



Department of  
Veterans Affairs

# Office of Inspector General

**MANAGEMENT LETTER  
FISCAL YEAR 1998  
FINANCIAL STATEMENTS  
VA LIFE INSURANCE PROGRAMS  
AND SELECTED LOAN GUARANTY  
PROGRAM FINANCIAL ACTIVITIES**

*VBA staff are implementing  
improvements, although enhancements  
are still needed.*

**Report No.: 9R1-G10-100**

**Date: May 21, 1999**

Office of Inspector General  
Washington DC 20420



**DEPARTMENT OF VETERANS AFFAIRS  
Office of Inspector General  
Washington DC 20420**

**Memorandum to: Director, Regional Office and Insurance Center (310)**

**Management Letter – Fiscal Year 1998 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) 1998 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 2.4 million policies in force at September 30, 1998, totaling over \$23 billion of face value coverage. VA also supervised group life insurance issued by a major insurance company, which provided uniformed servicemembers and separated veterans with 2.8 million policies having a face value of nearly \$481 billion.
3. The Finance Division of VA's Regional Office and Insurance Center in Philadelphia provided accounting for certain loan guaranty funding fee and portfolio loan collections during FY 1998. VA processed funding fees totaling about \$21.9 million through January 1998; subsequently the accounting and collection of funding fees was contracted out to a vendor. Philadelphia's Finance Division also accounted for about \$502,000 of initial collections for new portfolio loans for three regional offices (Baltimore, Washington and Philadelphia), until accounts could be established in the portfolio loan contractor's system.
4. 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. However, some control weaknesses noted in prior years continued to exist. VA management had actions underway to correct three conditions discussed in our prior year audit report<sup>1</sup>. For these three issues, we

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<sup>1</sup> Report No. 8R1-G10-106, dated May 29, 1998, Management Letter, Fiscal Year 1997 Financial Statements, VA Life Insurance Programs and Selected Loan Guaranty Program Financial Activities.

reaffirmed 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 our observations of the status of open conditions to reemphasize the continuing need and importance of enhancing internal controls and improving operations.

5. One new condition identified in this year's audit related to the verification of some insurance disbursements. We noted that most computer generated insurance payments were disbursed without being verified to supporting documents. ADP system controls were relied on to support the integrity of these disbursements. The effectiveness of ADP general controls was tested and reported<sup>2</sup> separately, and found vulnerable to unauthorized and undetected alteration, or destruction. Because of these access control weaknesses, we expanded testing of disbursements to awards beneficiaries, and concluded that other financial controls generally reduced the risk associated with the alteration or destruction of information, except for computer generated disbursements. While compensating controls play a significant role in supporting financial integrity, increased verifications will enhance these controls and reduce the risk of altered or unauthorized computer generated disbursements. We are therefore recommending increased oversight of insurance funds by implementing sample verifications of computer generated disbursements.

6. None of the issues reviewed had a material effect on VA's financial statements, based on audit tests made. 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

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

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<sup>2</sup> Report No. 9AF-G10-087, dated April 22, 1999, Management Letter, ADP Security at Philadelphia Regional Office and Insurance Center and Benefits Delivery Center.

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

### **Purpose**

As part of our audit of the Department of Veterans Affairs (VA) Fiscal Year (FY) 1998 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 1998 Consolidated Financial Statements. We reviewed financial and administrative records, and tested selected general ledger accounts, fund balance reconciliations with the Department of the Treasury for life insurance and loan guaranty (Agency Location Codes 104, 310, 313, and 372) 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 were sent to the sampled policyholders to confirm system generated data. We compared responses to insurance files associated with the sampled records and discussed discrepancies with the VA Regional Office and Insurance Center (VAROIC) Philadelphia staff. This examination required documentation reviews at three sites: 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 was scheduled to close at the end of FY 1999, following a 3-year consolidation of VA-administered life insurance program functions in Philadelphia. All new death claims processing functions were transferred to VAROIC Philadelphia during FY 1997. Seventy-five percent of the active policy workload and the entire Veterans' Mortgage Life Insurance program operations were consolidated by the end of FY 1998. The transfer of all St. Paul life insurance program operations was completed in March 1999.

The Insurance Service Actuarial Staff in Philadelphia prepared the financial statement information for the VA insurance programs. As of September 30, 1998, there were over 2.4 million policies in force in the six VA-administered life insurance programs representing nearly \$23 billion face value. The SGLI program administered by The Insurer accounted for another 2.8 million policies with nearly \$481 billion face value.

Accounting and collection responsibilities for nationwide loan guaranty funding fees and portfolio loans were assumed by VAROIC Philadelphia in 1995, and gradually privatized to contractors. In June 1997, portfolio loan accounting and collections were transferred to a contractor, except for initial payments on new portfolio loans. In FY 1998, VA collections of initial payments on new loans represented about \$502,000. VAROIC Philadelphia collected and accounted for \$21.9 million of manually processed funding fee receipts during the first 4 months of FY 1998. Thereafter, these functions were performed by a contractor.

**DETAILS OF AUDIT - Improvements Underway**

Management had actions underway to resolve weaknesses in three 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 1998, VAROIC Philadelphia Life Insurance Program accounts receivable totaled 433 items amounting to about \$1,030,213 (excluding anticipated recoveries from fraud convictions). These items were not analyzed to determine their collectibility.

Management initiated several actions during FY 1998. 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 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 and obtained system design revisions for new general ledger accounts to record allowances for doubtful accounts and associated bad debts expenses. A VAROIC Program Administration team reviewed legislation, analyzed existing accounts receivable, and recommended write-off criteria. These criteria were being reviewed for implementation by management.

**Interest Charges on Accounts Receivable**

Management did not expect to resolve the issue of charging interest on accounts receivable until completion of an accounts receivable analysis. The concept of charging interest on benefit debts has been an on-going debate. 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 steadily 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, but increased again to 39 percent in FY 1998.

The differences found by our FY 1998 confirmations with sampled policyholders represented errors in the VMLI program data, which resulted in misstating 11.8 percent of the financial data for the cases tested. The number of policyholders sampled was insufficient to project test results across the program universe, but did confirm continuing problems with the accuracy of VMLI program data. The VMLI program discrepancies existed in the following areas:

- VMLI coverage amount,
- interest rate, and/or
- amount financed.

These data are used by the Insurance Actuarial Staff 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 \$206 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 recommended that management:



### **APPENDIX III**

- (1) Confirm critical information in the data files with all policyholders at the end of each calendar year. 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) Document the confirmation process and take appropriate action to correct incomplete or inaccurate VMLI program data.

Our prior audits of FY 1995, FY 1996, FY 1997 noted that the recommended initial confirmation of all policyholders was not performed. Philadelphia officials indicated that a confirmation of VMLI program data is planned for FY 1999. As noted previously, all in-house life insurance program functions were recently consolidated in VAROIC Philadelphia. As of August 1998, responsibility for, and administration of, the VMLI program was transferred to the Philadelphia Insurance Center. Although the recommended confirmation had not been performed, management had implemented several VMLI system processing improvements since the consolidation.

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.

**DETAILS OF AUDIT - Improvements Needed**

Verifications need to be expanded for computer generated insurance program disbursements.

**Verifications of Insurance Disbursements**

Disbursements clerically initiated by Insurance Service staff were verified to supporting documents, while most computer generated transactions were disbursed without verification. The Insurance Service Internal Control Staff verified cash surrender, loan, lump sum death award, and clerically initiated endowment award disbursements to supporting records. However, computer generated dividends, refunds, and installment awards, representing an estimated \$489 million (29 percent) of annual insurance program disbursements, were not verified. These types of disbursements were also not itemized or quantified to permit sample analysis. Our testing did not identify any erroneous disbursements, although they were vulnerable to error or manipulation without being detected.

**Conclusion**

Insurance Service officials did not verify computer generated disbursements because of resource constraints, and their reliance on the ADP system internal controls. ADP controls play a significant role in supporting financial integrity. However, tests of the insurance program ADP controls concluded that significant weaknesses existed compromising system disbursements. Because of access control weaknesses, we expanded testing of disbursements to awards beneficiaries, and concluded that other financial controls generally reduced the risks associated with the alteration or destruction of information, except for computer generated disbursements. ADP access control weaknesses increased the vulnerability of computer generated disbursements to unauthorized and undetected alteration or destruction. Implementing external compensating financial controls by verifying a sample of computer generated disbursements will enhance financial integrity and reduce the risk of errors resulting from these weaknesses. Use of scientific sampling techniques would require minimal additional resources, while strengthening assurances of adequate controls.

**Recommendation**

We recommend that Insurance Service management increase oversight of Life Insurance Program funds by using sampling techniques to verify computer generated disbursements to supporting documents.

**FINAL REPORT DISTRIBUTION**

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