**STATEMENT OF**
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**OFFICE OF INSPECTOR GENERAL**
**DEPARTMENT OF VETERANS AFFAIRS**
**BEFORE THE**
**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**
**COMMITTEE ON VETERANS' AFFAIRS**
**UNITED STATES HOUSE OF REPRESENTATIVES**
**HEARING ON**
**VA FINANCIAL MANAGEMENT**
**MAY 24, 2017**

Mr. Chairman, Ranking Member Kuster, and Members of the Subcommittee, thank you for the opportunity to discuss the Office of Inspector General's (OIG) work regarding VA's financial management. Our statement today focuses on the results of the fiscal year (FY) 2016 Audit of VA's Consolidated Financial Statements, and our work related to the Improper Payments and Recovery Act (IPERA). I am accompanied by Ms. Sue Schwendiman, Director, OIG's Financial Audits Division.

## BACKGROUND

Effective financial management is important because it enables VA to plan, direct, monitor, and control its financial resources. It supports the safeguarding of VA's assets and the timely payment of its obligations. Good financial information helps users identify links between resources and results, and to understand and improve value for appropriated funds. It can also be used to manage risk effectively and support decisions through financial analysis.

The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the OIG to conduct an audit of VA's consolidated financial statements. Since 2000, we have contracted with an independent public accounting firm to conduct the audit; and since 2010, we have contracted with CliftonLarsonAllen LLP (CLA). This work helps ensure accountability for public resources.

VA's consolidated financial statements are published in VA's annual Agency Financial Report, and these statements summarize VA's financial results, financial condition, and the status of budgetary resources. Although VA has received an unmodified or "clean" opinion, on its consolidated financial statements from our contracted auditors, VA has continuously faced challenges in achieving those results. A clean opinion means the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United Statement of America. It does not, however, mean VA can easily obtain that opinion or that VA does not have internal control weaknesses.

The contract auditor has regularly identified and reported on material weaknesses and significant deficiencies. A material weakness is a deficiency, or a combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of VA's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal controls that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

## FISCAL YEAR 2016 FINANCIAL STATEMENT AUDIT RESULTS

The audit of VA's FY 2016 consolidated financial statements identified six material weaknesses and two significant deficiencies—two more in total than the prior year. As described above, these material weaknesses make it more difficult for management to ensure the accuracy of VA's financial statements and also more difficult to audit the statements.

The material weaknesses are:

- *Information technology security controls* – This is a repeat finding that our contract auditors have reported since FY 2000. Weaknesses existed in configuration management, such as untimely patching to mitigate security vulnerabilities; access controls, including inconsistent enforcement of password standards; security management; and contingency planning. Without good information technology security controls, VA's financial information may not be safe in terms of confidentiality, integrity, and availability.

- *Community care obligations, reconciliations, and accrued expenses* – This is a repeat finding from the FY 2015 audit. CLA identified numerous examples of obligations for Community Care Programs that were overstated compared to actual payments. As a result, VA management performed its own analysis and recorded journal entries of approximately \$1.9 billion to reduce overstated Choice Program obligations and \$2.6 billion to reduce other overstated Community Care Program obligations in VA's general ledger on September 30, 2016. The overestimation of obligations also resulted in a large overstatement of accrued expenses, which management also reduced through journal entries.

  CLA identified several causes of these overstatements, but overall, significant system limitations hindered effective and efficient operations and controls. CLA also reported that methods to estimate the cost of care were inconsistent at medical centers and the Office of Community Care's procedures for its monitoring activities were not adequate. For most of FY 2016, the Office of Community Care had not performed a nationwide consolidated reconciliation of obligations and disbursements between VA's Financial Management System (FMS) and the system used to authorize and process individual non-VA care claims.

- *Financial reporting* – This is a repeat finding from the FY 2015 audit. VA's financial management and general ledger system is FMS. Since its implementation in 1992, Federal financial reporting requirements have become more complicated and the level of financial information needed by management and oversight bodies has become increasingly complex. Due to FMS' limited functionality to meet current financial reporting needs, VA utilizes another system to create financial statements for external reporting. However, this process requires significant manual intervention and workarounds to ensure accurate financial reporting. CLA reported that VA recorded a large number of adjustments (called journal vouchers) to its accounts in order to prepare VA's financial statements. Also, significant abnormal account balances (that is, an account balance that shows a debit balance when it should be a credit balance or vice versa) were not researched and cleared timely. These weaknesses increase the risk of material errors in financial reporting. Although VA has made improvements in areas such as the reduced use of journal vouchers, many issues have existed for years and require extensive efforts to implement solutions to resolve them.

- *Education benefits accrued liability* – This is a new finding identified during the FY 2016 audit. CLA reported VA did not use the appropriate method to account for veterans' education benefits. VA manages several education benefit programs with total disbursements of approximately $14.5 billion in FY 2016, with the Post 9/11 G.I. Bill Program being the largest. Prior to FY 2016, management did not view education benefit payments as post-employment benefits. As a result, VA did not report an estimated liability for future benefit payments as required by accounting standards. In FY 2016, VA reported this liability in the amount of approximately $60 billion for the first time on its balance sheet.

- *Control environment surrounding the compensation, pension, and burial actuarial estimates* – This is a new finding identified during the FY 2016 audit. It resulted from the lack of succession planning for the chief actuary who was responsible for the calculation of VA's unfunded veterans' compensation and burial liability amount. This amount was reported on VA's balance sheet as of September 30, 2016, as approximately $2.5 trillion. The chief actuary left VA in July 2016, and VA did not have a successor actuary with the appropriate qualifications and experience to take full responsibility to manage the actuarial model assumptions and review the related calculations. Management subsequently obtained the services of a credentialed actuary on detail from another department. VA also noted its model's assumption for the rate of new compensation cases was outdated and adjusted its balance sheet by $277 billion. CLA reported VA needed to review the reasonableness of its key model assumptions, which would include comparing relevant actuarial information from the Department of Defense.

- *CFO organizational structure for VA and VHA* – This was elevated from a significant deficiency in FY 2015 to a material weakness in FY 2016. CLA reported VA has a decentralized and fragmented organizational structure for financial management and reporting that did not operate in a fully integrated manner. The VA CFO establishes financial policy and produces VA's consolidated financial statements. Business components, such as the Veterans Health Administration (VHA), the Veterans

Benefits Administration (VBA), and the National Cemetery Administration, have their own CFOs, who oversee financial management operations and follow the chain of command within those organizations. VHA's financial management structure was further fragmented, with three different CFO organizational structures within the Administration. CLA observed instances where procedures the VA CFO depended on were not completed by VA components or communication issues existed.

CLA concluded the decentralization of financial management functions among the VA component entities without organizational reporting and accountability back to the VA CFO decreased the VA CFO's ability to affect financial management at the component level and across the VA enterprise, and also presented a risk to VA's planned conversion to a shared service provider in order to modernize its financial systems.

CLA also reported two significant deficiencies. As stated above, a significant deficiency is a deficiency or combination of deficiencies in internal controls that is less severe than a material weakness, yet important enough to merit attention by those charged with governance

- *Procurement, Undelivered Orders, Accrued Expenses, and Reconciliations* – Regarding this significant deficiency, CLA reported:

    - Centralized, complete, and consolidated reconciliations among various procurement subsidiary systems and FMS were not performed.
    - VA used miscellaneous obligating documents, also called "1358s", extensively, but lacked sufficient controls, such as monitoring to ensure obligations and accrued expenses were not overstated.
    - VA did not have an adequate process to validate estimated accrued expenses against actual payment data.
    - Pervasive and long standing procurement related issues, including instances of untimely liquidation of undelivered orders, untimely recording of contracts and modifications in FMS, recording of obligations prior to contract execution, over-obligation of funds, and obligations recorded months or years after receiving goods or services.

- *Loan Guaranty Liability* – VBA uses complex models to estimate future cash flows and determine the cost of its loan guarantees on a present value basis for budgetary and financial reporting purposes. CLA reported structural deficiencies in model design have impacted VA's ability to forecast future program cash flows following the housing crisis. VBA's models have consistently shown significant differences between model forecasts and actual program performance. Based on the auditor's discussions with management regarding this issue, VBA revised certain model assumptions, thus reducing the Loan Guaranty Liability as of September 30, 2016, by $830 million.

Additionally, CLA noted that VA reported two violations of the Antideficiency Act[1] in August 2016 and was in the process of reporting four other violations at the time of their audit report.

Overall, CLA reported VA's financial management systems do not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996.[2] VA's complex, disjointed, and legacy financial management system architecture continued to deteriorate and no longer met increasingly stringent and demanding financial management and reporting requirements mandated by the U.S. Department of the Treasury and the Office of Management and Budget (OMB). VA continued to be challenged in its efforts to apply consistent and proactive enforcement of established policies and procedures throughout its geographically dispersed portfolio of legacy applications and systems.

FMS' limitations required VA to use another system to produce financial statements. However, VA still had to re-enter or re-perform numerous manual journal vouchers, reconciliations, and analyses for each reporting period to produce VA's financial statements and trial balances for submission to the U.S. Department of the Treasury. During FY 2016, FMS was not centrally and completely reconciled with key subsidiary systems such as the Electronic Contract Management System; Integrated Funds Distribution Control Point Activity, Accounting and Procurement System; and the Fee Basis Claims System.

VA is currently working with the U.S. Department of Agriculture to obtain financial services, which is consistent with OMB guidance to obtain financial services from a shared service provider.[3] The VA Office of Finance, within the Office of Management, is leading the Financial Management Business Transformation program along with the Office of Acquisition and Logistics and the Office of Information and Technology. In FY 2017, VA began efforts to standardize business processes and identify potential levels of change required for the transformation.

In the FY 2016 audit report,[4] CLA made recommendations for VA to address the identified material weaknesses and significant deficiencies. Those recommendations ranged from specific, targeted actions to broader improvements in policies, processes, and systems.

## THE IMPROPER PAYMENTS ELIMINATION AND RECOVERY ACT

We recently issued our annual determination on VA's compliance with the Improper Payments Elimination and Recovery Act (IPERA)[5] finding VA did not comply with two of

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[1] 31 CFR §1341(a) and 1517(a)
[2] Public Law-104-208, §803(a), *Federal Financial Management Improvement Act of 1996*
[3] OMB Memorandum 13-08*, Improving Financial Management Through Shared Services*
[4] *Audit of VA's Financial Statements for Fiscal Years 2016 and 2015* (Report No. 16-01484-82, November 15, 2016)
[5] *Review of VA's Compliance With the Improper Payments Elimination and Recovery Act for FY 2016* (Report No. 16-04416-231, May 15, 2017)

the six requirements in OMB's guidance for compliance with IPERA[6]. Specifically, VA did not:

- Maintain a gross improper payment rate of less than 10 percent for two programs —the VA Community Care Program and the Purchased Long Term Services and Support (PLTSS) Program—reported in the Agency Financial Report.
- Meet reduction targets for six programs reported in the Agency Financial Report.

VA met the other four IPERA requirements:

- Published the FY 2016 Agency Financial Report on VA's website
- Performed risk assessments
- Published improper payments estimates for programs identified as susceptible to significant improper payments
- Provided information on corrective action plans.

Although VA published improper payment estimates as required, we determined estimates for the Supplies and Materials Program and the Post-9/11 G.I. Bill Program were not reliable because of weaknesses in sample evaluation procedures. Overall, VA reported improper payment estimates totaling approximately $5.5 billion in VA's Agency Financial Report for FY 2016, compared with $5 billion for FY 2015.

<u>Areas of Non-Compliance</u>

The two programs that exceeded the 10 percent improper payment rate threshold were the VA Community Care Program and the PLTSS Program. Improper payment rates for these programs were high at approximately 76 percent and 69 percent, respectively. This is a repeat of last year's determination of noncompliance, but the rates were lower last year at approximately 55 percent and 59 percent, respectively. VA reported the improper payment rate for the VA Community Care Program was high because VHA purchased a significant amount of medical care from non-VA providers using individual authorizations. The individual authorizations were not compliant with the Federal Acquisition Regulation (FAR). The high PLTSS improper payment rate was also due to the lack of FAR-compliant contracts. VA must generally follow the FAR when other legal authorities are not available for the procurement of goods and services. According to OMB's definition of improper payments, "an improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements." Therefore, when purchases do not follow applicable legal requirements, such as having contracts in place that comply with the FAR, the resulting payments are improper. As such, VA counted payments for non-FAR compliant medical care purchases as improper.

VA also did not meet its annual reduction targets for six programs. VA provided the following explanations for missing the reduction targets in these programs:

[6] OMB Circular A-123, Appendix C, Part II-A(1), *Responsibilities of Agency Inspectors General.*

- VA Community Care Program – The improper payment rate increased due to the inclusion of individual authorizations under $2,500 in the improper payment estimate.
- PLTSS – The higher improper payment rate was due to contracting errors and the inclusion of individual authorizations under $2,500 in the improper payment estimate.
- Beneficiary Travel – Other priorities, such as access to care and timely payment processing, have taken precedence over meeting the reduction target.
- Civilian Health and Medical Program of the Department of Veterans Affairs – System improvements are needed to address identified system issues and expand automated business rules that would reduce the number of human entries and decisions.
- State Home Per Diem Grants – VHA identified an increase in improper payments associated with missing or incomplete documentation for domiciliary residents, due in part to a change in sampling stratification.
- Supplies and Materials Program -- Our review identified additional improper payments, primarily due to insufficient supporting documentation that increased the improper payment rate above the target rate.

We also noted the VA Community Care Program and PLTSS Program did not achieve the expected level of precision for their improper payment estimates because of larger than expected variances in sample results. Despite not meeting expectations, VHA did design its sampling methodology appropriately.

We made several recommendations to Agency leadership in VHA, VBA, the Office of Management, and the Office of Acquisition, Logistics, and Construction, to take steps to reduce improper payment rates, achieve reduction targets, and improve improper payment estimates. VA management agreed with our recommendations and provided plans for corrective action. We will follow-up on their implementation during the FY 2017 IPERA review.

**CONCLUSION**

VA's financial management and system challenges are many and complex. VA plans to move from FMS to a shared services provider to gain access to modern technology. Initial operational capacity is scheduled for FY 2020. VA will need strong organizational leadership and cooperation to manage this significant change. VA also faces challenges in reducing improper payments related to the procurement of medical care through contracts that are not compliant with the Federal Acquisition Regulation. As we review these areas annually, we will monitor VA's actions to address its financial management and systems challenges and its compliance with IPERA.

Mr. Chairman, this concludes my statement. We would be happy to answer any questions you or other Members of the Committee may have.