



Department of
Veterans Affairs

Office of Inspector General

MANAGEMENT LETTER FISCAL YEAR 1996 FINANCIAL STATEMENTS VA LIFE INSURANCE PROGRAMS

*While enhancements continue
to be needed, VBA staff have
made many improvements.*

Report No.: 7R1-G10-072

Date: April 11, 1997

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, Office of Resource Management (24)

**Management Letter - Fiscal Year 1996 Financial Statement
VA Life Insurance Programs**

1. The Office of Inspector General (OIG) audited selected Philadelphia, PA and St. Paul, MN Department of Veterans Affairs (VA) Regional Office and Insurance Center internal controls as part of our review of VA's Fiscal Year 1996 Consolidated Financial Statements.¹ The purpose of the audit was to determine whether financial information processed at these centers was reliable and whether operations complied with applicable laws and regulations.
2. Overall we concluded that staff established required internal controls for monitoring financial information, and generally complied with VA policies and procedures based on audit tests made. VA management had corrected two of eight conditions discussed in our prior year audit report², had actions underway to correct five conditions, and had not taken action to address one condition which we recommend be eliminated from further consideration. No new conditions were identified in this year's audit.
3. None of the issues reviewed had a material effect on VA's financial statements, based on audit tests made. Therefore, we are not making any formal recommendations. However, we are providing you our observations to reemphasize the continuing need and importance of enhancing internal controls and improving operations.
4. You are not required to provide an official response to this management letter. However, we would appreciate any written comments you wish to make. We will continue to monitor these issues during future yearly financial statement audits.

¹ Report No. 7AF-G10-051, dated February 25, 1997, Report of Department of Veterans Affairs Consolidated Financial Statements For Fiscal Years 1996 and 1995.

² Report No. 6R1-G10-075, dated July 24, 1996, Management Letter, Fiscal Year 1995 Financial Statements, VA Life Insurance Programs.

5. 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 617-687-3120.

For the Assistant Inspector General for Auditing

(Original signed by:)

THOMAS L. CARGILL, JR.

Director, Bedford Audit Operations Division

PURPOSE, SCOPE AND METHODOLOGY

Purpose

As part of our audit of the Department of Veterans Affairs (VA) Fiscal Year (FY) 1996 Consolidated Financial Statements, we determined whether financial information processed at the Regional Office and Insurance Centers at Philadelphia, PA and St. Paul, MN was reliable and whether operations complied with applicable laws and regulations.

Scope and Methodology

In performing this audit, we evaluated internal controls and tested data presented on the FY 1996 Consolidated Financial Statements. We reviewed financial and administrative records; and, tested selected general ledger accounts, cash reconciliations with the Department of the Treasury for life insurance and loan guaranty receipts, cash receipts, investment transactions, life insurance benefit payments, policy loans, premium receipts, dividend payments and the mathematical accuracy of actuarial reserve summary reports as well as other data used in the financial statements.

In support of the above tests, we reviewed general ledger entries, various reports prepared by actuarial and finance staff, microfiche, and hard-copy veterans records. We also selected a sample of 52 life insurance policyholders and a second sample of 51 mortgage life insurance policyholders to confirm that data maintained in the computer system is accurate. Letters sent to the sampled policyholders confirmed system generated data. This examination was accomplished at three sites: the VA Regional Office and Insurance Center (VAROIC) Philadelphia, PA, VAROIC St. Paul, MN, and, Veterans Benefits Administration (VBA) Office of Resource Management, Loan Guaranty and Insurance Accounting and Reporting Division at Washington, D.C.

The audit was performed in accordance with *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*. The audit consisted of such tests as we considered necessary under the circumstances.

BACKGROUND

VA life insurance programs are managed by Insurance Service officials at VAROIC Philadelphia, with a field operating office at VAROIC St. Paul. These offices collect premiums, maintain policies, and pay death and disability claims for the six insurance programs that are administered directly by VA. The Insurance Service also supervises the group life insurance policy issued by a major insurance company (*The Insurer*), which provides Servicemember's Group Life Insurance (SGLI) to members of the uniformed services and Veterans' Group Life Insurance (VGLI) to separated veterans. The day to day operations of these programs are handled by The Insurer's Office of Servicemembers' Group Life Insurance at Newark, NJ.

The Insurance Service Actuarial Staff in Philadelphia prepared the financial statement information for the VA insurance programs. As of September 30, 1996, there were approximately 2.7 million policies in force in the six VA-administered life insurance programs representing over \$24.7 billion face value. The SGLI and VGLI programs administered by The Insurer accounted for another 3 million policies with over \$535.6 billion face value.

Effective April 1, 1995, the Finance Division of VAROIC Philadelphia assumed accounting responsibility for nationwide loan guaranty funding fee and portfolio loan collections. Fiscal Year 1996 funding fee receipts totaled \$168.5 million, and portfolio loan receipts were \$107.1 million.

DETAILS OF AUDIT

We found that management had completed corrective action sufficient to resolve weaknesses noted in two of eight areas during last year's audit, and provided adequate explanation to resolve weaknesses in a third area. Additionally, we noted no new conditions requiring management action.

Policyholder Files

In past years we noted that policyholder files needed to be maintained in a secure manner, and that VBA needed to establish formal policy on information retained in policyholder files. The Insurance Service moved into a new building about September 1996. Policyholder files stored in the new building are generally secure and located away from public access and high traffic areas. Desks of supervisory personnel are strategically located to restrict unauthorized people from entering the Files Section. This satisfactorily provides security for clients' personal data. Also, formal guidelines were issued on May 3, 1996 prescribing information to be retained in the files. We consider this item resolved.

Periodic Change of Computer Passwords to Process Cash Collections

Clerks in the Cash Collections Section are required to enter a password in order to begin processing remittances. However, their passwords were not periodically changed during FY 1995 and prior periods. Management stated that Collections Section passwords were changed on a regular basis during the latter part of FY 1996. Also, VA Manual 29-1, Part 1, Change 4, was issued on January 30, 1997, including guidelines for Collections Section personnel to change terminal passwords every 4 months. Last year's audit report also noted that access to cash resources and records should be limited, and accountability for the custody and use of resources should be assigned and maintained. The above manual also satisfactorily addresses these access and accountability issues. We consider this item resolved.

Summary Accounting Data

Reports from audits of the last 2 years noted that insurance accounting system reports needed additional detailed audit trail information and totals summarizing transactions. While management concurred that having all information in one report would make it complete and easy to reconcile, they considered improvement to be a low priority because the information questioned did exist in multiple sources. Management added that previous auditors found difficulty when auditing,

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in that they were unfamiliar with the system and had to obtain data from many sources. Management also stressed that the Insurance Service has never had a “business driven” need to compile the questioned data into one report. We recognize and accept management’s position and understand that the data is available. Therefore we are removing this recommendation from further audit and management consideration.

DETAILS OF AUDIT

Management had actions underway to resolve weaknesses in five of eight areas noted as open during last year's audit.

Philadelphia Data Processing Center Disaster Recovery Plan

Audit reports from prior years indicated that the Center's disaster recovery plan had been updated, but received limited testing. Adequate testing could not be performed because of hardware incompatibility between Philadelphia, PA Benefits Delivery Center (BDC) and Hines, IL BDC (the backup site). Federal Information Processing Standards Publication Number 87, *Guidelines for ADP Contingency Planning*, requires that contingency planning be performed to ensure that all critical functions can be continued in the event of a disruption in processing, or the inability to access the building housing the data center.

VA planned to test the recovery plan in June 1996. However, the Philadelphia, PA BDC moved to a new building in mid-1996 which precluded the finalization and testing of the plan with Hines, IL BDC, the backup site. Management indicated that efforts are continuing to finalize and test the disaster recovery plan in FY 1997.

Accounts Receivable - Allowance for Uncollectible Items

Past year audits noted that VBA needed to review accounts receivable and establish an allowance account for uncollectible items based on collection experience and other analysis including aging reports. As of September 30, 1996, VAROIC Philadelphia had about 470 items in accounts receivable amounting to about \$900,000 (excluding fraud related accounts). We noted that VAROIC Philadelphia had not analyzed their accounts receivable or determined them collectible. Therefore, they may be misstated, and warrant management attention.

VAROIC management have been developing a program to house both accounts receivable and data for uncollectible items in a new environment and included system development provisions in the Finance Division's Work Plan for FY 1997.

Accounts Receivable - Interest Charges

VBA did not charge interest on accounts receivable as required by veterans benefits legislation. VAROIC Philadelphia officials are coordinating actions to

computerize accounts receivable tracking, assess reserves needed for bad debts and establish a bad debt account and the interest rate to be charged.

Programming Enhancements

Prior years' recommended actions included (1) incorporating premium and other information currently obtained from charts and tables as part of a VMLI data base and (2) creating algorithms to calculate needed VMLI information. Management indicated that the VMLI program computer software is being rewritten and the actuarial staff is assessing the system.

Prior years' audits also recommended enhancing the insurance awards system security module by eliminating the ability for one individual to input and authorize a disbursement transaction without approval by a second person. This weakness existed at both insurance centers during FY 1996 within the *Falcon* system (a licensed software package). The Awards Data Entry (ADE) System (a new system for processing insurance claims) was installed at the Philadelphia Insurance Center in December 1996, as a partial replacement for *Falcon*. ADE has controls which prohibit one person from both initiating and authorizing a disbursement transaction. However, the older *Falcon* system is still used exclusively for disbursements by the St. Paul Insurance Center, and is operational for certain disbursements from the Philadelphia Center.

In February 1997, Insurance Service management terminated the use of *Falcon* to make lump sum awards disbursements at Philadelphia. However, the Philadelphia Insurance Center retained ability to make certain types of cash surrender and disability insurance disbursements through *Falcon*. The *Falcon* system is expected to be totally terminated at both insurance centers by the end of 1997. Until *Falcon* is terminated, associated disbursements need to be closely monitored to prevent transactions from occurring without independent review and approval.

Control Procedures to Enhance the Reliability of the Veterans Mortgage Life Insurance (VMLI) Program Data Files

In FY 1992, VA began using its VMLI data files to support the VMLI reserves estimates. Accounting and auditing standards require that data used in compiling financial estimates be accurate, complete, and relevant. However, audits during the past 3 years indicated that differences had increased between information from policyholders and data from VMLI files. In FY 1994, 25 percent of responses from sampled policyholders confirmed differences in information reported from VMLI data files. These differences had increased to 36 percent and 38 percent of policyholder responses in FY 1995 and FY 1996, respectively.

The differences found by our sample represent errors in the VMLI data files which were not considered significant to the Consolidated Financial Statements taken as a whole; however, they resulted in misstating 6 percent of the FY 1996 balances tested for the VMLI program. Discrepancies such as these decrease the reliability of VMLI reserves estimates and need to be resolved.

To improve the reliability of VMLI data files, we previously recommended that VBA:

- (1) confirm critical information in the data files with all policyholders at year-end. Most policyholders receive their annual statements from their mortgage companies at the end of the calendar year. These statements provide information on outstanding mortgage balances, monthly payments, and other statistics that may be useful in confirming data.
- (2) establish a process to annually update segments of the data files as of December 31st of each year after the year of the initial confirmation process; and,
- (3) document the confirmation process.

Our audits of FY 1995 and FY 1996 noted that the recommended initial confirmation of all policyholders was not performed, and that the confirmation process used is accomplished once every 3 years. Insurance Service management stated that computer programming is underway to enhance the reliability of the VMLI program data files and is expected to be completed by April 1997. Thereafter, they plan to confirm critical information from all VMLI policyholders data files. We reaffirm that the above recommendations should be implemented. The comprehensive initial confirmation planned by management is satisfactory to establish the integrity of VMLI data, and to resolve the significant rate of discrepancies. Thereafter, annual confirmations to update segments of the data files at years-end would safeguard the accuracy of critical information and require minimal additional resources.

FINAL REPORT DISTRIBUTION

VA Distribution

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