



Department of  
Veterans Affairs

# Office of Inspector General

**MANAGEMENT LETTER  
FISCAL YEAR 1997  
FINANCIAL STATEMENTS  
VA LIFE INSURANCE PROGRAMS  
AND SELECTED LOAN GUARANTY  
PROGRAM FINANCIAL ACTIVITIES**

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

**Report No.: 8R1-G10-106**

**Date: May 29, 1998**

**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 1997 Financial Statement**  
**VA Life Insurance Programs and Selected Loan Guaranty Program Financial**  
**Activities**

1. The Office of Inspector General (OIG) reviewed selected internal controls at the Department of Veterans Affairs (VA) Regional Office and Insurance Centers (located in Philadelphia, PA and St. Paul, MN) as part of our audit of VA's Fiscal Year (FY) 1997 Consolidated Financial Statements. The purpose of the audit was to determine whether financial information processed at these centers was reliable, accurate, and complete. In addition, we reviewed operations to evaluate compliance with applicable laws and regulations.
2. The six life insurance programs administered by VA represented over 2.5 million policies in force at September 30, 1997, totaling nearly \$24.1 billion of face value coverage. VA also supervised group life insurance issued by a major insurance company, which provided uniformed servicemembers and separated veterans another 2.9 million policies with nearly \$505.1 billion of face value coverage. The Finance Division of VA's Regional Office and Insurance Center in Philadelphia also provided nationwide accounting functions for \$101.6 million of loan guaranty funding fee receipts and \$74.9 million of portfolio loan receipts during FY 1997.
3. 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 one of five conditions discussed in our prior year audit report<sup>1</sup>, and had actions underway to correct three conditions. A fifth condition previously reported (ADP Disaster Recovery Plan) will be discussed in another Management Letter addressing ADP Security at the Philadelphia, PA Benefits Delivery Center. No new conditions were identified in this year's audit.

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<sup>1</sup> Report No. 7R1-G10-072, dated April 11, 1997, Management Letter, Fiscal Year 1996 Financial Statements, VA Life Insurance Programs.

4. None of the issues reviewed had a material effect on VA's financial statements, based on audit tests made. Therefore, we are making no new recommendations. However, we are reaffirming the recommendations made to you last year concerning: (i) analyzing accounts receivable and making provisions for uncollectible items, (ii) charging interest on accounts receivable, and (iii) confirming and updating critical policyholder information and documenting this process. We are also providing you our observations of the status of open conditions to reemphasize the continuing need and importance of enhancing internal controls and improving operations.

5. The findings and recommendations addressed in this report have been reviewed and discussed with and concurred in by members of your Insurance Service staff. Therefore, you are not required to provide an official response to this management letter. We will continue to monitor these issues during future annual financial statement audits. If you wish to discuss this report or would like our assistance concerning any other issues, please call me at 781-687-3120.

For the Assistant Inspector General for Auditing

*(Original signed by)*

THOMAS L. CARGILL, JR.  
Director, Bedford Audit Operations Division

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## **PURPOSE, SCOPE, AND METHODOLOGY**

### **Purpose**

As part of our audit of the Department of Veterans Affairs (VA) Fiscal Year (FY) 1997 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, accurate and complete. In addition, we reviewed VA's insurance operations for compliance with applicable laws and regulations.

### **Scope and Methodology**

In performing the audit, we evaluated Life Insurance Program internal controls and tested data presented on the FY 1997 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 (Agency Location Codes 103 and 310) and loan guaranty (Agency Location Codes 104, 313, and 372) 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, Insurance Terminal System transaction history screens, 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 reliable. Letters sent to the sampled policyholders confirmed system generated data. This examination was conducted through contacts 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 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 Division in VAROIC St. Paul is scheduled to close by FY 1999, following a 3-year consolidation of all in-house life insurance program functions in VAROIC Philadelphia. During FY 1997, 20 percent of active policy workload and all new death claims processing functions were transferred to the Philadelphia office. Transfer of active policy records was originally planned at about 5 percent (38,000) every other month, but was accelerated to monthly from December 1997 to April 1998. This accelerated consolidation took place due to a decline of staff in VAROIC St. Paul below anticipated levels.

The Insurance Service Actuarial Staff in Philadelphia prepared the financial statement information for the VA insurance programs. As of September 30, 1997, there were over 2.5 million policies in force in the six VA-administered life insurance programs representing nearly \$24.1 billion face value. The SGLI program administered by The Insurer accounted for another 2.9 million policies with nearly \$505.1 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 1997 funding fee receipts totaled \$101.6 million, and portfolio loan receipts were \$74.9 million. As of June 24, 1997, portfolio loan collections were turned over to a private contractor.

**DETAILS OF AUDIT - Improvements Completed**

We found that management had completed action sufficient to resolve weaknesses in one of four areas (Programming Enhancements) reported in prior years' audits. Prior years' audits identified the need for additional programming enhancements by recommending actions to: (i) eliminate the ability for one individual to input and authorize an insurance award disbursement, (ii) incorporate premium and other information into the Veterans Mortgage Life Insurance (VMLI) program data base, and (iii) create algorithms to calculate needed VMLI program information. Management implemented the intent of these recommendations. Additionally, we noted no new conditions requiring management action.

**Programming Enhancements**

During FY 1997, management substantially reduced the ability for one individual to input and authorize an award disbursement, implemented system programs to calculate VMLI program premiums, and deferred creating computer based algorithms indefinitely, because of their questionable benefit.

The Insurance Service reduced the ability for one individual to input and authorize an awards disbursement transaction without approval by a second person, installed the Awards Data Entry (ADE) System (a new system for processing insurance awards), terminated processing insurance awards at VAROIC St. Paul, and limited the use of the *Falcon* system at Philadelphia, while increasing oversight controls. The ADE system has controls which prohibit one person from both initiating and approving award disbursements. In addition to terminating VAROIC St. Paul's insurance awards processing function, management limited VAROIC Philadelphia's use of the *Falcon* system to disbursing certain types of cash surrenders, commuted value, and disability insurance awards payments. These (*Falcon*) awards also received increased oversight, representing a post-transaction review designed to identify attempts by one individual to both initiate and approve a disbursement. The new ADE system and oversight improvements were implemented for about 90 percent of all insurance awards disbursed in FY 1997. Therefore, we consider this weakness resolved.

In FY 1997, the Insurance Service completed a system revision which calculates VMLI program premiums by means of a stand alone Fortran program. They considered this methodology better than incorporating the premiums into the database, as recommended, or following the previous procedure of obtaining this information from charts and tables. We agree with management's actions, and consider this portion of our recommendation resolved.

In addition, Insurance Service management deferred creating computer based algorithms indefinitely, since only the Actuarial Staff would potentially need algorithms to determine VMLI program reserves. The Actuarial Staff include VMLI program information from the database in their calculations, without using computer based algorithms, and are satisfied with their accuracy. Thus, creating computer based algorithms has been deferred indefinitely, and is of questionable benefit to the Life Insurance Program operations. Because of these circumstances, we consider the Insurance Service actions practicable and the recommendation resolved.



**DETAILS OF AUDIT - Improvements Underway**

Management had actions underway to resolve weaknesses in three of four areas (Allowance for Uncollectible Items, Interest Charges on Accounts Receivable, and VMLI Program Database Enhancements) noted as open during last year's audit. Prior years' audits recommended: (i) analyzing accounts receivable and making provisions for uncollectible items, (ii) charging interest on accounts receivable, and (iii) enhancing the reliability of the VMLI program database. During FY 1998, management initiated actions to record an allowance for doubtful accounts, to analyze collecting interest on accounts receivable, and to plan accomplishing a one-time confirmation of all VMLI program data.

**Allowance for Uncollectible Items**

Past years' audits noted that management needed to review accounts receivable and establish an allowance account for uncollectible items based on collection experience and other analyses including aging reports. At the end of FY 1997, VAROIC Philadelphia Life Insurance Program accounts receivable totaled 516 items amounting to about \$960,000 (excluding anticipated recoveries from fraud convictions). These items were not analyzed to determine their collectibility.

However, management initiated several actions after the close of FY 1997. In January 1998, management implemented a new computer program application to collect and track Life Insurance Program accounts receivable, and began monitoring these activities. Insurance Service officials indicated that during the first half of FY 1998, 99 accounts (\$1,038) were written-off as uncollectible and 91 accounts (\$241,879) were referred to the Internal Revenue Service for offset. Management also requested system design revisions for new general ledger accounts to record allowances for doubtful accounts and associated bad debts expenses. This system revision is scheduled for completion by September 1998.

**Interest Charges on Accounts Receivable**

Management continues to consider charging interest on accounts receivable, as required by veterans benefits legislation. However, the concept of charging interest on benefit debts has been an on-going debate, and is still unresolved. In response to a VA Office of Resource Management request for comments concerning charging interest on benefit-related debts, the VA Insurance Service responded that it should not be a high priority based on the small amount of receivables outstanding and the low probability of collecting many debts. Most of these receivables represent various types of overpayments to policyholders/beneficiaries over a period of years, which have since been prevented by improved

controls. The ultimate position on charging interest is currently under review by the Office of the Assistant Secretary for Finance and Information Resources Management.

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

Management plans to enhance the reliability of the VMLI program data files, but has been temporarily delayed because of resource constraints and consolidation of the St. Paul Insurance Center into Philadelphia. In FY 1992, VA began using its VMLI program data files to support the VMLI program reserves estimates. Accounting and auditing standards require that data used in compiling financial estimates be accurate, complete, and relevant. However, audits during FY 1994, FY 1995, and FY 1996 indicated that differences had increased between information from policyholders and data from VMLI program files. In FY 1994, 25 percent of responses from sampled policyholders confirmed differences in information reported from VMLI program data files. These differences had increased to 36 percent and 38 percent of policyholder responses in FY 1995 and FY 1996, respectively. In FY 1997 differences decreased slightly to 32 percent.

The differences found by our confirmations with sampled policyholders represent errors in the VMLI program data which resulted in misstating 13.7 percent of the FY 1997 cases tested for the VMLI program in the following areas:

- interest rate,
- effective date,
- mortgage term, and/or
- amount financed.

These data are used to determine mortgage balances and VMLI program reserves. Discrepancies such as these decrease the reliability of VMLI program reserves estimates and need to be resolved. However, these discrepancies did not significantly misstate VA's Consolidated Financial Statements taken as a whole, because the aggregate face value of policies in the VMLI program (approximately \$203 million) represents less than 1 percent of the total face value of policies in all VA-administered life insurance programs.

To improve the reliability of VMLI program data files, we previously recommended that management perform the following steps.

- (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.
- (3) Document the confirmation process.

Our audits of FY 1995, FY 1996, and FY 1997 noted that the recommended initial confirmation of all policyholders was not performed, and that the confirmation process used is accomplished once every 3 years. St. Paul officials indicated that a one-time confirmation of all VMLI program data was planned, but was not accomplished because of higher priority work. No revised target implementation date was established. As noted previously, all in-house life insurance program functions are being consolidated in VAROIC Philadelphia over a 3-year period beginning in FY 1997. Insurance Service officials anticipate that this consolidation will result in added resources being made available to correct the above problems. In April 1998, transfer of program functions to Philadelphia were ahead of schedule, and are anticipated to be completed before the year 2000.

We reaffirm that the above recommendations should be implemented. The comprehensive initial confirmation planned by management is satisfactory to establish the integrity of VMLI program 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**

Assistant Secretary for Management (004)

Under Secretary for Benefits (20A11)

Deputy Assistant Secretary for Financial Management (047)

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Director, VA Regional Office and Insurance Center (310)