Department of
Veterans Affairs

Office of Inspector General

MANAGEMENT LETTER
FISCAL YEAR 1996
FINANCIAL STATEMENTS
BENEFITS PROGRAMS

Several compliance and internal control issues require VBA management attention.

Report No.: 7R4-G10-053
Date: March 3, 1997

Office of Inspector General
Washington DC 20420

DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Director, Office of Resource Management (24)

Management Letter -- Fiscal Year 1996 Financial Statements-Benefits Programs

1. The Office of Inspector General (OIG) tested selected Department of Veterans Affairs (VA) Hines Finance Center (HFC), Debt Management Center (DMC), and VA regional office (VARO) internal controls as part of our audit of VA's Fiscal Year 1996 Consolidated Financial Statements. The purpose of our tests at the HFC, DMC, and VAROs was to determine whether Veterans Benefits Administration (VBA) operations complied with applicable laws and regulations.

2. Overall, we concluded that VBA staff established required internal controls for monitoring financial information, and generally complied with VA policies and procedures based on audit tests made. However, HFC staff did not take action to correct or improve three conditions discussed in last year's audit report, and VARO staff did not take action to correct or improve three other conditions also discussed in last year's report.[1] In addition, DMC staff had not taken action to correct or improve two conditions found in prior audits. Based on audit tests made, we concluded that improvements in internal controls are needed to better monitor benefit award programs.

3. We identified one condition in non-compliance with current laws and regulations. VA's DMC does not charge interest and administrative costs on certain accounts receivable. However, that issue will be discussed in the OIG national VA consolidated financial statement audit report. In this management letter, we are providing you other observations so that you can alert VBA managers and staff to the continuing need and importance of enhancing internal controls and improving operations.

4. The following conditions warrant VBA management attention:

- HFC overstated expenses and the related accrued liabilities for education programs.

- HFC does not distinguish between canceled and undeliverable checks, resulting in understating certain benefits expenses.

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[1] *Management Letter, Fiscal Year 1995 Financial Statements, Benefits Programs, Report No. 6R4-G01-059, dated May 22, 1996.*

- HFC needs to implement computer program changes to permit accurate and more efficient recording of benefit accruals.
- HFC does not timely record bank deposits in transit.
- DMC does not record interest charges for accounts receivable related to compensation and pension programs.
- DMC does not analyze loans receivable to determine if the current estimate for allowance for doubtful accounts is appropriate.
- VAROs need to update security policies for accessing sensitive personal data and financial payment information in the Benefits Delivery Network (BDN).
- VAROs need to ensure that BDN master record data is accurate.
- VAROs need to improve quality assurance for the processing and authorizing of compensation, pension, and education awards.

5. In addition, we had planned to review the Financial Management System's (FMS) function regarding VA financial statements during the course of this audit. However, we learned from HFC staff that VA does not currently rely on FMS to prepare its financial statements for benefits programs. Therefore, although HFC staff expressed some concerns regarding internal control weaknesses in FMS, a thorough review of this system would be outside the scope of this audit.

6. You are not required to provide an official response to this management letter. However, we would appreciate any written comments you may wish to make. We will continue to monitor these issues during future yearly financial statement audits.

7. We are available to provide assistance on these issues. If you wish to discuss this report, or would like our assistance concerning any other issues, please call me at (708) 216-2667.

For the Assistant Inspector General for Auditing

(Original signed by:)
WILLIAM V. DEPROSPERO
Director, Chicago Audit Operations Division

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PURPOSE, SCOPE, AND METHODOLOGY

Purpose

As part of our audit of Department of Veterans Affairs (VA) Fiscal Year 1996 Consolidated Financial Statements (CFS), we tested the Veterans Benefits Administration (VBA) compensation and pension (C&P) and education programs' account balances, selected transactions that affect the CFS, internal controls, and compliance with laws and VA regulations.

Scope and Methodology

We obtained an understanding of the control structure and assessed risk related to management's assertions that data were complete and related to events that occurred during Fiscal Year 1996.

We visited four VA regional offices (VAROs) and tested the reliability and accuracy of C&P and education award information contained in VBA computer based systems and claim folders. The data base systems and source documents contained in the claim folders form the basis for authorizing and issuing each benefit payment. The offices visited (one for each of VBA's four national regions) are located in:

- Southern Region: New Orleans, LA
- Eastern Region: Pittsburgh, PA
- Central Region: St. Louis, MO
- Western Region: Los Angeles, CA

St. Louis, MO also serves as one of VBA's four regional educational processing offices.

Overall, we randomly sampled 109 C&P transactions and payments. We also judgmentally sampled 16 C&P payments of $7,000 or more, and 20 special (outside the system) payments. For education awards, we randomly sampled 63 payments, and judgmentally sampled 5 payments of $2,000 or more, and 5 special payments. We also tested controls and compliance factors at each site visited.

We evaluated the adequacy of procedures relating to accounts receivable, accrued liabilities, benefit payments, and revenue and expense at the Hines Benefits Delivery Center (BDC) and the Hines Finance Center (HFC). We also reviewed procedures for accounts receivable at the Debt Management Center (DMC) in St. Paul, MN. We tested the reliability and security of electronic data processing (EDP) operations and activities at these locations by reviewing selected source documents. However, we did not validate the accuracy of the electronic data bases. We conducted this audit in conjunction with the overall Fiscal Year 1996 CFS audit.

The audit was performed in accordance with generally accepted Government auditing standards: Government Auditing Standards, issued by the Comptroller General of the United States; and the Office of Management and Budget's Audit Requirements for Federal Financial Statements. This audit consisted of such tests as we considered necessary under the circumstances.

BACKGROUND

VBA provides an integrated program of veterans benefits. The major benefits include compensation, pension, burial benefits, rehabilitation assistance, education, and training assistance. The Fiscal Year 1996 benefit entitlement appropriations totaled over $20 billion**.** VA estimates the veteran population at 26.2 million as of July 1, 1995. VA also estimates that 2.7 million veterans received C&P and 682,900 beneficiaries received survivor compensation or death pension benefits in 1996. In addition, VA estimates that 285,048 veterans, 15,515 service persons and 85,662 reservists received education and training benefits in calendar year 1996.

VBA administers veterans benefits through a network of 58 VAROs, which include offices in Washington, DC, Puerto Rico, and the Philippines. There are eight VAROs that are co-located with VA medical centers, and two VAROs that are co-located with insurance centers in St. Paul, MN and Philadelphia, PA. VBA has designated four of the 58 VAROs as regional education processing offices. VBA also has out-based facilities, which are small satellite offices. One or two VBA employees staff most of these offices and provide personalized vocational rehabilitation counseling, veterans' benefit counseling, fiduciary oversight, and other individual services.

VBA divides benefit program operations between the VAROs, which determine program eligibility and process status changes, and the Hines BDC. The Hines BDC updates beneficiary master records and produces the information used to generate payment checks at a disbursing center. The HFC is located in the BDC, and accounting for benefits appropriations is primarily performed there. The DMC is located in St. Paul, MN, and performs most of VBA's debt collection activities. The DMC maintains a centralized accounts receivable system (CARS), which controls approximately $2.1 billion in debts, as of September 30, 1996, owed the Government.

DETAILS OF AUDIT

Hines Finance Center Internal Controls

VBA management has not taken action to correct the three audit conditions identified in last year's management letter. The following issues (one newly identified) warrant management's attention. HFC staff need to:

- Properly record canceled and undeliverable C&P benefit checks, to avoid understating expenditures and accrued liabilities.
- Implement computer program changes to permit accurate, more efficient recording of benefit accruals.
- Ensure that deposits-in-transit are recorded on a timely basis.
- Accurately state education benefits expense accruals (new finding).

Recording Canceled and Undeliverable Benefit Checks

Because HFC staff did not differentiate between incoming "canceled" checks, and "undeliverable" checks, HFC staff understated C&P expenditures and accrued liabilities by approximately $312,636 at year-end (September 30, 1996). According to HFC staff, returned checks should be recorded as a decrease to benefits expense (credit General Ledger (G/L) account 4042), and as an increase to disbursing authority (debit G/L account 1012). This procedure reverses benefits expenses for veterans and beneficiaries when a liability no longer exists.

The above procedure is proper for processing "canceled" checks. That is because VA no longer owes the veteran or beneficiary any benefits, and the stated procedure removes the expense and liability from the G/L. To illustrate, a canceled check may be returned to the HFC when VBA staff in the field determine that a payee has died and is not entitled to the funds.

However, such an entry would not be correct when checks are returned to the HFC because the check could not be delivered to the payee. "Undeliverable" checks returned to the HFC because of incorrect addresses must continue as liabilities in the G/L. HFC staff could distinguish between canceled and undeliverable checks by using available

Treasury Department reason codes posted next to each entry on the returned check listings.

Since HFC staff did not distinguish between canceled and undeliverable checks when recording returned checks, they understated monthly expenses, as well as VA's year-end liability balance. For Fiscal Year 1996, we estimate that VBA understated those accounts by $312,636.

Benefit Payment Accruals

Due to programming limitations, HFC staff must break down benefit accruals into several entries in order to enter the correct amount into the C&P computer system. This process is time consuming and increases the risk of processing errors. The current computerized accounting system only allows HFC staff to enter a maximum of eight digits for any one entry. Therefore, the C&P system limits the largest entry to $999,999.99.

This year, HFC staff had to make 20 separate entries to record the benefits expense accrual. To create the needed $19,308,803.90 accrual, HFC staff made 18 entries at $999,999.99 each, and 2 additional entries totaling $1,308,804.08. Making multiple entries instead of a single entry for large adjustments is inefficient and increases the probability of recording errors in the financial statements.

Recording Deposits-in-Transit

VBA does not timely record bank deposits. The C&P system does not recognize, and HFC does not record, deposits-in-transit (i.e., payments received at VAROs for accounts receivable, loans receivable, interest, overpayments, etc.) at the end of the month.

Our review of bank deposits from the VAROs for the last quarter of Fiscal Year 1996 shows that VBA did not record all deposits from that quarter into appropriations until October and November of the following fiscal year. This occurred because some VAROs did not submit bank deposit data to the HFC in time for this data to be recorded in the proper month. As a result, the accounts receivable for the C&P and education systems were slightly overstated (by $117,550.96) at the end of the fiscal year.

Education Benefits Expense Accrual

HFC staff also overstated education expense and the related accrued liability by approximately $3.5 million at fiscal year-end. Education workload is seasonal and the average yearly workload is not a good estimate of the last days of September. Due to

September's lower workload, accruals based on the yearly average overstate benefits expense and accrued liability. The following table summarizes current methodology and our proposed accrual methodology:

Program	Current Methodology	Recorded Accrual	Proposed Methodology	Proposed Accrual	Difference
Chapter 30[1]	Total September vouchers divided by working days in month, multiplied by accrual days needed.	$4,491,348	Use last 4 vouchers in September divided by voucher days, multiplied by accrual days needed.	$1,908,883	$2,582,465
Chapter 31[2]	Total of first vouchers from each month in the fiscal year divided by 12, then divided by 5, multiplied by accrual days needed.	$1,699,912	All September vouchers minus recurring payments, divided by voucher days, multiplied by accrual days.	$1,653,447	$ 46,465
Chapter 32[3]	Estimate based on September vouchers.	$ 180,913	All September vouchers minus recurring payments, divided by voucher days, multiplied by accrual days. (Same as Chapter 31)	$ 86,400	$ 94,513
Chapter 35[4]	Total September vouchers divided by working days in month, multiplied by accrual days needed. (Same as Chapter 30)	$1,344,094	All September vouchers minus recurring payments, divided by working days in month, multiplied by accrual days needed.	$ 716,478	$ 627,616
Chapter 1606[5]	Total of first vouchers from each month in the fiscal year divided by 12, then divided by 5, multiplied by accrual days needed. (Same as Chapter 31)	$ 579,937	All September vouchers minus recurring payments, divided by voucher days, multiplied by accrual days. (Same as Chapters 31 & 32)	$ 428,569	$ 151,368
	TOTAL:	**$8,296,204**	**TOTAL:**	**$4,793,777**	**$3,502,427**

Based on our review for Fiscal Year 1996, we estimate that VBA overstated the education expense and accrued liability by $3,502,427.

[1] *Montgomery GI Bill - Active Duty*
[2] *Vocational Rehabilitation and Counseling (VR&C)*
[3] *Post-Vietnam Era Veterans Educational Assistance Program (VEAP)*
[4] *Dependent's Educational Assistance Program (DEA)*
[5] *Montgomery GI Bill - Selected Reserves*

Conclusion

While none of the above issues had a material effect on the Fiscal Year 1996 financial statements, VBA can take actions to strengthen HFC procedures and controls. We are, therefore, presenting the following observations and suggestions to improve the financial reporting process:

- Discontinue understating expenditures and accrued liabilities by requiring HFC staff to post only those returned check amounts on the G/L that are for “canceled” checks which are no longer considered liabilities.

- Initiate programming upgrades to permit existing accounting systems to accept accrual amounts totaling over 8 digits.

- Notify VAROs of the importance of submitting bank deposit data on a timely basis, or make adjusting entries for bank deposits to avoid recording them in an improper accounting month.

- Change the current methodology for education benefits accruals in order to avoid overstating education benefits expense and the related accrued liability.

DETAILS OF AUDIT

Debt Management Center Internal Controls

VBA management has not taken action to correct two problems found in prior audits. These issues continue to warrant management's attention:

- DMC does not record interest charges for accounts receivable related to C&P overpayments. In addition, DMC does not allocate administrative costs associated with maintaining these accounts to the debtors.

- DMC does not analyze loans receivable to determine if the current practice of assuming two-thirds of loans receivable is an appropriate allowance for loss on loans receivable.

Interest and Administrative Costs of Accounts Receivable

Public Law (PL) 96-466 (Veterans Rehabilitation and Education Amendments of 1980) and Title 38 U.S.C., Section 5315, prescribe that interest and administrative costs shall be charged for debts owed to the Government due to participation in a benefits program administered by the Secretary, other than a loan, loan guaranty, or loan-insurance program.

We have reported this condition of non-compliance with PL 96-466 in every year since Fiscal Year 1992. VBA has responded that it will not comply because, in a July 1992 decision, the former VA Deputy Secretary decided that VA would not charge interest on C&P debts.

The details of this finding will be presented in the Fiscal Year 1996 Office of Inspector General national VA financial statement audit report.

Allowance for Loss on Loans Receivable

DMC staff continue to perform incomplete analysis of the "Allowance for Loss on Loans Receivable." VARO St. Paul, MN accounting staff, on behalf of the DMC, calculate the allowance for loss as 66 percent of the year-end loans receivable for Appropriation 4118, "Education Loan Fund Liquidating Account." VBA staff calculate this allowance without an analysis of collections and write-offs from prior years and without an "aging" of the receivables. Prior audits, since 1992, have also noted an absence of complete analysis of the allowance accounts.

The absence of a complete analysis by DMC staff to determine the "Allowance for Loss on Loans Receivable" at year-end could result in errors or irregularities in VA financial statements.

Conclusion

The national financial statement report will address VBA's not recognizing the interest and administrative cost charges associated with C&P accounts receivable in compliance with PL 96-466 and Title 38 U.S.C., Section 5315.

We suggest that DMC staff analyze the adequacy of the "Allowance for Loss on Loans Receivable" as part of their year-end procedures. The analysis should include the amount of collections and write-offs in prior years, the aging of receivables, and DMC staff's cumulative knowledge regarding the probability of collecting receivables.

DETAILS OF AUDIT

Regional Office Internal Controls

We identified opportunities for VBA staff to improve controls for: accessing Benefits Delivery Network (BDN) information; processing, storing, and retrieving data; and processing C&P and education awards.

Controls Over Access to BDN Information

Our audit showed that VARO staff used BDN security access codes that exceeded VA Central Office (VACO) guidelines. Audit tests showed that Adjudication and Finance staff used BDN security access codes that were not in conformance with VACO policy. We sampled 75 employees (39 in adjudication and 36 in finance) to test their access to the BDN and found that 34 adjudication employees (87 percent) and 34 finance employees (94 percent) had access capabilities beyond the scope of current VA policy.

VA issued relevant policy in Manual M23-1, Part V, Appendix B, Change 15 on April 16, 1985. This policy provides a detailed listing of codes that VBA should issue to staff processing claims. Limiting access is a fundamental control designed to discourage the improper manipulation of data and to maintain an adequate separation of duties among staff processing claims.

However, since the issuance of the policy, VBA continues to disseminate additional codes to VAROs as VBA makes program and EDP changes. These periodic changes have contributed to supervisors issuing new codes from time to time without the formality of a detailed authorization and documentation process.

We believe that the rapidly changing EDP environment has resulted in obsolete security access policies and weakened security controls.

Controls for Processing, Storing, and Retrieving Data

Veterans' benefits information in the BDN system did not always agree with documents found in the veterans' claim folders. This occurred because VARO staff did not input and update all master records in BDN when receiving verifying information needed to adjudicate claims.

The importance of correctly inputting, processing, and maintaining secured data in the BDN system is underscored if VBA intends to achieve a paperless work environment. Such an environment will eventually eliminate the capability to verify electronic data with alternate source documents now retained in veterans' claim folders.

In total, we reviewed 145 C&P folders and 73 education folders at the four VAROs we visited. We looked at C&P (BDN Master Record M-11 screens) and education (BDN Master Record M-21 screens) and compared the data in the system to source documents in the claim folders. We also reviewed Beneficiary Identification and Records Locator System (BIRLS) data and related BDN financial screens providing payment data.

The following issues did not have a material effect on the financial statements, but we are providing these observations to alert managers and staff to the continuing need to improve processing controls:

Compensation and Pension:

- In eight cases (5.5 percent), BDN did not contain accurate veteran's military service dates.

- Five cases (3.4 percent) did not contain the same claimant address in BDN as documented in the claim folder.

- Six cases (4.1 percent) did not contain the veteran's character of discharge in BDN which was documented in BIRLS.

- One case (0.7 percent) did not have all service-connected conditions listed in BDN.

- In one case (0.7 percent), VBA assigned an invalid social security number as a beneficiary's claim number.

- In one case (0.7 percent), BDN did not list all of the veteran's dependents.

<u>Education</u>:

- In two Chapter 1606[6] cases (2.7 percent), VBA failed to pay the beneficiaries for a legislative pay increase effective October 1, 1995.

- In one Chapter 1606 case (1.3 percent), VBA could not establish eligibility with an enrollment certificate. VARO staff concluded that the certification was mis-filed.

Processing Compensation, Pension, and Education Awards

Generally, we found that VARO staff were properly developing and approving claims for benefits. We randomly sampled 109 C&P cases (73 benefit payments and 36 transactions) and 63 education cases to confirm that payments were made to eligible veterans by employees designated to authorize claims. We also judgmentally sampled 16 C&P payments of $7,000 or more, and 20 special (outside the system) payments. For education awards, we judgmentally sampled 5 payments of $2,000 or more, and 5 special payments. We also tested controls and compliance factors at each site visited. The following issues were identified:

<u>Compensation and Pension</u>:

- In two cases, VARO staff paid the beneficiaries an incorrect amount. In one case, we found that the VARO overpaid a beneficiary $10,474. The other case showed that VARO staff underpaid a beneficiary $967.

<u>Education</u>:

- In one Chapter 1606 case, VARO staff paid the beneficiary twice during the same period (February 1996), resulting in a $376 overpayment.

- In two Chapter 30[7] cases, VARO staff erroneously paid the beneficiaries full-time rates when they should have been paid the three-quarter time rate. This resulted in $228 in overpayments.

[6] *Montgomery GI Bill - Selected Reserves*
[7] *Montgomery GI Bill - Active Duty*

Conclusion

We concluded that VACO officials needed to update security policies for accessing sensitive personal data and financial payment information in the BDN system. VBA officials need to improve the reviews of EDP security violations and training for security officers. VBA also needs to enhance controls for input, authorization, processing, storage, and retrieval of C&P and education data.

These issues did not have a material effect on financial statements, but we are providing the following observations and suggestions to alert managers and staff to the continuing need to improve processing controls. We discussed the following observations and suggestions with VARO staff at the sites visited:

- Update EDP access code policies to reflect programming changes affecting award processing.
- Improve VARO procedures and controls for entering and updating EDP master record data.
- Emphasize the need for regular reviews of BDN security violations and thorough training for security officers.
- Improve quality controls for processing and authorizing C&P and education awards.
- Recover the $10,474 overpayment in the case noted from the beneficiary's running award, and resolve other over- and under-payments identified.

FINAL REPORT DISTRIBUTION

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