VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS

Department of Veterans Affairs

Audit of VA's Consolidated Financial Statements for Fiscal Year 2010

November 10, 2010
10-01406-20

To Report Suspected Wrongdoing in VA Programs and Operations:

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Excerpts from Part III of the Department of Veterans Affairs' FY 2010 Performance and Accountability Report

For the complete Department of Veterans Affairs' FY 2010 Performance and Accountability Report, please go to the following web site: http://www.va.gov/budget/report/

Department of Veterans Affairs

Memorandum

Date: November 10, 2010

From: Assistant Inspector General for Audits and Evaluations (52)

Subj: Audit of VA's Consolidated Financial Statements for Fiscal Year 2010

To: Secretary of Veterans Affairs (00)

1. We contracted with the independent public accounting firm, Clifton Gunderson LLP, to audit VA's consolidated financial statements as of September 30, 2010, and for the year then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of Clifton Gunderson LLP's audit are presented in the attached reports.

2. Clifton Gunderson LLP provided an unqualified opinion on VA's fiscal year 2010 consolidated financial statements. They also identified one material weakness, information technology security controls, which is a repeat condition. The Department has taken corrective actions sufficient to eliminate one material weakness previously cited last year and reduce two others to significant deficiencies in this year's internal control report.

3. Clifton Gunderson 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 instances of non-compliance with the Debt Collection Improvement Act of 1996.

4. Clifton Gunderson LLP is responsible for the attached auditor's reports dated November 10, 2010, and the conclusions expressed in the reports. We do not express opinions on VA's financial statements, internal control, or compliance with FFMIA. We also do not express conclusions on VA's compliance with laws and regulations. The independent auditors will follow up on these internal control findings and evaluate the adequacy of corrective actions taken during the fiscal year 2011 audit of VA's consolidated financial statements.

Belinda J. Finn

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Attachments

Section I

Independent Auditor's Reports

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

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the accompanying consolidated balance sheet of the Department of Veterans Affairs (VA) as of September 30, 2010, and the related consolidated statements of net cost, changes in net position, and the combined statement of budgetary resources for the year then ended. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of VA as of September 30, 2009 were audited by other auditors whose report dated November 16, 2009, expressed an unqualified opinion on those financial statements.

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 applicable provisions of Office of Management and Budget 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the fiscal year 2010 financial statements referred to above present fairly, in all material respects, the financial position of VA as of September 30, 2010, and its net costs, changes in net position, and budgetary resources for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the consolidated financial statements, management adopted Statement of Federal Financial Accounting Standards No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuation Dates* in 2010, which required a change in its policy for calculating the actuarial liability for Veterans benefits.

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In accordance with *Government Auditing Standards,* we have also issued our reports dated November 10, 2010, on our consideration of VA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, not to provide an opinion on internal control over financial reporting or compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) is not a required part of the financial statements, but is supplementary 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 the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

All other information exclusive of the consolidated financial statements, MD&A, RSSI and RSI listed in the table of contents is presented for additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2010

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control Over Financial Reporting

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2010, and have issued our report thereon dated November 10, 2010. 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 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered VA's internal control over financial reporting by obtaining an understanding of the design effectiveness of internal controls, determined whether these controls had been placed in operation, assessed control risk, and performed tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, 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 deficiencies, significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described below in Section 1 to be material weaknesses in internal control over financial reporting.

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A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below in Section 2 to be significant deficiencies.

SECTION 1 – MATERIAL WEAKNESS

1. Information Technology (IT) Security Controls (Repeat Condition)

The VA relies on extensive Information Technology (IT) systems to administer benefits to Veterans. Internal controls over these operations are essential to ensure the integrity, confidentiality, and reliability of critical data while reducing the risk of errors, fraud and other illegal acts. For several years there have been IT weaknesses at VA. VA continues to make progress and we commend VA for the effort and improvement in the IT controls environment.

Our current year audit identified that while weaknesses were corrected in some locations, they still continue to exist in other areas. This is evidenced by the continued existence of previously identified IT weaknesses at VA facilities. Many of these weaknesses may be attributed to ineffective implementation and enforcement of an agency-wide information security program and ineffective communication from VA management to the individual field offices. Our assessment of the general and application controls of VA's key IT infrastructure and financial systems identified the following conditions:

Conditions:

Security Management

- Security management documentation, including the Risk Assessments, System Security Plans, and Memoranda of Understanding/Information Security Agreements, were outdated and did not accurately reflect the current system environment.
- Background reinvestigations were not being performed timely and personnel were not receiving the proper level of investigation for their position sensitivity levels.
- Plans of Actions and Milestones (POA&M) were not updated in a timely manner, milestones were frequently missed, and supporting documentation was not adequate to support closure of POA&Ms.
- Specialized training for IT personnel was inconsistently performed.

Access Controls

- Password standards were not consistently implemented and enforced across multiple VA systems including the network domain, Oracle databases, and key financial applications.

- Inconsistent reviews of financial application user access resulted in numerous generic, system, and inactive user accounts that were not removed from the system.
- Reviews of the user access requests were not consistently performed to eliminate conflicting roles and enforce the principle of least privilege.

Segregation of Duties

- Users within key financial applications had conflicting roles assigned within the applications. For example, users within the Veterans Health Information Systems and Technology Architecture (VistA) had the ability to purchase and obligate funds and to approve bills and receive cash; users within the Veterans Services Network (VETSNET) had the ability to establish claims and authorize awards; and IT personnel had access to both the production and development environments.

Configuration Management

- Change control policy and procedures for authorizing, testing and approval of system changes were not consistently implemented for the VistA and Insurance Payment Systems.
- Systems were not patched or securely configured to mitigate known and unknown information security vulnerabilities.
- Baseline configurations, including implementation of the Federal Desktop Core Configuration, were not consistently implemented to mitigate significant system security risks and vulnerabilities across the facilities and data centers.

Contingency Planning

- VA policy related to contingency plan testing did not contain explicit and consistent guidance regarding the testing of contingency plans.
- Contingency Plan documentation was outdated and the testing of Contingency Plans at selected facilities and data centers was not routinely performed.

Criteria:

OMB Circular A-130, Appendix III, *Security of Federal Automated Information Resources*, states that "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."

The Federal Information Security Management Act of 2002 (FISMA) requires that each agency develop an agency-wide information security program that includes:

- Periodic assessments of risk, including the magnitude of harm that could result from the unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems that support the operations and assets of the organization;

- Policies and procedures that are based on risk assessments, cost-effectively reduce information security risks to an acceptable level and address information security throughout the life cycle of each organizational information system;
- Plans for providing adequate information security for networks, facilities, information systems, or groups of information systems, as appropriate;
- Security awareness training to inform personnel of the information security risks associated with their activities and their responsibilities in complying with organizational policies and procedures designed to reduce these risks;
- Periodic testing and evaluation of the effectiveness of information security policies, procedures, practices, and security controls to be performed with a frequency depending on risk, but no less than annually;
- A process of planning, implementing, evaluating, and documenting remedial actions to address any deficiencies in the information security policies, procedures, and practices of the organization;
- Procedures for detecting, reporting, and responding to security incidents; and
- Plans and procedures for continuity of operations for information systems that support the operations and assets of the organization.

Cause:

The dispersed locations, the continued reorganization, and the diversity in applications have impacted facilities and management's ability to effectively address and reduce the number of prior year IT deficiencies. VA continues to be challenged with the consistent and proactive enforcement of the established policies and procedures throughout its geographically dispersed portfolio of legacy applications and newly implemented systems. The continued reorganization of components within the VA, such as the shift of control from the Medical Center level to the Veterans Integrated Service Network (VISN) level and from the Regional Office level to the Network Service Center level, has caused delays in communication with personnel throughout the VA.

Effect:

By not effectively documenting, implementing and enforcing IT policies and procedures, there is an increased risk that financial and personally identifiable information may be inadvertently or deliberately misused and may result in improper disclosure or theft without detection. Additionally, inappropriate or unnecessary changes may be made to key financial information systems, which could result in misstated financial information. Finally, inadequate contingency plan testing increases the risk that VA would not be able to recover systems and data in a timely manner and could have an adverse effect on financial processes.

Recommendations:

The Assistant Secretary for Information and Technology should continue to analyze and prioritize remediation efforts to accomplish security and control objectives. Key tasks should include, but are not limited to:

- Review and update security documentation, including Risk Assessments, System Security Plans, and Memoranda of Understanding/Information Security Agreements on at least an annual basis to ensure all required information is included and accurately reflects the current environment.
- Develop and implement a process to ensure that facilities track reinvestigations for employees in high risk positions and the Security Investigation Center (SIC) initiates all reinvestigations. Additionally, develop and implement a process for the facilities to accurately and timely report any change in position sensitivity to the SIC.
- Implement a process to review and update POA&Ms in a timely manner and ensure that closed POA&Ms are adequately supported with appropriate documentation.
- Develop and implement a process to ensure that appropriate IT personnel receive specialized security training according to job responsibilities and retain documentation of completed training.
- Establish and implement a process to verify the baseline configuration of the password settings on the domain controller and financial applications agree with the requirements in VA policy.
- Implement a process for the periodic review of user access to the network and financial applications that addresses password deficiencies and identifies and eliminates generic and inactive accounts on systems and networks.
- Implement controls to enforce appropriate segregation of duties principles and eliminate conflicting user access roles and permissions for key financial applications.
- Establish and implement change control procedures to ensure the consistent approval and testing during development and implementation of changes to VA financial applications.
- Establish and implement a process to ensure that systems, including network devices, servers, and databases are patched, updated and maintained at vendor recommended version levels.
- Establish and implement a process to ensure that workstations are patched, updated and configured to maximize security and are in compliance with Federal Desktop Core Configuration requirements.
- Review and update existing contingency planning procedures to provide more explicit guidance, communication and coordination of contingency testing activities. In addition, enforce procedures for the annual review and update of Contingency Plans.

SECTION 2 – SIGNIFICANT DEFICIENCIES

1. Financial Management System Functionality (Repeat Condition)

Conditions:

VA relies extensively on information technology systems to initiate, authorize, record, process, summarize and report financial transactions in the preparation of its financial statements. The underlying financial systems are complex and disjointed legacy applications and operating platforms. For example, VA utilizes the Financial Management System (FMS) and many business line specific financial systems to support its mission. In addition, VA utilizes a reporting system (MinX) to assist in managing the preparation of the consolidated financial statements. As a result, VA lacks a coherent financial system architecture that controls financial transactions from their initiation to their summarization and presentation in the financial statements.

Because of the VA fragmented system architecture, transaction flows are cumbersome. There is a lack of common data elements, lack of common controls and inconsistent level of summary and transaction history. Similar transactions processed by different applications may have a different transaction flow with their unique and separate control activities. As a result, certain financial statement line items may not be readily re-created and supported by audit trails of detailed financial transactions. Not all current interfaced systems can be readily accessed and used without extensive manipulation, and manual processing and reconciliation.

During the current fiscal year, VA made significant improvements in their systems and controls. We commend VA for these efforts and recognize that many conditions that existed in prior years have been corrected. Still specific challenges remain as follows:

- VA closes its core 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 are often 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 fully record the MinX entries, or their net effect, in VA's core general ledger system. Therefore, the MinX reporting system includes the cumulative net effect of certain entries recorded in it each and every year, from the date the VA commenced using it, but the core general ledger system does not. As a result, the general ledger system does not contain accounts with balances that agree with the amounts reported in VA's issued financial statements.

- The Benefits Delivery Network (BDN) system does not retain detail transaction data supporting general ledger activity for more than 60 to 90 days. Detail transaction data for Chapter 18, 31, 34, and 35 education benefit expense, BDN receivable setup, write-offs, waivers and "A-28" adjusting entries continue to be overwritten and not retained in the Data Warehouse.

Criteria:

31 U.S.C. paragraph 902 (a) (3) states 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…"

Cause:

Many of VA's systems are outdated, leading to the inability to fully capture all financial information in the core financial system and the need for significant manual workarounds and the posting of entries solely to the financial reporting system (MinX) that is separate from the core financial system.

Effect:

The system deficiencies, the inability to post all entries and adjust all balances in the core financial system, and the significant manual workarounds all increase the risk of processing errors and misstatements in the financial statements.

Recommendation:

We recommend that the Assistant Secretary for Management and the Assistant Secretary for Information and Technology work to improve system functionality in order to better support preparation of the financial statements, retain critical accounting data, reduce the number of adjusting journal entries required, and post necessary adjustments in the core financial accounting system.

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

2. Compensation, Pension and Burial Actuarial Liabilities (Repeat Condition)

Conditions:

The Federal Employee and Veterans Benefits Liability on VA's consolidated balance sheet includes an estimate of the present value of future cash payments to veterans and their dependents for compensation and burial benefits (approximately $1.5 trillion). In addition, an estimate of the present value of future cash payments for pension benefits (approximately $81 billion) is disclosed in the notes to the financial statements. The accuracy of these calculations is highly dependent on (i) the accuracy of the actuarial 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 by the actuaries for use in the actuarial model is derived from the VETSNET and BDN systems. Assuring the data being provided to the actuaries is complete and accurate requires VBA finance to perform a number of analyses, adjustments and reconciliations prior to providing the data to the actuaries.

We noted that VBA finance has made significant progress in providing complete and accurate information to the actuaries and has also made progress identifying adjusting items to the data; however, further analysis and enhancements to the policies and procedures are needed. For example, although the reconciliations of data are materially accurate, further analysis of the data could help identify all the causes of minor unidentified imbalances.

We also noted that VBA does not currently have written standard operating procedures related to the analysis of data provided to the actuaries.

Criteria:

OMB Circular A-123, *Management Responsibility for Internal Controls*, 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.

In order for the actuaries to accurately calculate the estimated actuarial liabilities, they must be provided with all relevant and accurate data in a timely manner.

Cause:

VBA financial management has not fully developed, documented and refined the process of reconciling C&P data on a monthly basis, and has not fully developed and refined the process of accumulating and reviewing the data being provided to the actuary. Much of the knowledge resides with one key VBA financial management professional.

Effect:

The lack of standard operating procedures related to the analysis of information provided to the actuaries increases the risk that an error in the calculation of the actuarial liability will occur. In addition, a potential error could occur if all causes of reconciling data are not documented and identified.

Recommendation:

We recommend that VBA management continue to work to fully develop, document and refine the process of reconciling C&P data on a monthly basis. We also recommend that VBA management continue to work to fully develop, document and refine the process of accumulating and providing data to the actuaries. We further recommend that the knowledge of the one key VBA financial management professional be further disseminated to the staff and the activities performed by this individual to reconcile the VBA data and prepare it for the actuaries be documented in written standard operating procedures.

3. Accounts Receivable

Conditions:

In response to the new Post 9/11 GI Bill (Chapter 33), which was effective on August 1, 2009, VA implemented emergency measures early in fiscal year 2010 to quickly provide education benefit payments to veterans at a time when the department was facing heavy backlogs in processing education benefit applications. As a temporary one-time measure, VA made advance payments of up to $3,000 to veterans for the 2009 fall term. Veterans could either apply for the advance in person at a VA regional office or apply online. In either case, the VA verified that the applicant was a veteran, but only obtained evidence of enrollment in an educational institution from veterans who applied in person at regional offices.

When the VA initiated the emergency measures, it did not have policies and procedures in place to provide guidance to those involved in the payment processing. VA Central Office communicated department directions to VA field offices through e-mail messages and slide presentations as the payments were being processed. VA faced increased risks that the advance payments would be made to veterans who were not entitled to receive them or in excess of amounts due.

VA did implement some procedures to limit the extent of its exposure to losses under the advance payment program, but despite these efforts, VA currently has a significant accounts receivable balance as a result of the emergency program.

As part of our testing of a sample of Education payments, we found a number of exceptions related to Chapter 33 payments including lack of evidence of approval, claimants not qualified to receive benefits, payment dates not recorded correctly and a time lag in recording the accounts receivable.

Criteria:

OMB Circular A-123, *Management Responsibility for Internal Controls*, 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:

VA implemented emergency measures early in fiscal year 2010 to quickly provide education benefit payments to veterans at a time when the department was facing heavy backlogs in processing education benefit applications. When VA initiated the emergency measures, it did not have policies and procedures in place to provide guidance to those involved in the payment processing.

Effect:

Advance payments made under emergency measures without implementing proper policies and procedures have resulted in payments being made to non-eligible individuals and the creation of potentially uncollectible accounts receivable. Recording financial data without sufficient policies and procedures also increases the likelihood that an error in the financial statements will occur and go undetected.

Recommendation:

We recommend that VA implement policies and procedures regarding Chapter 33 Education and other future benefits under similar circumstances as described above and ensure that formal review procedures are followed. Furthermore, VA should create an advisory committee to manage emergency measures and implement contingency plans to address emergency situations, identifying the key control policies and procedures required for any emergency situation. We also recommend that VA use available data within the VA to ascertain the eligibility of claimants based on the key requirements of the benefit programs to minimize possible risk of granting benefits to ineligible individuals or for unintended purposes.

4. Accounts Payable and Undelivered Orders (Partial Repeat Condition)

Conditions:

In order to calculate, record, and track estimates for accrued services payable on nearly 175,000 unpaid obligations each month, VA employs a system generated accrual code at the time of obligation. This "accrual flag" code calculates the cost incurred based on the percentage of time passed on the obligation less disbursements made to date. Although this approach is reasonable in concept, the accrual flag is not used for some obligations where an accrual is needed and VA does not have a process to validate the results and record material adjustments as appropriate. We noted the following with respect to accrued services payable:

- VA did not record accruals on any of its $5 billion in open construction contracts because such accruals are difficult to estimate.

- VA did not apply the accrual flag on one large federal IT support contract with $17.6 million in unpaid services.
- VA recorded accruals valued at $65 million on several other large federal contracts when little or no services had yet been performed.
- Inaccurate contract end dates in FMS for two large contracts resulted in $2.7 million in overaccruals (an 83% overstatement).
- VA did not record any accruals for costs incurred for its $600 million in open grant obligations.
- VA did not record accruals for pharmaceutical deliveries received but unpaid as of June 30 and September 30, 2010.

Criteria:

Statement of Federal Financial Accounting Standards (SSFAS) No. 1, *Accounting for Selected Assets and Liabilities*, states, "Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities." SFFAS No. 1 continues, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of goods. If invoices for these goods are not available when the financial statements are prepared, the amounts owed should be estimated."

OMB Circular A-123, *Management Responsibility for Internal Controls*, 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:

VA does not have a structured process in place to periodically review and validate the reasonableness of the liabilities determined by the "accrual flag."

Effect:

The accruals for certain types of obligations, as denoted by VA's "budget object codes," may be materially misstated. As a result, VA may not accurately state the value of its assets, or the net cost of specific programs. We were able to perform sufficient audit procedures to ensure the net impact of these discrepancies was not material to the financial statements as a whole.

Recommendation:

VA should perform a comprehensive review of each "budget object class" and its underlying accrual and disbursement patterns and ensure that the current accrual flag policy should provide a reasonable estimation of the amount of services provided for that type of obligation. VA should also require program managers to review their largest open obligations at the end of each quarter, obtain additional supporting information of the performance of the contract as necessary and record any material adjustments to the automated accruals before the end of the quarter.

5. Intra-Governmental Reconciliations and Related Controls (Repeat Condition)

Condition:

Unreconciled differences existed throughout the year and at year-end, primarily with the VA's trading partner, the Department of Defense (DoD). Also, unreconciled differences are not aged to determine how long they have been outstanding. The VA has made significant effort to put procedures in place to correct this deficiency but has not been able to receive supporting information from DoD agencies to fully reconcile outstanding differences.

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.

Effect:

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

Recommendation:

VA should continue to work with trading partners to attempt to identify and reconcile all differences and continue to elevate this condition to the Department of the Treasury for guidance and assistance.

STATUS OF PRIOR YEAR'S CONTROL DEFICIENCIES

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have reviewed the status of VA's corrective actions with respect to the findings and recommendations included in the prior year Independent Auditors' Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit Performed in Accordance with *Government Auditing Standards* dated November 16, 2009.

The prior year report identified four material weaknesses in the areas of (1) Financial Management System Functionality, (2) Information Technology (IT) Security Controls, (3) Financial Management Oversight, and (4) Compensation, Pension and Burial Liabilities. VA has made significant progress on these material weaknesses in fiscal year 2010. Only the IT Security Controls deficiency is repeated as a material weakness this year. The Financial Management System Functionality and the Compensation, Pension and Burial Liabilities material weaknesses have been reported as significant deficiencies this year. The Financial Management Oversight finding was not repeated.

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We also noted certain other nonreportable matters involving internal control over financial reporting that we will communicate in a separate letter to VA management.

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

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2010

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance and Other Matters

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2010, and have issued our report thereon dated November 10, 2010. 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 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of VA is responsible for complying with laws and regulations applicable to the VA. As part of obtaining reasonable assurance about whether VA's financial statements are free of material misstatements, we performed tests of VA's compliance with certain provisions of laws and regulations, 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 07-04, as amended. We limited our tests of compliance to those provisions and we did not test compliance with all laws and regulations applicable to VA. Providing an opinion on compliance with certain provisions of laws and regulations 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 of compliance with laws and regulations described in the preceding paragraph disclosed no instances of reportable noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin 07-04, as amended.

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether the financial management systems used by VA substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The objective of our audit was not to provide an opinion on compliance with FFMIA. Accordingly, we do not express such an opinion. However, except for matters described below, where VA did not substantially comply with applicable Federal financial management systems requirements, the results of our work disclosed no other instances in which VA's financial management systems did not substantially comply with Federal accounting standards and the United States SGL at the transaction level.

1. Non-compliance with FFMIA

Our report on internal control over financial reporting identified a material weakness over "Information Technology (IT) Security Controls" and a significant deficiency over "Financial Management System Functionality." The conditions cited in these control deficiencies indicate that VA's financial management systems do not substantially comply with the Federal financial management systems requirements as required by FFMIA Section 803(a).

2. Non-compliance with Debt Collection Improvement Act

Condition:

We tested various sample transactions for compliance with the Debt Collection Improvement Act of 1996 (DCIA), and noted the following exceptions:

- 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, for 87 sample items out of a total of 90 sample selections tested, VBA did not charge interest or administrative costs on delinquent payments from veterans related to certain receivables for Compensation, Pension, and Education.

Criteria:

Public Law 96-466 and Title 38 U.S.C § 501(a) and §5315, and 38 CFR 1.919 require VA to charge interest and administrative costs on any amount owed to the United States.

Cause:

This has been a long standing issue and is based on a former VA Deputy Secretary's instruction in July 1992, that VA not charge interest or administrative costs on veteran debts.

Effect:

VA is noncompliant with the Debt Collection Improvement Act of 1996.

Recommendation:

We recommend that VA:

- Implement policies and procedures to assess applicable interest and administrative costs or propose a legislative remedy to request a waiver of these requirements.

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

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2010

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Department of Veterans Affairs

Memorandum

Date: NOV 10 2010

From: Acting Assistant Secretary for Management (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2010 and 2009

To: Assistant Inspector General for Auditing (52)

1. The Office of Management has reviewed the Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2010 and 2009, and we are pleased with the receipt of an unqualified opinion. We are also pleased that we met the FY 2010 reporting timeline established by OMB. Please extend to your staff and the staff of Clifton Gunderson, LLP our appreciation for their detailed planning, hard work, and cooperation during this year's audit.

2. VA senior officials, as well as program managers in the Administrations and affected staff offices, are aware of the unqualified audit opinion. As a result of the dedicated efforts of staff throughout the Department, three of the four material weaknesses identified in the Department's 2009 financial statements (Financial Management System Functionality, Financial Management Oversight, and Compensation, Pension and Burial Liabilities) are no longer identified as material weaknesses. This 75 percent reduction in material weaknesses in just one year is a tremendous accomplishment. We will continue to focus on completing corrective actions as detailed in the remediation plans for the one remaining material weakness, Information Technology (IT) Security Controls. For this repeat material weakness, the existing remediation plans will be revised and expanded, as needed, to address the findings and recommendations in your audit report.

3. Thank you again for your efforts in another successful conclusion of the audit cycle.

W. Todd Grams

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,		2010		2009
ASSETS				
INTRAGOVERNMENTAL				
Fund Balance with Treasury (Note 3)	$	43,155	$	27,086
Investments (Note 5)		10,711		11,328
Accounts Receivable, Net (Note 6)		29		65
Other Assets		873		873
TOTAL INTRAGOVERNMENTAL ASSETS		**54,768**		**39,352**
PUBLIC				
Investments (Note 5)		184		184
Accounts Receivable, Net (Note 6)		1,808		1,552
Loans Receivable, Net (Note 7)		3,185		2,968
Cash (Note 4)		20		50
Inventories and Related Properties, Net (Note 8)		56		59
General Property, Plant and Equipment, Net (Note 9)		16,730		14,699
Other Assets		42		37
TOTAL PUBLIC ASSETS		**22,025**		**19,549**
TOTAL ASSETS	**$**	**76,793**	**$**	**58,901**
Heritage Assets (Note 10)				
LIABILITIES				
INTRAGOVERNMENTAL				
Accounts Payable	$	16	$	54
Debt		1,655		1,550
Other Liabilities (Note 14)		1,859		1,530
TOTAL INTRAGOVERNMENTAL LIABILITIES		**3,530**		**3,134**
PUBLIC				
Accounts Payable		4,973		4,530
Liabilities for Loan Guarantees (Note 7)		4,885		3,916
Federal Employee and Veterans Benefits Liabilities (Note 12)		1,476,662		1,319,235
Environmental and Disposal Liabilities (Note 13)		879		884
Insurance Liabilities (Note 16)		11,688		12,161
Other Liabilities (Note 14)		7,394		6,456
TOTAL PUBLIC LIABILITIES		**1,506,481**		**1,347,182**
TOTAL LIABILITIES		**1,510,011**		**1,350,316**
Commitments and Contingencies (Note 17)				
NET POSITION				
Unexpended Appropriations – Earmarked Funds		-		-
Unexpended Appropriations – All Other Funds		14,385		1,998
Cumulative Results of Operations – Earmarked Funds		892		998
Cumulative Results of Operations – All Other Funds		(1,448,495)		(1,294,411)
TOTAL NET POSITION	**$**	**(1,433,218)**	**$**	**(1,291,415)**
TOTAL LIABILITIES AND NET POSITION	**$**	**76,793**	**$**	**58,901**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS				
CONSOLIDATED STATEMENTS OF NET COST (dollars in millions)				
FOR THE YEARS ENDED SEPTEMBER 30,		2010		2009
NET PROGRAM COSTS BY ADMINISTRATION (Note 20 & 23)				
Veterans Health Administration				
Gross Cost	$	51,765	$	47,181
Less Earned Revenue		(3,681)		(3,191)
Net Program Cost		48,084		43,990
Veterans Benefits Administration				
Gross Cost		59,922		51,195
Less Earned Revenue		(2,057)		(2,083)
Net Program Cost		57,865		49,112
National Cemetery Administration				
Gross Cost		274		224
Less Earned Revenue		-		-
Net Program Cost		274		224
Indirect Administrative Program Costs				
Gross Cost		4,204		4,580
Less Earned Revenue		(672)		(1,171)
Net Program Cost		3,532		3,409
NET PROGRAM COSTS BY ADMINISTRATION BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITIES		**109,755**		**96,735**
CHANGES IN ACTUARIAL LIABILITIES (Note 12)				
COMPENSATION:				
Changes in Experience Assumptions		122,400		
Changes in Discount Rate Assumptions		110,500		
Changes in Cost of Living Adjustment (COLA) Rate Assumptions		(45,700)		
Other Changes		35,800		
TOTAL COMPENSATION		223,000		(148,100)
BURIAL:				
Changes in Discount Rate Assumptions		300		
Other Changes		500		
TOTAL BURIAL		800		(1,100)
NET (GAIN)/LOSS FROM ACTUARIAL LIABILITY CHANGES		**223,800**		**(149,200)**
NET COST (BENEFIT) OF OPERATIONS (Note 20)	**$**	**333,555**	$	**(52,465)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2010

	Earmarked Funds	All Other Funds	Eliminations	FY 2010 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 998	$ (1,294,257)	$ (154)	$ (1,293,413)
Cumulative Change in Accounting Principle (Note 12)	-	66,500	-	66,500
Beginning Balance, As Adjusted	998	(1,227,757)	(154)	(1,226,913)
Budgetary Financing Sources				
Appropriations Used	-	111,501	-	111,501
Nonexchange Revenue	-	11	-	11
Donations and Forfeitures of Cash and Cash Equivalents	24	-	-	24
Transfer In/Out Without Reimbursement	(2,801)	2,847	(46)	-
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	36	1	-	37
Transfers In/Out Without Reimbursement	-	-	-	-
Imputed Financing	-	1,601	-	1,601
Other	-	(309)	-	(309)
Total Other Financing Sources	(2,741)	115,652	(46)	112,865
Net Cost/(Benefit) of Operations	(2,635)	336,190	-	333,555
Net Change	**(106)**	**(220,538)**	**(46)**	**(220,690)**
Ending Balance – Cumulative Results	892	(1,448,295)	(200)	(1,447,603)
Unexpended Appropriations				
Beginning Balance	-	1,844	154	1,998
Budgetary Financing Sources				
Appropriations Received	-	123,922	-	123,922
Appropriations Transferred In/Out	-	62	46	108
Other Adjustments	-	(142)	-	(142)
Appropriations Used	-	(111,501)	-	(111,501)
Total Budgetary Financing Sources	-	12,341	46	12,387
Total Unexpended Appropriations	**-**	**14,185**	**200**	**14,385**
Total Net Position	**$ 892**	**$ (1, 434,110)**	**$ -**	**$ (1,433,218)**

The accompanying notes are an integral part of these Consolidated 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 and Forfeitures of Cash and Cash Equivalents	35	-	-	35
Transfer In/Out Without Reimbursement	(2,726)	2,767	(41)	-
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	27	1	-	28
Transfers In/Out Without Reimbursement	2	(4)	2	-
Imputed Financing	-	1,653	-	1,653
Other	-	(820)	(2)	(822)
Total Other Financing Sources	(2,662)	102,777	(41)	100,074
Net Benefit 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 Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 21) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2010

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources		
Unobligated Balance brought forward, October 1	$ 11,210	$ 2,580
Adjustment to Unobligated Balance brought forward, October 1	-	(4)
Recoveries of Prior Year Unpaid Obligations	3	-
Budget Authority		
Appropriations Received	127,863	-
Borrowing Authority	-	1,463
Spending Authority from Offsetting Collections		
Earned	5,414	3,785
Change in Unfilled Customer Orders	(344)	
Subtotal	144,146	7,824
Nonexpenditure Transfers, Net	108	-
Temporarily Not Available Pursuant to Public Law	-	-
Permanently Not Available	(137)	(1,358)
Total Budgetary Resources	**$ 144,117**	**$ 6,466**
Status of Budgetary Resources		
Obligations Incurred	$ 120,326	$ 4,093
Unobligated Balance Available	21,175	-
Unobligated Balance Not Available	2,616	2,373
Total Status of Budgetary Resources	**$ 144,117**	**$ 6,466**
Change in Obligated Balance		
Unpaid Obligations Balance, brought forward, October 1	$ 16,669	$ 50
Adjustment to Unpaid Obligations brought forward, October 1	-	4
Obligations Incurred	120,326	4,093
Less Gross Outlays	(117,236)	(3,902)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(3)	-
Change in Uncollected Customer Payments from Federal Sources	312	34
Obligated Balance, Net End of Period	**$ 20,068**	**$ 279**
Net Outlays		
Gross Outlays	$ 117,236	$ 3,902
Less Actual Offsetting Collections	(5,383)	(3,820)
Less Distributed Offsetting Receipts	(3,291)	(398)
Net Outlays	**$ 108,562**	**$ (316)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources		
Unobligated Balance brought forward, October 1	$ 10,559	$ 3,285
Recoveries of Prior Year Unpaid 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		
Unpaid Obligations Balance, brought forward, October 1	$ 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 Actual 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 Consolidated Financial Statements.

Notes to Consolidated Financial Statements

For the Years Ended September 30, 2010 and 2009 (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, including the Combined Statements of Budgetary Resources, report all activities of VA components. VA components include the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and Indirect Administrative Program Costs. 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 principal financial statements have been prepared to report the financial position and results of operations of VA, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of VA in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that VA is a component of the U.S. Government, a sovereign entity. VA's fiscal year end is September 30th.

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 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.

The Combined Statements of Budgetary Resources identify the Department's budget authority and provide information on budgetary resources available to the Department during the year and the status of those resources at the end of the year. Specific forms of budget authority that the Department receives are appropriations, borrowing authority and spending authority from offsetting collections. Detail on the amounts shown in the Combined Statements of Budgetary Resources is included in the Required Supplementary Information section on the Schedule of Budgetary Activity shown by major account. The Combined Statements of Budgetary Resources are prepared on a combined basis and do not include intra-entity eliminations.

Basis of Accounting

The principal financial statements are prepared in accordance with GAAP as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the OMB Revised Circular A-136, Financial Reporting Requirements. The American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards No. 91, Federal GAAP Hierarchy, established a hierarchy of GAAP for Federal financial statements.

Revenues and Other Financing Sources

Exchange revenues, which are primarily medical revenues, are recognized when earned from other federal agencies or the public as a result of costs incurred or services performed on their behalf. Medical revenue is earned by VA when services provided can be billed to the first party (Veterans) and third party insurance companies. Medical revenue is accrued to the extent medical service is billable to the first party (Veterans) and third party insurance companies but final billings have not been completed. 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 paid by the Office of Personnel Management (OPM). Nonexchange revenue, (e.g., donations) is recognized when received, and the related receivables, refunds, and offsets are recognized when measurable and legally collectible.

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

VA, as the transferring (parent) entity, is a party to allocation transfers with the Department of Defense (DoD). 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 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, the 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 net of amortized premiums or discounts and accrued interest, which approximates market value, 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 2025, 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 (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
Accounts receivable are recorded at net realizable value measured as the carrying amount less an allowance for loss provision or contractual adjustment for medical care as considered necessary. Probable losses on accounts receivable are provided using the allowance method. The allowance is determined based on VA's historical experience and collection efforts. Uncollectible amounts are written off against the allowance for loss provision or contractual adjustment for medical care once VA determines an amount, or a portion thereof, to be uncollectible.

Accounts receivable consists of intragovernmental accounts receivable and public accounts receivable. Intragovernmental accounts receivable consists of amounts due from other federal government agencies primarily for reimbursement of costs and lease payments receivable. All amounts due from federal government agencies are considered fully collectible; therefore, no allowance for loss provision is recognized.

Public accounts receivable consists primarily of (a) amounts due for Veterans' health care, (b) amounts due for compensation, pension, and readjustment benefit overpayments, (c) amounts due for education benefits and readjustment overpayments and (d) other miscellaneous receivables due primarily for general fund advances, insurance, Loan Guaranty receivables and medical research.

Amounts due are reviewed for collectability and allowances are provided based on VA's estimate of uncollectible balances including prior experience and the contractual nature of the balance due. Contractual adjustments are provided on amounts due from the Medical Care Collection Fund (MCCF) third party receivables and insurance companies. An allowance for loss provision is provided on the remaining outstanding balances due based on VA's estimate of uncollectible balances including prior experience.

VA is required by Public Law (P.L.) 96-466 to charge interest and administrative costs on benefit debts similar to charges levied on other debts owed the federal government. VA's current policy is not to charge interest on compensation and pension debts, based on a July 1992 decision by the then-VA Deputy Secretary.

Loans Receivable
Loans receivable for direct loans 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.

VA accrues interest on performing and non-performing loans receivable until the outstanding balance is paid in full. Performing loans receivable are those loans where the amount due on the outstanding balance is paid in full by the established due date. Non-performing loans receivable are those loans where the amount due on the outstanding balance is not paid in full by the established due date which results in a delinquency of the indebtedness. Interest receivable is accrued on the non-performing loan balance until the amount due is paid to a current status, debt is paid in full or otherwise resolved through compromise, waiver of the charges or termination of collection action. VA charges a fixed interest rate on loans issued for the duration of the loan term, including any delinquency period. The interest rate is set at loan inception based on three benchmark interest rates tracked by VA. VA will apply payments received from the debtor first to penalties and administrative costs, second to interest receivable and third to outstanding debt principal.

Inventories
Inventories consist primarily of items such as Canteen Service retail store stock held for current sale 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 two 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 are assets not significant enough to be reported in a separate category on the consolidated balance sheets. Substantially all the Other Assets consist of advance payments under Intragovernmental Assets and Public Assets, respectively, on the consolidated balance sheets. Intragovernmental Advances - Federal 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. Substantially all of the Public Advance Payments are made by Veterans Health Administration (VHA) primarily to hospitals and medical schools under house staff contracts, grantees and beneficiaries, with the balance of the advances being made to employees on official travel.

Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other federal government agencies and accounts payable from cancelled appropriations. The remaining accounts payable consist of amounts due to the public. Accrued expenses are classified as Other Liabilities except when specifically required to be reclassified to Accounts Payable under Treasury reporting requirements.

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

At the balance sheet dates, all debt is classified as intragovernmental debt in the consolidated balance sheets in the disclosure category of

Other Debt – Due to Treasury. Substantially all the debt is related to borrowing by the Loan Guaranty and Direct Loan Programs. Total debt was $1,655 and $1,550 at September 30, 2010 and 2009, respectively.

Loan Guaranty debt was $1,654 and $1,549 as of September 30, 2010 and 2009, respectively, with a 30-year term from the date of issuance and bears interest at the Treasury securities rate at the time of borrowing. The interest rates ranged from 2.00 to 7.58 percent in FY 2010 and 3.40 to 7.58 percent in FY 2009.

Direct Loans debt under the Vocational Rehabilitation Program was $1 and $1 as of September 30, 2010 and 2009, respectively, with a 2-year term from the date of issuance and bears interest at the Treasury securities rate at the time of borrowing. The interest rates ranged from 1.07 to 4.119 percent in FY 2010 and .42 to 4.01 percent in FY 2009.

The Loan Guaranty net borrowings (repayments) were $105 in FY 2010 and ($29) in FY 2009. The Direct Loans net borrowings (repayments) under the Vocational Rehabilitation Program were $0 in FY 2010 and ($1) in FY 2009.

No debt was held by the public during FY 2010 or FY 2009. There were no redemptions or calls of debts before maturity or write-offs of debt owed to Treasury.

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 2010 and FY 2009 calculations. Included in Insurance Liabilities are unearned premiums, insurance dividends left on deposit and related interest payable and dividends payable to policy holders.

Annual Leave

Federal employees' annual leave is accrued as it is earned, and the accrual is reduced annually for actual leave taken. Each year, the accrued annual leave balance is adjusted to reflect the latest 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 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 administered by OPM. 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 and burial 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, presumptive service conditions resulting in benefits coverage and life expectancy, impact the amount of the liability.

For FY 2009, the estimated liabilities for Veterans compensation and burial obligations in the financial statements were measured at September 30, 2009. Discount rates used to measure the actuarial liabilities were based on the September 30, 2009 spot rate for the interest rate yield curve on marketable Treasury securities with maturities consistent with the period of expected future payments.

Effective October 1, 2009, discount rates used to measure the actuarial liabilities are based on the 10-year average historical interest rate yield curve on marketable Treasury securities at September 30 of each year for the 10-year historical period with maturities consistent with the period of expected future payments. Estimated liabilities for Veterans compensation and burial obligations in the financial statements are measured as of the end of the fiscal year based on June 30 beneficiary data that is adjusted for material known changes in the number of participants covered (enrollment) during the 4th quarter. The method used to measure the liabilities provides for consistency in the underlying relationship between discount rate, COLA, and the other economic assumptions.

For FY 2010, valuation techniques or their application used to measure the fair value of the actuarial liabilities were consistently applied compared to prior years. However, there were also refinements to the valuation techniques or their application used to measure the fair value of the actuarial liabilities that were considered preferable by management. The refinements were made to the valuation techniques or their application because VA management concluded that the resulting measurements were equally or more representative of fair value of the actuarial liabilities in the circumstances and were made possible due to improved computer software modeling capability and improved information. The changes in fair value of the actuarial liabilities that resulted from the changes in valuation techniques or their application are treated as a change in estimate and accounted for on a prospective basis beginning in FY 2010. However, the disclosures for a change in accounting estimate are not required. The most significant refinements include a change in (1) the method of estimating future changes in the degree of disability connected with military service due to the elimination of computer software modeling limitations, (2) the estimate of future Cost of Living Adjustments (COLA) based on a linear regression model of the Consumer Price Index (CPI) and Treasury interest rates to account for low interest rate environments compared to a constant real rate of interest assumption, and (3) the use of attained age method for future benefit calculations compared to the use of the age at valuation date for future benefit calculations.

Effective August 31, 2010, subject to the 60-day waiting period, three new presumptive service conditions resulting in benefits being recognized were included in the compensation actuarial liability at September 30, 2010. Vietnam Veterans who have any of three specific illnesses, from an association with herbicides used in Vietnam, including Agent Orange are subject to compensation. The illnesses are B cell leukemia, such as hairy cell leukemia; Parkinson's disease; and ischemic heart disease.

Contingencies

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, Commitments Contingencies.

Non-Federal Trusts

VA has entered into enhanced-use leases to maximize use of underutilized VA property. In 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 included in the accompanying 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.

Comparative Data

Certain amounts in the FY 2009 Consolidated Balance Sheet were reclassified from Other Liabilities to Accounts Payable and Insurance Liabilities to conform to the FY 2010 presentation. The reclassifications had no other effect on the Consolidated Financial Statements.

2. Non-Entity Assets

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

Non-Entity Assets as of September 30,		2010		2009
Fund Balance with Treasury	$	15	$	61
Intragovernmental Accounts Receivable		1		1
Public Accounts Receivable		50		43
Total Non-Entity Assets	$	66	$	105

3. Fund Balance with Treasury

Fund Balance with Treasury as of September 30,		2010		2009
Entity Assets				
Trust Funds	$	80	$	82
Revolving Funds		3,135		3,045
Appropriated Funds		39,646		23,601
Special Funds		235		245
Other Fund Types		44		52
Total Entity Assets		43,140		27,025
Non-Entity Assets				
Other Fund Types		15		61
Total Non-Entity Assets		15		61
Total Entity and Non-Entity Assets	$	43,155	$	27,086
Reconciliation of VA General Ledger Balances with Treasury				
Balance per VA General Ledger	$	41,066	$	28,717
Reconciled Differences, principally timing		2,177		(1,655)
Unreconciled Differences		(88)		24
Fund Balance with Treasury	$	43,155	$	27,086
Status of Fund Balance with Treasury				
Unobligated Balance				
Available	$	21,105	$	8,277
Unavailable		3,172		3,548
Obligated Balance not yet Disbursed		18,584		14,903
Deposit /Clearing Account Balances		294		358
Fund Balance with Treasury	$	43,155	$	27,086

4. Cash

Cash as of September 30,		2010		2009
Canteen Service	$	3	$	3
Agent Cashier Advance		17		14
Loan Guaranty Program		-		33
Total Cash	$	20	$	50

5. Investments

Investment Securities as of September 30, 2010		Cost	Amortization Method		Amortized (Premium)/ Discount	Interest Receivable	Investments, Net		Market Value
Intragovernmental Securities									
Non-Marketable: Special Bonds	$	10,487	N/A	$	-	141	10,628	$	10,628
Treasury Notes		83	Effective Interest		(1)	1	83		83
Total	$	10,570		$	(1)	142	10,711	$	10,711
Public Securities									
Trust Certificates (Loan Guaranty)	$	140	N/A	$	-	-	140	$	140
Mutual Funds (Non-Federal Trusts)		48	Straight-line		(4)	-	44		44
Total	$	188		$	(4)	-	184	$	184
as of September 30, 2009									
Intragovernmental Securities									
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
Public 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

6. Accounts Receivable, Net

Accounts Receivable, Net
as of September 30,

		2010		2009
Intragovernmental Accounts Receivable, Net	$	29	$	65
Public Accounts Receivable				
Medical Care	$	2,068	$	1,983
Contractual Adjustment and Allowance for Loss Provision		(907)		(921)
Net Medical Care		1,161		1,062
Compensation and Pension		1,117		1,039
Allowance for Loss Provision		(729)		(678)
Net Compensation and Pension		388		361
Education Benefits		380		123
Allowance for Loss Provision		(185)		(56)
Net Education Benefits		195		67
Other		74		70
Allowance for Loss Provision		(10)		(8)
Net Other		64		62
Total Public Accounts Receivable		3,639		3,215
Total Contractual Adjustment and Allowance for Loss Provision		(1,831)		(1,663)
Public Accounts Receivable, Net	$	1,808	$	1,552

The Total Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Public Accounts Receivable was approximately 50 percent and 52 percent at September 30, 2010 and 2009, respectively. The Medical Care Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Medical Care related accounts receivable was approximately 44 percent and 46 percent at September 30, 2010 and 2009, respectively.

Included in the Medical Care Contractual Adjustment and Allowance for Loss Provision is an Allowance for Contractual Adjustment of $537 and $630 or approximately 54 percent and 62 percent, respectively of Medical Care Collection Fund third party receivables of $991 and $1,020 at September 30, 2010 and 2009, respectively.

The Compensation and Pension Allowance for Loss Provision as a percentage of Total Compensation, Pension and Readjustment Benefit Overpayment-related accounts receivable was approximately 65 percent and 65 percent at September 30, 2010 and September 30, 2009, respectively. The Education Benefits Allowance for Loss Provision as a percentage of Total Education Benefits and Readjustment Benefit Overpayment-related accounts receivable was approximately 49 percent and 45 percent at September 30, 2010 and September 30, 2009, respectively.

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 Credit Reform Act). This disclosure is also in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Guarantees, as amended. 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.

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, 2010

	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)	$ 17	10	-	-	$ 27
Insurance Policy Loans	503	12	-	-	515
Total Loans Receivable and Related Foreclosed Property Excluding Direct Loans Obligated After 1991, Net					$ 542

	Loans Receivable Gross	Interest Receivable	Allowance for Subsidy (Present Value)	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated After FY 1991	$ 686	9	713	22	$ 1,430
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					$ 1,972

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 1991	$ 739	1	718	18	$ 1,476
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					$ 2,058

Direct Loans Disbursed
The total amount of new direct loans disbursed for the years ended September 30, 2010 and 2009, was $251.5 and $50, 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 2010, 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,

	2010	2009
Interest Differential	$ (107)	$ (8)
Defaults*	1	1
Fees**	(4)	-
Other***	94	5
Subtotal	(16)	(2)
for the years ended September 30,		
Interest Rate Reestimates	25	39
Technical Reestimates	37	55
Total Direct Loan Subsidy Expense	$ 46	$ 92

* “Defaults” includes approximately $6 thousand and $7 thousand in defaults and other expenses for the Vocational Rehabilitation Program in FY 2010 and FY 2009, respectively.
** "Fees" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.
*** "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 loans. 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 loans and prior year(s) loans. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Direct Loans by Component

Interest Differential	(74.28%)
Defaults	17.74%
Fees	(1.94%)
Other	43.88%

Allowance for Subsidy for Direct Loans (Post-1991)

VA reports the allowance for subsidy for direct loans, subject to the Credit Reform Act 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. 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. For FY 2010, the subsidy rate is (4.45) percent for Veterans Housing Direct – Vendee Loans, 10.15 percent for Veterans Housing Direct – Acquired Loans, and (32.78) percent for Native American Direct. In FY 2009, the subsidy rate was (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. The allowance for subsidy as of September 30, 2010 and 2009 is $(713) and $(718), respectively.

Schedule for Reconciling Subsidy Cost Allowance Balances Beginning Balance, Changes and Ending Balance	FY 2010	FY 2009
Beginning balance of the allowance	$ (718)	$ (748)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(107)	(8)
Default costs (net of recoveries)	1	1
Fees and other collections	(4)	-
Other subsidy costs	94	5
Total of the above subsidy expense components	(16)	(2)
Adjustments:		
Fees received	3	1
Foreclosed property acquired	(29)	(19)
Loans written off	(1)	(1)
Subsidy allowance amortization	(31)	(54)
Change in reestimate execution	17	11
Total Adjustments	(41)	(62)
Ending balance of the allowance before reestimates	(775)	(812)
Subsidy reestimates by component		
Interest rate reestimate	25	39
Technical/default reestimate	37	55
Total of the above reestimate components	62	94
Ending balance of the allowance	$ (713)	$ (718)

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, 2010

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	$ 21	-	(18)	5	$ 8
Defaulted Guaranteed Loans - Post-1991 Guarantees	5	-	-	1,200	1,205
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 1,213

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 Guarantees	5	-	-	890	895
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 910

Total Loans Receivable and Related Foreclosed Property, Net

as of September 30,	2010	2009
Total Direct Loans	$ 1,972	$ 2,058
Total Guaranteed Loans	1,213	910
Total Loans Receivable and Related Foreclosed Property, Net	$ 3,185	$ 2,968

Foreclosed Property

Prior to the foreclosure of property secured by a VA Loan Guarantee, 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, 2010 and 2009, the estimated number of residential properties in VA's inventory was 10,835 and 8,464, respectively. For FY 2010 and FY 2009, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 8 months and 9 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 20,500 and 17,000 as of September 30, 2010 and 2009, respectively.

Guaranteed Loans				
as of September 30,				
		2010		**2009**
Guaranteed Loans Outstanding:				
Outstanding Principal Guaranteed Loans, Face Value	$	214,726	$	183,365
Amount of Outstanding Guarantee		58,080		50,368
New Guaranteed Loans Disbursed:				
Outstanding Principal Guaranteed Loans, Face Value	$	57,641	$	68,200
Amount of Outstanding Guarantee		14,837		17,492
Liabilities for Loan Guarantees Post 1991 (Present Value Method)	$	4,885	$	3,916

Guaranty Commitments

VA guaranteed 280,579 loans in FY 2010. The FY 2010 total guaranty amount is $15 billion. The total amount of loans guaranteed is $57.7 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,	2010	2009
Defaults	$ 951	$ 726
Fees*	(1,058)	(1,170)
Subtotal	(107)	(444)
Interest Rate Reestimates	204	(65)
Technical Reestimates	1,224	481
Total Guaranteed Loan Subsidy Expenses**	$ 1,321	$ (28)

* 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,	2010	2009
Defaults	$ 6	$ -
Other	(1)	-
Subtotal	5	-
Interest Rate Reestimates	16	(9)
Technical Reestimates	16	1
Total Loan Sale-Guaranteed Subsidy Expense	$ 37	$ (8)

Total Subsidy Expense for the years ended September 30,	2010	2009
Total Direct Loans	$ 46	$ 92
Total Guaranteed Loans	1,321	(28)
Total Sale Loans	37	(8)
Total Subsidy Expense	$ 1,404	$ 56

Subsidy Rates for Loan Guarantees by Component

The subsidy rates disclosed below pertain only to the loans guaranteed in the current year. 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 loan guarantees issued and prior year(s) loan guarantees issued. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Loan Guarantees	
Defaults	1.51%
Fees	(1.68)%

Loan Sales

VA owns mortgages and real estate on certain defaulted loans that were guaranteed by VA and have gone through the foreclosure process with the lender. VA sells the real estate to a third party owner and makes the direct loan for the underlying mortgage loan receivable. To reduce the administrative burden of servicing these loans, VA will bundle these loans and sell them to a third party investor (Trust) pursuant to a sale agreement. It is at least reasonably possible that the proceeds from the sale of its loans will differ from the reported carrying value of the loans and the underlying value of their related assets resulting in a realized gain or loss on sale.

Under the sale agreement, the Trust owns the mortgage loans and other property acquired in the sale and 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. In addition, the Trust will issue certificates backed by mortgage loans and installment contracts. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. On the closing date of the certificates, VA transfers its entire interest in the related loans receivable and collateral to the Trustee for the benefit of the related certificate holders pursuant to the sale agreement. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates backed by the full faith and credit of the federal government.

During the period FY 1992 through FY 2010, the total loans sold amounted to $14.5 billion. VA recognized loan sale proceeds of $229 million during FY 2010 resulting in a gain of $2 million. There were no loan sales during FY 2009. As a result of the sale of $227 million of loans receivable in FY 2010, the amount of guaranteed loans sold increased by the carrying amount of the loans receivable at the date of sale. The components of the loan sale are summarized in the tables below.

Loan Sales		
Years Ended September 30,		
	2010	**2009**
Loans Receivable Sold	$ 227	$ -
Net Proceeds from Sale	(229)	-
Gain on Receivables Sold	$ (2)	$ -

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,		
	2010	**2009**
Outstanding Balance Guaranteed Loans Sold, Start of Year	$ 1,714	$ 1,901
Sold to the Public	227	-
Payments, Repayments, and Terminations	(280)	(187)
Outstanding Balance Guaranteed Loans Sold, End of Year	$ 1,661	$ 1,714

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 the Credit Reform Act 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 2010 and FY 2009 is 2.42 percent and 0 percent, respectively. The liability for loan sale guarantees as of September 30, 2010 and 2009 is $62 and $45, respectively.

Schedule for Reconciling Loan Sale Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2010**	**2009**
Beginning balance of the liability	$ 45	$ 73
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	6	-
Other subsidy costs	(1)	-
Total of the above subsidy expense components	5	-
Adjustments:		
Claim payments to lenders	(23)	(20)
Interest accumulation on the liability balance	1	2
Change in reestimate execution	2	(2)
Ending balance of the liability before reestimates	30	53
Subsidy reestimates by component		
Interest rate reestimate	16	(9)
Technical/default reestimate	16	1
Total of the above reestimate components	32	(8)
Ending balance of the liability	$ 62	$ 45

Liability for Loan Guarantees (Post-1991)
VA reports the liability on the guarantee of loans, subject to the Credit Reform Act 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 2010 and FY 2009 subsidy rate was (0.20) and (0.66) percent, respectively. The liability for loan guarantees as of September 30, 2010 and 2009 is $4,823 and $3,871, respectively.

Schedule for Reconciling Loan Guarantee Liability Balances		
Beginning Balance, Changes and Ending Balance	**2010**	**2009**
Beginning balance of the liability	$ 3,871	$ 3,379
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	951	726
Fees and other collections	(1,058)	(1,170)
Total of the above subsidy expense components	(107)	(444)
Adjustments:		
Fees received	867	855
Foreclosed property and loans acquired	(351)	(325)
Claim payments to lenders	(995)	(403)
Interest accumulation on the liability balance	103	124
Change in reestimate execution	7	269
Ending balance of the liability before reestimates	3,395	3,455
Subsidy reestimates by component		
Interest rate reestimate	204	(65)
Technical/default reestimate	1,224	481
Total of the above reestimate components	1,428	416
Ending balance of the liability	$ 4,823	$ 3,871

Administrative Expense

Administrative expense on direct and guaranteed loans for the fiscal years ended September 30, 2010 and 2009 was $145 and $140, respectively.

8. Inventories and Related Properties, Net

Inventories as of September 30,	2010	2009
Held for Current Sale	$ 54	$ 56
Other	2	3
Total Inventories	$ 56	$ 59

9. General Property, Plant and Equipment

General Property, Plant and Equipment
as of September 30, 2010

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	$ 789	$ (101)	$ 688
Buildings	20,142	(10,455)	9,687
Equipment	3,726	(1,865)	1,861
Other Structures and Capital Leases	2,720	(1,560)	1,160
Internal Use Software	477	(336)	141
Construction Work in Progress	2,997	-	2,997
Internal Use Software in Development	196	-	196
Total Property, Plant, and Equipment	$ 31,047	$ (14,317)	$ 16,730

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

Depreciation and amortization expense totaled $1.4 billion and $1.1 billion in FY 2010 and FY 2009, respectively.

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.

Heritage Assets in Units					
as of September 30,	2009 Balance	2010 Additions	2010 Withdrawals	2010 Balance	Condition
Art Collections	211	34	-	245	A
Buildings and Structures	1,516	-	(6)	1,510	*U
Monuments/Historic Flag Poles	984	22	-	1,006	A
Other Non-Structure Items	226	21	-	247	A
Archaeological	34	1	-	35	A
Cemeteries	163	1	-	**164	A
Total Heritage Assets in Units	3,134	79	(6)	3,207	

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

VA liabilities not covered by budgetary resources are shown in the following table.

Components of Unfunded Liabilities as of September 30,		2010		2009
Workers' Compensation (FECA)*	$	2,289	$	2,151
Annual Leave		1,733		1,655
Judgment Fund		798		663
Environmental and Disposal		879		884
Veterans Compensation and Burial		1,474,800		1,317,500
Insurance		1,073		847
Amounts due to Non-Federal Trust		161		173
Total	$	1,481,733	$	1,323,873

Total Unfunded Liabilities include Workers' Compensation (FECA) which is comprised of the actuarial Workers' Compensation (FECA) Liability, Accrued FECA Liability for DOL funded costs not yet appropriated and Unfunded Employee Liability. The Accrued FECA Liability and Unfunded Employee Liability are Intragovernmental Liabilities totaling $427 and $416 at September 30, 2010 and 2009, respectively.

* The actuarial estimate for workers' compensation provided by DOL was computed using an interest rate of 4.72 percent to discount the projected annual benefit payments as of FY 2010 and FY 2009.

12. Federal Employee and Veterans Benefits Liabilities

Federal Employee Benefits: Imputed Expenses-Employee Benefits Years ended September 30,		2010		2009
Civil Service Retirement System	$	145	$	313
Federal Employees Health Benefits		1,348		1,251
Federal Employees Group Life Insurance		1		3
Total Imputed Expenses-Employee Benefits	$	1,494	$	1,567

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 under Title 38, Part 2, Chapter 23 in recognition of a Veteran's military service and are recorded as a liability on the balance sheet in the period the requirements are met.

Federal Employee and Veterans Benefits Liabilities		
as of September 30,		
	2010	2009
Workers' Compensation (FECA)	$ 1,862	$ 1,735
Compensation	1,470,500	1,313,900
Burial	4,300	3,600
Total Federal Employee and Veterans Benefits Liabilities	$ 1,476,662	$ 1,319,235

VA provides certain Veterans and/or their dependents with pension benefits if the Veteran died or was disabled from nonservice-related causes, based on annual eligibility reviews. The actuarial present value of the future liability for pension benefits is a nonexchange 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, 2010 and September 30, 2009 was $80.8 billion and $91.4 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) above are also incorporated into the projection. The projected liability does not include any administrative costs. Actual administrative costs incurred annually are included in the Veterans Benefits Administration's Net Program Costs shown in the accompanying Statements of Net Cost.

For FY 2010, there were refinements to the valuation techniques or their application used to measure the fair value of the actuarial liabilities that were considered preferable by VA because management concluded that the resulting measurements were equally or more representative of fair value of the actuarial liabilities in the circumstances due to improved computer software modeling capability and improved information. The changes in fair value of the actuarial liabilities that resulted from the changes in valuation techniques or their application are treated as a change in estimate and accounted for on a prospective basis beginning in FY 2010. The FY 2010 impact of the change in estimates is noted in the following discussion of assumptions.

The liability for future compensation and burial payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Discount rates at September 30, 2010 were based on the 10-year average historical interest rate yield curves on marketable Treasury securities at September 30 of each year for the period 2001 to 2010. The yield rates resulting from this average range from 1.86 to 4.64 percent. Discount rates at September 30, 2009 were based on the interest rate yield curve on marketable Treasury securities with maturities consistent with the period of expected future payments at September 30, 2009 with rates ranging from .40 to 4.37 percent. The change in selecting the discount rate for measuring the compensation, pension and burial liabilities is more fully discussed in the section captioned "Adoption of New Accounting Standard" below.

All calculations were performed separately by age for the Compensation, Pension and Burial programs.

Various assumptions in the actuarial model, such as the number of Veterans and dependents receiving payments, cost of living adjustments, presumptive service conditions resulting in benefits coverage, change in degree of disability connected with military service and life expectancy, impact the amount of the liability.

The total number of Veterans, estimated future military separations and total number of beneficiary participants are determined through actual and projected data. The amount of benefits by beneficiary category and age were based on current amounts being paid, future cost of living adjustments (COLA), change in degree of disability connected with military service and presumptive service conditions in existence at September 30, 2010 resulting in benefits coverage 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, 2010 and 2009 was 2.86 percent and 1.3 percent, respectively. COLA rates for future years are modeled to be consistent with the discount rate assumption described above. Expected changes in benefits due to other reasons, including presumptive disability benefits, were also reflected.

Beginning in FY 2010, the estimate of future COLA adjustments is based on a linear regression model of the Consumer Price Index (CPI) and Treasury interest rates to account for low interest rate environments compared to a constant real rate of interest assumption used in 2009.

Effective August 31, 2010, subject to the 60-day waiting period, three new presumptive service conditions resulting in benefits being recognized were included in the compensation actuarial liability at September 30, 2010. Vietnam Veterans who have any of three specific illnesses, from an association with herbicides used in Vietnam, including Agent Orange are subject to compensation. The illnesses are B cell leukemia, such as hairy cell leukemia; Parkinson's disease; and ischemic heart disease. This had the effect of increasing the calculated liability amounts by $105,900.

Changes in degree of disability connected with military service tend to increase with age. The method of estimating these changes was revised in FY 2010 due to an improvement in the capabilities of the computer modeling software.

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 2008. 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 2006 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.

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, 2010.

Veteran's Presumptive Disability Benefits
Congress established a process to guide the creation of new presumptive disability benefit payments through the Agent Orange Act of

1991, P.L. No. 102-4. If the process results in the publication of a final regulation, as authorized by the Agent Orange Act, the adjudication of cases based on the presumptions can begin. The new adjudications must conform to the presumptions as determined in the final regulation. As a result of the process described above, the Secretary of the VA announced on October 13, 2009, that relying on an independent study by the Institute of Medicine (IOM), he determined that presumptions of service connection are warranted for Vietnam Veterans who have any of three specific illnesses, based on the latest evidence of an association with herbicides used in Vietnam, including 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. Effective August 31, 2010, subject to the 60-day waiting period, a final regulation was issued. In accordance with the Agent Orange Act, after the 60-day waiting period, the adjudication of cases based on these three new presumptions can begin.

For accounting purposes, the three new presumptive disability benefits were recognized in the compensation actuarial liability at September 30, 2010 as previously discussed. For the year ended September 30, 2009, a liability for potential additional benefit costs may have existed, but there was no legal obligation to pay benefits at that date until a final regulation was published and the amount or range of the possible liability was not measureable at that date. See Note 17 for discussion of contingent liabilities.

Adoption of New Accounting Standard

Effective October 1, 2009, VA adopted SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuation Dates* (SFFAS 33). SFFAS 33 will apply to the actuarial liabilities recognized for Veterans compensation and burial obligations reported in VA's general purpose financial reports prepared pursuant to Federal Accounting Standard Advisory Board (FASAB) standards.

SFFAS 33 requires the display of gains and losses from changes in long-term assumptions used to measure liabilities for Veterans compensation and burial obligations, as separate line items on the statements of net costs. The Standard also requires disclosure in notes to the financial statements of a reconciliation of beginning and ending Veterans compensation and burial obligations balances, including all material components of expense "from experience" and "from assumptions changes" by significant programs and in total. In addition, SFFAS 33 provides standards for selecting the discount rate assumption to measure the Veterans compensation and burial obligations as of the reporting date and selecting a valuation date for estimating the obligation which will establish a consistent method for such measurements.

The adoption of the new accounting standard, effective October 1, 2009, is being accounted for as a change in accounting principle and resulted in a $66.5 billion reduction in the Veterans Compensation and Burial Actuarial Liabilities. The cumulative effect of the change in accounting principle on prior periods is reported as an adjustment to the beginning balance of Cumulative Results of Operations, in the Consolidated Statement of Changes in Net Position with an offsetting reduction in the Veterans Compensation and Burial Actuarial Liabilities in the FY 2010 Consolidated Balance Sheet. The FY 2009 financial statements presented for comparative purposes are presented as previously reported. The cumulative effect of the change in accounting principle had no effect on operations in the Consolidated Statements of Net Cost for FY 2010 and FY 2009.

Following is a reconciliation of the changes in the Veterans Compensation and Burial Actuarial Liabilities that have occurred since FY 2009 year end.

Reconciliation of Veterans Compensation and Burial Actuarial Liabilities For the Year Ended September 30,	Compensation	Burial	TOTAL
Liability at September 30, 2009	$ 1,313,900	$ 3,600	$ $1,317,500
Cumulative Effect of Change in Accounting Principle:			
Changes in Assumptions:			
Changes in Discount Rate Assumption	(186,200)	(500)	(186,700)
Changes in COLA Rate Assumption	119,800		119,800
Other Assumption Changes	-	400	400
Net (Gain)/Loss from Changes in Assumptions	(66,400)	(100)	(66,500)
Changes in Experience:			
Changes in Veterans Status	-	-	-
Changes in Veterans Population Count	-	-	-
Other Experience Changes	-	-	-
Net (Gain)/Loss from Changes in Experience	-	-	-
Net Actuarial (Gain)/Loss from Cumulative Effect of Change In Accounting Principle	**(66,400)**	**(100)**	**(66,500)**
Liability at October 1, 2009 as adjusted	1,247,500	3,500	1,251,000
Current year changes:			
Changes in Assumptions:			
Changes in Discount Rate Assumption	110,500	300	110,800
Changes in COLA Rate Assumption	(45,700)	(100)	(45,800)
Model Refinements (Net)	40,700	600	41,300
Other Assumption Changes	(4,900)	-	(4,900)
Net (Gain)/Loss from Changes in Assumptions	100,600	800	101,400
Changes in Experience:			
Changes in Veterans Counts and Status	16,500	-	16,500
Changes due to New Presumptive Conditions	105,900	-	105,900
Other Experience Changes	-	-	-
Net (Gain)/Loss from Changes in Experience	122,400	-	122,400
Net Actuarial (Gain)/Loss from Current Year Activity	**223,000**	**800**	**223,800**
Liability at September 30, 2010	**$ 1,470,500**	**$ 4,300**	**$ 1,474,800**

13. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $879 and $884 as of September 30, 2010 and 2009, 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,

	2010	2009
Deposit and Clearing Account Liabilities	$ 22	$ 78
Accrued Expenses - Federal	828	232
Deferred Revenue	41	47
Resources Payable to Treasury	177	189
Custodial Liabilities	25	44
Credit Reform Act Reestimates*	50	280
General Fund Receipts Liability	6	6
Accrued VA Contributions for Employee Benefits	283	238
Total Other Intragovernmental Funded Liabilities	$ 1,432	$ 1,114

* Credit Reform Act 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 guaranteed loans. The subsidy amount for each guaranteed loan 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,

	2010	2009
Accrued FECA Liability	$ 415	$ 409
Unfunded Employee Liability	12	7
Total Other Intragovernmental Unfunded Liabilities	$ 427	$ 416
Total Other Intragovernmental Liabilities	$ 1,859	$ 1,530

Other Public Funded Liabilities				
as of September 30,				
		2010		**2009**
Accrued Funded Annual Leave	$	16	$	13
Accrued Expenses		3,348		2,808
Accrued Salaries and Benefits		1,242		1,072
Capital Lease Liability		10		15
Other		86		57
Total Other Public Funded Liabilities	$	4,702	$	3,965

Other Public Unfunded Liabilities				
as of September 30,				
		2010		**2009**
Annual Leave*	$	1,733	$	1,655
Amounts due to non-federal trust		161		173
Judgment Fund-Unfunded**		798		663
Total Other Public Unfunded Liabilities	$	2,692	$	2,491
Total Other Public Liabilities	$	7,394	$	6,456

* Annual leave is accrued when earned and is adjusted at the end of each reporting period 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 $10 and $15 as of September 30, 2010 and 2009, respectively. Future commitments for Real Property and Equipment leases are based on leases in effect as of September 30, 2010. 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 2010 in lieu of actual amounts being available. VA's FY 2010 operating lease costs were $468 for real property rentals and $119 for equipment rentals. The FY 2009 operating lease costs consisted of $396 for real property rentals and $113 for equipment rental. The following chart represents VA's projected operating lease commitments or costs for the next five years.

Leases:		
Year	Real Property	Equipment
2011	260	119
2012	235	119
2013	208	119
2014	180	119
2015	157	119

16. Insurance Programs

Through VA, the United States Government administers six life insurance programs including the Veterans Mortgage Life Insurance (VMLI) program for certain totally disabled Veterans. In addition, VA supervises the Servicemembers 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 Servicemembers 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 Servicemembers 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 Servicemembers 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 Servicemembers 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 Servicemembers. SGLI is supervised by VA and is administered by the Office of Servicemembers Group Life Insurance (OSGLI) under terms of a group policy. This program provides low-cost term insurance protection to Servicemembers 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 Servicemember'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 thousand to a maximum of $100 thousand, 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 Servicemembers 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 Servicemember's coverage. Each dependent child of every active duty Servicemember 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 Servicemember'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 Servicemembers' 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, 2010

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 6,753	$ 95	$ 55	$ 6,903
USGLI	10	3	-	13
VSLI	1,550	8	16	1,574
S-DVI	462	5	565	1,032
VRI	251	1	2	254
VI&I	115	-	-	115
Subtotal	$ 9,141	$ 112	$ 638	$ 9,891
Unearned Premiums				70
Insurance Dividends Left on Deposit and Related Interest Payable				1,604
Dividend Payable to Policyholders				121
Unpaid Policy Claims				2
Insurance Liabilities reported on the Consolidated Balance Sheet				11,688
Less Liability not Covered by Budgetary Resources				(1,073)
Liability Covered by Budgetary Resources				$ 10,615

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
Unearned Premiums				87
Insurance Dividends Left on Deposit and Related Interest Payable				1,683
Dividend Payable to Policyholders				142
Insurance Liabilities reported on the Consolidated Balance Sheet				12,161
Less Liability not Covered by Budgetary Resources				(847)
Liability Covered by Budgetary Resources				$ 11,314

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 6,132,150 and 5,999,771 insured for a face value of $1.3 trillion and $1.3 trillion as of September 30, 2010 and September 30, 2009, 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, 2010 and 2009. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2010 Policies	2009 Policies	2010 Face Value	2009 Face Value
Supervised Programs				
SGLI Active Duty	1,562,000	1,530,000	$ 602,853	$ 590,304
SGLI Ready Reservists	783,500	779,500	277,400	278,591
SGLI Post Separation	88,000	93,000	33,093	35,050
SGLI Family - Spouse	1,149,000	1,104,000	113,466	108,958
SGLI Family - Children	2,123,000	2,064,000	21,230	20,640
TSGLI*	-	-	234,550	230,950
VGLI	426,650	429,271	58,946	57,760
Total Supervised	6,132,150	5,999,771	$ 1,341,538	$ 1,322,253
Administered Programs				
NSLI	748,895	834,026	$ 8,924	$ 9,790
VSLI	167,320	175,715	2,218	2,287
S-DVI	213,295	202,110	2,179	2,053
VRI	31,425	35,264	317	349
USGLI	3,765	4,671	11	14
VMLI	2,381	2,273	177	166
Total Administered	1,167,081	1,254,059	$ 13,826	$ 14,659
Total Supervised and Administered Programs	7,299,231	7,253,830	$ 1,355,364	$ 1,336,912

*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 2010 and FY 2009 were $273 and $310, respectively.

17. Commitments and 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. Medical malpractice cases comprised 78 percent and 88 percent of the amounts funded on behalf of VA by the Judgement fund in FY 2010 and FY 2009 respectively. Contract dispute payments for FY 2010 and FY 2009 were

$5.5 and $4.6, respectively. The discrimination case payments for FY 2010 and FY 2009 were $1.1 and $2.0, respectively.

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, 2010 and 2009.

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 $798 for FY 2010 and $663 for FY 2009. The contract and personnel law cases where there was at least a reasonable possibility that a loss may occur were 14 cases totaling $75.8 for FY 2010 and 11 cases totaling $26.7 for FY 2009, excluding the data theft litigation explained below. 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,

		2010		2009
Fiscal Year Settlement Payments	$	114	$	92
Less Contract Dispute and “No Fear” Payments		(7)		(7)
Imputed Financing-Paid by Other Entities		107		85
Increase (Decrease) in Liability for Claims		135		59
Operating Expense	$	242	$	144

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2010 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 2010 tort payments were $107.

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. The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2010 and 2009 was $74.3 and $74.8, respectively.

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 2006-2010, the average medical care cost per year was $36.8 billion.

Veterans Presumptive Disability Benefits

As more fully discussed in Note 12, the Secretary of the VA announced on October 13, 2009, that relying on an independent study by the Institute of Medicine (IOM), he determined that presumptions of service connection are warranted for Vietnam Veterans who have any of three specific illnesses, based on the latest evidence of an association with herbicides used in Vietnam, including Agent Orange. Effective August 31, 2010, subject to the 60-day waiting period, a final regulation was issued and the adjudication of cases based on these three new presumptions can begin. For accounting purposes, the three new presumptive disability benefits were recognized in the compensation actuarial liability at September 30, 2010 (see Note 12). For the year ended September 30, 2009, it was probable that a contingent liability for potential additional benefit costs may have existed, but there was no legal obligation to pay benefits at that date until a final regulation was published and the amount or range of the possible liability was not measureable at that date.

VA Data Theft Litigation

VA was 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 in FY 2009 that was settled and the claim paid from the Judgment Fund in FY 2010 in the amount of $20 million.

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 that are not assets of the Federal government as a whole and are available for authorized expenditures and are thus assets of the earmarked fund. 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.

The VA's Earmarked Funds are as follows:

Fund Name	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
Medical Care Collections Fund	36x5287	P.L. 105-33 111 Stat 665	Third-party and patient co-payments for medical services.	Public, primarily insurance carriers.
Cemetery Gift Fund	36x8129	38 U.S.C. 1007	Donations for Veterans cemeteries.	Public donors.
National Service Life Insurance Fund	36x8132	38 U.S.C. 720	Premiums insure WWII Veterans.	Public, Veterans.
Post-Vietnam Era Education Assistance Program	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to Veterans.	Veterans, DoD.
U.S. Government Life Insurance	36x8150	38 U.S.C. 755	Premiums insure WWI Veterans.	Public, Veterans.
Veterans Special Life Insurance Fund	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict Veterans.	Public, Veterans.
General Post Fund, National Homes	36x8180	38 U.S.C. 101-228	Donations for patient benefits.	Public, mostly Veterans.
Canteen Service Revolving Fund	36x4014	38 U.S.C. 78	Operates the canteen services at hospitals.	Revenue from sales.
National Cemetery Administration Facilities Operation Fund	36x5392	P.L. 108-454	Proceeds benefit land and buildings.	Proceeds from leases.
Service-Disabled Veterans Insurance Fund	36x4012	38 U.S.C. 1922	Provides insurance to Veterans with service-connected disabilities.	Public, Veterans.
Servicemen's Group Life Insurance	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	36x4010	38 U.S.C. 1925	Provides insurance to World War II and Korea Veterans.	Public, Veterans.
Enhanced-Use Lease Trusts	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 related to Cumulative Results of Operations – Earmarked Funds in the Consolidated Statements of Changes in Net Position:

Balance Sheet as of September 30, 2010	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	$ 29	$ 249	$ 66	$ 1	$ 345
Investments with Treasury	10,629	82	-	-	10,711
Other Assets	517	1,330	-	2	1,849
Total Assets	$ 11,175	$ 1,661	$ 66	$ 3	$ 12,905
Liabilities and Net Position:					
Payables to Beneficiaries	$ 235	$ 29	$ 1	$ -	$ 265
Other Liabilities	11,571	177	-	-	11,748
Total Liabilities	$ 11,806	$ 206	$ 1	$ -	$ 12,013
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(631)	1,455	65	3	892
Total Liabilities and Net Position	$ 11,175	$ 1,661	$ 66	$ 3	$ 12,905

Statement of Net Cost for the Year Ended September 30, 2010	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Gross Program Costs	$ 1,263	$ 521	$ 1	$ -	$ 1,785
Less Earned Revenues	988	3,431	1	-	4,420
Net Program Costs	275	(2,910)	-	-	(2,635)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost of Operations	$ 275	$ (2,910)	$ -	$ -	$ (2,635)

Statement of Changes in Net Position for the Year Ended September 30, 2010	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Net Position Beginning of Period	$ (403)	$ 1,333	$ 65	$ 3	$ 998
Budgetary and Other Financing Sources	47	(2,788)	-	-	(2,741)
Net Cost of Operations	275	(2,910)	-	-	(2,635)
Change in Net Position	(228)	122	-	-	(106)
Net Position End of Period	$ (631)	$ 1,455	$ 65	$ 3	$ 892

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

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.

The Office of Financial Policy within VA's Office of Finance established policy requiring a four-part biennial self certification program to be implemented by the Veterans Health Administration. The first part of the certification program requires medical facilities to certify whether charges established by VHA are sufficient to recover the full cost of providing services. The second part requires VA medical facilities certify its cost accounting procedures comply with SFFAS No. 4. Any medical facility with a fully functional Decision Support System (DSS) that produces timely (i.e. current year) data will be able to certify compliance with this requirement. The third part requires medical facilities to certify its compliance with Federal pricing policies and that it has fully disclosed situations where it does not comply with those policies as required by SFFAS No. 7. The fourth part requires medical facilities to certify whether its enhanced health care sharing contracts recover full cost or market price as defined in OMB Circular A-25.

The Management Quality Assurance Service (MQAS) within VA's Office of Business Oversight (OBO) is responsible for reviewing the implementation and execution of the self certification program. Each year MQAS reviews half of the Veterans Integrated Service Networks (VISNs); even VISNs one year and odd VISNs the second year. Generally, one station is selected for review per VISN. MQAS review efforts culminate in a summary report issued to the Veterans Health Administration Chief Financial Officer (CFO) and is distributed to VA senior management including the Assistant Secretary for Management.

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 eight 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 seven cemeteries to private sector entities, for which it receives rental payments. NCA also leases buildings at two 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.

Public Exchange Transactions
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, tort feasor 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 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 2010 were $877 and for FY 2009 were $863. The loan guarantee lender participation fees collected for FY 2010 were $1.7 and for FY 2009 were $2.2.

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. Classification of revenue and/or costs as Intragovernmental or with the Public is determined on a transaction by transaction basis for disclosure purposes.

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 $406.8 during FY 2010 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). 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 Program

Schedule of Net Program Costs by Administration

For the Period Ending September 30, 2010 (Dollars in Millions)	Veterans Health Administration	Veterans Benefits Administration	National Cemetery Administration	Indirect Administrative Program Costs	Total
Production Costs					
Intragovernmental Costs	$ 8,039	$ 362	$ 36	$ 809	$ 9,246
Less Earned Revenues	37	(1,145)	-	(589)	(1,697)
Net Intragovernmental Production Costs	8,076	(783)	36	220	7,549
Public Costs	43,726	59,561	238	3,395	106,920
Less Earned Revenues	(3,718)	(913)	-	(83)	(4,714)
Net Public Production Costs	40,008	58,648	238	3,312	102,206
Net Cost by Administration before changes in Veterans Benefits Actuarial Liabilities	48,084	57,865	274	3,532	109,755
Net (Gain)/Loss on Actuarial Liability Changes	-	223,000	800	-	223,800
Total Net Cost of Operations	$ 48,084	$ 280,865	$ 1,074	$ 3,532	$ 333,555

Schedule of Net Program Costs by Administration					
For the Period Ending September 30, 2009 (Dollars in Millions)	Veterans Health Administration	Veterans Benefits Administration	National Cemetery Administration	Indirect Administrative Program Costs	Total
Production Costs					
Intragovernmental Costs	$ 6,576	$ (291)	$ 34	$ 837	$ 7,156
Less Earned Revenues	84	(1,431)	-	(1,086)	(2,433)
Net Intragovernmental Production Costs	6,660	(1,722)	34	(249)	4,723
Public Costs	40,605	51,486	190	3,743	96,024
Less Earned Revenues	(3,275)	(652)	-	(85)	(4,012)
Net Public Production Costs	37,330	50,834	190	3,658	92,012
Net Cost by Administration before changes in Veterans Benefits Actuarial Liabilities	43,990	49,112	224	3,409	96,735
Net (Gain)/Loss on Actuarial Liability Changes	-	(148,100)	(1,100)	-	(149,200)
Total Net Cost of Operations	$ 43,990	$ (98,988)	$ (876)	$ 3,409	$ (52,465)

21. Disclosures Related to the Statements of Budgetary Resources

Apportionment Categories of Obligations Incurred: Direct Vs. Reimbursable Obligations
Years Ended September 30,

Category A, Direct consists of amounts requested to be apportioned by each calendar quarter in the fiscal year. Category B, Direct consists of amounts requested to be apportioned on a basis other than calendar quarters, such as activities, projects, objects, or a combination of these categories.

	2010	2009
Category A, Direct	$ 62,594	$ 47,603
Category B, Direct	56,540	56,264
Reimbursable	5,285	4,949
Total Obligations	$ 124,419	$ 108,816

Borrowing Authority
Loan Guaranty had borrowing authority of $1.5 billion and $1.8 billion as of September 30, 2010 and 2009, respectively. The interest rates on the borrowing authority range from 2.00 to 7.58 percent for FY 2010 and range from 3.4 to 7.58 percent for FY 2009. Principal repayment is expected over a 30-year period from the date of issuance of debt. Direct Loans under the Vocational Rehabilitation Program had borrowing authority of $2.7 and $3.6 as of September 30, 2010 and 2009, respectively. The interest rates on the borrowing authority range from 1.07 to 4.119 percent for FY 2010 and range from .42 to 4.01 percent for FY 2009. Principal repayment is expected over a 2-year period from the date of issuance of debt. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to housing trusts. The Vocational Rehabilitation loans generally had a duration of one year, and repayment was made from offsetting collections.

Adjustments to Budgetary Resources
During the reporting period, $2.9 was recovered from prior year obligations. For FY 2010, VA appropriations were subjected to a rescission of $11.1 under the provisions of P.L. 111-5, The American Recovery and Reinvestment Act of 2009.

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 (SBR) are comprised 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 comprised of unobligated funds that were not apportioned by OMB for FY 2010 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 2010 Appropriation Law (P.L. 111-117) and Supplemental Appropriations Law (P.L. 111-188). These purposes include: Veteran's 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 the SBR and the Budget of the US Government
As a result of analysis of obligations and advances, obligations were reduced by $20.3 for FY 2010 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 a Period
The amount of budgetary resources obligated for undelivered orders at the end of FY 2010 and FY 2009 was $9.3 billion and $7.8 billion, respectively.

Contributed Capital
The amount of contributed capital received during FY 2010 consisted of donations in the amount of $59.8 to the General Post Fund and $0.3 to the National Cemetery Gift Fund. For FY 2009, $61.5 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 VA with its net cost of operations.

DEPARTMENT OF VETERANS AFFAIRS		
RECONCILIATION OF NET COSTS OF OPERATIONS TO BUDGET		
for the Years Ended September 30,	2010	2009
Resources Used to Finance Activities		
Obligations Incurred	$ 124,419	$ 108,816
Less Spending Authority from Offsetting Collections and Adjustments	(8,858)	(7,702)
Obligations Net of Offsetting Collections and Adjustments	115,561	101,114
Less Offsetting Receipts	(3,689)	(4,204)
Net Obligations	111,872	96,910
Donations of Property	37	28
Transfers-out	-	-
Imputed Financing	1,601	1,653
Other Financing Sources	(309)	(822)
Total Resources Used to Finance Activities	**113,201**	**97,769**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(1,909)	117
Resources that Finance the Acquisition of Assets	(7,646)	(6,262)
Resources that Fund Expenses Recognized in Prior Periods	(1,178)	(173)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	4,535	3,842
Total Resources that Do Not Fund Net Cost of Operations	(6,198)	(2,476)
Total Resources Used to Finance the Net Cost of Operations	**107,003**	**95,293**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	78	146
Increase (Decrease) in Environmental and Disposal Liability	(5)	(45)
Reestimates of Credit Subsidy Expense	1,129	(536)
Increase in Exchange Revenue Receivable from the Public	(528)	18
Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities	224,308	(149,090)
Depreciation and Amortization	1,378	1,131
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	676	356
Loss on Disposition of Assets	171	307
Other	(655)	(45)
Total Costs That Do Not Require Resources in the Current Period	**226,552**	**(147,758)**
Net Cost (Benefit) of Operations	**$ 333,555**	**$ (52,465)**

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

Consolidated Statements of Net Cost
The presentation of the Consolidated Statements of Net Cost (SNC) has been changed and the prior year, FY 2009 has been reclassified to conform to the current period presentation. The reclassification has no other effect on the Consolidated Financial Statements.

Beginning in FY 2010, in order to better align its costs within the department's appropriation rollup structure, VA has consolidated its business lines shown in the SNC from the ten programs previously reported in 2009 to its major administrations: Veterans Health Administration, Veterans Benefits Administration, National Cemetery Administration and also its Indirect Administrative Program Costs. This has the added benefit of enabling VA to identify and accumulate the information needed to prepare the Statement of Net Cost using a fully systematic approach that aligns the costs incurred directly to the source of funding.

Consolidated Balance Sheet Reclassifications
Insurance Dividends Left on Deposit and Related Interest Payable, Dividends Payable to Policyholders and Unearned Premiums of $1,683, $142 and $87, respectively, for FY 2009 were reclassified from Other Liabilities to Insurance Liabilities to conform to the FY 2010 presentation. Accounts Payable from Cancelled Appropriations of $15 and Accrued Interest Payable of $45 for FY 2009 were reclassified from Other Liabilities – Public to Accounts Payable – Public to conform to Treasury reporting requirements. The reclassifications had no other effect on the Consolidated Financial Statements.

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,	**2010**	**2009**	**2008**	**2007**	**2006**
State Extended Care Facilities	$ 242	$ 163	$ 162	$ 138	$ 85
State Veterans Cemeteries	49	40	37	46	18
Total Grant Program Costs	$ 291	$ 203	$ 199	$ 184	$ 103

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 $790. 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 $438 to 40 states and territories. 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,		
	2010	2009
Program Expenses		
Education and Training-Dependents of Veterans	$ 477	$ 464
Vocational Rehabilitation and Education Assistance	9,031	4,393
Administrative Program Costs	348	304
Total Program Expenses	$ 9,856	$ 5,161
Program Outputs (Participants)		
Dependent Education	81,974	82,345
Veterans Rehabilitation	77,176	72,803
Veterans Education	634,038	822,738*

*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,		
	2008	2007
Program Expenses		
Education and Training-Dependents of Veterans	$ 451	$ 450
Vocational Rehabilitation and Education Assistance	3,102	3,095
Administrative Program Costs	251	243
Total Program Expenses	$ 3,804	$ 3,788
Program Outputs (Participants)		
Dependent Education	80,409	79,134
Veterans Rehabilitation	68,826	69,409
Veterans Education	459,594	490,826

Veterans and Dependents Education	
Years Ended September 30,	
	2006
Program Expenses	
Education and Training-Dependents of Veterans	$ 430
Vocational Rehabilitation and Education Assistance	2,943
Administrative Program Costs	232
Total Program Expenses	$ 3,605
Program Outputs (Participants)	
Dependent Education	79,430
Veterans Rehabilitation	71,627
Veterans Education	461,488

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,					
	2010	2009	2008	2007	2006
Program Expenses					
Physician Residents and Fellows	$ 584	$ 547	$ 508	$ 469	$ 462
Associated Health Residents and Students	113	99	88	81	65
Instructional and Administrative Support	794	707	623	606	452
Total Program Expenses	$ 1,491	$ 1,353	$ 1,219	$ 1,156	$ 979
Program Outputs					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	36,600	35,099	34,003	33,775	31,290
Medical Students	21,267	20,567	18,135	18,728	17,289
Nursing Students	33,580	31,380	28,320	27,515	24,870
Associated Health Residents and Students	23,416	22,916	20,946	20,875	18,990
Total Program Outcomes	114,863	109,962	101,404	100,893	92,439

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. VA has affiliation agreements with 107 allopathic and 15 osteopathic medical schools for physician education, and in 40 other health professions represented by affiliation agreements with more than 1,200 colleges and universities. 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,				2010
	Basic	Applied	Development	Total
Medical Research Service	$ 202.9	$ 97.5	$ -	$ 300.4
Rehabilitative Research and Development	6.4	50.6	35.0	92.0
Health Services Research and Development	-	91.0	-	91.0
Cooperative Studies Research Service	34.0	63.6	-	97.6
Medical Research Support	-	581.0		581.0
Total Program Expenses	$ 243.3	$ 883.7	$ 35.0	$ 1,162.0

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	$ 1,020.0

Program Expense Year Ended September 30,				2008
	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 Year Ended September 30,				2007
	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 Year Ended September 30,				2006
	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

In addition, VHA researchers received grants from the National Institutes of Health in the amount of $444 and $195 in other grants during FY 2010. 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 2010, VA's R&D general goal related to stewardship was to ensure that VA's Pre-clinical Research and Clinical Research Program (excluding CSP) 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,					
	2010	2009	2008	2007	2006
Percent of Funded Research Projects Relevant to VA's Health-Care Mission	100.0%	100.0%	100.0%	100.0%	100.0%
Number of Research and Development Projects	2,350	2,193	1,956	2,019	

2,190

VA's Pre-clinical Research and Clinical Research Program's (excluding CSP) 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 maintenance 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,	**2010**	**2009**
General PP&E	$ 5,166	$ 4,851
Heritage Assets	648	540
Total Deferred Maintenance	$ 5,814	$ 5,391

2. Schedule of Budgetary Activity Year Ended September 30, 2010

	Total Budgetary Resources	Obligations Incurred	Spending Authority from Offsetting Collections and Adjustments	Obligated Balance Net, Oct. 1	Obligated Balance Net, Sept. 30	Total Outlays
Veterans Health Administration						
Medical Admin 0152	$ 5,236	$ 4,956	$ 35	$ 832	$ 1,041	$ 4,712
Medical Care 0160	39,058	37,519	380	4,325	4,884	36,581
Medical Facilities 0162	5,225	5,041	27	2,093	2,432	4,674
Information Technology 0167	4,064	3,339	41	834	1,605	2,528
All Other	7,214	3,544	402	2,990	3,514	2,616
Total	$ 60,797	$ 54,399	$ 885	$ 11,074	$ 13,476	$ 51,111
Veterans Benefits Administration						
Compensation, Pension, & Burial Benefits 0102	$ 61,894	$ 48,069	$ -	$ 3,755	$ 3,922	$ 47,901
Readjustment Benefits 0137	9,262	8,986	407	154	416	8,317
Direct Loan Financing 4127	539	386	476	42	15	-63
Guaranteed Loan Financing 4129	5,588	3,406	3,041	11	264	-112
National Service Life Insurance Fund 8132	1,297	1,297	219	1,339	1,269	1,147
All Other	5,278	2,933	1,741	498	502	1,189
Total	$ 83,858	$ 65,077	$ 5,884	$ 5,799	$ 6,388	$ 58,603
National Cemetery Administration						
Total	$ 339	$ 327	$ -	$ 160	$ 199	$ 287
Indirect Administrative Program Costs						
General Operating Expenses 0151	$ 2,881	$ 2,757	$ 690	$ 349	$ 648	$ 1,767
Supply Fund 4537	1,997	1,245	1,019	(680)	(424)	(31)
All Other	711	614	377	21	60	198
Total	$ 5,589	$ 4,616	$ 2,086	$ (310)	$ 284	$ 1,934
Total of all Administrations	$ 150,583	$ 124,419	$ 8,855	$ 16,723	$ 20,347	$ 111,935

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