Department of
Veterans Affairs

Office of Inspector General

AUDIT OF ADMINISTRATION OF INVESTED FUNDS FOR THE SERVICEMEN'S GROUP LIFE INSURANCE AND VETERANS' GROUP LIFE INSURANCE PROGRAMS

VA needs more financial information in order to more closely supervise administration of invested funds.

Report No.: 7R1-B12-002
Date: October 23, 1996

Office of Inspector General
Washington DC 20420

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DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Director, Insurance Service (29)

Audit of Administration of Invested Funds for the Servicemen's Group Life Insurance and Veterans' Group Life Insurance Programs

1. The Office of Inspector General conducted an audit of the administration of invested funds for the Servicemen's Group Life Insurance (SGLI) and Veterans' Group Life Insurance (VGLI) programs. SGLI and VGLI are programs supervised by the Department of Veterans Affairs (VA), Veterans Benefits Administration (VBA), and administered by a major insurance company hereinafter referred to as The Insurer. During Calendar Years (CYs) 1993 and 1994, The Insurer reported $32 million and $40 million of program earnings from investments, respectively. The purpose of the audit was to assess the accuracy, reliability, and sufficiency of The Insurer's financial information regarding SGLI and VGLI investment funds, and to determine whether opportunities exist to enhance the management of invested funds. This audit is one in a series of audits performed of the SGLI and VGLI programs.

2. We concluded that more information needs to be obtained about program financial operations to assess whether opportunities exist for improvement. Our audit of the Insurer's financial records and reports showed that:

- Investment expenses were deducted from income, and funds were transferred to The Insurer without being reported to VA.
- Invested amounts were misstated, and were not periodically reconciled to program reserves.
- Audits were conducted of special interest issues, but did not attest to annual financial conditions and results of operations.
- Specific provisions were not established governing the insureds' equity in investments and program reserves.

3. Governing legislation and provisions of the group insurance policy did not require The Insurer to report this financial information to VA. However, its absence impeded VA management's ability to fully assess the accounting of invested funds and program reserves, and determine whether program investment earnings could be enhanced. As a result of the audit, The Insurer is considering a restoration of $3.8 million to invested assets and a reimbursement of lost income to the SGLI and VGLI programs' reserves of $3.2 million. The amounts of these reimbursements are subject to further review by Insurance Service management.

4. VBA insurance program management indicated that they were aware of The Insurer's investment methodology and considered it superior to other methods used in the insurance industry. However, they were not informed of the source and use of invested program funds, nor did they consider investment portfolio management as an appropriate function within their program oversight. Management did review reported rates of return credited to the SGLI and VGLI programs in comparison to average rates reported by commercial life insurance companies. Management also instituted independent audits of certain segments of program administration. While these assessments were useful in evaluating program adherence to industry-wide practices and earnings, they did not address the potential for increased earnings.

5. We recommend that the Director, Insurance Service, obtain more information about program financial operations, and take action to verify the accuracy of The Insurer's accounting of SGLI and VGLI investment funds, to include:

- having the Insurer provide annual reports fully disclosing SGLI and VGLI programs' funds invested as distinguished from program reserves, and identifying the source of annual changes to these funds.

- providing independent audits of financial presentations of condition and operations of the SGLI and VGLI programs.

- clarifying provisions with The Insurer concerning the insureds' ownership equity in investments, program reserves, earnings and extraneous program transactions.

- reviewing financial information to assess whether opportunities exist to enhance program earnings.

- determining whether The Insurer's estimate of previous interbranch charges to program funds, including those described as "Dividends to Stockholders", is reasonable, and whether the Insurer's proposed $3.8 million restoration to invested assets and $3.2 million reimbursement to program reserves are equitable.

6. The Under Secretary for Benefits concurred with the recommendation and provided an acceptable implementation plan. He plans to obtain additional financial information from The Insurer, review these disclosures for opportunities to enhance program earnings, and implement the other recommended improvements. We consider all issues resolved and will follow up on the implementation of corrective actions planned.

For the Assistant Inspector General for Auditing

[Signed]
THOMAS L. CARGILL, JR.
Director, Bedford Audit Operations Division

RESULTS AND RECOMMENDATIONS

VA Needs More Financial Information From The Insurer to More Closely Supervise Administration of Invested Funds

More financial information needs to be obtained about the Servicemen's Group Life Insurance (SGLI) and the Veterans' Group Life Insurance (VGLI) programs' financial operations to enable the Department of Veterans Affairs (VA) to more closely supervise the administration of invested funds. Our audit of the Insurer's financial records and reports showed that:

- Investment expenses were deducted from income, and funds were transferred to The Insurer without being reported to VA.
- Invested amounts were misstated, and were not periodically reconciled to reserves.
- Audits were conducted of special interest issues, but did not attest to annual financial conditions and results of operations.
- Specific provisions were not established governing the insureds' equity in investments and program reserves.

Governing legislation and provisions of the group insurance policy did not require The Insurer to report this financial information to VA. However, its absence impeded VA management's ability to fully assess the accounting of invested funds and program reserves, and determine whether program investment earnings could be enhanced. As a result of the audit, The Insurer is considering a restoration of $3.8 million to invested assets and a reimbursement of lost income to the SGLI and VGLI programs' reserves of $3.2 million. The amounts of these reimbursements are subject to further review by Insurance Service management.

Background

The SGLI and VGLI programs' group policy is the largest group life policy underwritten by The Insurer. In policy year ended June 30, 1993, the reserves held by The Insurer for the SGLI and VGLI programs ($344 million) far exceeded those reserves held for any other group policy**.** Policy reserves are a measure of the value of obligations to policyholders. Most assets held and invested by insurance companies support these policy reserve liabilities. In addition to policy reserves, there are other liabilities for taxes, licenses, fees, etc.

Title 38 U.S.C., Chapter 19, Subchapter III, requires The Insurer to submit an annual accounting statement to VA. That statement is to include the amounts of premiums actually accrued, the total of all mortality and other claim charges, and the amounts of the insurers' expense and risk charge. In addition, the group policy requires The Insurer to report the amount of premiums returned to VA, and the amount of interest added to the Contingency Reserve. Neither Title 38 nor the provisions of the group policy provides detailed guidance for VA's role of oversight in supervising The Insurer's administration of the SGLI and VGLI programs' activities or programs' reserves. The Insurer's responsibilities as program administrator are based on the provisions of the above legislation, which include receiving premium payments, paying death claims, and submitting a Statement of Annual Accounting to VA. These provisions are also articulated in the group life insurance policy agreement with VA. The Insurer's custody and investment of reserves and earnings are outlined in Article I, Section 7 of the policy, which states that the contingency reserve shall bear interest at a rate to be determined by The Insurer and approved by VA.

VA's selection of The Insurer, as prescribed in Title 38 U.S.C, Chapter 19, Subchapter III, is based on certain business volume and financial size thresholds, without mandatory adherence to government procurement requirements. Title 38 also provides that VA will approve prospective interest rates for crediting to the contingency reserve, as being consistent with rates generally used by The Insurer for similar funds held under other group life insurance policies.

Investment Operations and Fund Transfers Were Not Reported or Audited

Our review of The Insurer's financial records and reports indicated that critical financial information, including deductions from income and assets, was not reported to VA. Invested assets and some reserves were not reported, nor were differences between investments and reserves reconciled. Audits of these investment operations were not performed, and provisions were not established governing the insureds' program equity. Governing legislation and provisions of the group insurance policy did not require The Insurer to report this financial information to VA. However, these information gaps impaired management's and the OIG's ability to make sound assessments of investment performance and opportunities to enhance earnings.

- **The Insurer Deducted Investment Fees from Program Investment Income, But Did Not Inform VA**

  The Insurer routinely deducted investment management fees from program investment income and did not inform VA. Although not required to be reported, VA management should be informed of these deductions as they directly affect program income. These fees amounted to $1.3 million or 4 percent of reported earnings in CY 1993, and $3.2 million or 8 percent of reported earnings in CY 1994. Management fees represented internally allocated costs of The Insurer for real estate transfer costs, investment company salaries, rents, etc. These charges were deducted from earnings reported to VA, but were not itemized as expenses or deductions in any documents routinely provided to VA.

- **The Insurer Transferred Program Funds from SGLI and VGLI Funds, and Did Not Inform VA**

  The Insurer's records indicated that a series of transfers occurred during CYs 1991, 1993 and 1994. These transfers involved additions to and deductions from the SGLI and VGLI programs' capital and surplus account, amounted to $18.3 million, and were not reported to VA. Additional funds may have been transferred in years prior to CY 1991, which we did not review. In July 1995, we requested the Insurer to explain these deductions, which were identified as meeting various objectives including "dividends to stockholders" and "interbranch transfers". The Insurer's officials responded that these transactions were transfers of surplus funds between corporate accounts and SGLI and VGLI programs' funds. As a result of the audit inquiry, The Insurer provided documentation regarding a proposed estimated $3.8 million restoration of invested assets and a $3.2 million reimbursement of lost income to the SGLI and VGLI programs' reserves. These reimbursements are subject to review and approval by VA.

- **Other Deductions and Transfers Were Made from Program Invested Assets, and Not Reported To VA**

  Federal income taxes and capital asset losses were deducted from program assets and not reported to VA. The Insurer routinely deducted ordinary federal income tax (FIT) payments from program invested assets, which amounted to $3.5 million in CY 1993 and $.7 million in CY 1994. These taxes are commonly paid by life insurance companies, and are computed by The Insurer's tax department based on the proportion of SGLI and VGLI programs' earnings. Although provisions for payment of FIT are included in the group insurance policy (i.e. Article I, Section 7), they were not itemized as deductions from program invested assets in any documents routinely provided to VA for CY 1994 and previous years.

  Losses from capital asset transactions were also deducted from program assets, and not reported as such to VA. These capital transactions amounted to a gain of $6 million in CY 1993 and a net loss of $11.6 million in CY 1994 representing a net loss of $5.6 million for the 2 years. Although amounts of capital gains and losses were listed in a separate schedule in annual reports submitted to VA, they were not shown as adjustments to invested assets, as would be done in a cash flow statement.

- **Invested Assets and Some SGLI and VGLI Reserves Were Not Reported to VA, Not Reconciled, and Were Misstated in The Insurer's Records**

  The Insurer did not report the amounts of SGLI and VGLI programs' assets invested and some amounts of program reserves to VA, or reconcile differences in these funds. SGLI and VGLI program assets are coinvested with other assets in The Insurer's group life and health portfolio. The Insurer's overall corporate portfolio consists of over 93 percent fixed income securities (e.g. bonds) and less than 7 percent equities (e.g. common stocks)[1]. An internal process, called the net cash available process, is used to allocate investment income to various product lines (e.g. group life) of The Insurer, including distribution to the SGLI and VGLI programs. The Insurer did not periodically inform VA management of the amount of SGLI and VGLI assets invested ($404.9 million and $564.7 million in CYs 1993 and 1994 respectively).

We found $78.6 million in reserves (13 percent of reserves) held by The Insurer in CY 1995 which were not reported to VA in the year-end financial reports. These reserves were held primarily as "supplementary contracts" for future payments to beneficiaries. Insurance Service officials were unsure of the propriety of considering these funds as liabilities of the program or The Insurer. They planned to clarify the issue with The Insurer.

There was also no reconciliation of differences between reserves and invested assets. The Insurer disclosed there had been a $109 million overstatement of SGLI and VGLI invested assets for CY 1993 due to computer miscodings. This error remained unreported for 2 years. We also observed an additional $55 million difference between SGLI and VGLI programs' invested assets and reserves as of December 31, 1993. The Insurer reconciled this difference to within $2 million, but indicated it was not able to totally reconcile this variance, since records prior to 1982 were not readily available. This remaining variance between program assets and reserves would have been resolved had a reconciliation been routinely performed and reported to VA.

- **Audits Were Performed of Special Interest Issues But Did Not Attest To Programs' Financial Condition**

  Audits of the SGLI and VGLI programs were initiated by program officials in 1987, and focused on special interest issues, but did not evaluate financial statements of condition or operations. Three independent audits focused on restricted aspects of the SGLI and VGLI programs' administration expenses which averaged about 2 percent of invested assets. The remaining audit focused on the conversion pool, which was about $44 million (6.8 percent of assets invested in CY 1995). Audits of financial condition and results of operations would better serve management in resolving unreported deductions from program funds.

In summary, The Insurer's financial investment operations were not fully disclosed to VA for the SGLI and VGLI programs. VA management was not apprised of critical financial data including deductions from program funds, amounts of invested assets and segments of program reserves. Although these reporting omissions did not violate governing program requirements, they impeded VA management's ability to improve the financial operations of the SGLI and VGLI programs.

[1]***Best's Insurance Reports, Life-Health, (Oldwick, New Jersey; A.M. Best Company, 1993).***

Provisions Were Not Established Governing The Insured's Program Equity

We discussed with VA Insurance Service management what the residual SGLI and VGLI insureds' equity would be in the event of program dissolution or change of insurer. For example, at the end of CY 1995, SGLI and VGLI programs' reserves totaled $608 million, while invested assets totaled $630 million. Management was initially uncertain of this residual equity amount. This question was also not clarified in governing legislation or the group policy. After discussing this matter with the Insurer, VA management agreed that the insureds' equity would be the amount of existing reserves, as distinguished from the amount of invested assets. Nevertheless, clear, written documentation of this agreement is needed to avoid potential conflict and litigation upon program dissolution or change of insurer, and to resolve ownership of all program related funds including those associated with "supplementary contracts" as discussed above.

All Financial Information Was Not Available for Supervision of the Program

While impeded from assessing several aspects of the programs' financial investment operations, VA management determined that earnings were comparable to those experienced in the insurance industry. Insurance officials indicated they were aware of The Insurer's investment methodology and considered it superior to other methods used in the insurance industry. However, they were not informed of the sources and use of invested program funds, nor did they consider investment portfolio management as an appropriate function within their program oversight.

- **Invested Funds and Investment Rates of Return**

  VA insurance management judged program earnings as comparable to the industry-wide average net rate of investment return for commercial life insurance companies. According to management, this comparison usually indicated the SGLI and VGLI rate of return was about average, when compared to other U.S. life insurance companies. This statistic is computed by the American Council of Life Insurance, and involves 2,391 reserve life insurance companies. As an indication of how representative this earnings statistic is of the population of respective insurance companies (2,391), we obtained the composite range of rates from the Program Director, Statistical Research, American Council of Life Insurance. The rate of investment return for individual companies in CY 1995 ranged from a loss of -54.6 percent of invested assets to a gain of 289 percent of invested assets and, in our opinion, represented a spectrum too broad to be an optimal measurement criterion.

  As an alternative baseline for comparing investment return, we analyzed earnings of the 14 largest American life insurance companies which met minimum legislative criteria to administer the SGLI and VGLI programs. Their average rate of return for CY 1994 (7.28 percent) was closely aligned with the SGLI and VGLI rate of return (7.16 percent), representing an insignificant difference (.12 percent). A comparison for CY 1993 revealed similar results, thus supporting the VA's conclusions regarding the comparability of program and industry-wide earnings.

- **Earnings May Be Enhanced Through Full Disclosure Reporting**

  VA management was not able to assess the validity of all deductions from program funds, as this information was not fully disclosed to them by The Insurer. In addition, the basis used in calculating the investment rate of return (i.e. average reserves or invested assets) was also not reported to VA. We believe that additional analysis of unreported deductions as well as the components used in calculating the rate of return may provide further understanding of reported earnings and the potential for enhanced program earnings.

Conclusion

We concluded that more information needs to be obtained about program financial operations to assess whether opportunities exist for improvement. While The Insurer fully complied with the contract and all applicable legal provisions regarding financial reporting, our audit showed that:

- Investment expenses were deducted from income, and funds were transferred to The Insurer without being reported to VA.
- Invested amounts were misstated, and were not periodically reconciled to program reserves.
- Audits were conducted of special interest issues, but did not attest to annual financial conditions and results of operations.
- Specific provisions were not established governing the insureds' equity in investments and program reserves.

The absence of critical financial information impeded VA management's ability to fully assess the accounting of invested funds and program reserves, and determine whether program investment earnings could be enhanced. As a result of the audit, The Insurer is considering a restoration of $3.8 million to invested assets and a reimbursement of $3.2 million of lost income to the SGLI and VGLI programs' reserves. These amounts are subject to further review by Insurance Service management.

Recommendation

We recommend that the Director, Insurance Service, obtain more information about program financial operations, and take action to verify the accuracy of The Insurer's accounting of SGLI and VGLI investment funds, to include:

- having the Insurer provide annual reports fully disclosing SGLI and VGLI programs' funds invested as distinguished from program reserves, and identifying the source of annual changes to these funds.

- providing independent audits of financial presentations of condition and operations of the SGLI and VGLI programs.

- clarifying provisions with The Insurer concerning the insureds' ownership equity in investments, program reserves, earnings and extraneous program transactions.

- reviewing financial information to assess whether opportunities exist to enhance program earnings.

- determining whether The Insurer's estimate of previous interbranch charges to program funds, including those described as **"**Dividends to Stockholders**"**, is reasonable, and whether the Insurer's proposed $3.8 million restoration to invested assets and $3.2 million reimbursement to program reserves are equitable.

The monetary benefit associated with this recommendation is shown in Appendix III, page 13.

Under Secretary for Benefits Comments

The Under Secretary for Benefits concurred with our findings and recommendation. While noting that The Insurer has fully complied with the terms of the contract and all applicable legal provisions regarding financial reporting, he stated that they have agreed to supply additional financial information and have done so for Calendar Year 1995. He further stated that the financial information provided by The Insurer was sufficient to allow effective program management, which included increased SGLI and VGLI programs' coverage, and revised premium scales for both programs.

However, he concurred with the need for expanding The Insurer's financial disclosures, and stated that The Insurer has agreed to provide a balance sheet and a statement of cash flows in addition to the statement of program operations, and has furnished this information for Calendar Year 1995. In addition, he indicated having requested and received an investment exhibit disclosing program investment expenses and rate of return information. Also, he indicated plans to: have the accuracy of these financial presentations audited annually, clarify the insureds' equity in program funds, and review financial disclosures for opportunities to enhance program earnings, without being involved in investment portfolio decisions.

The Under Secretary for Benefits also stated that The Insurer's report on erroneous transfers was being reviewed to confirm whether the recommended funds restorations ($3.8 million) and reimbursements ($3.2 million) were both reasonable and equitable. (See Appendix IV on pages 14 through 16 for the full text of the Under Secretary's comments.)

Office of Inspector General Comments

The Under Secretary concurred with the recommendation and provided an acceptable implementation plan. He plans to obtain additional financial information from The Insurer, review these disclosures for opportunities to enhance program earnings, implement annual audits of these financial statements, clarify insureds' ownership equity, and confirm whether reimbursements for erroneous interbranch transfers of program funds are reasonable and equitable. The Under Secretary reiterated statements by The Insurer's officials that they have fully complied with the terms of the contract and all applicable legal provisions regarding financial reporting. We agree with this position and have revised segments of this report to emphasize that the Insurer was fully compliant with governing financial reporting requirements. We consider all issues resolved and will follow-up on the implementation of corrective actions planned.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The purpose of this audit was to assess the accuracy, reliability, and sufficiency of The Insurer's financial information regarding SGLI and VGLI investment funds, and to determine whether opportunities exist to enhance the management of invested funds. This audit is one in a series of audits performed of the SGLI and VGLI programs.

Scope and Methodology

We audited SGLI and VGLI investment funds and related expenses, the adequacy of investment earnings, and the insureds' equity in invested assets and reserves. The reserves amounted to $347 million and $481 million in Policy Years ended June 30, 1993 and 1994, respectively.

We evaluated the propriety of deductions (e.g. investment expenses, federal income taxes, and capital losses) by researching Title 38 United States Code, and the SGLI and VGLI group insurance policy. We obtained and analyzed documents and reports concerning investment related administrative expenses, federal income taxes, capital losses, and transfers from SGLI and VGLI capital and surplus account. We tested the reliability of The Insurer's reports by comparing The Insurer's internal reports of expenses/deductions to reports routinely provided to VA. We compared the investment earnings of the SGLI and VGLI portfolio with the earnings of the life insurance industry as a whole, and also with the 14 largest life insurers in the United States. We contacted the American Council of Life Insurance in Washington D.C., and obtained information concerning rates of investment return. We reviewed The Insurer's 'net cash available' method of allocating investment earnings, capital gains and taxes.

We discussed these matters with responsible officials from The Insurer, and The Insurer's investment company and tax department. We also discussed program equity with VA insurance and The Insurer's officials, and requested a reconciliation of SGLI and VGLI invested assets with SGLI and VGLI programs' reserves.

The Insurer appointed the SGLI and VGLI financial manager as the primary point of contact during the audit to receive requests for information and provide explanations. This contact obtained information from primary sources within the company, and provided requested information to us. Because of The Insurer's concerns about safeguarding proprietary information and processes, we were not afforded open access to, and we did not examine, primary sources of data, e.g. The Insurer's general ledger accounts, and the capital and surplus account. Because of this limitation, and the level of reporting omissions which we noted during our examination, we are unable to provide assurance that we identified all material transactions which impacted SGLI and VGLI programs' reserves during the period of audit. Nevertheless, nothing came to our attention that information was deliberately withheld. Also, we did not perform actuarial studies to attest to the adequacy of the reserves.

The audit was conducted in accordance with generally accepted government auditing standards.

BACKGROUND

The Department of Veterans Affairs (VA), Veterans Benefits Administration (VBA), Regional Office and Insurance Center, at Philadelphia, Pennsylvania, supervises the administration of two life insurance programs by a major insurance company (The Insurer).

Effective September 29, 1965, the Uniformed Services-Group Life Insurance Act (Public Law 89-214) established the Servicemen's Group Life Insurance (SGLI) program, which provided up to $10,000 group life insurance to members on active duty in the uniformed services (i.e., Army, Navy, Air Force, Marine Corps, Coast Guard, Public Health Service, and the National Oceanic and Atmospheric Administration). Over the years this coverage was broadened to include certain National Guard and Reserve personnel, and increased to the maximum amount of $200,000.

The Veterans' Group Life Insurance (VGLI) program was established by the Veterans' Insurance Act of 1974 (Public Law 93-289) effective August 1, 1974, and currently provides 5-year term coverage, renewable for life, in amounts ranging from $10,000 to $200,000. This coverage is available to all veterans separated from active duty but only for an amount equal to or less than their terminating SGLI program coverage. Beginning January 1, 1986, the VGLI program became available to members of the Individual Ready Reserve and the Inactive National Guard.

The SGLI program began and continues because service members were unable to obtain life insurance from private companies with warfare coverage at reasonable rates. Additionally, Congress intended to provide insurance benefits to service members' survivors and dependents especially during war time. The intent of the VGLI program was to provide a low-cost life insurance policy to veterans during their readjustment from military to civilian life. The Insurer administers the two insurance programs based on the provisions of a group policy held by VA. As of December 31, 1993, the SGLI and VGLI programs represented about 3 million and 335,946 insureds, respectively, with a face value of nearly $494.8 billion. Premiums collected for CYs 1993 and 1994 were $498 million and $486 million, respectively. Death claims incurred were $519 million for CY 1993 and $454 million for CY 1994.

The SGLI and VGLI programs' reserves are those amounts which, together with future premiums and interest, are retained to pay future claims. Thus, reserves are liabilities and represent obligations to policyholders which stem from that portion of premiums not used immediately to pay policy claims or expenses. Reserves held for the SGLI and VGLI programs totaled $347 million and $481 million in the Policy Years (PYs) ended June 30, 1993 and 1994, respectively. Some major components of reserves for PY 1994 were: expected VGLI mortality costs reserve ($250 million), reserve for pending SGLI and VGLI program death claims ($86 million), and reserve for SGLI and VGLI programs' unreported death claims ($56 million). The SGLI and VGLI group policy specifies these reserves will earn a minimum rate of return prospectively guaranteed by The Insurer, and subject to an increase adjustment at year end, depending on investment performance.

SGLI and VGLI programs' premiums and interest income, not immediately used to pay claims and expenses, are invested by The Insurer's subsidiary investment company to support reserve liabilities. These investments are commingled with cash receipts from The Insurer's other group life and health customers, and invested primarily in fixed income securities. The Insurer's 'net cash available' process allocates investment income, expenses, gains and losses to various product lines (e.g. group life) of The Insurer, including distribution to the SGLI and VGLI programs. Average invested assets allocated to the SGLI and VGLI programs were $405 million and $565 million in CYs 1993 and 1994, respectively. Net investment income earned on these assets was $32 million in CY 1993 and $40 million in CY 1994.

MONETARY BENEFITS IN ACCORDANCE WITH IG ACT AMENDMENTS

REPORT TITLE: Audit of Administration of Invested Funds for the Servicemen's Group Life Insurance and Veterans' Group Life Insurance Programs

PROJECT NUMBER: 4R1-142

Recommendation Number	Category/Explanation of Benefits	Better Use of Funds	Questioned Costs
1	Improved Use of Resources. Insurer's estimate of funds from erroneous transfers to be restored to invested assets.	$3.8 million[1]	
1	Potential Recovery. Insurer's estimate of lost income to be reimbursed to program reserves.		$3.2 million[1]

[1]Insurer officials provided their analysis to VA after completion of our examination. These proposed reimbursements are subject to review and approval by VA.

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

Department of
Veterans Affairs

Memorandum

Date: September 20, 1996

From: Deputy Under Secretary for Benefits (201)

Subj: Draft Report, Audit of Administration of Invested Funds for the Servicemen's Group Life Insurance and Veterans' Group Life Insurance Programs

To: Assistant Inspector General for Auditing (52)

1. We have reviewed your draft report concerning the administration of invested funds for the Servicemen's Group Life Insurance (SGLI) and Veterans' Group Life Insurance (VGLI) programs. We concur with your findings and your recommendation, but would like to clarify and elaborate on a few points.

2. With regard to your recommendation, it should be noted that the Insurer has fully complied with the terms of the contract and all applicable legal provisions regarding financial reporting. For your information we have attached a copy of the Insurer's comments to us regarding your report. In their comments, they emphasize the point that they have been fully compliant with the group policy contract provisions. They have agreed to supply us with the additional financial information, and have already done so for calendar year 1995.

3. We would also like to put the scope of financial reporting into context. That is, in recent years the CFO Act and similar legislation has required increased financial disclosure and accountability. Nevertheless, the financial information provided by the Insurer has been sufficient to allow effective management of the program. In each year since the origin of the program, the Insurer has provided us with a Statement of Annual Accounting, as required under the contract. This is our primary source of financial information regarding program operations and program reserves. It has enabled us to effectively manage the financial operations of the SGLI and VGLI programs. In recent years, such management has included the quadrupling of SGLI coverage, the extension of the VGLI program from five year coverage to lifetime coverage, and the revision of premium scales for both the SGLI and VGLI programs. The Statement of Annual Accounting also includes an investment exhibit and a schedule of capital gains and losses since the origin of the program.

VA Form 2105
Mar 1989

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

2.

Assistant Inspector General for Auditing (52)

4. While the Statement of Annual Accounting has been the primary tool for the financial management of the group life insurance programs, we concur that it does not provide the extensive financial disclosure that the Comptroller General has required Government agencies to provide in their financial statements. As is the case for most annual report presentations, including our internal CFO statements, the statement of operations should also be accompanied by a balance sheet and a statement of cash flows. The Insurer has agreed to provide these statements and has furnished such for calendar year 1995. In addition, an investment exhibit disclosing program investment expenses and rate of return information has been requested and provided. We believe that the provision of these additional statements by the Insurer should satisfactorily address the first two findings in your report.

5. The third issue concerns the formal auditing of these financial statements and exhibits. We plan to address this issue by having the Insurer bring in an independent auditor to certify the accuracy of these financial presentations each year. The audit report also expressed concern that further written clarification is needed concerning the insureds' equity in program funds in the event of program dissolution or change of insurer. While we are confident that the Insurer and VBA officials had a clear understanding of this issue, we plan to provide such clarification as part of the next set of contractual revisions with the Insurer. In the meantime, we will pursue an exchange of letters of understanding with the Insurer so that written documentation of our agreement will be available.

6. With the additional financial disclosure that the Insurer has agreed to provide each year, we believe that we will be in a position to address that part of your recommendation that we review such information to determine whether opportunities exist to enhance program earnings. This additional reporting will better enable us to review program asset allocation, as well as changes to such allocation resulting from program operations, capital gains and losses, federal income taxes and credits, and investment management expenses. This type of review could lead to specific areas of investigation that may afford opportunities for improved program earnings. We want to clarify, however, that does not mean that Insurance program managers should or will be involved in investment portfolio decisions. We do not believe that is an appropriate function for program managers under the current statutory arrangement, which requires that the program's assets be invested similarly to the Insurer's other large group policies.

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

3.

Assistant Inspector General for Auditing (52)

7. Regarding the final finding, on the guaranteed rate of return, although we agree that the Insurer did not disclose the basis of the guaranteed rate of return, we did not and do not consider that significant. In fact, we have a unique agreement with the Insurer that benefits servicemembers. Namely, instead of crediting the program with the guaranteed rate of return as they do with other group policies, the SGLI program receives the actual rate of return, which has always been higher than the conservatively calculated guaranteed rate of return.

8. The final portion of your recommendation concerned some erroneous transfers that were made by the Insurer from program allocated assets in recent years. The Insurer has investigated these transfers and has furnished us with a formal report of their findings. This report recommends a restoration of $3.8 million in allocated assets and a reimbursement to the program of $3.2 million of lost investment income that resulted from these errors. It appears that these figures are accurate and the Insurer has agreed to the restoration and reimbursement. We are now reviewing these findings to confirm that their resolution of this matter is both reasonable and equitable.

9. We appreciate your interest on behalf of the group life insurance programs. Questions may be referred to Mr. Paul Koons, Assistant Director for Insurance, telephone (215) 381-3029.

[Signed]
Stephen L. Lemons

Attachment

FINAL REPORT DISTRIBUTION

VA Distribution

Secretary (00)
General Counsel (02)
Under Secretary for Benefits (20A11)
Assistant Secretary for Management (004)
Assistant Secretary for Policy and Planning (008)
Chief Financial Officer (24)
Deputy Assistant Secretary for Congressional Affairs (60)
Deputy Assistant Secretary for Public Affairs (80)
Director, Office of Management Controls (004B)
Director, Insurance Service (29)

Non-VA Distribution

Office of Management and Budget
U.S. General Accounting Office

Congressional Committees:

Chairman, Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Governmental Affairs
Chairman, Senate Committee on Veterans' Affairs
Senate Ranking Minority Member, Committee on Veterans' Affairs
Chairman, Senate Committee on Appropriations
Chairman, House Committee on Appropriations
Chairman, Subcommittee on VA, HUD, and Independent Agencies, Senate Committee on Appropriations
Senate Ranking Minority Member, Subcommittee on VA, HUD, and Independent Agencies, Committee on Appropriations
Chairman, House Committee on Government Reform and Oversight
House Ranking Minority Member, Committee on Government Reform and Oversight
Chairman, House Committee on Veterans' Affairs
House Ranking Minority Member, Committee on Veterans' Affairs