

During FY 1999, HCFA management directed an analysis of accounts receivable balances at Medicare contractors. The analysis revealed two major findings: 1) Many receivables were aged to such an extent that collectibility was extremely unlikely and recognition of those receivables materially overstated gross receivables. Also, 2) some receivables balances could not be verified with documentation or the debtor organization no longer exists. For the first group, which amounted to $2.7 billion, HCFA has written off those gross receivables and the related allowance balances to zero. However, collection activities will continue, though recovery is extremely unlikely. For the second group, which amounted to $.2 billion, the receivables balances were adjusted to zero, and no collection activities can be pursued.

NOTE 5. LOANS RECEIVABLE, NET

Loans receivable are included for the Health Education Assistance Loans (HEAL) guaranteed loan program which is administered by HRSA. The gross receivables amount for this program represents defaulted loans, which have been paid to lenders under the guarantee, and includes principal and interest.

	Principal	Interest	Gross	Allowance	Net
Pre-1992 loans	496	13	509	(136)	373
Post-1991 loans	38	1	39	(11)	28
Total Loans Receivable, Net	534	14	548	(147)	401

NOTE 6. ADVANCES WITH THE PUBLIC

Advances with the Public includes advances to grantees in excess of their grant-related expenses, payments to HHS employees for travel and emergency salary advances, and advances to Non-Federal agencies for goods and services to be provided to HHS.

Grant Advances	67
Travel Advances and Emergency Employee Payments	84
Other	54
Total Advances With the Public	205

“Advances with the Public” does not include advances to Federal agencies for goods and services to be provided–these advances are reported as “Advances to Other Federal Entities” in Note 10, “Other Assets.”

NOTE 7. CASH AND OTHER MONETARY ASSETS

Restricted cash is the total amount of time account balances at the Medicare contractors’ commercial banks. The Checks Paid Letter-of-Credit method is used for reimbursing Medicare contractors for the payment of covered Medicare services. Medicare contractors issue checks against a Medicare benefits account maintained at commercial banks. In order to compensate commercial banks for handling the Medicare Benefits accounts, Medicare funds are deposited into non-interest-bearing time accounts. The earnings allowances on the time accounts are used to reimburse the commercial banks.

NOTE 8. INVENTORY AND RELATED PROPERTY, NET

HHS inventories are valued at historical cost. Inventory items are classified into appropriate categories, when received, based upon U.S. Standard General Ledger definitions derived from Statement of Federal Financial Accounting Standard (SFFAS) No. 3, Accounting for Inventory and Related Property.

HHS inventories are comprised of inventory held for sale, operating materials and supplies used in general operations and stockpile materials. CDC is mandated by law to maintain a vaccine stockpile to meet unanticipated needs for the vaccines, and for national emergencies. Vaccine stockpiles are maintained by the vaccine manufacturers and consist of several types of vaccines. CDC may only sell these vaccines to state, local, or territorial health departments.

Operating Materials and Supplies reserved for future use	25
Excess, obsolete, and unserviceable operating material and supplies	(4)
Total, operating materials and supplies	21
Inventory held for current sale	36
Stockpile material held for emergency or contingency	18
Total Inventory and Related Property, Net	75

NOTE 9. GENERAL PROPERTY PLANT AND EQUIPMENT, NET

Balances for the major categories of HHS Property, Plant and Equipment are listed below:

	Depreciation Method	Est. Useful Lives	Acquisition Cost	Accumulated Depreciation	Net Book Value
Land and Land Rights	N/A	N/A	47	-	47
Construction In Progress	N/A	N/A	321	-	321
Buildings, Facilities and Other Structures	Straight Line	3-10 yrs	2,065	(953)	1,112
Assets Under Capital Lease	Straight Line	Life of Lease	23	(2)	21
Leasehold Improvements	Straight Line	7-15 years or life of lease	1	-	1
Equipment	Straight Line	3-10 years	647	(327)	320
Total General Property Plant and Equipment, Net			3,104	(1,282)	1,822

See the supplemental disclosure *Deferred Maintenance* in the Required Supplementary Information section for information on deferred maintenance for General PP&E.

NOTE 10. OTHER ASSETS

Other Assets at September 30, 1999 is comprised of the following:

Other Assets	
Advances to Other Federal Entities	152
Other	78
Total Combined Other Assets	230
Less: Intra-HHS eliminations	(146)
Total Consolidated Other Assets	84

NOTE 11. EMPLOYMENT TAX REVENUE ADJUSTMENT

For periods after December 31, 1993, employees and employers are each required to contribute 1.45 percent of employees' wages, and self-employed persons are required to contribute 2.90 percent of net income, with no limitation, to the HI Trust Fund. The Social Security Act requires the transfer of these contributions from the General Fund of Treasury to the HI Trust Fund based on the amount of wages certified by the Commissioner of Social Security from SSA records of wages established and maintained by SSA in accordance with wage information reports. The SSA uses the wage totals reported annually by employers via the quarterly Internal Revenue Service Form 941 as the basis for conducting quarterly certification of regular wages.

NOTE 12. ENTITLEMENT BENEFITS PAYABLE

Entitlement Benefits Payable represents benefits due and payable to the public from entitlement programs enacted by law. In HHS, the largest entitlement programs, which comprise the bulk of HHS entitlement spending, are Medicare and Medicaid (HCFA).

Medicare	23,676
Medicaid	11,626
Total Entitlement Benefits Payable	35,302

NOTE 13. ACCRUED GRANTS

For non-block grants, OPDIVs record the initial draw down of funds from grant awards as an Advance with the Public. When grantees submit their quarterly expense reports (SF 272), OPDIVs reduce the advance and increase expense for the amounts reported by the grantee. At fiscal year end, OPDIVs book an accrual for IBNR grant expenses. If grant advances outstanding at year-end exceed the accrual for IBNR, then the OPDIV reports an asset for net grant advances. Otherwise, the OPDIV reports a liability called Accrued Grants for the excess of IBNR over outstanding grant advances. However, operating on a cash basis of accounting, the accrual is calculated to equal the grant liability.

At the department level, the asset and liability balances for the individual OPDIVs are separately combined and reported as separate line-items on the HHS-wide Balance Sheet. Netting OPDIV grant advance balances with OPDIV accrued grant liability balances would result in a net liability for HHS of almost 1.5 billion dollars, as follows:

Grant Advances, Net	67
Accrued Grants	1,518
Total Net of Grant Liabilities and Advances	(1,451)

NOTE 14. ENVIRONMENTAL and DISPOSAL COSTS

Environmental and Disposal Costs Cleanup costs are the costs of removing, containing, and or disposing of (1) hazardous waste from property, or (2) material and or property that consists of hazardous waste at a permanent or temporary closure or shutdown of associated PP&E. In accordance with SFFAS # 5 Accounting for Liabilities of the Federal Government and SFFAS #6 Property Plant and Equipment, HHS has recognized a liability for cleanup of $15 million. The following table presents HHS OPDIV cleanup costs; the total estimated cleanup cost is the liability recognized:

OPDIV	Method for Assigning Cost	Liability recognized for cleanup costs
NIH	Estimated cost of similar remediation	9
FDA	Estimated cost of similar remediation	6
Total Environmental Disposal Cost		15

NOTE 15. LIABILITY FOR DEFAULTED LOAN GUARANTEES

HHS' loan guarantees are with HRSA's Health Education Assistance Loan (HEAL) program. The liability for loan guarantees is equal to the amount of defaulted guaranteed loans.

	Defaulted Loan Guarantees
Pre-1992 guarantees	38
Post-1991 guarantees	295
Total Defaulted Loan Guarantees	333

NOTE 16. FEDERAL EMPLOYEE AND VETERANS' BENEFITS

PHS Commissioned Corps Pension: HHS administers the PHS Commissioned Corps Retirement System for approximately 5,764 active duty officers and 4,077 retiree annuitants or survivors. Authorized by Public Law 78-410, it is a defined benefit plan and is non-contributory. The plan does not have accumulated assets, funding is provided entirely on a "pay as you go" basis by Congressional appropriations. Administrative costs are not borne by the plan. The actuarial present value of accumulated plan benefits is $4,802 million, of which 478 million is non-vested. The assumed interest rate is 6.50 percent. Economic assumptions are the same as those used by the Military Retirement System. Withdrawal and retirement rates are based on the historical trends of officers in the PHS retirement system. The actuarial liability was established based upon the Public Health Service's Report for Commissioned Corps Retirement System for Plan Year Ending September 30, 1999.

Future Workers' Compensation Benefits: The actuarial liability for future workers' compensation benefits includes the expected liability for death, disability, medical and miscellaneous costs for approval compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payment related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting in 1999 was 5.69 percent in year 1 and thereafter.

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) are applied to the calculation of projected future benefits. These factors are also used to adjust the methodology's historical payments to current year dollars. The methodology also includes a discounting formula to recognize the timing of compensation payments per year instead of one lump sum per year. The projected number of years of benefit payments is 37 years.

Both the PHS Commissioned Corps Pension and Future Workers' Compensation Benefits are liabilities not covered by budgetary resources.

PHS Commissioned Corps Pension	4,802
Future Workers' Compensation Benefits	138
Total Federal Employee and Veterans' Benefits	4,940

NOTE 17. OTHER LIABILITIES

The Vaccine Injury Compensation Program (VICP), administered by HRSA, provides compensation for vaccine-related injury or death. The liability of $404 million represents the estimated future payment value of injury claims outstanding for VICP as of September 30, 1999. Other liability categories are described in Note 1, Significant Accounting Policies.

	Liabilities Covered by Budgetary Resources		Liabilities Not Covered by Budgetary Resources	
	Intra-governmental	With the Public	Intra-governmental	With the Public
Vaccine Injury Compensation Program		404		
Advances from Other Federal Agencies	81			
Accrued Payroll and Benefits	21	290		
Accrued Worker Compensation		1		
Accrued Leave Liability		7		345
Deferred Revenue	125	211		30
Custodial Liabilities	(12)	1		1
Liability for Deposits Funds		11	(2)	33
Capital Lease Liabilities		6	21	
Other Liabilities	261	38		12
Total Other Liabilities	476	969	19	421

NOTE 18. NET POSITION

Net position is the difference between assets and liabilities. The section contains two line items: Unexpended Appropriations, including unobligated appropriations and undelivered orders, and Cumulative Results of Operations. Unobligated appropriations are either available for obligation or not available (permanently or temporarily) pursuant to a specific provision in law. Undelivered orders represents appropriations obligated (i.e., legally reserved) for the amount of goods or services ordered but not yet received. Cumulative results of operations represents the net difference between (1) expenses and losses and (2) financing sources, including appropriated capital used, and revenues and gains since the inception of the activity.

Unexpended Appropriations:		
Unobligated		
Available	$	2,863
Unavailable		9,290
Undelivered Orders		48,809
Total Unexpended Appropriations		60,962
Cumulative Results of Operations		163,265
Total Net Position	$	224,227

NOTE 19. LEASES

Capital Leases: HHS and it's components have entered into various capital leases with Indian Tribes and the General Services Administration (GSA) for office and warehouse space. Lease terms vary from one to twenty years. Capitalized assets acquired under capital lease agreements and their related liability are reported at the present value of minimum lease payments.

Operating Leases: HHS and it's components also have commitments under various operating leases with private entities and GSA for office, laboratory space, and land. Leases with private entities have initial or remaining noncancelable lease terms from one to twenty years. GSA leases in general are cancelable within 120 days notice.

Future minimum lease payments due for capital and operating leases are as follows:
(Note: Lease payments are reported in THOUSANDS.)

Period	Capital	Operating	Total
Year 1	2,538	75,336	77,874
Year 2	2,538	77,113	79,651
Year 3	2,538	75,675	78,213
Year 4	2,538	75,198	77,736
Year 5	2,538	65,670	68,208
After 5 years	43,263	340,499	383,762
Total Lease Payments	55,953	709,491	765,444

NOTE 20. GROSS COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION

Costs incurred by budget function are presented below with the respective earned revenue to derive Net Cost by Budget Function.

	Education, Training and Social Services	Health	Medicare	Income Security	Admin of Justice	Natural Resources and Env.	Combined
Intragovernmental Costs		1,420	70,782			15	72,217
With the Public	13,172	137,951	205,129	23,304	179	60	379,795
Gross Cost	13,172	139,371	275,911	23,304	179	75	452,012
Less: Earned Revenue	(17)	(2,142)	(21,564)		(8)		(23,731)
Total Net Cost	13,155	137,229	254,347	23,304	171	75	428,281

NOTE 21. PRIOR PERIOD ADJUSTMENTS

Prior period adjustments are included in the calculation of the net change in cumulative results of operations to correct errors and accounting changes with retroactive effect. The majority of the prior period adjustments noted in the table below result from some of the HHS FY 1998 OPDIV audits not being complete as of the date the FY 1998 HHS-wide Accountability report was published. This "timing difference" caused some of the OPDIV net position ending balances to differ from the ending balances reported in the HHS-wide statements. These prior period adjustments reconcile these differences.

Correction of Errors	(1,349)
Change in Accounting Principles	(142)
Total Prior Period Adjustments	(1,491)

NOTE 22. CUSTODIAL ACTIVITY

ACF receives monies from the Internal Revenue Service for outlay to the states for child support. These monies represent delinquent child support payments withheld from internal revenue tax refunds. During FY 1999, receipts amounts to $1,325 million and outlays amounted to $1,328 million. At September 30, 1999, ACF held $3 million in its Fund Balance with Treasury accounts relating to these funds.

NOTE 23. MEDICARE BENEFIT PAYMENTS

Medicare Claims Estimated Improper Payments

Federal government audits require the review of programs for compliance with Federal laws and regulations. Accordingly, the OIG reviewed a statistically valid sample of Medicare claims to determine that claims were paid properly by Medicare contractors, and that services were actually performed and were medically necessary. Medicare, like other insurers, makes payments based on a standard claims form. The internal claims process involves reviewing claims as billed and paying the correct amount for the services rendered. The claims submitted for payment to Medicare contractors contained no visible errors. However, when the medical review asked for documentation from providers to support their claims, there was a 7.97 percent error rate with a dollar value in the range of $9.1-17.9 billion ($13.5 billion midpoint). This is a slight increase from 1998 error rate of 7.1 percent with a dollar value in the range of $7.8 – 17.4 billion ($12.6 billion midpoint). While this year's estimate is bigger than last year's, the OIG could not conclude that the current error rate is substantially different. The majority of the errors fell into four broad categories: lack of medical necessity, incorrect coding, insufficient or no documentation and noncovered/ unallowable services.

Cost Report Settlement Process

The cost report settlement process represents the value of final outlays to providers based on fiscal intermediary audits, reviews and final settlements of Medicare cost reports. All institutional providers are required to file Medicare cost reports. For providers paid under the Prospective Payment System (PPS), the cost report includes costs that are not covered under PPS, such as disproportionate share, hospital payments, indirect medical education payments, and other indirect costs. For providers paid on a cost basis, the cost report represents the total costs incurred by the provider for medical services to patients and reflects the final distribution of these costs to the Medicare program.

In 1999, 34,791 cost reports totaling $110.1 billion were reviewed. Approximately $82 billion represented inpatient claims to PPS providers. The cost report settlements, therefore, focused on the remaining non-PPS balance of about $28 billion.

1999 Cost Report Summary
($ in millions)

	Desk Reviews and Others	Audits	Total
Providers	28,045	6,746	34,791
Costs Claimed	$ 41,271	$ 68,858	$ 110,129
Disallowed	$ 1,084	$ 1,632	$ 2,716

The $2.7 billion disallowed represents 10 percent of this $28 billion non-PPS balance. Based on the current disallowance rates, if the full-scope audits were expanded to include the entire universe, the total amount disallowed would range from $2.7 billion to $3.3 billion. Therefore, by limiting the amount of full-scope audits that were conducted, HCFA may have overpaid providers by as much as $600 million.

HCFA routinely processes and settles cost reports for institutional providers. As part of this process some providers have filed suits challenging aspects of the cost report settlement process. We cannot reasonably estimate the probability of the providers successfully winning their suits nor the potential liability for the Department. However, in the opinion of management the resolution of these matters will not have a material impact on the results of operations and financial condition of HHS.

NOTE 24. MEDICARE PREMIUMS COLLECTED AND FEDERAL MATCHING CONTRIBUTION

SMI benefits and administrative expenses are financed by monthly premiums paid by Medicare beneficiaries and are matched by the Federal government through the general fund appropriation, Payments to the Health Care Trust Funds. Section 1844 of the Social Security Act authorizes appropriated funds to match SMI premiums collected, and outlines the ratio for the match as well as the method to make the trust funds whole if insufficient funds are available in the appropriation to match all premiums received in the fiscal year. The monthly SMI premium per beneficiary is $43.80 from October 1998 through December 1998 and is $45.50, beginning January 1998. Premiums collected from beneficiaries totaled $20.2 billion in FY 1999 and were matched by a $62.2 billion contribution from the Federal government.