

VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS



Department of Veterans Affairs

*Audit of VA's
Consolidated Financial
Statements for Fiscal
Years 2009 and 2008*

November 16, 2009
09-00976-25

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Contents

Excerpts from Part III of the Department of Veterans Affairs' FY 2009 Performance and Accountability Report

Pages Excerpted

Memorandum to the Secretary	51
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Section I – Independent Auditors' Reports

- Independent Auditors' Report.....52
- Independent Auditors' Report on Internal Control Over Financial
Reporting and Compliance and Other Matters.....53-77
- Acting Assistant Secretary for Management's Comments.....78

Section II – Financial Statements

- Consolidated Financial Statements.....4-9
- Notes to Consolidated Financial Statements.....10-49
- Required Supplementary Stewardship Information (Unaudited).....79-84
- Required Supplementary Information (Unaudited).....85-86

Report Distribution

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FY 2009 Performance and Accountability Report,
please go to the following web site:
<http://www.va.gov/budget/report/>**



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

TO: Secretary of Veterans Affairs (00)

SUBJECT: Audit of VA's Consolidated Financial Statements for Fiscal Years 2009 and 2008

1. We contracted with the independent public accounting firm, Deloitte & Touche LLP, to audit VA's consolidated financial statements as of September 30, 2009 and 2008 and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of Deloitte & Touche LLP's audit are presented in the attached reports.

2. Deloitte & Touche LLP provided an unqualified opinion on VA's fiscal year 2009 and 2008 consolidated financial statements. They also identified four material weaknesses. Three of the four material weaknesses are repeat conditions from the prior year audit and identified as (i) financial management system functionality, (ii) information technology security controls and (iii) financial management oversight. The fourth material weakness, compensation, pension, and burial liabilities, was identified during the fiscal year 2009 audit.

3. Deloitte & Touche LLP reported that VA is not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996 because VA did not substantially comply with Federal financial management systems requirements. They also noted four other instances of non-compliance with law, including a violation of the Antideficiency Act.

4. Deloitte & Touche LLP is responsible for the attached auditor's report dated November 16, 2009, and the conclusions expressed in the report. We do not express opinions on VA's financial statements or internal control or on whether VA's financial management systems substantially complied with FFMIA; or conclusions on compliance with laws and regulations. Independent auditors will follow up on these internal control findings and evaluate the adequacy of corrective actions taken during the fiscal year 2010 audit of VA's consolidated financial statements.

BELINDA J. FINN
Assistant Inspector General
for Audits and Evaluations

Attachments

Section I

Independent Auditors' Reports

- **Independent Auditors' Report**
- **Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance and Other Matters**
- **Assistant Secretary for Management's Comments**



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INDEPENDENT AUDITORS' REPORT

To the Secretary and the Inspector General of
Department of Veterans Affairs

We have audited the accompanying consolidated balance sheets of the Department of Veterans Affairs ("VA") as of September 30, 2009 and 2008, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources for the years then ended which collectively comprise VA's basic financial statements. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget ("OMB") Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of VA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VA as of September 30, 2009 and 2008, and its net costs, changes in net position, and budgetary resources thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2009, on our consideration of VA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

November 16, 2009

Member of
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INDEPENDENT AUDITORS’ REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Secretary and the Inspector General of
Department of Veterans Affairs

We have audited the basic financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2009, and have issued our report thereon dated November 16, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered VA’s internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of VA’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of VA’s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.



Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

We identified the matters in Sections I and II involving the internal control over financial reporting and its operation that we consider to be significant deficiencies. In Section III, we identify matters relating to compliance with laws and regulations. The significant deficiencies and compliance issues that we also identified in our prior year report dated November 17, 2008 are identified in this report as "Repeat Condition".

Deficiencies described in Section I include significant departures from certain requirements of OMB Circular A-127, *Financial Management Systems*; Circular A-123, *Management's Responsibility for Internal Control*; and Circular A-130, *Management of Federal Information Resources*. We consider each of the four deficiencies identified as "Financial Management System Functionality," "Information Technology (IT) Security Controls," "Financial Management Oversight", and "Compensation, Pension and Burial Liabilities" to be material weaknesses.

Distribution

This report is intended solely for the information and use of the VA Office of Inspector General, the management of VA, the Office of Management and Budget, the U.S. Government Accountability Office, Office of the President, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

November 16, 2009



SECTION I — MATERIAL WEAKNESSES

We consider the following deficiencies in VA's internal control over financial reporting to be material weaknesses as of September 30, 2009:

1. Financial Management System Functionality – Material Weakness (Repeat Condition)

The VA operates different legacy financial systems to support its missions including a core accounting system and business line specific financial systems, such as the Financial Management System (FMS), and Benefits Delivery Network (BDN), the Fixed Assets Package, and medical center systems. The business line financial systems provide summary transactions to the core general ledger system to generate VA's consolidated financial statements. Many of these systems are outdated, leading to inefficiencies in the reliable, timely and consistent preparation, processing, and analysis of financial information for VA's consolidated financial statements and are inherently more difficult to integrate than systems based on newer technologies. In fiscal year 2008, VA started the transition from BDN to Veterans Services Network (VETSNET), a new system that had not been integrated into FMS as of September 30, 2009.

To assist in managing the preparation of consolidated financial statements, VA management implemented a reporting system (MinX) to automate the preparation of the consolidated financial statements in fiscal year 2006. Although it has provided significant improvement, we identified continuing difficulties with the legacy systems related to the reliable, timely and consistent preparation, processing, and analysis of financial information for VA's consolidated financial statements. VA management continues to work to remediate the integration and functionality issues but significant challenges remain. Key examples of significant deficiencies resulting from the legacy systems are:

Conditions:

- VA closes its general ledger system at year-end on September 30 and then allows additional entries to be recorded in a "period 13" general ledger. Under the current process, period 13 is kept open on October 1 for one day. However, many entries cannot be identified and recorded in just one day and need to be recorded after period 13 is closed. These entries often are the result of routine account analysis and reconciliation. Business lines also need more time to record their normal recurring or year-end entries. Because the general ledger is closed after October 1, VA uses the MinX reporting system as a de facto general ledger.

This period 13 one day window is the primary cause of a significant number of manual entries being posted through the MinX reporting system at year-end to prepare the financial statements. There is not a process in place to record the MinX entries, or their net effect, in the VA's general ledger system. Therefore, the MinX reporting system includes the cumulative net effect of the entries recorded in it each and every year, from the date the VA commenced using it, but the general ledger system does not. As a result, the general ledger system does not contain accounts with the balances that are reported in VA's issued financial statements.



- The BDN system does not retain detail transactional data supporting the general ledger activity for more than 60 to 90 days. During fiscal year 2008, the Veterans Benefits Administration (VBA) began transferring BDN data into its Data Warehouse which allowed BDN data to be retained and retrieved to support the financial statements. However, certain detail transaction data such as Chapter 31 and 35 education benefit expense details, BDN receivable setup, write-offs, and waivers continue to be overwritten and not retained in the Data Warehouse.
- Formal internal control policies and procedures were not established for the transfer of data to the Data Warehouse until June 2009, and have not been fully implemented as of September 30, 2009. In addition, formal internal control procedures have not been established for the maintenance of such data once contained in the Data Warehouse.
- Due to a system limitation, VBA could not provide sub-ledgers or veteran-level details to support certain amounts recorded in FMS; detailed support for miscellaneous “A-28” adjusting entries to Compensation and Pension (C&P) benefit expenses; expense details for Chapter 18 education benefits; and a detailed transaction listing to support certain deductions from education benefits due to prior overpayments.
- Due to the lack of a functioning interface between VETSNET and FMS, transactions originated and recorded in VETSNET are not automatically posted in FMS. Instead, on a monthly basis, VETSNET transactions are captured on manual journal entries, posted to the BDN system, and since BDN transactions are posted to FMS, eventually included in the FMS account balances. The manual journal entries prepared monthly have a dollar limitation of \$999,999.99 imposed by the system, and as a result, thousands of manual journal entries are prepared each and every month for recording into the BDN system.
- Automated inventory systems at the Consolidated Mail Outpatient Pharmacy (CMOP) facilities were primarily developed for operations and accordingly cannot provide the data needed to record the proper cost of inventory. Automated systems implemented at the CMOP facilities have different software versions which prevent standardized control and summary reports from being generated.
- The Fixed Asset Package (FAP) does not readily provide information to support activity in the related general ledger accounts. The FAP cannot readily identify all current year property, plant and equipment additions and reclassifications or work in progress due to system limitations.
- VA does not have an automated cost allocation system that can identify and accumulate the information needed to prepare the statement of net cost. As a result, they use a complex set of spreadsheets which increases the risk of error.



Criteria - 31 U.S.C § 902 (a) (3) states that an agency Chief Financial Officer shall “develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which:

- (A) complies with applicable accounting principles, standards, and requirements, and internal control standards;
- (B) complies with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget;
- (C) complies with any other requirements applicable to such systems; and
- (D) provides for –
 - i. “complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management...”

OMB Circular A-127, *Financial Management Systems*, states that agency financial management systems “shall be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data within the systems...”

Cause – Many of the VA’s systems are outdated, leading to inefficiencies in the reliable, timely and consistent preparation, processing, and analysis of financial information for VA’s financial statements and are inherently more difficult to integrate than systems based on newer technologies.

Effect - The system deficiencies result in the inability to support certain amounts in the general ledger, significant manual workarounds, and the posting of a large number of journal entries that increase the risk of processing errors and misstatements in the financial statements.

Recommendation - The VA Chief Information Officer (CIO) and Chief Financial Officer (CFO) should work to improve system functionality in order to better support preparation of the financial statements and accountability of CMOP inventory and fixed assets, retain critical accounting data, and reduce the number of adjusting journal entries required. Also, formal internal control policies and procedures pertaining to the transfer and storage of data in the Data Warehouse should be established or fully implemented.

VA management should inventory all manual workaround processes performed during the year-end closing period and continue to make improvements through adjustment of timing, refinement and consolidation of the processes.

2. **Information Technology (IT) Security Controls – Material Weakness (Repeat Condition)**

The VA continued to make steady progress in addressing information technology (IT) security and control weaknesses in certain areas during fiscal year 2009. For example, VA management provided an increased level of information security training for Information Security Officers; revised the Risk Assessment methodology used as part of the Certification and Accreditation



process for IT systems; and implemented the revised risk assessment methodology for a limited number of systems. The Office of Information Technology continued to focus efforts on reducing the overall level of security and control weaknesses agency-wide, and the control environment at the three primary data centers showed improvement. However, in fiscal year 2009, IT security and control weaknesses remain pervasive. These security and control weaknesses continue to place VA’s program and financial data at risk. Our assessment of the general and application controls of VA’s key IT infrastructure and financial systems identified the following conditions.

Conditions:

Security Management

- Many IT security control deficiencies were not analyzed and remediated across the agency and a large backlog of deficiencies remained in the VA Plan of Action and Milestones (POA&M) system. In addition, previous POA&Ms were closed in the absence of sufficient and documented support for the closure.
- The risk assessments conducted as part of the Certification and Accreditation process did not always accurately identify the existence or effectiveness of certain security controls, and control recommendations based on the risk analysis were not consistently identified in the risk assessments.

Access Control

- Passwords for key VA network domains and financial applications were not consistently configured to comply with VA Handbook 6500.
- Access to BDN, VETSNET, and Veterans Health Information Systems and Technology Architecture (VistA) applications were not adequately restricted for system programmers and IT operations personnel.
- Reviews of user access to multiple financial applications, security violations, and system audit logs were not consistently performed or documented.

Segregation of Duties

- Many VistA application users had access to both Create and Approve purchase orders. In some instances, employees had access to Create and Approve purchase orders and Obligate funds, and in some instances employees had access to Obligate funds and make Payments in IFCAP and Obligate or make Payments in FMS. In addition, system programmers and IT operations personnel had update access to the production environment supporting the VistA application.

Configuration Management

- Change control policy and procedures for authorizing, testing, and approving changes were not consistently implemented and enforced to reduce the risk of data integrity issues related to VETSNET, BDN, VistA, and the Insurance System.
- Many systems, including network and application components, were not patched in a timely manner to mitigate vulnerabilities.



Contingency Planning

- The Master Continuity of Operations Plan (COOP), was not fully developed to provide overall guidance, direction, and coordination. Two of the major VA program offices did not formally develop COOPs.
- Testing of contingency plans for financial management systems at selected Veterans Health Administration (VHA) facilities and Regional Data Processing Centers were not routinely performed and documented to meet the requirements of VA Handbook 6500.

Criteria:

E-Government Act 2002, Title III, *Federal Information Security Management Act of 2002* states:

“Each agency shall develop, document, and implement an agency wide information security program to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source.”

OMB A-130, Appendix III, *Security of Federal Automated Information Resources* states:

“Agencies shall implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated in general support systems and major applications.”

Cause:

Despite taking positive steps toward reducing the number of deficiencies in the current year, management continues to face challenges to implement a more robust and consistent process to enforce the established security policies and procedures, and to analyze and remediate system security and control weaknesses throughout the large and geographically dispersed organization and for its diverse portfolio of legacy applications and newly implemented systems.

Effect:

Information security and control weaknesses place sensitive information, including financial information and veterans' medical and benefit information, at risk of inadvertent or deliberate misuse, fraudulent use, improper disclosure, theft, or destruction, possibly occurring without detection. In addition, inconsistent or inadequate contingency planning and testing increases the risk the VA would not be able to recover their systems and data in the timeframe required by the business owners to support their operations and financial reporting requirements.

Recommendations:

VA management should continue to devote resources to provide training and establish more effective processes to analyze the cause of reported deficiencies and to prioritize remediation activities to accomplish its security and control objectives. Key tasks should include, but are not limited to, the following:

- Apply a more robust process to implement corrective action plans to prioritize and remediate deficiencies reported in the POA&M system. Proactively apply controls to key financial management systems based on the deficiencies identified from independent audits and



management self-assessments and provide necessary training and fully implement the new risk assessments methodology for all systems subject to the C&A process.

- Implement a more rigorous process and procedure and provide appropriate training to ensure that system logical security settings and updates are properly implemented for all interconnected networks, systems, and applications; user access to VA financial management systems is authorized based on need; and that proper logging and oversight of system activities is performed.
- Identify and implement segregation of duties standards for financial management systems. Apply adequate resources to perform proper management, provide recurring training on segregation of duties requirements, and restrict the configuration of financial management systems.
- Facilitate a rigorous and consistent enforcement of change control policies and procedures for the development, testing, and implementation of changes and patches to VA financial applications and networks.
- Complete the Master Continuity of Operations Plan and complete and implement service continuity procedures that will provide effective guidance, communication, and coordination of service continuity planning and testing activities to enforce VA Handbook 6500 requirements.

3. **Financial Management Oversight – Material Weakness (Repeat Condition)**

Conditions:

We have identified 7 significant deficiencies that support the need for enhanced management oversight. Most of these deficiencies relate to observations also identified in prior years that remain uncorrected. When aggregated, the series of deficiencies has a recurring theme of inadequate or ineffective management oversight, thus resulting in an overall material weakness.

The following significant deficiencies support the overall material weakness and are also described in greater detail in Section II of this report:

- ***Outsourced Property Management (VBA)***
The VA uses an outside contractor to manage the day to day activities of properties owned by VA due to foreclosure. There is a lack of effective and efficient processes to transfer certain records to the VA on a timely basis.
- ***Incorrect Recording of Subsidy Reestimates (VBA)***
VBA management did not perform an effective review of reclassification entries entered by VBA personnel.
- ***Accounts Receivables (VBA)***
VBA financial management did not perform adequate reviews to ensure that accounts receivable were properly established and allowance analysis was performed on a timely basis.



- ***Accrued Services Payable and Undelivered Orders (VHA)***
VHA financial management did not perform adequate reviews to ensure that invalid obligations were de-obligated timely and that expenses were accrued and recorded in the correct period.
- ***Property, Plant and Equipment- Estimated Useful Life and Recording of Transactions (VHA)***
VHA financial management did not remove from the accounting records certain assets that were disposed of or traded in; and other transactions were incorrectly recorded.
- ***Property, Plant and Equipment - Work in Progress (VHA and OCFM)***
Work in progress balances were not reconciled to supporting documentation and reviewed for timely capitalization due to lack of policies and procedures that define roles and responsibilities over the reconciliation and review of medical center construction projects.
- ***Accrual for Unbilled Receivables and Allowance for Contractual Adjustments (VHA)***
VHA financial management has not initiated adequate processes to review the allowance for contractual adjustments and information used in the calculation of accrual for unbilled receivables to assure these amounts are recorded in accordance with generally accepted accounting principles.

Criteria – Management must maintain a system of internal controls in accordance with *Standards for Internal Control in the Federal Government* issued by the Government Accountability Office (GAO). These five standards for internal control include:

- **Control Environment** – It provides the discipline and structure as well as the climate which influences the quality of internal control.
- **Risk Assessment** – It is the identification and analysis of relevant risks associated with achieving control objectives.
- **Control Activities** – They are the policies, procedures, techniques, and mechanisms that enforce management’s directives.
- **Information and Communications** – Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.
- **Monitoring** – Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Cause – The operational causes for the deficiencies highlighted above vary. Common issues include a lack of human resources with the appropriate skills, a significant volume of transactions, and decentralization.



Effect – Recording financial data without sufficient review and monitoring increases the likelihood that an error in the financial statements will occur and go undetected.

Recommendations – Management should review its financial management organizational structure to determine if the financial management organization has sufficient authority and resources to solicit support to improve financial management at all levels of the organization. VA should also assess the resource and control challenges associated with operating in a highly decentralized accounting function. While the assessment is being performed, management should develop an immediate interim review and monitoring plan to detect and resolve issues in each of the deficiencies discussed above.

4. **Compensation, Pension, and Burial Liabilities – Material Weakness**

The Federal Employees and Veterans Benefit Liability on VA’s consolidated balance sheet includes an estimate of the present value of the future cash payments to be paid to veterans and their dependents for compensation and burial benefits. At September 30, 2009, this amount was approximately \$1.3 trillion. In addition, an estimate of the present value of the future cash payments for pension benefits is included in the notes to the financial statements. At September 30, 2009, this amount was approximately \$92 billion. Calculation of these estimates for the VA quarterly and annual financial statements involves many individuals from various departments within the VA. The accuracy of this calculation is highly dependent on (i) the accuracy of an actuarial liability model maintained by VA actuaries (ii) the accuracy and reasonableness of the assumptions used in the actuarial model, and (iii) the accuracy and completeness of the underlying detail veteran data provided by VBA Finance to the actuaries for input into the actuarial model.

The data that is needed for the actuaries to use in the actuarial model is derived from several different sources including VETSNET, BDN, and FMS. Assuring the data being provided to the actuaries is complete and accurate requires a number of analyses and reconciliations to be prepared prior to providing the data to the actuaries. VBA Finance has the responsibility to accumulate the needed data, perform the analyses and reconciliations, and provide the data to the actuaries. We noted that VBA Finance does not consistently provide complete and accurate data to the actuaries and therefore the resulting estimated liability may be incorrect and when corrected, the change could be material to the VA’s financial statements. Many of these errors are discovered through our audit procedures and therefore the VA is inappropriately dependent on their external auditor to identify errors.

We identified 3 significant deficiencies which support the need for enhanced internal control over the calculation of the estimated liabilities for compensation, pension, and burial. These significant deficiencies are described in greater detail in Section II of this report. They are:

- **Compensation, Pension, and Burial Actuarial Liabilities - Reconciliations and Data (VBA)**

VBA Finance did not completely reconcile expense data files to information provided to the actuaries and therefore was unable to provide the actuaries timely, accurate data to use in the actuarial model to calculate the estimated liabilities. In addition, VBA management did not provide the actuaries with all relevant data.



- **Financial Management Resources (VBA)**

The structure, number of personnel, and knowledge of personnel in VBA Finance is not adequate for the workload required of the department.

- **Lack of Accounting Policies and Procedures Regarding the Analysis of Events for Inclusion in the Actuarial Model (VBA and Office of Management)**

There are no accounting policies and procedures in place to effectively (i) identify events that need to be analyzed to determine if they need to be considered in the actuarial liability model, and (ii) determine when such events should initially be included in the actuarial model.

Criteria - OMB Circular A-123, *Management’s Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Effective internal controls over financial reporting require that management establishes policies and procedures that provide reasonable assurance of reliable accounting estimates, including procedures to ensure actuarial calculations are proper and effective in producing reasonable estimates.

Cause: The operational causes for the deficiencies highlighted above vary. Common issues include a lack of sufficient personnel with the appropriate knowledge and skills. Also, financial management does not consistently monitor, identify and detect these issues.

Effect: Lack of sufficient reconciliations and review of the actuarial model inputs could potentially result in material misstatements in the financial statements.

Recommendation: We recommend that VA management perform a gap analysis of its resources to adequately perform the needed analyses and reconciliations, hire and/or train key personnel to perform such work, and document the processes.

SECTION II — SIGNIFICANT DEFICIENCIES

We consider the following deficiencies in VA’s internal control over financial reporting to be significant deficiencies as of September 30, 2009. Items with an asterisk (*) are repeat observations included in a letter we issued to management in the prior year.

1. Outsourced Property Management (VBA-Loan Guaranty)

Condition - An outside contractor manages day to day activities of properties owned by VA due to foreclosure. These activities include the maintenance, marketing, and selling of the properties, and VA’s financing of their purchase through vendee loans. The VA reimburses the contractor for qualified expenses at the time the property is sold. During our site visit and substantive testing, we noted the following:

- The VBA and contractor were significantly behind schedule in processing property management invoices for qualified expenses.



- At year end, the contractor reported to VBA approximately \$41 million of vendee loans without sufficient supporting detail, which resulted in the transaction not being recorded in FMS on a timely basis and led to a violation of the Antideficiency Act as of September 30, 2009.

Criteria - OMB Circular A-123, *Management’s Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management’s responsibility includes proper oversight and administration of contracted functions.

Cause – Management attributed the invoice backlog to a change in contractors, which occurred in the prior fiscal year, business changes within the current contractor, and the lack of an effective process to transmit property management costs with supporting details to VBA in a timely manner. The contractor and VBA use manual reporting processes for property management expenses and vendee loans, leading to delays and potential errors.

Effect – Property management expenses may not be paid and recorded in VA’s financial records in a timely manner. A violation of the Antideficiency Act resulted from the lack of timely transaction processing.

Recommendation - We recommend that VA implement efficient and effective processes to reduce the invoice backlog and transfer needed information from the contractor to VA systems in a timely manner.

2. Incorrect Recording of Subsidy Reestimates (VBA-Loan Guaranty)

Condition - We noted that the balances of five accounts as of June 30, 2009 and September 30, 2009, were not properly stated due to VBA posting erroneous entries for the reclassification of prior year subsidy reestimates. As a result, VBA had to record an adjustment of \$735 million to correct the errors.

Criteria - OMB Circular A-123, *Management’s Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Effective internal control includes ensuring that all entries posted during the year are reviewed by management to ensure accurate and reliable financial reporting.

Cause - VBA management did not perform an effective review of reclassification entries entered by VBA personnel.

Effect - The account balances and the financial statements were not properly stated as of June 30, 2009.

Recommendation - We recommend that management ensure that the VBA Finance department is fully staffed and properly trained to ensure that its existing controls for journal entries are performed as designed to detect and prevent any erroneous entries.



3. Compensation, Pension, and Burial Actuarial Liabilities – Reconciliations and Data (VBA-Compensation, Pension & Education)*

Conditions – VBA Finance does not have a reliable process to ensure that timely, accurate data is provided to the actuaries for their use in the actuarial model used to calculate the estimate of the compensation and burial liabilities (approximately \$1.3 trillion) included in the Federal Employee and Veterans Benefit Liability on the VA’s consolidated balance sheet, and the pension liability (approximately \$91 billion) disclosed in the notes to the financial statements. In addition, there are no written policies and procedures regarding this process that an individual could look to for guidance. We noted the following that could potentially significantly affect the accuracy of the calculation of the actuarial liabilities:

- Reconciliations were prepared to identify relevant data to be used by the actuaries to calculate the compensation, pension, and burial liabilities. The data in the reconciliations are the product of two different systems: VETSNET and BDN. A number of errors and deficiencies were identified in the original reconciliations and data provided to us. VBA then produced another set of reconciliations and data to correct the errors identified, and they also contained errors and deficiencies and had to be redone again.
- Data to be used in the actuarial model needs to be generated as of the balance sheet date to be relevant and useful to estimate the future liabilities. As a result of our audit procedures, it was discovered that at both June 30, 2009 and September 30, 2009, VETSNET data provided to the actuary was generated as of different dates, and therefore contained information that was not appropriate for use in the actuarial model.
- Inaccurate veteran severance and separation pay files were generated and provided to the VA actuaries.
- Certain veterans have their monthly payment split between themselves and another individual(s) and therefore more than one check is sent. These situations are known as “apportionment cases”. Information for apportionment cases was incorrectly classified in the data provided to the actuary and therefore treated incorrectly in the actuarial model.
- Different categories of veterans were combined together into the “Other Withholdings” category without a detailed breakdown although those categories have different effects on the model.
- The list of incarcerated veterans provided to the actuaries was inaccurate.
- For 35,000 veteran records, VBA could not identify the gender of the veteran and for 900 veteran records, VBA could not identify the age of the veteran.
- VBA cannot produce a termination report with the cause and the timing of termination identified from VETSNET related records.
- VBA Finance did not provide the actuaries with sufficient knowledge of data to be used in the retro-to-recurring ratio calculation, which resulted in an error in the calculation.



- VBA Finance was not able to provide the actuaries with data to support the assumption for severance and separation period in the actuarial model.

Criteria – In order for the actuaries to accurately calculate the estimated actuarial liabilities, they must be provided with all relevant and accurate data.

Cause – VBA financial management did not perform sufficient reconciliations and reviews to determine if the data in the reconciliations was accurate, data was generated as of the right date and data was relevant to the model.

Effect – Providing financial data to the actuaries without sufficient monitoring and control procedures increases the likelihood that a material error in the financial statements will occur.

Recommendation – We recommend that VBA Finance implement a process where the preparation and review of the reconciliations and data used in the calculation of the actuarial liabilities assures that accurate information is provided to the actuaries. An accurate reconciliation between the net payment files for BDN and VETSNET, and the gross award summary payment file provided to the actuaries should be prepared. Reconciling items identifying data relevant to the calculation of the estimated liabilities should be provided to the actuaries. In addition, policies and procedures should be documented in writing.

4. Lack of Accounting Policies and Procedures Regarding the Analysis of Events for the Inclusion in the Actuarial Model (VBA and Office of Management)

Condition – On October 13, 2009, the VA announced a decision to establish a service-connection for Vietnam Veterans with 3 specific illnesses based on evidence of an association with herbicides referred to as Agent Orange. According to VA, between January 1965 and April 1970, an estimated 2.6 million military personnel who served in Vietnam were potentially exposed to sprayed Agent Orange. When implemented, the October decision will make compensation program benefits available to qualifying veterans that were not previously allowed. VBA did not initially identify this event for analysis of its potential effect on the financial statements (the event was identified as requiring analysis by the external auditors). Additionally, when brought to their attention, an analysis was prepared to present VA’s proposed accounting treatment, but parts of the analysis relied on the opinion that no legal liability exists until final rule-making is complete. Authoritative accounting literature often requires the recognition and/or disclosure of liabilities prior to the completion of final legal proceedings.

Criteria - Statement of Federal Financial Accounting Standards 5: *Accounting for Liabilities of The Federal Government*, categorizes VA’s disability compensation benefits as employee benefits for accounting purposes because they are a measurable program benefit that directly relates to a veteran’s prior military service. Additionally, recognition of a liability or contingent liability is based in part on the probable future outflow or other sacrifice of resources as a result of a past transaction.



Codification of Statements on Auditing Standards Section 560, *Subsequent Events*, issued by the American Institute of Certified Public Accountants, and incorporated by reference into the Government Accountability Office's *Government Auditing Standards*, provides the standards for evaluating events that occur subsequent to the balance-sheet date but prior to issuance of the financial statements, and their potential accounting and/or reporting treatment in the financial statements.

Cause - VBA does not have accounting policies and procedures in place to effectively (i) identify events that need to be analyzed to determine if they need to be considered in the actuarial liability model, and (ii) determine when such events should initially be included in the actuarial model.

Effect - If an event is not identified, and should have been considered in the financial statements, the financial statements could have a material error or lack adequate disclosures. Also, when an analysis is prepared, if it is not based on concepts contained in generally accepted accounting principles, the conclusion could be wrong and the financial statements could have a material error.

Recommendation - We recommend that management prepare accounting policies and procedures to ensure that events which occur that can potentially impact the actuarial liability are identified and analyzed to determine the appropriate accounting treatment in accordance with generally accepted accounting principles.

5. Financial Management Resources (VBA)

Condition - We observed that the accuracy and completeness of VBA financial information is dependent on only a few key knowledgeable individuals. This results in the inability to effectively address routine and non-routine transactions and requests in a timely manner. This affects many of the responsibilities and deliverables that VBA Finance has on a day to day basis.

For example, this situation results in a high risk of error in the calculation of the compensation, pension, and burial liabilities. Because of the magnitude of these balances, an error in this calculation can result in a material misstatement in the VA's consolidated financial statements. Only a limited number of personnel in VBA Finance have the knowledge and experience to effectively perform or review the required analyses and reconciliations. These accounting analyses and reconciliations for the data that is provided to the actuary for the calculation of the actuarial benefit liabilities are critical to producing accurate financial statements.

Criteria - The GAO *Standards for Internal Control in the Federal Government* states:

"Management should ensure that skill needs are continually assessed and that the organization is able to obtain a workforce that has the required skills that match those necessary to achieve organizational goals. Training should be aimed at developing and retaining employee skill levels to meet changing organizational needs. Qualified and continuous supervision should be provided to ensure that internal control objectives are achieved."

Cause - There is a lack of sufficient knowledgeable financial resources at VBA.



Effect - The lack of sufficient knowledgeable and experienced personnel to perform the work could potentially result in errors in the financial statements.

Recommendation - We recommend that a study be performed with the objective of understanding the various functions that VBA Finance needs to perform, the current staffing structure, and the related roles and responsibilities. The outcome of the study would be a recommendation of how to best structure and staff VBA Finance so that it can effectively and efficiently provide VBA and other stakeholders with accurate and timely financial information and other deliverables that it is responsible for.

6. Accounts Receivable (VBA – Compensation, Pension & Education)

Condition - We noted the improper establishment and/or calculation of accounts receivable and lack of sufficient authorization on accounts receivable establishment. From a sample selection of 45 veteran files, eight accounts receivable were erroneously established or calculated; one account receivable was established without sufficient authorization; and two accounts receivable were recorded without any supporting documentation. In addition, during our accounts receivable interim substantive testing, out of nine sample selections, we noted two accounts were transposed and five accounts receivable were erroneously established.

We also noted that the accounts receivable allowance and related bad expense analysis were not performed on a timely basis.

Criteria - The GAO *Standards for Internal Control in the Federal Government* states:

- “Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority.”
- “In addition, control activities help to ensure that all transactions are completely and accurately recorded.”
- “Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination.”

Cause - Veterans service representatives (VSRs) input veteran information to VETSNET through manual processes and there are not required reviews of these processes. In addition, there is a lack of sufficient knowledgeable VSRs at regional stations to perform the work and the accounts receivable allowance analysis was not performed until year end.

Effect - The erroneous establishment and/or calculation of accounts receivable could result in errors in the financial statements.

Recommendation - We recommend that VA implement policies and procedures to ensure that accounts receivable amounts are established or calculated correctly. Furthermore, VA should ensure that all VSRs are properly trained and that formal review procedures are established and that an analysis of the allowance for receivables be performed on a timely basis.



7. Accrued Services Payable and Undelivered Orders (VHA)*

Conditions- We noted the following with respect to accrued services payable, undelivered orders, and the recording or payment of expenses:

- During our medical center site visits, we noted several instances where accrued services payable and undelivered orders were not properly monitored in accordance with VA policy to ensure they were valid and correctly calculated. Specifically, we noted instances of invalid residual balances for obligations and accrued services payable that should have been de-obligated or closed out and we noted classification errors between undelivered orders and accrued services payable.
- The FMS has an automatic accrual “flag” function which when activated allows expenses to be recorded in the correct accounting period. However, we noted both manual and system problems with this function. Specifically, we noted instances where the accrual flag was not manually set when it needed to be, or where it was incorrectly activated for construction expenses and other services resulting in untimely capitalization and recognition of an expense before the item was received.
- We noted an instance where invoices had not been received, but an estimate for work performed should have been accrued under work in progress.
- We noted two instances of expenses that were paid out of the wrong budget fiscal year. We also noted an inaccurate payment due to computational error, and untimely finalization of a contract resulting in unpaid invoices from fiscal year 2007 and 2008.
- We noted inadequate controls over the payment process and approval of invoices from non-VA healthcare providers. At one facility, there was no indication that invoice payments were reviewed by a supervisor. As a result, payment was made from the wrong budget fiscal year. In another instance the service provider was overpaid.

Criteria- OMB Circular A-123, *Management's Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause- Invalid undelivered orders or accrued services payable occurred because of lack of adequate review and follow-up procedures with individuals who initiated the purchase orders. Medical center staff identified the system limitation where FMS did not accrue amended prior year obligations and obligations with multiple fund control points without a manual intervention. Other errors, including classification errors, occurred due to untimely processing of receiving reports, incorrect activation of accrual flags for a construction project, and insufficient review of expenses and the fiscal year they were charged to. We also noted inadequate financial management oversight over the non-VA healthcare provider's payment process. No process was in place to accrue for construction or other products that did not use receiving reports unless invoices had been received from vendors or contractors.



Effect- Accrued services payable, undelivered orders, and expense balances could be misstated and in some cases, unauthorized transactions may not be detected. Untimely payment of invoices could result in Prompt Pay Act penalties.

Recommendation- We recommend that the VHA CFO, in coordination with the Veterans Integrated Service Network (VISN) CFOs:

- Consider a system control to identify payments as final to help eliminate residual balances.
- Ensure medical center staff are trained on the proper use of the accrual flag; specifically, when to set it and how to manually intervene for proper classification of expenses.
- Seek a solution to the FMS limitation that prevents accrual of amended prior year obligations and accrual of obligations with multiple fund control points.
- Enhance the process used in monitoring aged accrued services payable and undelivered orders.
- Improve processes or monitoring to ensure correct recording and payment of expenses and accruals for work in progress.

8. **Property, Plant and Equipment (PP&E) – Estimated Useful Life and Recording of Transactions (VHA)***

Condition- During our medical center site visits, we noted the following:

- Some assets remained capitalized even though they were traded in or disposed of and were no longer property of VA.
- Some discrepancies existed in the estimated useful life of capital projects as recorded in the fixed assets subsidiary ledger and as approved by engineers.
- Use of incorrect budget object codes resulted in improper capitalization or expensing of certain fixed assets transactions.
- Intra-entity costs were improperly capitalized.

Criteria- OMB Circular A-123, *Management's Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause- These exceptions were caused at least in part because of:

- Lack of adequate reviews and controls in place to ensure that assets that are no longer in VA's possession are taken off the books, correct budget object codes are used, and assets are assigned the appropriate useful life.



Effect- PP&E and related expense accounts may be misstated.

Recommendation- We recommend that the VHA CFO, in coordination with the VISN CFOs, ensure procedures are in place and followed so that:

- Projects no longer in use are removed from the general ledger.
- Estimated useful life recorded in the fixed asset subsidiary ledger is consistent with engineering recommendations.
- Correct budget object codes are used and intra-entity costs are expensed and not capitalized.

9. Property, Plant and Equipment (PP&E) – Work in Progress (VHA and OCFM)

Condition- Work in progress is comprised of minor construction projects and non-recurring maintenance projects that are managed by the medical centers and major construction projects that are managed by Office of Construction and Facilities Management (OCFM) located at VA Central Office. During our medical center site visits we noted that both minor and major construction projects were not always transferred from work in progress to property in service, and depreciated on a timely basis. For major construction projects, detailed project records such as contract files and progress billings are kept at OCFM. Once expenditures are incurred and processed for payment by OCFM, payment will be reflected in the medical centers work in process report. Due to lack of supporting documentation, the medical centers are unable to reconcile work in progress balances to subsidiary records and determine whether balances are properly classified as work in progress.

Criteria - OMB Circular A-123, *Management's Responsibility for Internal Control*, requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause – These exceptions were caused by:

- Minor construction and non-recurring maintenance projects - Lack of timely communication between the accounting group and facilities management at the medical centers. The accounting group is reliant on effective communications from facilities management on the status of projects. This communication has not been effective.
- Major construction - There is a lack of policies and procedures that define roles and responsibilities over the reconciliation, review, and capitalization of medical center major construction projects that are managed by OCFM

Effect – Lack of work in progress reconciliations could result in misstated asset balances.



Recommendation - We recommend that:

- VHA CFO, in coordination with the VISN CFOs, takes action to ensure better coordination between accounting and facilities management for minor construction projects.
- Work in progress projects are reviewed for completion dates and are recorded timely as property in service. Management should consider enhancing the fixed assets reporting module to include the project estimated completion date to assist in the timely transfer to property in service.
- VHA and OCFM should work together to develop policies and procedures to ensure that work in progress balances are reconciled and capitalized timely for major construction projects.

10. Accrual for Unbilled Receivables and Allowance for Contractual Adjustments (VHA)*

Condition- The following conditions were noted during the review of accounts receivable:

- Accrual for unbilled receivables is calculated using a three-month moving average of change in accounts receivable, write-offs and collections multiplied by the number of days it takes to bill a receivable after services are provided. However, management has not validated the reasonableness of the accrual methodology by analyzing actual billings subsequent to the accounting period.
- The allowance for contractual adjustments for medical care accounts receivable is a system calculated percentage. During our review, we noted that management had not completed their review of the reasonableness of the allowance based on prior year actual amounts.

Criteria- GAO’s *Standards for Internal Control in the Federal Government* states that managers need to compare actual performance to planned or expected results and analyze significant differences.

Cause- VHA central office did not perform a sufficient financial management review.

Effect- Accounts receivable balances could be misstated as a result of an inadequate accrual and allowance amount.

Recommendation- We recommend that VHA CFO validate the methodology for the accrual for unbilled receivables and the allowance for contractual adjustments by comparing actual activity to prior estimates.

11. Intra-Governmental Reconciliations and Related Controls - Office of Management*

Condition- Unreconciled differences existed throughout the year and at year-end, primarily with the VA’s trading partner, the Department of Defense. Also, unreconciled differences are not aged to determine how long they have been outstanding.



Criteria- The Treasury Financial Manual, Bulletin No. 2007-03 section VII, outlines the difference resolution procedures that trading partners must follow. These rules apply to all intra-governmental trading partners.

Cause- VA does not have sufficient data from their trading partners to properly reconcile all the accounts. VA does not elevate its differences with the Department of Defense to the CFOs Council's Intragovernmental Dispute Resolution Committee for resolution of differences within 60 days of their identification in the material differences report.

Effect- Significant unreconciled differences may result with trading partners and inaccurately reflect the related inter-agency accounts on both the VA's and individual trading partner's stand-alone financial statements.

Recommendation- All significant differences should be resolved with trading partners as outlined in Section VII, Resolving Intra-governmental Disputes and Major Differences, including the escalation of unresolved differences to the CFOs Council's Intragovernmental Dispute Resolution Committee. Differences should be aged to assist in the resolution of outstanding items.

Follow-Up on Previous Report

In our *Independent Auditors' Report On Internal Control Over Financial Reporting And Compliance Based Upon the Audit Performed in Accordance with Government Auditing Standards* dated November 17, 2008, we reported three material weaknesses in the areas of (1) Financial Management System Functionality, (2) Information Technology (IT) Security Controls, and (3) Financial Management Oversight. These three material weaknesses are again reported this year.

Other

The VA engaged an independent public accounting firm to assist in an internal control assessment pursuant to OMB Circular A-123 Appendix A, *Management's Responsibility for Internal Control*. The firm issued a report dated October 2, 2009 titled *Findings and Recommendations, Internal Controls Over Financial Reporting* which reported 9 significant deficiencies and 7 control deficiencies.

SECTION III — COMPLIANCE AND OTHER MATTERS

Compliance With Laws and Regulations

As part of obtaining reasonable assurance about whether VA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. Except as discussed below, the results of our tests disclosed no instances of noncompliance which are required to be reported herein under *Government Auditing Standards*. Items with an asterisk (*) are repeat conditions included in last year's report.



1. Non-compliance with FFMIA (VA)*

Under FFMIA, we are required to report whether the agency’s financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance and evaluative criteria issued by OMB in Circular A-127.

The material weaknesses in internal control over financial reporting discussed above and identified as “Financial Management System Functionality,” and “Information Technology (IT) Security Controls” indicate that VA’s financial management systems did not substantially comply with the Federal financial management systems requirements as required by FFMIA section 803(a).

2. Non-compliance with 5 CFR Part 1315, Prompt Payment Act (VBA)

Condition – We noted several instances where VBA was not in compliance with the Prompt Payment Act. The following exceptions were noted during the testing:

- From a selection of 45 loan guaranty foreclosure acquisitions tested, two claims submitted by a servicer were not paid within 30 days.
- From a selection of 45 loan guaranty cash disbursement samples tested, one invoice was not paid within 30 days and the necessary vendor set up procedures had not been completed for the associated vendor.
- During our compensation and pension site visit, we noted one servicer company’s invoice was not paid within 30 days.

Criteria - The Prompt Payment Act and 5 CFR Part 1315 require that payment should be made to vendors within 30 days from the time a proper invoice is received.

Cause – Causes include:

- VBA management relies on a legal interpretation of a precursor regulation (OMB Circular A-125) prepared in 1982 to determine the extent to which the Loan Guaranty program must implement the requirement of the current regulation.
- Vendor set up procedures were not completed in a timely manner.

Effect - Late payments resulted in a failure to comply with the Prompt Payment Act.

Recommendation - We recommend that VA implement procedures to ensure that all payments are made within the timeframe prescribed by the Prompt Payment Act and that they review and update the legal interpretation to ensure that its conclusions are valid based on the changes to the regulation. We also believe that any conclusions should be discussed with the OMB for their concurrence.



3. **Non-compliance with 5 U.S.C. §552a subsection D5 –(VBA-Compensation, Pension & Education)***

Condition - There were several instances in our testing of VBA where the appropriate documents were not available to substantiate the amounts recorded. Some of these were comprised of instances where key forms were missing from the veteran’s file.

Criteria - 5 U.S.C. §552A subsection D5 states:

“An agency should maintain all records which are used by the agency in making any determination about any individual with such accuracy, relevance, timeliness, and completeness as is reasonably necessary to assure fairness to the individual in the determination.”

Cause - Inadequate control over the retention of documents in the Veteran files.

Effect - The VA is not in compliance with USC Title 5, §552A; subsection D5. Also, certain of the balances recorded in the FMS cannot be substantiated due to the lack of supporting documentation.

Recommendation - We recommend that VBA adheres to its procedures to ensure that all documents that should be retained in the veteran files are retained and can be located.

4. **Non-compliance with Debt Collection Improvement Act (VA)***

Condition - We selected sample transactions to test various attributes for VA’s compliance with the Debt Collection Improvement Act of 1996 (“DCIA”). The following exceptions were noted with respect to the attributes tested:

- VBA- Interest and administrative costs are required to be charged to VA’s delinquent debtors. The rates are determined by the Treasury on a yearly basis. However, VBA did not charge interest or administrative costs on delinquent payments from veterans related to certain receivables for Compensation and Pension, Education loans, and VBA Life Insurance.
- VBA – Life Insurance did not follow the requirements for cross-servicing and Treasury offset during the prescribed timeframes for several of the selections tested. We also noted one instance where the Debt Management Center did not meet the requirements for cross-servicing. The DCIA requires federal agencies to refer debt to Treasury for cross-servicing if they are delinquent for a period of 180 days.
- VBA – Life Insurance did not maintain adequate documentation to support actions taken to demonstrate timely compliance with DCIA and VA policies on debt collection for many of the selections tested.
- VBA – Life Insurance did not follow up on delinquent debt in a timely manner for many of the selections tested.



Criteria:

- 38 U.S.C. § 501(a) and §5315, and 38 CFR 1.919 require VA to charge interest on any amount owed the United States.
- 31 U.S.C. § 3711 describes VA’s requirement to submit debt to Treasury for cross-servicing.

Cause – In July 1992, a former VA Deputy Secretary instructed VA to not charge interest or administrative costs on veteran debts. Also, adequate documentation was not maintained for delinquent debt files and procedures for referring debt to Treasury were not followed.

Effect - This finding represents noncompliance by VA with the Debt Collection Improvement Act of 1996.

Recommendation - We recommend the VA:

- Implement policies and procedures to administer the requirements of Public Law 96-466 and Title 38 with respect to interest charges or propose a legislative remedy to request a waiver of these requirements.
- Ensure that procedures are in place and followed for debt collection, cross-servicing, and documentation.

5. Non-compliance with Antideficiency Act (ADA), 31 U.S.C. 1341(a) (VBA-Loan Guaranty)

Condition- During our year end loans receivable testing, we noted that VA incurred approximately \$41 million of obligations related to vendee loans originated in fiscal year 2009, which was in excess of the amount available in the direct loan financing account for such purpose.

Criteria- 31 U.S.C. § 1341(a) states that “An officer or employee of the United States Government or the District of Columbia government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation”

2 U.S.C. § 661 c(b) requires that new direct loan obligations may be incurred only to the extent that budget authority to cover their costs is provided in advance in an appropriation Act.

Cause- There were 376 vendee loans originated by a contractor that were not recorded in FMS due to the lack of an effective process to transfer and record transactions. As a result, sufficient available unobligated budgetary resources necessary to fund these loans were not retained, but were returned to the Department of Treasury.

Effect- VA was not in compliance with the Antideficiency Act (ADA), 31 U.S.C. 1341(a).

Recommendation- We recommend that VA implement efficient and effective processes to transfer needed information from the contractor to VA systems in a timely manner.



Consistency of Other Information

The VA's Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information is presented for the purpose of additional analysis and is not a required part of the basic financial statements, but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methodology and presentation of this information. We also reviewed such information for consistency with the related information presented in the VA's financial statements. However, we did not audit this information, and accordingly, we express no opinion on it.

SECTION IV — OTHER

We noted other matters involving the internal control and compliance over financial reporting that will be reported to VA in a separate letter.



**Department of
Veterans Affairs**

Memorandum

Date: **NOV 16 2009**

From: Acting Assistant Secretary for Management (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2009 and 2008

To: Assistant Inspector General for Auditing (52)

1. We have reviewed the Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2009 and 2008 and are pleased with the receipt of an unqualified opinion. We are also proud that we were able to meet the FY 2009 reporting timeline established by the Office of Management and Budget. Please extend to your staff and the staff of Deloitte & Touche, LLP our appreciation for their detailed planning, hard work, and cooperation during this year's audit.
2. The Department's senior officials and I, as well as program managers in VHA, VBA, NCA, and affected staff offices, are aware of the results of the audit. We will continue to focus on completing corrective actions as detailed in the remediation plans for the three previously-identified material weaknesses, Financial Management System Functionality, Information Technology (IT) Security Controls, and Financial Management Oversight. For these repeat material weaknesses, the existing remediation plans will be revised and expanded, as needed, to address the findings and recommendations in your audit report. A remediation plan will be developed to address the findings and recommendations in your audit report for the new material weakness, Compensation, Pension, and Burial Liabilities, and implementation of the plan will begin in FY 2010.
3. Thank you again for your efforts in bringing us to another successful conclusion of the audit cycle.

A handwritten signature in blue ink, reading "Rita A. Reed", is positioned above the printed name.

Rita A. Reed

Section II

Consolidated Financial Statements

- **Consolidated Financial Statements**
- **Notes to Consolidated Financial Statements**
- **Required Supplementary Stewardship Information (Unaudited)**
- **Required Supplementary Information (Unaudited)**



Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS

CONSOLIDATED BALANCE SHEETS (dollars in millions)

As of September 30, 2009 2008

ASSETS

INTRAGOVERNMENTAL

Fund Balance with Treasury (Note 3)	\$	27,086	\$	26,292
Investments (Note 5)		11,328		11,924
Accounts Receivable, Net (Note 6)		65		52
Other Assets		873		593
TOTAL INTRAGOVERNMENTAL ASSETS		39,352		38,861

PUBLIC

Investments (Note 5)		184		183
Accounts Receivable, Net (Note 6)		1,552		1,760
Loans Receivable, Net (Note 7)		2,968		2,908
Cash (Note 4)		50		40
Inventories and Related Properties, Net (Note 8)		59		61
General Property, Plant and Equipment, Net (Note 9)		14,699		13,068
Other Assets		37		33
TOTAL PUBLIC ASSETS		19,549		18,053

TOTAL ASSETS

\$ 58,901 \$ 56,914

Heritage Assets (Note 10)

LIABILITIES

INTRAGOVERNMENTAL

Accounts Payable	\$	54	\$	79
Debt		1,550		1,580
Other Liabilities (Note 14)		1,530		1,903
TOTAL INTRAGOVERNMENTAL LIABILITIES		3,134		3,562

PUBLIC

Accounts Payable		4,470		4,141
Liabilities for Loan Guarantees (Note 7)		3,916		3,452
Federal Employee and Veterans Benefits Liability (Note 12)		1,319,235		1,468,605
Environmental and Disposal Liabilities (Note 13)		884		928
Insurance Liabilities (Note 16)		10,249		10,751
Other Liabilities (Note 14)		8,428		7,433
TOTAL PUBLIC LIABILITIES		1,347,182		1,495,310

TOTAL LIABILITIES

1,350,316 1,498,872

NET POSITION

Unexpended Appropriations – Earmarked Funds (Notes 18 and 23)		-		-
Unexpended Appropriations – All Other Funds (Note 23)		1,998		3,994
Cumulative Results of Operations – Earmarked Funds (Notes 18 and 23)		998		1,356
Cumulative Results of Operations – All Other Funds (Note 23)		(1,294,411)		(1,447,308)
TOTAL NET POSITION	\$	(1,291,415)	\$	(1,441,958)
TOTAL LIABILITIES AND NET POSITION	\$	58,901	\$	56,914

The accompanying Notes are an integral part of these financial statements.



Part III - Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS

CONSOLIDATED STATEMENTS OF NET COST (dollars in millions)

for the Years Ended September 30,

2009

2008

NET PROGRAM COSTS (NOTE 20)

Medical Care	\$	40,975	\$	35,019
Medical Education		1,512		1,367
Medical Research		1,011		917
Compensation		42,499		37,869
Pension		4,413		3,978
Education		3,193		2,537
Vocational Rehabilitation and Employment		904		787
Loan Guaranty		495		(565)
Insurance		116		118
Burial		437		448

**NET PROGRAM COSTS BEFORE CHANGES IN VETERANS
BENEFITS ACTUARIAL LIABILITIES**

95,555

82,475

Compensation	(148,100)	338,100
Burial	(1,100)	900
SUBTOTAL	(149,200)	339,000

NET NON-PROGRAM COSTS

1,180

1,147

NET (BENEFIT) COST OF OPERATIONS (NOTE 20)

\$

(52,465)

\$

422,622

The accompanying Notes are an integral part of these financial statements.



DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2009

	Earmarked Funds	All Other Funds	Eliminations	FY 2009 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	\$ 1,356	\$ (1,447,195)	\$ (113)	\$ (1,445,952)
Budgetary Financing Sources				
Appropriations Used	-	99,170	-	99,170
Nonexchange Revenue	-	10	-	10
Donations	35	-	-	35
Transfer without Reimbursement	(2,726)	2,767	(41)	-
Other Financing Sources (Non-Exchange)				
Donations of Property	27	1	-	28
Transfers In/Out Reimbursement	2	(4)	2	-
Imputed Financing	-	1,653	-	1,653
Other	-	(820)	(2)	(822)
Total Financing Sources	(2,662)	102,777	(41)	100,074
Net Cost of Operations	(2,304)	(50,161)	-	(52,465)
Net Change	(358)	152,938	(41)	152,539
Ending Balance – Cumulative Results	998	(1,294,257)	(154)	(1,293,413)
Unexpended Appropriations				
Beginning Balance	-	3,881	113	3,994
Budgetary Financing Sources				
Appropriations Received	-	97,230	-	97,230
Appropriations Transferred In/Out	-	(22)	41	19
Other Adjustments	-	(75)	-	(75)
Appropriations Used	-	(99,170)	-	(99,170)
Total Budgetary Financing Sources	-	(2,037)	41	(1,996)
Total Unexpended Appropriations	-	1,844	154	1,998
Total Net Position	\$ 998	\$ (1,292,413)	\$ -	\$ (1,291,415)

The accompanying Notes are an integral part of these financial statements.



Part III – Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)

FOR THE YEAR ENDED SEPTEMBER 30, 2008 (Note 23)

	Earmarked Funds	All Other Funds	Eliminations	FY 2008 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	\$ 972	\$ (1,111,608)	\$ (80)	\$ (1,110,716)
Budgetary Financing Sources				
Appropriations Used	-	87,147	-	87,147
Nonexchange Revenue	-	12	-	12
Donations	36	-	-	36
Transfer without Reimbursement	(2,410)	2,443	(33)	-
Other Financing Sources (Non-Exchange)				
Donations of Property	20	1	-	21
Transfers In/Out Reimbursement	-	(335)	96	(239)
Imputed Financing	-	1,375	-	1,375
Other	-	(870)	(96)	(966)
Total Financing Sources	(2,354)	89,773	(33)	87,386
Net Cost of Operations	(2,738)	425,360	-	422,622
Net Change	384	(335,587)	(33)	(335,236)
Ending Balance – Cumulative Results	1,356	(1,447,195)	(113)	(1,445,952)
Unexpended Appropriations				
Beginning Balance	-	2,027	80	2,107
Budgetary Financing Sources				
Appropriations Received	-	89,084	-	89,084
Appropriations Transferred In/Out	-	12	33	45
Other Adjustments	-	(95)	-	(95)
Appropriations Used	-	(87,147)	-	(87,147)
Total Budgetary Financing Sources	-	1,854	33	1,887
Total Unexpended Appropriations	-	3,881	113	3,994
Total Net Position	\$ 1,356	\$ (1,443,314)	\$ -	\$ (1,441,958)

The accompanying Notes are an integral part of these financial statements.

**DEPARTMENT OF VETERANS AFFAIRS****COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 21) (dollars in millions)****FOR THE YEAR ENDED SEPTEMBER 30, 2009**

	Non-Budgetary Budgetary Credit Program	
Budgetary Resources		
Unobligated Balance at the Beginning of the Period	\$ 10,559	\$ 3,285
Recoveries of Prior Year Obligations	14	-
Budget Authority		
Appropriations Received	101,157	-
Borrowing Authority	-	1,755
Spending Authority from Offsetting Collections		
Earned	5,439	2,536
Unfilled Customer Orders	(287)	-
Subtotal	116,882	7,576
Nonexpenditure Transfers, net	19	-
Temporarily Not Available Pursuant to Public Law	-	-
Permanently Not Available	(87)	(1,784)
Total Budgetary Resources	\$ 116,814	\$ 5,792
Status of Budgetary Resources		
Obligations Incurred	\$ 105,604	\$ 3,212
Unobligated Balance Available	8,356	-
Unobligated Balance Not Available	2,854	2,580
Total Status of Budgetary Resources	\$ 116,814	\$ 5,792
Change in Obligated Balance		
Obligated Balance, Net Beginning of Period	\$ 15,924	\$ 62
Obligations Incurred	105,604	3,212
Less Gross Outlays	(105,120)	(3,183)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(14)	-
Change in Uncollected Customer Payments from Federal Sources	275	(41)
Obligated Balance, Net End of Period	\$ 16,669	\$ 50
Net Outlays		
Gross Outlays	\$ 105,120	\$ 3,183
Less Offsetting Collections	(5,426)	(2,496)
Less Distributed Offsetting Receipts	(3,168)	(1,036)
Net Outlays	\$ 96,526	\$ (349)

The accompanying Notes are an integral part of these financial statements.



Part III - Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 21) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2008

		Non-Budgetary Budgetary Credit Program
Budgetary Resources		
Unobligated Balance at the Beginning of the Period	\$ 18,312	\$ 2,950
Recoveries of Prior Year Obligations	3	-
Budget Authority		
Appropriations Received	92,718	-
Borrowing Authority	-	1,294
Spending Authority from Offsetting Collections		
Earned	5,120	2,872
Unfilled Customer Orders	(133)	-
Subtotal	116,020	7,116
Nonexpenditure Transfers, net	45	-
Temporarily Not Available Pursuant to Public Law	(8,352)	-
Permanently Not Available	(126)	(766)
Total Budgetary Resources	\$ 107,587	\$ 6,350
Status of Budgetary Resources		
Obligations Incurred	\$ 97,028	\$ 3,065
Unobligated Balance Available	7,907	-
Unobligated Balance Not Available	2,652	3,285
Total Status of Budgetary Resources	\$ 107,587	\$ 6,350
Change in Obligated Balance		
Obligated Balance, Net Beginning of Period	\$ 12,911	\$ 87
Obligations Incurred	97,028	3,065
Less Gross Outlays	(94,170)	(3,157)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(3)	-
Change in Uncollected Customer Payments from Federal Sources	158	67
Obligated Balance, Net End of Period	\$ 15,924	\$ 62
Net Outlays		
Gross Outlays	\$ 94,170	\$ 3,157
Less Offsetting Collections	(5,145)	(2,938)
Less Distributed Offsetting Receipts	(2,879)	(1,364)
Net Outlays	\$ 86,146	\$ (1,145)

The accompanying Notes are an integral part of these financial statements.



Notes to Consolidated Financial Statements

For the Years Ended September 30, 2009 and 2008 (dollars in millions, unless otherwise noted).

1. Summary of Significant Accounting Policies

Reporting Entity and Basis of Presentation

The Department of Veterans Affairs' (VA) consolidated financial statements report all activities of VA components, including the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and staff organizations. The consolidated financial statements meet the requirements of the Chief Financial Officers Act (CFO) of 1990 and the Government Management Reform Act (GMRA) of 1994. The consolidated financial statements differ from the financial reports used to monitor and control budgetary resources, but are prepared from the same books and records. The statements should be read with the understanding that VA is a component unit of the U.S. Government.

Organization

The mission of VA is to provide medical care, benefits, social support, and lasting memorials to Veterans, their dependents, and beneficiaries [(38 U.S.C. Section 301(b) 1997)].

The Department is organized under the Secretary of VA. The Secretary's office includes a Deputy Secretary and has direct lines of authority over the Under Secretary for Health, the Under Secretary for Benefits, and the Under Secretary for Memorial Affairs. Additionally, six Assistant Secretaries, an Inspector General, a General Counsel, an Executive-In-Charge for Human Resources and Administration, and the chairmen of the Board of Contract Appeals and the Board of Veterans' Appeals support the Secretary.

Budgets and Budgetary Accounting

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources, and facilitates compliance with legal constraints and controls over the use of federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of the purchase. Assets and liabilities that do not consume budgetary resources are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

Basis of Accounting

The principal financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the Office of Management and Budget (OMB) Revised Circular A-136, Financial Reporting Requirements. The American Institute of Certified Public Accountant's (AICPA) Statement on Auditing Standards No. 91, Federal GAAP Hierarchy, established a hierarchy of GAAP for Federal financial statements.

Revenues and Other Financing Sources

Exchange revenues are recognized when earned to the extent the revenue is payable to VA from other federal agencies or the public as a result of costs incurred or services performed on its behalf. Revenue is recognized at the point the service is rendered. Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by the Department of the Treasury (Treasury) Judgment Fund and post-retirement benefits for VA employees. Non-exchange revenue, e.g., donations, is recognized when received, and related receivables are recognized when measurable and legally collectible, as are refunds and related offsets.



Accounting for Intragovernmental Activities

VA, as a department of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these consolidated financial statements do not reflect the results of all financial decisions applicable to VA as though the Department were a stand-alone entity.

In order to prepare reliable financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements.

Transferring Budget Authority to Other Agencies

The VA is a party to allocation transfers with the Department of Defense (DoD) as a transferring (parent) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g. budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived.

Fund Balance with Treasury

Treasury performs cash management activities for all federal government agencies. The Fund Balance with Treasury represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Educational Assistance Trust Fund, the National Service Life Insurance (NSLI) Fund,

the United States Government Life Insurance (USGLI) Fund, the Veterans Special Life Insurance (VSLI) Fund, General Post Fund, and the National Cemetery Gift Fund. The use of these funds is restricted.

Cash

Cash consists of Canteen Service and Loan Guaranty Program amounts held in commercial banks, cash held by non-federal trusts as well as Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Amounts relating to the Loan Guaranty Program represent deposits with trustees for offsets against loan loss claims related to sold loan portfolios. Funds held by non-federal trusts are restricted and may be used only in accordance with the terms of the trust agreements.

Investments

Investments are reported at cost and are redeemable at any time for their original purchase price. Insurance program investments, which comprise most of VA's investments, are in non-marketable Treasury special bonds and certificates. Interest rates for Treasury special securities are initially set based on average market yields for comparable Treasury issues. Special bonds, which mature during various years through the year 2024, are generally held to maturity unless needed to finance insurance claims and dividends. Other program investments are in securities issued by Treasury, with the exception of non-federal Trust investments in mutual funds and the Loan Guaranty Program investments in trust certificates issued by the American Housing Trusts.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in American Housing Trust certificates I through V. The estimated allowance computations are based upon discounted cash flow analysis. VA continues to use the income from these subordinated certificates to fund the American Housing Trust Reserve Fund, which is



used in turn to fund deficiencies in scheduled monthly principal and interest on the loans as well as to cover any realized losses incurred in the prior month. Any excess funds in the Reserve Fund are reimbursed to VA upon request.

Accounts Receivable

Intragovernmental accounts receivable consists of amounts due from other federal government agencies and are considered to be fully collectible.

Public accounts receivable consists mainly of amounts due for Veterans' health care and amounts due for compensation, pension, and readjustment benefit overpayments. Allowances are based on prior experience. For FY 2009, contractual adjustments were 62 percent of the Medical Care Collection Fund third party receivables. The bad debt allowances for medical-related receivables were 14 percent. For FY 2008, contractual adjustments were 20 percent and bad debt allowances for medical-related receivables were 13 percent. Educational-related receivables bad debt allowances were 45 percent for FY 2009 and FY 2008. Compensation and pension benefits overpayment-related bad debt allowances were 65 percent for FY 2009 and 72 percent for FY 2008.

VA is required by Public Law 96-466 to charge interest and administrative costs on benefits debts similar to charges levied on other debts owed the federal government. In a July 1992 decision, the then-VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. This decision continues to be VA policy.

Loans Receivable

Loans Receivable are recorded as funds are disbursed. For loans obligated prior to October 1, 1991, loan principal and interest receivable amounts are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience and an

analysis of outstanding balances. For loans obligated after September 30, 1991, an allowance equal to the subsidy costs associated with these loans adjusts the loans receivable. This adjustment is due to the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows.

Inventories

Inventories consist of items such as Canteen Service retail store stock and are valued at cost. VA follows the purchase method of accounting for operating supplies, medical supplies, and pharmaceutical supplies in the hands of end users. The purchase method provides that these items be expensed when purchased. VA defines an end user as a VA medical center, regional office, or cemetery.

Property, Plant, and Equipment

The majority of the general property, plant, and equipment is used to provide medical care to Veterans and is valued at cost, including transfers from other federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Construction costs are capitalized as Construction Work in Progress until completion, and then transferred to the appropriate property account. Other Structures and Capital Leases includes items such as leasehold improvements and structures not classified as buildings.

Individual items are capitalized if the useful life is 2 years or more and the unit price is \$100,000 or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is also depreciated on a straight-line basis over its useful life, usually 5 to 20 years. Internal use software is also subject to the \$100,000 threshold for capital assets. The costs subject to capitalization, including design, development, and testing, are accumulated in Software in Development until a project is successfully tested and placed in



service. The costs are amortized on a straight-line basis, and the amortization term is in accordance with the planned life cycle established during the software's planning phase. There are no restrictions on the use or convertibility of general property, plant, and equipment. For disclosure regarding Heritage Assets see Note 10.

Other Assets

Other assets consist of advance payments. Public advance payments are primarily to hospitals and medical schools under house staff contracts, grantees, beneficiaries, and employees on official travel. Intragovernmental advance payments are primarily to the Army Corps of Engineers (Corps) and the General Services Administration (GSA). Advances to the Corps are primarily for non-recurring maintenance of VHA medical facilities. Advances to the GSA are primarily for rent, supplies, printing, and equipment.

Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other federal government agencies. The remaining accounts payable consist of amounts due to the public.

Loan Guarantees

For direct loan obligations and loan guaranty commitments made after 1991, the resulting direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. The present value of the subsidy costs associated with direct loans and loan guarantees is recognized as a cost in the year the direct or guaranteed loan is disbursed. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimated will most likely require a future cash outflow to pay defaulted claims. Interest is accrued on VA-owned loans by computing interest on a loan-by-

loan basis at the end of the month and recording the amount owed as an accrual.

The guaranteed loan sales liability represents the present value of the estimated cash flows to be paid by VA as a result of the guarantee. VA guarantees that the principal and interest payment due on a loan will be paid by the 15th of each month. If the payment is not made, VA allows the loan servicer to receive funds from a cash reserve account for the amount of the deficiency. VA guarantees the loans against losses at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

Debt

All intragovernmental debt is due to Treasury and is primarily related to borrowing by the Direct Loan and Loan Guaranty Program. The interest rates ranged from 0.42 to 4.01 percent in FY 2009 and 2.40 to 4.58 percent in FY 2008.

Insurance Liabilities

Actuarial reserve liabilities for VA's insurance programs are based on mortality and interest rate assumptions at the time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest rate assumptions range from 2.25 to 5.0 percent for both the FY 2009 and FY 2008 calculations.

Annual Leave

The accrued annual leave balance is adjusted at the end of the fiscal year to reflect current pay rates for leave that has been earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not used, funding will be obtained from future financing sources.

Workers' Compensation Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and



beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. Claims incurred for benefits for VA employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by VA.

Workers' compensation is comprised of two components: (1) the accrued liability which represents money owed by VA to DOL for claims paid by DOL on behalf of VA through the current fiscal year, and (2) the actuarial liability for compensation cases to be paid beyond the current year.

Future workers' compensation estimates are generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases and for potential cases related to injuries incurred but not reported. The liability is determined by utilizing historical benefit payment patterns related to a particular period to estimate the ultimate payments related to that period.

Pension, Other Retirement Benefits, and Other Post-Employment Benefits

Each employing federal agency is required to recognize its share of the cost and imputed financing of providing pension and post-retirement health benefits and life insurance to its employees. Factors used in the calculation of these pensions and post-retirement health and life insurance benefit expenses are provided by the Office of Personnel Management (OPM) to each agency.

VA's employees are covered under the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS); VA makes contributions according to both plan requirements. CSRS and FERS are multi-employer plans. VA does not maintain or report information about the assets of the plans, nor

does it report actuarial data for the accumulated plan benefits. That reporting is the responsibility of OPM.

Veterans Benefits Liability

VA provides compensation benefits to Veterans who are disabled by military service-related causes. Benefits are also provided to deceased Veterans' beneficiaries. These benefits are provided in recognition of a Veteran's military service. The liability for future compensation payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Various assumptions in the actuarial model, such as the number of Veterans and dependents receiving payments, discount rates, cost of living adjustments, and life expectancy, impact the amount of the liability.

Litigation

VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations other than disclosed in Note 17, Contingencies.

Non-Federal Trusts

VA has entered into enhanced-use leases to maximize use of underutilized VA property. In seven of these enhanced-use leases, the assets and liabilities were transferred to a non-federal trust. The assets, liabilities, and results of operations of these seven trusts are consolidated in VA's consolidated financial statements.

Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.



2. Non-Entity Assets

Entity and Non-Entity assets have been combined on the balance sheet. Non-Entity assets relate primarily to patient funds.

Non-Entity Assets as of September 30,

	2009	2008
Fund Balance with Treasury	\$ 61	\$ 96
Intragovernmental Accounts Receivable	1	1
Public Accounts receivable	43	34
Total Non-Entity Assets	\$ 105	\$ 131

3. Fund Balance with Treasury

Fund Balance with Treasury as of September 30,

	2009	2008
Entity Assets		
Trust Funds	\$ 82	\$ 93
Revolving Funds	3,045	3,734
Appropriated Funds	23,601	22,110
Special Funds	245	214
Other Fund Types	52	45
Total Entity Assets	27,025	26,196
Non-Entity Assets		
Other Fund Types	61	96
Total Non-Entity Assets	61	96
Total Entity and Non-Entity Assets	\$ 27,086	\$ 26,292
Reconciliation of VA General Ledger Balances with Treasury		
Entity VA General Ledger	\$ 28,717	\$ 27,774
Reconciled Differences, principally timing	(1,655)	(1,537)
Unreconciled Differences	24	55
Fund Balance with Treasury	\$ 27,086	\$ 26,292
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	\$ 8,277	\$ 7,852
Unavailable	3,548	4,010
Obligated Balance not yet Disbursed	14,903	14,076
Deposit /Clearing Account Balances	358	354
Fund Balance with Treasury	\$ 27,086	\$ 26,292



4. Cash

Cash			
as of September 30,			
		2009	2008
Canteen Service	\$	3	\$ 2
Agent Cashier Advance		14	6
Loan Guaranty Program		33	32
Total Cash	\$	50	\$ 40

5. Investments

Investment Securities						
as of September 30, 2009						
	Cost	Amortization Method	Amortized (Premium)/ Discount	Interest Receivable	Investments, Net	Market Value
Intragovernmental Securities						
Marketable (T-Bills)	\$ -	Straight-line	\$ -	-	-	\$ -
Non-Marketable: Special Bonds	11,092	Interest	-	155	11,247	11,247
Treasury Notes	82	Effective Interest	(2)	1	81	81
Total	\$ 11,174		\$ (2)	156	11,328	\$ 11,328
Other Securities						
Trust Certificates (Loan Guaranty)	\$ 140	N/A	\$ -	-	140	\$ 140
Mutual Funds (Non-Federal Trusts)	47	Straight-line	(3)	-	44	44
Total	\$ 187		\$ (3)	-	184	\$ 184
as of September 30, 2008						
Intragovernmental Securities						
Marketable (T-Bills)	\$ 26	Straight-line	\$ -	-	26	\$ 26
Non-Marketable: Special Bonds	11,657	Interest	-	168	11,825	11,825
Treasury Notes	73	N/A	(1)	1	73	73
Total	\$ 11,756		\$ (1)	169	11,924	\$ 11,924
Other Securities						
Trust Certificates (Loan Guaranty)	\$ 140	N/A	\$ -	-	140	\$ 140
Mutual Funds (Non-Federal Trusts)	46	Straight-line	(3)	-	43	43
Total	\$ 186		\$ (3)	-	183	\$ 183



6. Accounts Receivable, Net

Accounts Receivable, Net as of September 30,

	2009	2008
Intragovernmental Accounts Receivable, Net	\$ 65	\$ 52
Public Accounts Receivable		
Public Accounts Receivable, Gross	\$ 3,215	\$ 3,041
Allowance for Loss Provision	(1,663)	(1,281)
Net Public Accounts Receivable	\$ 1,552	\$ 1,760

7. Direct Loans and Loan Guarantees

Direct loan obligations and loan guarantee commitments made after 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990 (the Act). This disclosure is also in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Guarantees. The Act provides that the present value of the subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. Direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimates will most likely require a future cash outflow to pay defaulted claims.

Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The recorded value of loans receivable, net, and the value of assets related to direct loans are not the same as the proceeds that VA would expect to receive from selling its loans. VA operates

the following direct loan and loan guaranty programs:

- Vocational Rehabilitation and Employment
- Education
- Insurance
- Loan Guaranty

Under the Loan Guaranty Program, a loan may be made to an eligible Veteran by an approved private sector mortgage lender. VA guarantees payment of a fixed percentage of the loan indebtedness to the holder of such a loan, up to a maximum dollar amount, in the event of default by the Veteran borrower. Occasionally, a delinquency is reported to VA and neither a realistic alternative to foreclosure is offered by the loan holder nor is VA in a position to supplementally service the loan. In such cases, VA determines, through an economic analysis, whether VA will authorize the holder to convey the property securing the loan (foreclosure) or pay the loan guarantee amount to the holder.

Recent economic conditions have led to decreases in interest and inflation rates, home prices, and home sales; and led to increases in unemployment rates, loan delinquency and foreclosure rates, and refinance loan levels. There were also various existing and new federal programs established to stabilize the housing and financial markets. These factors led to increases in demand for VA guaranty loans. The actual and projected economic conditions and changes in loan originations affected



revisions of loan subsidy cost estimates to fund actual and future defaults (net of recoveries and fees, etc.).

Low mortgage rates may increase demand for loans and decrease the probability of loan delinquencies and foreclosures. This may reduce loan subsidy costs. High unemployment rates, decline in home prices and sales, high refinance loan levels, low interest rates, and expansion of credit may increase loan

subsidy costs. Overall in fiscal year 2009 and 2008, there were net upward revisions to subsidy costs, in order to finance higher projected default losses.

In FY 2009 and FY 2008, VA had no modifications as prescribed by the Act, and no restrictions on foreclosed properties.

Direct Loans

Loans receivable related to direct loans represent the net value of assets related to acquired pre-1992 and post-1991 direct loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated

uncollectible loans). For post-1991 loans, the assets are offset by an allowance for subsidy costs at present value. An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the direct loans are provided in the tables that follow:

Loans Receivable and Related Foreclosed Property From Direct Loans as of September 30, 2009

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 21	10	(2)	-	\$ 29
Insurance Policy Loans	540	13	-	-	553
Total Loans Receivable and Related Foreclosed Property Excluding Direct Loans Obligated After 1991, Net					\$ 582

	Loans Receivable Gross	Interest Receivable	Allowance for Subsidy (Present Value)	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated After FY 1991	\$ 739	1	718	18	\$ 1,476
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					\$ 2,058



**Loans Receivable and Related Foreclosed Property From Direct Loans
as of September 30, 2008**

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 25	10	(6)	-	\$ 29
Insurance Policy Loans	569	14	-	-	583
Total Loans Receivable and Related Foreclosed Property Excluding Direct Loans Obligated After 1991, Net					<u>\$ 612</u>

	Loans Receivable Gross	Interest Receivable	Allowance for Subsidy (Present Value)	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated After 1991	\$ 721	10	748	29	<u>\$ 1,508</u>
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					<u>\$ 2,120</u>

Direct Loans Disbursed

The total amount of new direct loans disbursed for the years ended September 30, 2009 and 2008, was \$50 and \$130, respectively.

Provision for Losses on Pre-1992 Loans

The present value of the cost VA will bear as loans already guaranteed default is an element of the mortgage loan benefit that VA provides to Veterans. This cost is reflected in the financial statements as an offset to the value of certain related assets.

The provision for losses on vendee loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The calculation is also based on the use of the average interest rate of U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding vendee or direct loans will default over a 12-year period. For FY 2009, VA determined that these vendee loans have sufficient equity, due to real estate appreciation and buy-down of principal, to minimize or eliminate any potential loss to VA.



Subsidy Expense for Post-1991 Direct Loans
Pursuant to the Credit Reform Act, all direct loans established after September 30, 1991, will

be subsidized. The subsidy expense for direct loans is as shown:

**Direct Loan Subsidy Expense
for the years ended September 30,**

	2009	2008
Interest Differential	\$ (8)	\$ (18)
Defaults*	1	9
Fees**	-	(1)
Other***	5	13
Subtotal	(2)	3
for the years ended September 30,		
	2009	2008
Interest Rate Reestimates	39	(10)
Technical Reestimates	55	12
Total Direct Loan Subsidy Expense	\$ 92	\$ 5

* Includes approximately \$7 thousand and \$5 thousand in defaults and other expenses for the Vocational Rehabilitation Program in FY 2009 and FY 2008, respectively.

** "Fees" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.

*** The "Other" expense for direct loans includes the estimated loss of scheduled principal and interest when vendee loans are sold.

Subsidy Rates for Direct Loans by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans

reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy rates for direct loans

Interest Differential	(29.19%)
Defaults	10.24%
Fees	(1.91%)
Other	20.61%

Allowance for Subsidy for Direct Loans (Post-1991)

VA reports the allowance for subsidy for direct loans, subject to Credit Reform requirements. For these loans, the allowance for subsidy represents the present value of the estimated net cash flows to be paid by VA as a result of a disbursed direct loan. VA disburses a direct loan and receives an allowance for subsidy along with borrowing from Treasury. VA reports the

allowance for subsidy for direct loans, subject to Credit Reform requirements. For those loans, an allowance equal to the subsidy costs associated with these loans adjusts the loans receivable. This adjustment is the result of the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows. VA disburses a direct loan and receives an allowance for



subsidy along with borrowing from the Treasury. For FY 2009, the subsidy rate is (3.29) percent for Veterans Housing Direct – Vendee Loans, 3.04 percent for Veterans Housing Direct – Acquired Loans, and (10.07) percent for Native American Direct. In FY 2008, the subsidy rate was (1.59) percent for Veterans Housing Direct – Vendee Loans, 8.84

percent for Veterans Housing Direct – Acquired Loans, and (14.48) percent for Native American Direct. The allowance for subsidy as of September 30, 2009 and 2008 is \$(718) and \$(748), respectively.

Schedule for Reconciling Subsidy Cost Allowance Balances

Beginning Balance, Changes and Ending Balance

	FY 2009	FY 2008
Beginning balance of the allowance	\$ (748)	\$ (620)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(8)	(18)
Default costs (net of recoveries)	1	9
Fees and other collections	-	(1)
Other subsidy costs	5	13
Total of the above subsidy expense components	(2)	3
Adjustments:		
Fees received	1	2
Foreclosed property acquired	(19)	(16)
Loans written off	(1)	(2)
Subsidy allowance amortization	(54)	(33)
Change in execution	11	(84)
Ending balance of the allowance before reestimates	(812)	(750)
Subsidy reestimates by component		
Interest rate reestimate	39	(10)
Technical/default reestimate	55	12
Total of the above reestimate components	94	2
Ending balance of the allowance	\$ (718)	\$ (748)

**Loan Guarantees**

Loans receivable related to loan guarantees represent the net value of assets related to pre-1992 and post-1991 defaulted guaranteed loans and non-defaulted guaranteed loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans).

An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy costs associated with loan guarantees are provided in the tables that follow:

**Loans Receivable and Related Foreclosed Property from Loan Guarantees
as of September 30, 2009**

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	\$ 33	-	(26)	8	\$ 15
Defaulted Guaranteed Loans - Post-1991	5	-	-	890	895
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					\$ 910

**Loans Receivable and Related Foreclosed Property from Loan Guarantees
as of September 30, 2008**

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	\$ 49	-	(39)	9	\$ 19
Defaulted Guaranteed Loans - Post-1991	5	-	-	764	769
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					\$ 788

**Total Loans Receivable and Related Foreclosed Property, Net
as of September 30,**

	2009	2008
Total Direct Loans	\$ 2,058	\$ 2,120
Total Guaranteed Loans	910	788
Total Loans Receivable and Related Foreclosed Property, Net	\$ 2,968	\$ 2,908

Foreclosed Property

Prior to the foreclosure of property secured by a VA loan, VA obtains an independent appraisal of the property. This appraisal is reviewed by VA staff to make a determination of the fair market value. To determine the net value of the property, VA costs such as acquisition,

management, and disposition of the property, as well as estimated losses on property resale, are subtracted from the estimated fair market value. The amount recorded for foreclosed property is estimated based upon the present value of future cash flows to be received upon the disposition of the property. Future cash flows are estimated



based on the estimated selling price less the amounts paid at foreclosure plus estimated costs to carry the property. Recent volatility in the United States housing market could change the estimates and assumptions used for these calculations in the future, which could impact the amounts reported and disclosed herein.

As of September 30, 2009 and 2008, the estimated number of residential properties in

VA's inventory was 8,464 and 7,605, respectively. For FY 2009 and FY 2008, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 8.89 months and 11.7 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 16,982 and 9,077 as of September 30, 2009 and 2008, respectively.

Guaranteed Loans as of September 30,

	2009	2008
<u>Guaranteed Loans Outstanding:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 183,365	\$ 220,839
Amount of Outstanding Guarantee	50,368	63,921
<u>New Guaranteed Loans Disbursed:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 68,200	\$ 36,090
Amount of Outstanding Guarantee	17,492	9,236
Liabilities for Loan Guarantees Post 1991 (Pre-1992 Present Value)	\$ 3,916	\$ 3,452

Guaranty Commitments

VA guaranteed 325,690 loans in FY 2009. The FY 2009 total guaranty amount is \$17.5 billion. The total amount of loans guaranteed is \$68.2 billion.

Subsidy Expense for Post-1991 Loan Guarantees

Pursuant to the Credit Reform Act, guaranteed loans closed after September 30, 1991, will be subsidized. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

Guaranteed Loan Subsidy Expenses for the years ended September 30,

	2009	2008
Defaults	\$ 726	\$ 454
Fees*	(1,170)	(587)
Subtotal	(444)	(133)
Interest Rate Reestimates	(65)	(212)
Technical Reestimates	481	(230)
Total Guaranteed Loan Subsidy Expenses**	\$ (28)	\$ (575)

* The "Fees" expense includes estimated up-front fees collected when the loans are guaranteed and the present value of estimated annual fees from loan assumptions.

** A negative subsidy rate indicates cash inflows from interest and fees are greater than disbursements.


**Loan Sale-Guaranteed Loan Subsidy Expense
for the years ended September 30,**

	2009	2008
Defaults	\$ -	\$ 5
Other	-	(1)
Subtotal	-	4
Interest Rate Reestimates	(9)	(49)
Technical Reestimates	1	(52)
Total Loan Sale-Guaranteed Subsidy Expense	\$ (8)	\$ (97)

**Total Subsidy Expense
for the years ended September 30,**

	2009	2008
Total Direct Loans	\$ 92	\$ 5
Total Guaranteed Loans	(28)	(575)
Total Sale Loans	(8)	(97)
Total Subsidy Expense	\$ 56	\$ (667)

Subsidy Rates for Loan Guarantees by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new

loan guarantees reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Loan Guarantees

Defaults	1.08%
Fees	(1.74)%

Loan Sales

VA has vendee loan sales to reduce the administrative burden of servicing vendee loans. During the period FY 1992 through FY 2009, the total loans sold amounted to \$14 billion. Under the sale of vendee loans, certificates are issued pursuant to the Pooling and Servicing Agreement (the Agreement) among VA, the Master Servicer, and the Trustee. On the closing date of the certificates, VA transfers its entire interest in the related loans to the Trustee for the benefit of the related certificate holders pursuant to the Agreement. Under the Agreement, the Trust will issue certificates backed by mortgage loans and installment contracts. The Trust owns the mortgage loans and other property described

in the offering and the Trust makes elections to treat certain of its assets as one or more Real Estate Mortgage Investment Conduits (REMIC) for U.S. federal income tax purposes. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. The certificates are issued as part of a designated series that may include one or more classes. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates and that guaranty is backed by the full faith and credit of the federal government.

VA may terminate the Trust, causing the early retirement of certificates, by purchasing all of



the Trust's assets on any distribution date on or after the distribution date on which the current aggregate principal balance of all principal certificates is less than 1 percent of the original aggregate principal balance, or if VA determines that the Trust's REMIC status has been lost or a substantial risk exists that such status will be lost. In the event of termination, the certificate holder will be entitled to receive payment for the full principal balance of the certificates plus any accrued interest and unpaid interest through the related distribution date.

The Agreement requires the mortgage loans to be serviced generally in compliance with Fannie Mae and Freddie Mac standards and consistent with prudent residential mortgage loan servicing standards generally accepted in the servicing industry. For mortgage loans sold during FY 2009, servicing was performed by the Bank of America's BAC Home Loans Servicing, LP, formerly known as Countrywide Home Loans, Inc. The Master Servicer is responsible for performing all the servicing functions under the separate Pooling and Servicing Agreements created for each Vendee Mortgage Trust. The Master Servicer is entitled to be compensated by retaining, from amounts received on each Mortgage Loan or Real Estate Owned (REO) Mortgage Loan (including REO Proceeds and Liquidation Proceeds) that are allocable to interest in accordance with the related Mortgage Note or, in the case of REO Proceeds and Liquidation Proceeds an amount equal to such

amount allocable to interest multiplied by a fraction, the numerator of which is 0.2075% and the denominator of which is the Mortgage Rate for the related Mortgage Loan.

Additional servicing compensation in the form of prepayment charges, assumption fees, and late payment charges shall be retained by the Master Servicer as received. The Master Servicer also shall be entitled to withdraw and retain, as additional compensation, investment income on amounts on deposit in the Certificate Account. The Master Servicer shall be entitled to receive as additional compensation the interest earned on amounts remitted by the Master Servicer to the Trustee and deposited by the Trustee in the Distribution Account. The Master Servicer shall be required to pay all expenses incurred by it in connection with its servicing activities hereunder (including, without limitation, the fees and expenses of the Trustee, and the fees of the Sub-Servicers under the respective Sub-Servicing Agreements, if any) and shall not be entitled to reimbursement therefore except as specifically provided in each Pooling and Servicing Agreement.

VA did not complete any vendee loan sales during FY 2009, and completed one vendee loan sale for \$193 in FY 2008. Gain or loss, if any, is recognized at time of sale. The components of the vendee sale are summarized in the tables below.

Loan Sales

Years Ended September 30,

	2009	2008
Loans Receivable Sold	\$ -	\$ (193)
Net Proceeds from Sale	-	197
Gain on Receivables Sold	\$ -	\$ 4

**Outstanding Balance of Loan Sale Guarantees**

The outstanding balance for guaranteed loans sold is summarized in the table below:

**Guaranteed Loans Sold
as of September 30,**

	2009	2008
Outstanding Balance Guaranteed Loans Sold, Start of Year	\$ 1,901	\$ 1,958
Sold to the Public	-	193
Payments, Repayments, and Terminations	(187)	(250)
Outstanding Balance Guaranteed Loans Sold, End of Year	\$ 1,714	\$ 1,901

Liability for Loan Sale Guarantees (Post-1991)

VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs, subject to Credit Reform requirements. For these loans, the guaranteed loan sale liability represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee.

These sales contain two types of guarantees for which VA pays net cash flow. VA guarantees that the principal and interest payment due on a loan sold will be paid by the 15th of each month.

If not paid by the borrower, VA allows the loan servicer to take funds from cash reserve accounts for the deficient amount. VA also guarantees the loan against loss at foreclosure. VA will not buy back the loans but will pay off the loan loss and foreclosure expenses. The subsidy rate for FY 2009 and FY 2008 is 0 percent and 2.14 percent, respectively. The liability for loan sale guarantees as of September 30, 2009 and 2008 is \$45 and \$73, respectively.

Schedule for Reconciling Loan Sale Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	2009	2008
Beginning balance of the liability	\$ 73	\$ 166
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	-	5
Other subsidy costs	-	(1)
Total of the above subsidy expense components	-	4
Adjustments:		
Claim payments to lenders	(20)	(10)
Interest accumulation on the liability balance	2	10
Other	(2)	4
Ending balance of the liability before reestimates	53	174
Subsidy reestimates by component		
Interest rate reestimate	(9)	(49)
Technical/default reestimate	1	(52)
Total of the above reestimate components	(8)	(101)
Ending balance of the liability	\$ 45	\$ 73

Liability for Loan Guarantees (Post-1991)

VA reports the liability on the guarantee of loans, subject to Credit Reform requirements. For these loans, the guaranteed loan liability represents the present value of the estimated net

cash flows to be paid by VA as a result of a defaulted loan guarantee. VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to a legally specified maximum based on the value of individual



loans. VA will pay the lender the guarantee and foreclosure expenses. If an agreement can be made with the Veteran, VA may acquire the loan by refunding the lender for the loan. The FY 2009 and FY 2008 subsidy rate was (0.66) and

(0.37) percent, respectively. The liability for loan guarantees as of September 30, 2009 and 2008 is \$3,871 and \$3,379, respectively.

Schedule for Reconciling Loan Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance

	2009	2008
Beginning balance of the liability	\$ 3,379	\$ 3,603
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	726	454
Fees and other collections	(1,170)	(587)
Total of the above subsidy expense components	(444)	(133)
Adjustments:		
Fees received	855	584
Foreclosed property and loans acquired	(325)	(132)
Claim payments to lenders	(403)	(246)
Interest accumulation on the liability balance	124	145
Change in execution	269	-
Ending balance of the liability before reestimates	3,455	3,821
Subsidy re-estimates by component		
Interest rate reestimate	(65)	(212)
Technical/default re-estimate	481	(230)
Total of the above reestimate components	416	(442)
Ending balance of the liability	\$ 3,871	\$ 3,379

Administrative Expense

Administrative expense on direct and guaranteed loans for the fiscal years ended September 30, 2009 and 2008 was \$140 and \$155, respectively.

8. Inventories and Related Properties, Net

Inventories

as of September 30,

	2009	2008
Held for Current Sale	\$ 56	\$ 58
Other	3	3
Total Inventories	\$ 59	\$ 61



9. General Property, Plant and Equipment

Depreciation and amortization expense totaled \$1,131 and \$1,024 in FY 2009 and FY 2008, respectively.

General Property, Plant and Equipment as of September 30, 2009

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	\$ 639	\$ (67)	\$ 572
Buildings	18,564	(9,665)	8,899
Equipment	3,586	(1,814)	1,772
Other Structures and Capital Leases	2,497	(1,468)	1,029
Internal Use Software	321	(213)	108
Construction Work in Progress	2,100	-	2,100
Internal Use Software in Development	219	-	219
Total Property, Plant, and Equipment	\$ 27,926	\$ (13,227)	\$ 14,699

General Property, Plant and Equipment as of September 30, 2008

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	\$ 576	\$ (47)	\$ 529
Buildings	17,355	(9,088)	8,267
Equipment	3,351	(1,786)	1,565
Other Structures and Capital Leases	2,324	(1,392)	932
Internal Use Software	274	(200)	74
Construction Work in Progress	1,459	-	1,459
Internal Use Software in Development	242	-	242
Total Property, Plant, and Equipment	\$ 25,581	\$ (12,513)	\$ 13,068

10. Heritage Assets

Heritage assets are properties that possess one or more of the following characteristics: historical or natural significance; cultural; educational or aesthetic value; or significant architectural characteristics. VA has properties at medical centers and National Cemeteries that meet the criteria for heritage assets. Heritage assets allow VA to meet its responsibilities under the National Historic Preservation Act to administer federally owned, administered, or controlled prehistoric or historic resources in a spirit of

stewardship for the inspiration and benefit of present and future generations.

Generally, additions to VA's heritage assets inventory result from field station surveys, which identify items such as new collections or newly designated assets. VA classifies its heritage assets as: Art Collections (including artwork, archives, historic medical equipment, medals and awards, furniture, archaeological materials, and photographs); Buildings and Structures (including historic hospitals, quarters,



lodges, and chapels); Monuments/Historic Flag Poles; Other Non-Structure Items (including rostrums, gates and historic walls); Archaeological Sites; and Cemeteries. According to VA's policy for heritage assets, only developed sections of National Cemeteries

are classified as heritage assets; while undeveloped sections are not until they are developed. VA's policy for heritage assets can be found, in its entirety, in Directive and Handbook 7545, Cultural Resources Management Procedures.

Heritage Assets in Units

as of September 30,	2008 Balance	2009 Additions	2009 Withdrawals	2009 Net Change	2009 Balance	2009 Condition
Art Collections	211	-	-	-	211	A
Buildings and Structures	1,543	-	(27)	(27)	1516	*U
Monuments/Historic Flag Poles	984	-	-	-	984	A
Other Non-Structure Items	225	1	-	1	226	A
Archaeological	34	-	-	-	34	A
Cemeteries	158	5	-	5	**163	A
Total Heritage Assets in Units	3,155	6	(27)	(21)	3,134	

Explanation of Condition: A = Acceptable (No to slight deterioration); U=Unacceptable (Moderate to significant deterioration)

*Buildings and Structures: Approximately 50% of VA's historic buildings and structures are unoccupied and risk deterioration. Many are in the "U" range.

** This total accounts only for open, operational cemeteries, not those under development.

11. Liabilities Not Covered By Budgetary Resources

The total amount of VA liabilities not covered by budgetary resources was \$1,323.7 billion and \$1,472.9 billion as of September 30, 2009 and

2008, respectively, as shown in the following table.

Components of Unfunded Liabilities

as of September 30

	2009	2008
Workers' Compensation*	\$ 2,151	\$ 2,304
Annual Leave	1,655	1,509
Judgment Fund	663	604
Environmental and Disposal	884	928
Accounts Payable – Canceled Appropriations	15	10
Veterans Compensation and Burial	1,317,500	1,466,700
Insurance	847	796
Total	\$ 1,323,715	\$ 1,472,851

* The actuarial estimate for workers' compensation provided by DOL was computed using interest rates of 4.72 percent and 4.77 percent to discount the projected annual benefit payments as of FY 2009 and FY 2008, respectively.



12. Federal Employee and Veterans Benefits

Federal Employee Benefits: Imputed Expenses-Employee Benefits

Years ended September 30,	2009	2008
Civil Service Retirement System	\$ 313	\$ 266
Federal Employees Health Benefits	1,251	1,025
Federal Employees Group Life Insurance	3	3
Total Imputed Expenses-Employee Benefits	\$ 1,567	\$ 1,294

Veterans Benefits

Certain Veterans who die or are disabled from military service-related causes, as well as their dependents, receive compensation benefits. Also, Veterans are provided with burial flags, headstones/markers, and grave liners for burial

in a VA national cemetery or are provided a burial flag, headstone/marker and a plot allowance for burial in a private cemetery. These benefits are provided in recognition of a Veteran's military service and are recorded as a liability on the balance sheet.

Federal Employee and Veterans Benefits Liabilities

as of September 30,	2009	2008
FECA	\$ 1,735	\$ 1,905
Compensation	1,313,900	1,462,000
Burial	3,600	4,700
Total Federal Employee and Veterans Benefits Liabilities	\$ 1,319,235	\$ 1,468,605

VA provides certain Veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the Veteran died or was disabled from nonservice-related causes. The actuarial present value of the future liability for pension benefits is a non-exchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2009 and 2008 was \$91.4 billion and \$97.3 billion, respectively.

Assumptions Used to Calculate the Veterans Benefits Liability

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for the projected benefit payments to: (1) those

beneficiaries, including Veterans and survivors, currently receiving benefit payments; (2) current Veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become Veterans in the future. Future benefits payments to survivors of those Veterans in classes (1), (2), and (3) are also incorporated into the projection. The projected liability does not include any administrative costs. Actual administrative costs incurred annually are shown in the Statement of Net Cost.

All future benefits were discounted. Discount rates were based on rates for securities issued by Treasury on September 30, 2009, ranging from 0.40 to 4.37 percent, and on September 30, 2008, ranging from 1.80 to 4.61 percent. All calculations were performed separately by attained age for the Compensation and Pension



programs, while the Burial liability was calculated on an aggregate basis.

Life expectancies of beneficiaries collecting benefits from the Compensation and Pension programs were based upon studies of mortality experience of those beneficiaries between 2002 and 2009. Life expectancies of Veterans not yet collecting these benefits used in the calculation of the liability for future beneficiaries are based on mortality derived from the 2004 U.S. Life Table. Applying mortality improvements at a rate that varies by age of between 0.85 and 1.00 percent per annum brought both sets of mortality rates forward. In addition, rates of benefit termination of beneficiaries due to reasons other than mortality are also reflected.

The amount of benefits by beneficiary category and age were based on current amounts being paid, future cost of living adjustments (COLA) to determine the average benefits per Veteran for each future time period, and changes in other factors that affect benefits. The average COLA rate used for all future years at September 30, 2009 was 1.3 percent. COLA rates for future years are modeled to be consistent with future interest rates implied by the Treasury Yield Curve as of September 30, 2009. Expected changes in benefits due to other reasons were also reflected.

Expected benefit payments have been explicitly modeled for the next 100 years. The Compensation and Pension projections only reflect benefits associated with military service through September 30, 2009.

Veteran's Presumptive Disability Benefits

The Secretary of the VA announced on October 13, 2009, that relying on an independent study by the Institute of Medicine (IOM), he has decided to establish service-connection for Vietnam Veterans who have any of three specific illnesses, based on the latest evidence of an association with the herbicides referred to as Agent Orange. The illnesses affected by the

recent decision are B cell leukemia, such as hairy cell leukemia; Parkinson's disease; and ischemic heart disease. Through the Agent Orange Act of 1991, Pub. L. No. 102-4, Congress established a regulatory process to guide the creation of new presumptions. If this process results in the publication of a final regulation, as authorized by the Agent Orange Act, the adjudication of cases based on these presumptions will begin. These new adjudications must conform to the presumptions as determined in the final regulation. For accounting purposes, a liability for potential additional benefit costs may exist, but the amount or range of the possible liability is not measureable at this time. No claims based on the yet-to-be-established presumptions have been paid or accrued as of this date.

New Accounting Standard

On October 14, 2008 the FASAB issued SFFAS No. 33, Pensions, Other Retirement Benefits, and Other Post-employment benefits: Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates, effective for periods beginning after September 30, 2009.

The changes resulting from implementing the standards in SFFAS No. 33 include: (1) disclosure of gains and losses from changes in long-term assumptions; (2) disclosure of the components of the expense associated with federal employee pensions, other retirement benefits, and other post-employment benefits pension liability balances, including Veterans compensation; and (3) standards for selecting the discount rate assumption and valuation dates for estimating the liability. Management has not yet determined the impact on the VA's consolidated financial statements.

13. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of \$884 and \$928 as of September 30, 2009 and 2008, respectively. The majority of the unfunded liabilities involve



asbestos removal, lead abatement, replacement of underground oil and gasoline tanks, decommissioning of waste incinerators, and decontamination of equipment prior to disposal.

While some facilities have applied prevailing state regulations that are more stringent than federal guidelines, the Occupational Safety and Health Administration and Environmental Protection Agency regulations are the legal base behind the majority of VA's environmental and disposal liabilities. Estimated liabilities for these projects are based on known contamination that exists today and have been

computed by the facility engineering staff based on similar projects already completed, or by independent contractors providing work estimates.

14. Other Liabilities

Other liabilities are liabilities not reported elsewhere. They consist of Funded and Unfunded Liabilities. Funded liabilities are generally considered to be current liabilities. Unfunded liabilities are generally considered to be non-current liabilities.

Other Intragovernmental Funded Liabilities as of September 30,

	2009	2008
Deposit and Clearing Account Liabilities	\$ 78	\$ 100
Accrued Expenses - Federal	232	232
Deferred Revenue	47	11
Resources Payable to Treasury	189	197
Custodial Liabilities	44	34
Credit Reform Reestimates*	280	735
General Fund Receipts Liability	6	5
Accrued VA Contributions for Employee Benefits	238	190
Total Other Intragovernmental Funded Liabilities	\$ 1,114	\$ 1,504

* Credit reform liabilities include subsidy reestimates for loans made after September 30, 1991, which are subject to the provisions of the Credit Reform Act of 1990. The liability provision for future losses on credit reform guaranteed loans is comprised of a funded subsidy for each loan guaranteed at the rate equal to the amount of the present value of estimated loss to the government for the cohorts of loans. The subsidy amount for each cohort is reestimated annually to ensure amounts reflect the actual losses on guaranteed loans. Based on the reestimated amounts, additional subsidy funds are provided for or excess funds are returned.

Other Intragovernmental Unfunded Liabilities as of September 30,

	2009	2008
Accrued FECA Liability	\$ 409	\$ 395
Unfunded Employee Liability	7	4
Total Other Intragovernmental Unfunded Liabilities	\$ 416	\$ 399
Total Other Intragovernmental Liabilities	\$ 1,530	\$ 1,903



Other Public Funded Liabilities
as of September 30,

	2009	2008
Accrued Funded Annual Leave	\$ 13	\$ 12
Accrued Expenses	2,853	2,197
Accrued Salaries and Benefits	1,072	908
Unearned Premiums	87	81
Insurance Dividends Left on Deposit and Related Interest Payable*	1,683	1,712
Dividend Payable to Policyholders	142	157
Capital Lease Liability	15	16
Other	57	53
Total Other Public Funded Liabilities	\$ 5,922	\$ 5,136

* Interest earned on dividends left on deposit is paid annually to insurance policyholders on the policy anniversary dates.

Other Public Unfunded Liabilities
as of September 30,

	2009	2008
Annual Leave*	\$ 1,655	\$ 1,510
Accounts Payable from Cancelled Appropriation	15	10
Amounts due to non-federal trust	173	173
Judgment Fund-Unfunded**	663	604
Total Other Public Unfunded Liabilities	\$ 2,506	\$ 2,297
Total Other Public Liabilities	\$ 8,428	\$ 7,433

* Annual leave is accrued when earned and is adjusted at the end of the fiscal year to reflect current pay rates of cumulative leave earned but not taken. Sick and other types of leave are expensed as taken.

** The Judgment Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgment Fund on behalf of VA (see Note 17, Contingencies).

15. Leases

VA has both capital and operating leases. The capital lease liability is \$15 and \$16 as of September 30, 2009 and 2008, respectively. Future commitments for Real Property and Equipment leases are based on leases in effect as of September 30, 2009. Due to the number of equipment operating leases and the decentralization of records, the future

commitment for equipment leases has been estimated using the amount from FY 2009 in lieu of actual amounts being available. VA's FY 2009 operating lease costs were \$396 for real property rentals and \$113 for equipment rentals. The FY 2008 operating lease costs consisted of \$348 for real property rentals and \$112 for equipment rental. The following chart represents VA's projected operating lease commitments or costs for the next 5 years.

**Leases:**

Year	Real Property	Equipment
2010	\$ 273	\$ 113
2011	253	113
2012	214	113
2013	190	113
2014	159	113

16. Insurance Programs

Through VA, the United States Government administers five life insurance programs and the Veterans' Mortgage Life Insurance (VMLI) program for certain totally disabled Veterans. VA supervises the Service members' Group Life Insurance (SGLI) and the Veterans' Group Life Insurance (VGLI) programs, which provide life insurance coverage to members of the uniformed armed services, reservists, and post-Vietnam Veterans. United States Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.

Administered Programs

The United States Government Life Insurance (USGLI) program was the government's first venture into life insurance. During World War I, the U.S. provided Marine Insurance to protect the interests of ship owners and merchants who were providing supplies to the allies in Europe. USGLI was the natural outgrowth of this Marine Insurance. The program was established to meet the needs of World War I Veterans, but remained open to service members and Veterans with service before October 8, 1940. The government became a self-insurer because private insurance companies were unwilling to assume the unpredictable risks associated with war. By establishing this program, Congress intended to avoid the financial burden imposed on the government by the pension programs that were established after previous wars. The government became the largest life insurer in the United States with the coverage provided by this program.

The National Service Life Insurance (NSLI) program covers policyholders who served during World War II. The program opened October 8, 1940, when it became clear that large-scale military inductions were imminent. Over 22 million policies were issued under the NSLI program. The majority of policies VA administers directly are NSLI policies. This program remained open until April 25, 1951, when two new programs were established for Korean War service members and Veterans.

The Veterans' Special Life Insurance (VSLI) program was established in 1951 to meet the insurance needs of Veterans who served during the Korean Conflict, and the post-Korean period through January 1, 1957. During this period, all service members on active duty were covered for \$10 thousand at no cost, under a program known as Servicemen's Indemnity. They remained covered for 120 days after their discharge. The VSLI program allowed these newly discharged service members to apply for \$10 thousand of contract term insurance. Application had to be made during the 120-day period during which they remained covered by Servicemen's Indemnity. It was during this period that representatives of the commercial insurance industry began a major lobbying effort to get the government out of the insurance business because the programs were viewed as competition. As a result, the VSLI program was closed to new issues at the end of 1956, and coverage for individuals in the uniformed services was terminated. Approximately 800,000 VSLI policies were issued between 1951 and 1957.



In addition to VSLI coverage, which was provided to healthy Veterans, the Insurance Act of 1951 also established the Service-Disabled Veterans Insurance (S-DVI) program for Veterans with service-connected disabilities. S-DVI is open to Veterans separated from the service on or after April 25, 1951, who receive a service-connected disability rating. New policies are still being issued under this program.

In 1964, Congress enacted legislation providing for a limited reopening of NSLI and VSLI, and the Veterans' Reopened Insurance (VRI) program was established. Beginning May 1, 1965, Veterans who had been eligible to obtain insurance between October 8, 1940, and January 1, 1957, could once again apply for government life insurance. They had one year to apply for this "reopened" insurance, which was available only to disabled Veterans. Approximately 228,000 VRI policies were issued. No term insurance policies were issued in this program.

The VMLI program began in 1971, and is designed to provide financial protection to cover eligible Veterans' home mortgages in the event of death. VMLI is issued to those severely disabled Veterans who have received grants for specially adapted housing from VA. These grants are issued to Veterans whose movement is substantially impaired because of their disability. The maximum amount of VMLI allowed an eligible Veteran is \$90 thousand. The insurance is payable if the Veteran dies before the mortgage is paid off and is payable only to the mortgage lender.

Supervised Insurance Programs

The SGLI program was established in 1965 for Vietnam-era service members. SGLI is supervised by VA and is administered by the Office of Service members' Group Life Insurance (OSGLI) under terms of a group policy. This program provides low-cost term insurance protection to service members and their families.

In 1974, the VGLI program became available. VGLI, like SGLI, is supervised by VA, but is administered by the OSGLI. VGLI provides for the conversion of SGLI coverage to lifetime term insurance protection after a service member's separation from service.

The Traumatic Injury Protection (TSGLI) program became effective December 1, 2005. TSGLI, which automatically covers all who participate in SGLI, provides for insurance payments to members who suffer a serious traumatic injury in service. These payments range from \$25,000 to a maximum of \$100,000, depending on the type and severity of injury.

Public Insurance Carriers

VA supervises the administration of the SGLI and VGLI programs. VA has entered into a group policy with Prudential Insurance Company of America whereby Prudential and its reinsurers provide service members and Veterans coverage in multiples of \$50 thousand up to a maximum of \$400 thousand. The basic SGLI coverage is provided to those members on active duty in the Army, Navy, Air Force, Marine Corps, Coast Guard, commissioned members of the Public Health Service and the National Oceanic and Atmospheric Administration. The Ready Reserve is also insured by SGLI, and includes reservists and members of the National Guard who are assigned to a unit or position in which they may be required to perform active duty or active duty for training. The VGLI coverage is composed of separated and retired active duty members and reservists covered under Basic SGLI.

The Veterans' Opportunities Act of 2001 extended life insurance coverage to spouses and children of members insured under the SGLI program, effective November 1, 2001. For a spouse, up to \$100 thousand of coverage can be purchased in increments of \$10 thousand, not to exceed the amount of the service member's coverage. Each dependent child of every active duty service member or reservist insured under



SGLI is automatically insured for \$10 thousand free of charge.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their spouses are deducted from the service member's pay by the Armed Services components through the Department of Defense (DoD). DoD, through the Defense Finance and Accounting Service (DFAS), remits collected premiums to VA, which are then transmitted to Prudential. Prudential records the premiums and maintains investments in their accounting records separate and independent from the VA reporting entity. VA monitors Prudential's insurance reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. The reserves for the contingent liabilities are recorded in Prudential's accounting records and are not reflected in the VA reporting entity because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy. Prudential administers the TSGLI program under an Administrative Services Only agreement with VA. Under the law, DoD pays for any claim costs for this program in excess of premiums collected.

The Secretary of Veterans Affairs determines the claim costs that are traceable to the extra hazards of duty in the uniformed services, on the basis of the excess mortality incurred by members and former members of the uniformed armed services insured under SGLI, above what their mortality would have been under peacetime conditions. The costs so identified by the Secretary are paid by the uniformed services, not from the service members' premiums, as are all other programs costs.

Reserve Liabilities

The insurance reserves for administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and Veterans Insurance and Indemnities (VI&I) reserves are reported as liabilities not covered by budgetary resources. Reserves for SGLI and VGLI are maintained in Prudential's financial records since the risk of loss is assumed by Prudential and its reinsurers. Actuarial reserve liabilities for the administered life insurance programs are based on the mortality and interest assumptions at time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest assumptions range from 2.25 to 5 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, the 1980 CSO Basic Table, and the 2001 CSO Table.



Insurance Liability (Reserve) Balances

As of September 30, 2009

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$ 7,275	\$ 104	\$ 66	\$ 7,445
USGLI	13	3	-	16
VSLI	1,563	8	18	1,589
S-DVI	355	3	467	825
VRI	273	1	2	276
VI&I	98	-	-	98
Subtotal	\$ 9,577	\$ 119	\$ 553	\$ 10,249
Less Liability not Covered by Budgetary Resources				(847)
Liability Covered by Budgetary Resources				\$ 9,402

As of September 30, 2008

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$ 7,768	\$ 115	\$ 78	\$ 7,961
USGLI	16	3	-	19
VSLI	1,567	9	20	1,596
S-DVI	341	3	437	781
VRI	295	1	3	299
VI&I	95	-	-	95
Subtotal	\$ 10,082	\$ 131	\$ 538	\$ 10,751
Less Liability not Covered by Budgetary Resources				(796)
Liability Covered by Budgetary Resources				\$ 9,955

Insurance In-Force

The amount of insurance in-force is the total face amount of life insurance coverage provided by each administered and supervised program as of the end of the fiscal year. It includes any paid-up additional coverage provided under these policies. Prudential and its reinsurers provided coverage to 5,999,771 and 5,891,781 insured for a face value of \$1,322 billion and

\$1,298 billion as of September 30, 2009 and 2008, respectively. The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in-force as of September 30, 2009 and 2008. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.



	2009 Policies	2008 Policies	2009 Face Value	2008 Face Value
Supervised Programs				
SGLI Active Duty	1,530,000	1,498,000	\$ 590,304	\$ 580,589
SGLI Ready Reservists	779,500	764,500	278,591	273,667
SGLI Post Separation	93,000	94,000	35,050	35,574
SGLI Family - Spouse	1,104,000	1,077,000	108,958	106,258
SGLI Family - Children	2,064,000	2,027,000	20,640	20,270
TSGLI*	-	-	230,950	226,500
VGLI	429,271	431,281	57,760	55,636
Total Supervised	5,999,771	5,891,781	\$ 1,322,253	\$ 1,298,494
Administered Programs				
NSLI	834,026	921,942	\$ 9,790	\$ 10,651
VSLI	175,715	183,778	2,287	2,348
S-DVI	202,110	194,583	2,053	1,965
VRI	35,264	39,331	349	383
USGLI	4,671	5,620	14	17
VMLI	2,273	2,309	166	165
Total Administered	1,254,059	1,347,563	\$ 14,659	\$ 15,529
Total Supervised and Administered Programs	7,253,830	7,239,344	\$ 1,336,912	\$ 1,314,023

*TSGLI coverage is a rider attached to SGLI coverage, so policies under SGLI also have TSGLI.

Policy Dividends

The Secretary of VA determines annually the excess funds available for dividend payment. Only administered policies are eligible for dividends. Dividends are based on an actuarial analysis of the individual programs at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. Policyholders can elect to: (1) receive a cash payment; (2) prepay

premiums; (3) repay loans; (4) purchase paid-up insurance; or (5) deposit the amount in an interest-bearing account. A provision for dividends is charged to operations, and an insurance dividend is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs. Policy dividends for FY 2009 and FY 2008 were \$310 and \$338, respectively.

17. Contingencies

VA is a party in various administrative proceedings, legal actions, and tort claims arising from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice. Certain legal matters to which VA may be a named party are administered and, in some instances, litigated by the Department of Justice. Generally, amounts (more than \$2.5

thousand for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award are funded from the Judgment Fund, which is maintained by Treasury. Of the amounts paid from the Judgment Fund on behalf of VA, medical malpractice cases claimed 88 percent in FY 2009 and 74 percent in FY 2008. Contract dispute payments for FY 2009 and FY 2008 were \$4.6 and \$20.3, respectively. The



discrimination case payments for FY 2009 were \$2.0 and \$1.7 for FY 2008.

VA uses accepted actuarial methods to estimate the liability resulting from medical malpractice and other tort claim exposure. VA discounted future estimated payments using U.S. Treasury spot rates as of September 30, 2009 and 2008.

VA has recorded a liability for pending legal claims that are estimated to be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is

required or not. This liability was \$663 for FY 2009 and \$604 for FY 2008. The contract and personnel law cases where there was at least a reasonable possibility that a loss may occur were 11 cases totaling \$26.7, excluding the data theft litigation explained below, for FY 2009 and 11 cases totaling \$19.1 for FY 2008. VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements.

Judgment Fund accounting is shown below:

Judgment Fund

For the Years Ended September 30,

	2009	2008
Fiscal Year Settlement Payments	\$ 92	\$ 103
Less Contract Dispute and "No Fear" Payments	(7)	(22)
Imputed Financing-Paid by Other Entities	85	81
Increase (Decrease) in Liability for Claims	59	46
Operating Expense	\$ 144	\$ 127

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2009 will not materially affect VA's operations or financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. Fiscal year 2009 tort payments were \$86.

The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2009 and 2008 was \$74.8 and \$28, respectively. Any payments due that may arise relating to cancelled appropriations will be paid out of the current year's appropriations in accordance with the provisions of the Expired Funds Control Act of 1990.

VA provides medical care to Veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the Veterans, by priority, who will be treated for that fiscal year

subject to change based on funds appropriated, estimated collections, usage, the severity index

of enrolled Veterans, and changes in cost. While VA expects to continue to provide medical care to Veterans in future years, an estimate of this amount cannot be reasonably made. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For the fiscal years 2005-2009, the average medical care cost per year was \$33.1 billion.

Haas v. Nicholson

The United States Court of Appeals for Veterans Claims (Veterans Court) issued a decision in Haas v. Nicholson, 20 Vet. App. 257 (2006), that reversed a decision of the Board of Veterans' Appeals, which denied service connection for disabilities claimed as a result of exposure to herbicides. VA disagreed with the court's decision in Haas and appealed to the United States Court of Appeals for the Federal Circuit. On May 8, 2008 the Federal Circuit ruled in favor of the VA; however, Mr. Haas filed a petition asking the U.S. Supreme Court to



hear the case. On January 21, 2009, the U. S. Supreme Court upheld the lower court ruling, ending the litigation.

Veteran's Presumptive Disability Benefits

Within the VA there were ongoing discussions about the establishment of service-connection for Vietnam Veterans who have any of three specific illnesses based on the latest evidence of an association with the herbicides referred to as Agent Orange. For accounting purposes, it is probable that a contingent liability for potential additional benefit costs may exist; however, an amount or range of the possible liability is not measureable at this time. See Note 12 for additional information.

VA Data Theft Litigation

VA is the subject of a class action lawsuit alleging breach of the Privacy Act, 5 U.S.C 552a (e) (10), in connection with the theft of a laptop computer containing sensitive personal information for approximately 17.5 million Veterans. The parties agreed to settle this matter for the sum of \$20 million subject to a settlement agreement that defines the settlement class, sets the requirements for obtaining relief, and provides for any remaining settlement proceeds to be distributed equally to specified non-profit entities assisting Veterans. On September 18, 2009, the Court granted final approval of the settlement, but the settlement is

pending for 60 days until all appeal rights expire. Once the appeal time expires, the claim will be paid from the Judgment Fund.

18. Earmarked Funds

SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, requires disclosure of all earmarked funds for which VA has program management responsibility. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, and are required by statute to be used for designated activities or purposes. They are accounted for separately from the Government's general revenues. VA's earmarked funds consist of trusts, special and revolving funds and remain available over time. The "trust" funds do not involve a fiduciary relationship with an individual or group but are designated exclusively for a specific activity, benefit or purpose. The investments (Treasury Securities) are assets of earmarked funds and are available for authorized expenditures. Treasury Securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund the authority to draw upon the Treasury for future expenditures. When the earmarked fund redeems its Treasury Securities to make expenditures, the Treasury will finance those expenditures in the same manner that it finances all other expenditures.



Part III - Notes to Consolidated Financial Statements

The VA's Earmarked Funds are as follows:

Fund Name	Fund Type	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
Medical Care Collections Fund	Special	36x5287	P.L. 105-33 111 Stat 665	Third-party and patient co-payments for medical services.	Public, primarily insurance carriers.
Cemetery Gift Fund	Trust	36x8129	38 U.S.C. 1007	Donations for Veterans' cemeteries.	Public donors.
National Service Life Insurance Fund	Trust	36x8132	38 U.S.C. 720	Premiums insure WWII Veterans.	Public, Veterans.
Post-Vietnam Era Education Assistance Program	Trust	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to Veterans.	Veterans, DoD.
U.S. Government Life Insurance	Trust	36x8150	38 U.S.C. 755	Premiums insure WWI Veterans.	Public, Veterans.
Veterans Special Life Insurance Fund	Trust	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict Veterans.	Public, Veterans.
General Post Fund, National Homes	Trust	36x8180	38 U.S.C. 101-228	Donations for patient benefits.	Public, mostly Veterans.
Canteen Service Revolving Fund	Revolving	36x4014	38 U.S.C. 78	Operates the canteen services at hospitals.	Revenue from sales.
National Cemetery Administration Facilities Operation Fund	Special	36x5392	P.L. 108-454	Proceeds benefit land and buildings.	Proceeds from leases.
Service-Disabled Veterans Insurance Fund	Revolving	36x4012	38 U.S.C. 1922	Provides insurance to Veterans with service-connected disabilities	Public, Veterans.
Servicemen's Group Life Insurance	Revolving	36x4009	38 U.S.C. 1965	Provides insurance to active duty, ready reservists, retired reservists and cadets attending service academies and ROTC.	Public, Veterans.
Veterans Reopened Insurance Fund	Revolving	36x4010	38 U.S.C. 1925	Provides insurance to World War II and Korea Veterans	Public, Veterans.
Enhanced-Use Lease Trusts	Trust	N/A	38 U.S.C 8162	Lease underutilized VA property.	Public.



The following tables provide condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances:

Balance Sheet					
as of September 30, 2009					
	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	\$ 46	\$ 266	\$ 66	\$ -	\$ 378
Investments with Treasury	11,247	81	-	-	11,328
Other Assets	557	1,201	-	3	1,761
Total Assets	\$ 11,850	\$ 1,548	\$ 66	\$ 3	\$ 13,467
Liabilities and Net Position:					
Payables to Beneficiaries	\$ 189	\$ 27	\$ 1	\$ -	\$ 217
Other Liabilities	12,064	188	-	-	12,252
Total Liabilities	\$ 12,253	\$ 215	\$ 1	\$ -	\$ 12,469
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(403)	1,333	65	3	998
Total Liabilities and Net Position	\$ 11,850	\$ 1,548	\$ 66	\$ 3	\$ 13,467

Statement of Net Cost					
for the Year Ended September 30, 2009					
Gross Program Costs	\$ 1,168	\$ 462	\$ 2	\$ -	\$ 1,632
Less Earned Revenues	1,072	2,863	1	-	3,936
Net Program Costs	96	(2,401)	1	-	(2,304)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost of Operations	\$ 96	\$ (2,401)	\$ 1	\$ -	\$ (2,304)

Statement of Changes in Net Position					
for the Year Ended September 30, 2009					
Net Position Beginning of Period	\$ (348)	\$ 1,635	\$ 66	\$ 3	\$ 1,356
Budgetary and Other Financing Sources	41	(2,703)	-	-	(2,662)
Net Cost of Operations	96	(2,401)	1	-	(2,304)
Change in Net Position	(55)	(302)	(1)	-	(358)
Net Position End of Period	\$ (403)	\$ 1,333	\$ 65	\$ 3	\$ 998



Balance Sheet					
as of September 30, 2008					
	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	\$ 45	\$ 233	\$ 67	\$ 1	\$ 346
Investments with Treasury	11,826	98	-	-	11,924
Other Assets	587	1,519	-	3	2,109
Total Assets	\$12,458	\$ 1,850	\$ 67	\$ 4	\$ 14,379
Liabilities and Net Position:					
Payables to Beneficiaries	\$ 199	\$ 22	\$ 1	\$ 1	\$ 223
Other Liabilities	12,607	193	-	-	12,800
Total Liabilities	\$12,806	\$ 215	\$ 1	\$ 1	\$ 13,023
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(348)	1,635	66	3	1,356
Total Liabilities and Net Position	\$12,458	\$ 1,850	\$ 67	\$ 4	\$ 14,379

Statement of Net Cost					
for the Year Ended September 30, 2008					
Gross Program Costs	\$ 1,256	\$ 381	\$ 3	\$ -	\$ 1,640
Less Earned Revenues	1,155	3,261	1	-	4,417
Net Program Costs	101	(2,880)	2	-	(2,777)
Costs Not Attributable to Program Costs	-	40	-	-	40
Net Cost of Operations	\$ 101	\$ (2,840)	\$ 2	\$ -	\$ (2,737)

Statement of Changes in Net Position					
for the Year Ended September 30, 2008					
Net Position Beginning of Period	\$ (280)	\$ 1,182	\$ 67	\$ 3	\$ 972
Budgetary and Other Financing Sources	33	(2,387)	1	-	(2,353)
Net Cost of Operations	(101)	2,840	(2)	-	2,737
Change in Net Position	(68)	453	(1)	-	384
Net Position End of Period	\$ (348)	\$ 1,635	\$ 66	\$ 3	\$ 1,356



19. Exchange Transactions

Exchange Revenues

Although VA recognizes full cost per SFFAS No. 4, VHA has legislated exceptions to the requirement to recover the full cost to the federal government of providing services, resources, or goods for sale. Under “enhanced sharing authority,” VHA facilities may enter into arrangements that are in the best interest of the federal government.

In FY 2009, 68 contracts at 11 medical facilities were reviewed by the Management Quality Assurance Service (MQAS) to determine compliance with SFFAS No. 7 and the Chief Financial Officers Act of 1990. MQAS found 9 contracts (13 percent) cost analyses were incorrect or outdated and 4 contracts (6 percent) analyses were not provided. In addition, 1 medical facility used incorrect revenue source codes on 10 agreements. Another medical facility used incorrect revenue source codes on 3 agreements and did not provide billing documents for 1 agreement. Three medical facilities certified and properly disclosed losses on 3 contracts for non-essential Veteran services.

VA’s Loan Guaranty Program collects rental fees on a small number of properties during the period when the property is titled to VA.

NCA leases lodges at 10 cemeteries to not-for-profit groups for no fee. These not-for-profit groups are required to provide the upkeep on the lodges and pay the costs for utilities, insurance, minor repairs, maintenance and any other costs associated with the lodges. NCA has agricultural licenses at 6 cemeteries to private sector entities, for which it receives rental payments. NCA also leases buildings at 2 cemeteries, one to a private sector entity for which it receives rental payments, and one to a not-for-profit group that is responsible for the historic preservation of the building at no cost to NCA.

Exchange Transactions with Public

VA’s Medical Care Collections Fund, “Conforming Amendments,” changed the language of specific sections of 38 USC Chapter 17 to substitute “reasonable charges” for “reasonable cost.” The VHA Chief Business Office (CBO) is responsible for implementing and maintaining these reasonable charges for billing third-party payers for services provided to insured Veterans for treatment of nonservice-connected conditions.

Reasonable charges are used to bill for reimbursable health insurance, non-federal workers’ compensation, tortfeasor and no-fault or uninsured motorists insurance cases. Reasonable charges are based on provider charges in the market area of each VA facility. Under regulations issued pursuant to section 1729 and published at section 17.101, title 38, Code of Federal Regulations, third party payers may elect to pay VA’s billed charges (less applicable deductible or co-payment amounts) for the care and services provided to Veterans. Alternatively, third party payers may elect to pay VA an amount, generally known as usual and customary, that it would pay to other providers for care and services in the same geographic area.

Cost-based per diems are calculated annually to produce rates used to bill for medical care or services provided by the VA:

- (a) in error or on tentative eligibility;
- (b) in a medical workers’ compensation (other than federal), humanitarian emergency;
- (c) to pensioners of allied nations;
- (d) for research purposes in circumstances under which VA medical care appropriation is to be reimbursed by VA research appropriation; and
- (e) to beneficiaries of the Department of Defense or other federal agencies, when the care or service provided is not covered by an applicable sharing agreement.



These per diem costs are derived primarily from cost and workload data from a national cost allocation report.

VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for FY 2009 were \$863 and for FY 2008 were \$567. The loan guarantee lender participation fees collected for FY 2009 were \$2.2. The loan guarantee lender participation fees collected for FY 2008 were \$2.1.

Intragovernmental Exchange Transactions

Intragovernmental costs relate to the source of goods and services purchased by VA and not to the classification of related intragovernmental revenue.

VA and DoD have authority to enter into agreements and contracts for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA's General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements, but the total amount billed below full cost is not readily available. VHA is in the process of developing mechanisms to report this information in the future. VBA collects funding from DoD in order to administer certain education programs. DoD transferred \$433 during FY 2009 for the

Post-Vietnam Era Education Assistance Program, Reinstated Entitlements Program for Survivors, and the New GI Bill for Veterans.

When VA furnishes medical care or services for beneficiaries of other federal agencies, and that care or service is not covered by an applicable local sharing agreement, the billing rates used are determined and published annually by the VHA CFO. Similar to the tort rates, interagency billing rates are determined from cost and workload data in the Cost Distribution Report.

VA reports intragovernmental trading partner information to the Treasury through Treasury's Intragovernmental Reporting and Analysis System (IRAS). VA and its trading partners are not able to completely reconcile all activities and balances with each other due to several factors including transaction volumes, recognition of timing differences, and system limitations between trading partners. In FY 2009 the Intra-Governmental Reporting System (IGRS) was delivered for use. IGRS is a Hyperion-based system that compiles reports and facilitates research into VA's transactions with other federal agencies. The implementation of IGRS has helped VA reduce its differences with federal trading partners.

20. Net Cost of Veterans Affairs Programs

All of VA's net program costs are part of the 700 budget functional classification (Veterans Benefits and Services).



Schedule of Net Program Cost

	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehabilitation	Loan Guaranty	Insurance	Burial	Non-Program	Total
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For the Year Ended September 30, 2009 (Dollars in Millions)

Production Costs												
Intragovernmental Costs	\$ 6,147	\$ 115	\$ 129	\$ 334	\$ 47	\$ 32	\$ 25	\$ 183	\$ 9	\$ 62	\$ 74	\$ 7,157
Less Earned Revenues	101	-	(15)	-	-	(434)	-	(348)	(650)	-	(1,088)	(2,434)
Net Intragovernmental Production Costs	6,248	115	114	334	47	(402)	25	(165)	(641)	62	(1,014)	4,723
Public Costs	37,988	1,397	911	(105,935)	4,366	3,791	879	691	1,182	(725)	2,279	(53,176)
Less Earned Revenues	(3,261)	-	(14)	-	-	(196)	-	(31)	(425)	-	(85)	(4,012)
Net Public Production Costs	34,727	1,397	897	(105,935)	4,366	3,595	879	660	757	(725)	2,194	(57,188)
Total Net (Benefit) Cost of Operations	\$ 40,975	\$ 1,512	\$ 1,011	\$ (105,601)	\$ 4,413	\$ 3,193	\$ 904	\$ 495	\$ 116	\$ (663)	\$ 1,180	\$ (52,465)

For the Year Ended September 30, 2008 (Dollars in Millions)

Production Costs												
Intragovernmental Costs	\$ 5,678	\$ 106	\$ 119	\$ 275	\$ 35	\$ 8	\$ 25	\$ 933	\$ 8	\$ 57	\$ 55	\$ 7,299
Less Earned Revenues	(50)	-	(32)	-	-	(396)	-	(249)	(701)	-	(780)	(2,208)
Net Intragovernmental Production Costs	5,628	106	87	275	35	(388)	25	684	(693)	57	(725)	5,091
Public Costs	32,821	1,261	842	375,694	3,943	3,118	762	(1,195)	1,267	1,291	1,924	421,728
Less Earned Revenues	(3,430)	-	(12)	-	-	(193)	-	(54)	(456)	-	(52)	(4,197)
Net Public Production Costs	29,391	1,261	830	375,694	3,943	2,925	762	(1,249)	811	1,291	1,872	417,531
Total Net (Benefit) Cost of Operations	\$ 35,019	\$ 1,367	\$ 917	\$ 375,969	\$ 3,978	\$ 2,537	\$ 787	\$ (565)	\$ 118	\$ 1,348	\$ 1,147	\$ 422,622



21. Disclosures Related to the Statements of Budgetary Resources

Apportionment categories of obligations incurred

Obligations

Years Ended September 30,

	2009	2008
Category A, Direct	\$ 47,603	\$ 41,643
Category B, Direct	56,264	52,739
Reimbursable	4,949	5,711
Exempt from Apportionment	-	-
Total Obligations	\$ 108,816	\$ 100,093

Borrowing Authority

Loan Guaranty had borrowing authority of \$1.8 billion and \$1.3 billion as of September 30, 2009 and 2008, respectively. The Vocational Rehabilitation Program had borrowing authority of \$3.6 million and \$4.0 million as of September 30, 2009 and 2008, for making direct loans. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to Vinnie MAC trusts. The Vocational Rehabilitation loans generally had duration of one year, and repayment was made from offsetting collections.

Adjustments to Budgetary Resources

During the reporting period, \$13.9 million was recovered from prior year obligations. There were no enacted rescissions.

Permanent Indefinite Appropriations

VA has four permanent and indefinite appropriations. The Veterans Housing Benefit Program Fund covers all estimated subsidy costs arising from post-1991 loan obligations for Veterans housing benefits. The Fund's objective is to encourage and facilitate the extension of favorable credit terms by private lenders to Veterans for the purchase, construction, or improvement of homes to be occupied by Veterans and their families. The Loan Guarantee Revolving Fund (which includes the Direct Loan Financing Account and the Guaranteed Loan Financing Account) is a liquidating account that contains all of VA's pre-credit reform direct and guaranteed loans. It

also holds fund balances received from reimbursements from financing accounts for loan modifications and rentals of foreclosed properties not yet transferred to financing accounts. The Native American Direct Loan Account was established to cover all subsidy costs arising from direct loan obligations related to a Veteran's purchase, construction, or renovation of a dwelling on trust land.

Use of Unobligated Balances of Budget Authority

Available unobligated balances on the Statement of Budgetary Resources are composed of current fiscal year apportioned funds for annual, multi-year, and no-year appropriations from Congress as well as revolving and trust funds. Other balances not available are composed of unobligated funds that were not apportioned by OMB for FY 2009 use and expired appropriation unobligated amounts, which generally are not available for new obligations, but can be used to increase existing obligations under certain circumstances.

Unobligated VA funds are available for uses defined in VA's FY 2009 Appropriation Law (P.L. 110-329) and Supplemental Appropriations Law (P.L. 111-005). These purposes include: Veterans medical care, research, education, construction and maintenance of VA buildings, Veterans and dependents benefits, Veterans life insurance, loan guaranty programs, Veterans burial benefits, and administrative functions. Various



obligation limitations are imposed on individual VA appropriations.

Explanation of Differences Between Statement of Budgetary Resources and the Budget

As a result of analysis of obligations and advances, obligations were reduced by \$137 for FY 2008 on the Combined Statement of Budgetary Resources. This adjustment was not reflected in the FACTS II data used to prepare the President's Budget. No other differences were identified as of the preparation date of the financial statements.

Undelivered Orders at the End of Period

The amount of budgetary resources obligated for undelivered orders at the end of FY 2009 and FY 2008 was \$7,804 and \$8,462, respectively.

Contributed Capital

The amount of contributed capital received during FY 2009 consisted of donations in the amount of \$61.5 to the General Post Fund and \$0.1 to the National Cemetery Gift Fund. For FY 2008 \$55.9 was donated to the General Post Fund and \$0.1 to the National Cemetery Gift Fund.

22. Reconciliation of Net Cost of Operations to Budget

The objective of the information shown below is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a

reconciliation of budgetary obligations and non-budgetary resources available to the VA with its net cost of operations.

DEPARTMENT OF VETERANS AFFAIRS

RECONCILIATION OF NET COSTS OF OPERATIONS TO BUDGET (dollars in millions)

for the Years Ended September 30,	2009	2008
Resources Used to Finance Activities		
Obligations Incurred	\$ 108,816	\$ 100,093
Less Spending Authority from Offsetting Collections and Adjustments	(7,702)	(7,861)
Obligations Net of Offsetting Collections and Adjustments	101,114	92,232
Less Offsetting Receipts	(4,204)	(4,243)
Net Obligations	96,910	87,989
Donations of Property	28	21
Transfers-out	-	(239)
Imputed Financing	1,653	1,375
Other Financing Sources	(822)	(966)
Total Resources Used to Finance Activities	97,769	88,180
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	117	(3,597)
Resources that Finance the Acquisition of Assets	(6,262)	(5,093)
Resources that Fund Expenses Recognized in Prior Periods	(173)	(1,676)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	3,842	4,553
Total Resources that Do Not Fund Net Cost of Operations	(2,476)	(5,813)



RECONCILIATION OF NET COSTS OF OPERATIONS TO BUDGET (dollars in millions)

for the Years Ended September 30,	2009	2008
Total Resources Used to Finance the Net Cost of Operations	95,293	82,367
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	146	144
Increase in Environmental and Disposal Liability	(45)	370
Reestimates of Credit Subsidy Expense	(536)	(675)
Increase in Exchange Revenue Receivable from the Public	18	(366)
Increase (Decrease) in Veterans Benefits Actuarial Liability	(149,090)	339,233
Depreciation and Amortization	1,131	1,024
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	356	424
Loss on Disposition of Assets	307	130
Other	(45)	(29)
Total Costs That Do Not Require Resources in the Current Period	(147,758)	340,255
Net (Benefit) Cost of Operations	\$ (52,465)	\$ 422,622

23. Reclassifications, Changes in Accounting Policy and Changes in Financial Statement Presentation

Transfers of Medical Care Collection Fund (MCCF) Collections

The FY 2008 components of Net Position on the Balance Sheet have been reclassified to conform to the current period presentation of MCCF transfers. The reclassification has no effect on Total Net Position.

The MCCF has been established by law to collect third party medical payments, making it a "Special Purpose" fund and has been designated as an Earmarked Fund. The collections are periodically transferred out of the Special Purpose MCCF using a two step process, first to transfer the funds from a receipt account to an expenditure account within the MCCF, and second to transfer the same funds from the MCCF to Medical Services, a general purpose (or non-Earmarked) fund.

Prior to FY 2009, the transfers of collections were accounted for by using Standard General Ledger (SGL) accounts that comprise both the Unexpended Appropriations and Cumulative Results of Operations components of Net Position. In FY 2006, when the VA adopted the accounting for Earmarked Funds, the transfers

started building a negative balance in the Unexpended Appropriations line item for Earmarked Funds, exposing one side of an entry that was exactly offset in Cumulative Results of Operations-Earmarked Funds. As well, the transfer into the Medical Services General fund (Other, non-Earmarked) was also disaggregated.

During FY 2009 the VA aggregated the effects of the transfers in the same line item, Cumulative Results of Operations, for both the MCCF Special Purpose, Earmarked fund and the Medical Services (Other, non-Earmarked) fund. The netting of these transfers is preferred presentation and in accordance with Treasury guidelines. For comparative purposes, the beginning and ending balances of the respective line items for FY 2008 as well as the transfer activity for that year have been reclassified to conform to FY 2009 presentation. The reclassification to the amounts previously shown on the September 30, 2008 Balance Sheet was for \$11,627. This was an increase to Unexpended Appropriations – Earmarked Funds and Cumulative Results of Operations – All Other Funds, and a decrease to Unexpended Appropriations – All Other Funds and Cumulative Results of Operations Earmarked Funds.



Required Supplementary Stewardship Information

These materials are not audited
(Dollars in millions, unless otherwise noted)

1. Non-Federal Physical Property

Annually, VA provides funding to state governments for the purchase, construction, or major renovation of physical property owned by

the state. In most cases these grant programs involve matching funds from the states.

Grant Program Costs

Years Ended September 30,	2009	2008	2007	2006	2005
State Extended Care Facilities	\$ 163	\$ 162	\$ 138	\$ 85	\$ 183
State Veterans Cemeteries	40	37	46	18	36
Total Grant Program Costs	\$ 203	\$ 199	\$ 184	\$ 103	\$ 219

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day health care for Veterans, and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, hospital, and day health care for Veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last 5 fiscal years, the State Home Construction Grant Program has awarded grants in excess of \$609. VA also provides per diem payment for the care of eligible Veterans in state homes.

Since the cemetery program was established in 1980, VA has awarded grants totaling more than \$390 to 39 states and the commonwealths of Guam and the Northern Marianas. The program provides up to 100 percent of the cost to establish, expand, or improve state Veterans' cemeteries. States provide the land and agree to operate the cemeteries.

2. Human Capital

Investment in human capital comprises those expenses for education and training programs for the general public that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal federal education and training of civilian employees.


Veterans and Dependents Education
Years ended September 30,

	2009	2008
Program Expenses		
Education and Training-Dependents of Veterans	\$ 464	\$ 451
Vocational Rehabilitation and Education Assistance	4,393	3,102
Administrative Program Costs	304	251
Total Program Expenses	\$ 5,161	\$ 3,804
Program Outputs (Participants)		
Dependent Education	82,345	80,409
Veterans Rehabilitation	72,803	68,826
Veterans Education	822,738*	459,594

*Due to the implementation of the new Post 9/11 GI Bill during FY 2009, total participants in the Veterans Education Program for FY 2009 may include two records for a single participant who switches from the Montgomery GI Bill (MGIB) to the Post-9/11 GI Bill mid-year.

Veterans and Dependents Education
Years ended September 30,

	2007	2006
Program Expenses		
Education and Training-Dependents of Veterans	\$ 450	\$ 430
Vocational Rehabilitation and Education Assistance	3,095	2,943
Administrative Program Costs	243	232
Total Program Expenses	\$ 3,788	\$ 3,605
Program Outputs (Participants)		
Dependent Education	79,134	79,430
Veterans Rehabilitation	69,409	71,627
Veterans Education	490,826	461,488

Veterans and Dependents Education
Years ended September 30,

	2005
Program Expenses	
Education and Training-Dependents of Veterans	\$ 405
Vocational Rehabilitation and Education Assistance	2,779
Administrative Program Costs	226
Total Program Expenses	\$ 3,410
Program Outputs (Participants)	



Veterans and Dependents Education

Years ended September 30,

Dependent Education	75,072
Veterans Rehabilitation	71,956
Veterans Education	444,359

Program Outcomes

VA's education and training programs are intended to provide higher education to dependents who might not be able to participate otherwise. Veterans' rehabilitation and employment programs are provided to service-disabled Veterans; they are designed to improve employability and promote independence for the disabled. Educational programs for active duty personnel, reservists, and Veterans provide higher education assistance to those who are eligible under the new Post-9/11 GI Bill, MGIB and the Veterans Educational Assistance Program. Education and training assistance is provided to dependents of Veterans who died of service-connected disability or whose service-connected disability was rated permanent and

total. The Vocational Rehabilitation and Employment program provides evaluation services, counseling, and training necessary to assist Veterans in becoming employable and maintaining employment to the extent possible. The program is open to Veterans who have a 10 percent or greater service-connected disability rating and are found to have a serious employment handicap. The Veterans Education program provides educational assistance to eligible servicemembers and Veterans, and eligible family members.

3. Health Professions Education

Health Professions Education

Years Ended September 30,

	2009	2008	2007	2006	2005
Program Expenses					
Physician Residents and Fellows	\$ 547	\$ 508	\$ 469	\$ 462	\$ 438
Associated Health Residents and Students	99	88	81	65	63
Instructional and Administrative Support	707	623	606	452	430
Total Program Expenses	\$ 1,353	\$ 1,219	\$ 1,156	\$ 979	\$ 931
Program Outputs					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	35,099	34,003	33,775	31,290	30,903
Medical Students	20,567	18,135	18,728	17,289	16,750
Nursing Students	31,380	28,320	27,515	24,870	22,675
Associated Health Residents and Students	22,916	20,946	20,875	18,990	16,862
Total Program Outcomes	109,962	101,404	100,893	92,439	87,190



Program Outcomes

VA's education mission contributes to high quality health care of Veterans by providing a climate of scientific inquiry between trainees and teachers; application of medical advances more readily through an academic setting; supervised trainees who provide clinical care; and educational programs that enable VA to recruit highly qualified health care professionals.

The Veterans Health Administration (VHA) conducts education and training programs to enhance the quality of care provided to Veterans within the VA health care system. Building on the long-standing, close relationships among VA and the Nation's academic institutions, VA plays a leadership role in defining the education of future health care professionals that helps meet the changing needs of the Nation's health care delivery system. Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. Through its partnerships with affiliated

academic institutions, VA conducts the largest education and training effort for health professionals in the Nation. Each year, over 100,000 medical and other students receive some or all of their clinical training in VA facilities through affiliations with over 1,200 educational institutions including 107 medical schools. Many have their health profession degrees and contribute substantially to VA's ability to deliver cost-effective and high-quality patient care during their advanced clinical training at VA.

4. Research and Development (R&D)

Investments in research and development comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other benefits.

Program Expense

Year ended September 30,

2009

	Basic	Applied	Development	Total
Medical Research Service	\$ 164.4	\$ 89.6	\$ -	\$ 254.0
Rehabilitative Research and Development	5.6	42.7	32.7	81.0
Health Services Research and Development	-	80.0	-	80.0
Cooperative Studies Research Service	33.3	61.7	-	95.0
Medical Research Support	-	510.0		510.0
Total Program Expenses	\$ 203.3	\$ 784.0	\$ 32.7	\$ 1020.0



Part III – Required Supplementary Stewardship Information

Program Expense				2008
Year ended September 30,				
	Basic	Applied	Development	Total
Medical Research Service	\$ 155.3	\$ 84.7	\$ -	\$ 240.0
Rehabilitative Research and Development	4.8	36.6	28.0	69.4
Health Services Research and Development	-	76.7	-	76.7
Cooperative Studies Research Service	32.9	61.0	-	93.9
Medical Research Support	-	411.0		411.0
Total Program Expenses	\$ 193.0	\$ 670.0	\$ 28.0	\$ 891.0

Program Expense				2007
Year ended September 30,				
	Basic	Applied	Development	Total
Medical Research Service	\$ 171.3	\$ 56.9	\$ -	\$ 228.2
Rehabilitative Research and Development	4.8	24.5	24.4	53.7
Health Services Research and Development	-	58.2	-	58.2
Cooperative Studies Research Service	32.9	41.0	-	73.9
Medical Research Support	-	408.6		408.6
Total Program Expenses	\$ 209.0	\$ 589.2	\$ 24.4	\$ 822.6

Program Expense				2006
Year ended September 30,				
	Basic	Applied	Development	Total
Medical Research Service	\$ 172.1	\$ 57.2	\$ -	\$ 229.3
Rehabilitative Research and Development	5.4	27.1	21.7	54.2
Health Services Research and Development	-	59.7	-	59.7
Cooperative Studies Research Service	30.6	38.2	-	68.8
Medical Research Support	-	353.0	-	353.0
Total Program Expenses	\$ 208.1	\$ 535.2	\$ 21.7	\$ 765.0



Program Expense Year ended September 30,					2005
	Basic	Applied	Development		Total
Medical Research Service	\$ 154.4	\$ 59.4	\$ -	\$	213.8
Rehabilitative Research and Development	4.9	23.9	19.6		48.4
Health Services Research and Development	-	61.7	-		61.7
Cooperative Studies Research Service	.5	47.8	-		48.3
Medical Research Support	-	381.7	-		381.7
Total Program Expenses	\$ 159.8	\$ 574.5	\$ 19.6	\$	753.9

In addition, VHA researchers received grants from the National Institutes of Health in the amount of \$603 and \$216 in other grants during FY 2009. These grants went directly to researchers and are not considered part of the VA entity. They are being disclosed here but are not accounted for in the financial statements.

Program Outputs/Outcomes

For FY 2009, VA's R&D general goal

related to stewardship was to ensure that VA medical research programs met the needs of the Veteran population and contributed to the Nation's knowledge about disease and disability. Target levels were established for the: (1) percent of funded research projects relevant to VA's health-care mission in designated research areas and (2) number of research and development projects. Strategies were developed in order to ensure that performance targets would be achieved.

Research and Development Measures-Actual Years ended September 30,					
	2009	2008	2007	2006	2005
Percent of Funded Research Projects Relevant to VA's Health-Care Mission	100.0%	100.0%	100.0%	100.0%	94.3%
Number of Research and Development Projects	2,247	1,956	2,019	2,190	2,107

VA's Medical Research Program goal is to be the premier research organization, leading our Nation's efforts to discover knowledge and create innovations that promote and advance the health and care of Veterans and the Nation. To achieve this goal, VA targets research projects that address special needs of Veteran patients

and balance research resources among basic and applied research to ensure a complementary role between the discovery of new knowledge and the application of these discoveries to medical practice.



Required Supplementary Information

(Dollars in millions, unless otherwise noted)

1. Deferred Maintenance

Deferred maintenance is classified as not performed when it should have been or as scheduled but delayed to a future period. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained and managed in a safe and effective manner; therefore, deferred maintenance is not applicable to them.

VA facilities reported their cost estimates for deferred maintenance by utilizing the Facility Condition Assessment Survey, where condition ratings are assigned. The costs assigned “D” (poor) and “F” (critical) ratings, qualify for reporting as deferred maintenance.

Deferred Maintenance

As of September 30,

	2009	2008
General PP&E	\$ 4,851	\$ 3,844
Heritage Assets	540	522
Total Deferred Maintenance	\$ 5,391	\$ 4,366



2. Schedule of Budgetary Activity Year Ended September 30, 2009

	Total Budgetary Resources	Obligations Incurred	Spending Authority from Offsetting Collections and Adjustments	Obligated Balance net, Oct. 1	Obligated Balance net, Sept. 30	Total Outlays
VHA						
0152 Medical Admin	\$ 4,694	\$ 4,332	\$ 48	\$ 773	\$ 832	\$ 4,225
0160 Medical Care	34,859	33,786	242	4,753	4,326	33,969
0162 Medical Facilities	5,145	4,799	30	1,943	2,092	4,620
0167 Medical Facilities	3,114	2,401	45	829	834	2,352
All Other	7,170	2,968	367	2,354	2,990	1,962
Total	\$ 54,982	\$ 48,286	\$ 732	\$ 10,652	\$ 11,074	\$ 47,128
VBA						
0102 Compensation, Pension, & Burial Benefits	\$ 44,819	\$ 44,631	\$ -	\$ 3,394	\$ 3,755	\$ 44,270
0137 Readjustment Benefits	4,935	4,374	433	89	154	3,875
4127 Direct Loan Financing	212	245	192	1	42	12
4129 Guaranteed Loan Financing	5,356	2,806	2,308	58	7	550
8132 National Service Life Insurance Fund	1,350	1,350	232	1,410	1,338	1,188
All Other	5,165	2,729	1,509	482	498	1,205
Total	\$ 61,837	\$ 56,135	\$ 4,674	\$ 5,434	\$ 5,794	\$ 51,100
NCA						
Total	\$ 330	\$ 288	\$ -	\$ 113	\$ 161	\$ 239
ADM						
0151 General Operating Expenses	\$ 2,373	\$ 2,232	\$ 354	\$ 299	\$ 349	\$ 1,820
4537 Supply Fund	2,405	1,428	1,627	(508)	(680)	(27)
All Other	679	447	301	(4)	21	121
Total	\$ 5,457	\$ 4,107	\$ 2,282	\$ (213)	\$ (310)	\$ 1,914
Total of all Business Lines	\$ 122,606	\$ 108,816	\$ 7,688	\$ 15,986	\$ 16,719	\$ 100,381

Report Distribution

VA Distribution

Office of the Secretary
Veterans Health Administration
Veterans Benefits Administration
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and Related Agencies
Senate Committee on Homeland Security and Governmental Affairs
National Veterans Service Organizations
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