

VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS



Department of Veterans Affairs

*Audit of VA's Financial
Statements for Fiscal
Years 2015 and 2014*

November 16, 2015
15-01708-36

To Report Suspected Wrongdoing in VA Programs and Operations:

Telephone: 1-800-488-8244

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(Hotline Information: <http://www.va.gov/oig/hotline>)



Audit of VA's Financial Statements for Fiscal Years 2015 and 2014

Why We Did This Audit

We contracted with the independent public accounting firm, CliftonLarsonAllen LLP, to audit VA's fiscal year (FY) 2015 financial statements. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of CliftonLarsonAllen LLP's audit are presented in the attached report. This report can also be found in VA's 2015 Agency Financial Report published on November 16, 2015.

What We Found

CliftonLarsonAllen LLP provided an unmodified opinion on VA's financial statements for FYs 2015 and 2014 and identified four material weaknesses: information technology (IT) security controls; procurement, undelivered orders and reconciliations; purchased care processing and reconciliations; and financial reporting.

CliftonLarsonAllen LLP also identified two significant deficiencies: accrued operating expenses and CFO organizational structure for VHA and VA.

They also reported VA's substantial noncompliance with applicable Federal financial management systems requirements and the United States Standard General Ledger at the transaction level under the Federal Financial Management Improvement Act (FFMIA). They noted improvements were needed in complying

with the Federal Managers' Financial Integrity Act. They cited instances of noncompliance with section 5315, title 38, United States Code, pertaining to the charging of interest and administrative costs, and three possible violations of the Antideficiency Act, with VA in the process of reporting two others.

What We Recommended

CliftonLarsonAllen LLP made recommendations regarding VA's IT security controls, financial management processes, and financial management structure.

CliftonLarsonAllen LLP is responsible for the attached audit report dated November 16, 2015, and the conclusions expressed in it. 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.

Agency Comments

Management expressed a firm commitment to addressing the material weaknesses and significant deficiencies, and the independent auditors will follow up on actions taken during the FY 2016 audit.

A handwritten signature in black ink that reads "Gary K. Abe".

Gary K. Abe
Acting Assistant Inspector General
for Audits and Evaluations

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**For the complete Department of Veterans Affairs
2015 Agency Financial Report,
please go to the following web site:
<http://www.va.gov/budget/report/index.asp>**

Section I

Independent Auditors' Report

- **Memorandum to the Secretary from the Acting Assistant Inspector
General for Audits and Evaluations**
- **Independent Auditors' Report**

Department of Veterans Affairs

Memorandum

Date: November 16, 2015

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

Subj: Audit of VA's Financial Statements for Fiscal Years 2015 and 2014

To: Secretary of Veterans Affairs (00)

1. We contracted with the independent public accounting firm, CliftonLarsonAllen LLP, to audit VA's financial statements as of September 30, 2015 and 2014, and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of CliftonLarsonAllen LLP's audit are presented in the attached report.

2. CliftonLarsonAllen LLP provided an unqualified opinion on VA's fiscal year (FY) 2015 and 2014 financial statements. With respect to internal control, CliftonLarsonAllen LLP identified four material weaknesses.

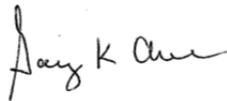
- Information technology security controls, which is a repeat condition
- Procurement, undelivered orders, and reconciliations, which is a new condition
- Purchased care processing and reconciliations, which is a new condition
- Financial reporting, which was elevated from a significant deficiency.

3. CliftonLarsonAllen LLP also identified two significant deficiencies, accrued operating expenses, which is a repeat condition, and CFO organizational structure for VHA and VA, which is a new condition.

4. They also reported the following conditions with respect to noncompliance with laws and regulations:

- Substantial noncompliance with applicable Federal financial management systems requirements and the United States Standard General Ledger at the transaction level under the Federal Financial Management Improvement Act (FFMIA) of 1996

- Improvements needed in complying with the Federal Managers' Financial Integrity Act
 - Instances of non-compliance with section 5315, title 38, United States Code, pertaining to the charging of interest and administrative costs
 - Three possible violations of the Antideficiency Act that VA is investigating, two of which involve the combination of minor construction projects above the \$10 million ceiling, beyond which Congressional approval for use of funds is required. The other investigation involves obligation of a contract in the wrong fund. VA is in the process of reporting two other violations that also involve the combination of minor construction projects.
 - Less than full compliance with IPERA for FY 2014 as reported by the Office of Inspector General.
5. CliftonLarsonAllen LLP is responsible for the attached audit report dated November 16, 2015, and the conclusions expressed in the report. 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 and compliance findings and evaluate the adequacy of corrective actions taken during the FY 2016 audit of VA's financial statements.



Gary K. Abe

Attachment

INDEPENDENT AUDITORS' REPORT

To the Secretary
And Deputy Inspector General
Department of Veterans Affairs

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Department of Veterans Affairs (VA), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources, for the years then ended, and the related notes to the consolidated financial statements (financial statements).

Management's Responsibility for the Financial Statements

VA management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the U.S.; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 15-02). Those standards and OMB Bulletin 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements

INDEPENDENT AUDITORS' REPORT (Continued)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Department of Veterans Affairs as of September 30, 2015 and 2014, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the U.S.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the U.S. issued by the Federal Accounting Standards Advisory Board (FASAB) require that VA's Management Discussion and Analysis (MD&A), other Required Supplementary Information (RSI), and Required Supplementary Stewardship Information (RSSI), be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by FASAB, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and other RSI in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. All other sections exclusive of the financial statements, MD&A, other RSI, and RSSI as listed in the table of contents of the Agency Financial Report is presented for purposes of additional analysis and is not a required part of the financial statements, RSI, or RSSI. This information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Report on Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered VA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of VA's internal control or on

INDEPENDENT AUDITORS' REPORT (Continued)

management's assertion on internal control included in the MD&A. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore material weaknesses or significant deficiencies may exist that were not identified. However, we identified certain deficiencies in internal control, described below and in Exhibits A and B, respectively, that we consider to be material weaknesses and 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 VA's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described below and in Exhibit A to be material weaknesses.

Information Technology Security Controls

VA continues to have control weaknesses in Configuration Management, Access Controls, Security Management, and Contingency Planning.

Procurement, Undelivered Orders and Reconciliations

VA does not perform a consolidated and centralized reconciliation for procurement obligations recorded in its Integrated Funds Distribution, Control Activity Point, Accounting and Procurement (IFCAP) system with its general ledger system. In addition, VA lacks adequate controls surrounding its extensive use of miscellaneous obligating documents, and other pervasive and long standing procurement related issues continue to exist.

Purchased Care Processing and Reconciliations

The Veterans Health Administration (VHA) had weaknesses in its design and implementation of controls over the purchased care program, from transaction authorization to liquidation of unfulfilled authorizations.

Financial Reporting

Due to its age and limited functionality, VA's legacy Financial Management System (FMS) continues to require extensive manipulations, journal entries, manual processes, and reconciliations in order for VA to produce a set of auditable financial statements.

A significant deficiency is a deficiency, or 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 and in Exhibit B to be significant deficiencies.

INDEPENDENT AUDITORS' REPORT (Continued)

Accrued Operating Expenses

VA does not have an adequate process to subsequently validate the reasonableness of its accrued operating expenses.

CFO Organizational Structure for VHA and VA

VA has a long history of decentralization in its Chief Financial Officer (CFO) organizational structure, which has led to challenges with entity-level accounting and financial management controls.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether VA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements.

The results of our tests, exclusive of those required by the Federal Financial Management Improvement Act of 1996 (FFMIA) as discussed below, disclosed instances of noncompliance and other matters, described below and in Exhibit C, that are required to be reported in accordance with *Government Auditing Standards*.

Noncompliance with Federal Managers' Financial Integrity Act (FMFIA)

VA did not provide adequate documentation to support its Section II and IV assurance statements, and its OMB Circular A-123 Appendix A testing was insufficient to address financial reporting risks of material misstatements.

Noncompliance with 38 USC 5315

The Veterans Benefit Administration (VBA) did not charge interest or recover administrative costs on delinquent payments from veterans related to certain receivables for Compensation, Pension, and Education.

Actual and Potential Violations of the Antideficiency Act

VA is engaged in investigating three possible violations of the Antideficiency Act, 31 U.S.C. 1341(a), and is in the process of reporting two other violations.

Noncompliance with Improper Payments Elimination and Recovery Act

On May 14, 2015, the VA Office of Inspector General reported that VA did not fully comply in FY 2014 with the Improper Payments Elimination and Recovery Act.

Systems Compliance with FFMIA Requirements

Under FFMIA, we are required to report whether the financial management systems used by VA substantially comply with the FFMIA Section 803(a) requirements. To meet this requirement, we performed tests of compliance with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Standard General Ledger (USSGL) at the transaction level. However, providing an opinion on compliance

INDEPENDENT AUDITORS' REPORT (Continued)

with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. Except for matters described in Exhibit C, where VA did not substantially comply with applicable Federal financial management systems requirements and the USSGL at the transaction level, the results of our tests of FFMIA disclosed no instances in which VA's financial management systems did not substantially comply with applicable Federal accounting standards.

Management's Responsibility for Internal Control and Compliance

VA management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under the FMFIA, (2) providing a statement of assurance on the overall effectiveness of internal control over financial reporting, (3) ensuring VA's financial management systems are in substantial compliance with FFMIA requirements, and (4) ensuring compliance with other applicable laws, regulations, contracts, and grant agreements.

Auditors' Responsibilities

We are responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, (2) testing whether VA's financial management systems substantially comply with the FFMIA requirements referred to above, and (3) testing compliance with certain provisions of laws, regulations, contracts and grant agreements.

We did not evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws, regulations, contracts and grant agreements applicable to VA. We limited our tests of compliance to certain provisions of laws, regulations, contracts and grant agreements that have a direct effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. Also, our work on FFMIA would not necessarily disclose all instances of noncompliance with FFMIA requirements.

Management's Response to Findings

Management has presented a response to the findings identified in our report. We did not audit VA's response and, accordingly, we express no opinion on it.

INDEPENDENT AUDITORS' REPORT (Continued)

Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of VA's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 12, 2014. The status of prior year findings is presented in Exhibit D.

Purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters sections of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of VA's internal control or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering VA's internal control and compliance. Accordingly, these reports are not suitable for any other purpose.

CLIFTONLARSONALLEN LLP

A handwritten signature in cursive script that reads "Clifton Larson Allen LLP".

Calverton, Maryland
November 16, 2015

EXHIBIT A
Material Weakness

1. Information Technology Security Controls (Repeat Condition)

VA relies extensively on Information Technology (IT) system controls to initiate, authorize, record, process, summarize, and report financial transactions in the preparation of its financial statements. 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. Our review of IT controls covered general and selected business process application controls across 24 selected VA medical centers, regional offices, and data centers. As noted in prior years' audits, VA continues to have weaknesses in Configuration Management, Access Controls, Security Management, and Contingency Planning Controls designed to protect mission-critical systems from unauthorized access, alteration, or destruction.

Our current year audit identified security weaknesses that were corrected in some locations and for certain control activities. Examples of VA improvements in its IT control environment include continued implementation of a Continuous Readiness in Information Security Program to ensure continuous monitoring year-round. As part of the Continuous Readiness in Information Security Program initiative, we noted continued improvements related to reducing the number of individuals with outdated background investigations, improving data center web application security, and ensuring consistent compliance with *United States Government Configuration Baseline* standards. In addition, VA has continued predictive scanning of its networks allowing for the identification of vulnerabilities across field offices. Furthermore, VA has continued the implementation of an IT Governance, Risk and Compliance (GRC) Tool to improve the process for assessing, authorizing, and monitoring the security posture of the Agency.

The aforementioned controls require time to mature and show evidence of their effectiveness. Accordingly, we continue to see information system security deficiencies similar in type and risk level to our findings in prior years and an overall inconsistent implementation of the security program. Moving forward, VA needs to ensure a proven process is in place across the Agency. VA also needs to continue to address control deficiencies that exist in other areas across all VA locations.

We continue to find control deficiencies in Configuration Management, Access Controls, Security Management, and Contingency Planning. Most importantly, we continue to identify significant technical weaknesses in databases, servers, and network devices that support transmitting financial and sensitive information between VA's medical centers, regional offices, and data centers. This is as a result of an inconsistent application of vendor patches and outdated system software that could jeopardize the data integrity and confidentiality of VA's financial and sensitive information. VA has made progress in deploying current patches; however, older patches and previously identified vulnerabilities related to configuration weaknesses and outdated system software persist on its networks. Even though VA has made some progress in these areas, more progress must be made to improve deployment of patches, system upgrades, and configuration management to mitigate security vulnerabilities and to implement a centralized process that is consistent across all field offices. In addition, VA continues to operate key financial management systems using outdated technology that hinders mitigation of certain vulnerabilities.

Many of these weaknesses can be attributed to an inconsistent enforcement of an agency-wide information security program across the enterprise and ineffective communication between VA management and the individual field offices. Therefore, VA needs to improve its performance

EXHIBIT A

Material Weakness

monitoring to ensure controls are operating as intended at all facilities and communicate security deficiencies to the appropriate personnel, who take responsibility for implementing corrective actions and ensuring those actions are taken. Our assessment of the general and application controls of VA's key IT infrastructure and financial systems identified the following conditions:

Conditions:

Configuration Management

- Systems including key databases supporting financial applications were not timely patched or securely configured to mitigate known and unknown information security vulnerabilities. The deployment of vendor patches and system upgrades to mitigate the vulnerabilities was decentralized, inconsistent, and not effective across all VA facilities. For example, we noted large variances in the number of critical and high vulnerabilities across all sites. Furthermore, VA did not have a complete inventory of the devices connected to its networks and thus we could not verify that all of the Department's computers undergo monitoring to ensure they remain securely configured, free of technical vulnerabilities, and adequately patched.
- Key financial management systems use outdated technology that hinders mitigation of certain vulnerabilities.
- VA needs to strengthen its methodologies for monitoring medical devices and ensuring they are properly segregated from other networks.
- Several VA organizations shared the same local network at some medical centers and data centers; however, the systems were not under the common control of the local site. Specifically, some non-Office of Information Technology (OIT) controlled networks had significant critical or high known vulnerabilities that weaken the overall security posture of the local sites.
- VA has not fully documented or approved security baseline deviations against Defense Information Systems Agency's - Security Technical Implementation Guide for various system platforms. In addition, existing security baselines have not been fully reviewed or updated to ensure that computer platforms comply with approved standards.
- Change management policies and procedures for authorizing, testing, and approving system changes were not consistently implemented for networks and mission-critical systems.
- An agency-wide process has not been implemented for identifying and removing unauthorized application software on Agency systems. VA is working on implementing an enterprise wide continuous monitoring solution for unauthorized software.

Access Controls

- Password standards were not consistently implemented and enforced across multiple VA systems, including the network domain, databases, and key financial applications. In addition, multi-factor authentication for remote and local system access had not been fully implemented across the agency.
- Inconsistent reviews of networks and financial application user access resulted in numerous generic, system, terminated, and inactive user accounts that were not removed from the system. In addition, inconsistent exit clearance processes for separated employees contributed to the increase in the number of inactive user accounts.

EXHIBIT A

Material Weakness

- Proper completion of user access requests was not consistently performed to eliminate conflicting roles and enforce principles of least system privilege.
- Monitoring of access for individuals with elevated application privileges within a major application's production environment was lacking.
- Identification, notification, and remediation of security incidents were not consistently implemented to ensure incidents were resolved timely. In addition, network security event logs, which provide audit trails, were not consistently maintained or reviewed across all facilities.

Security Management

- Security management documentation including risk assessments, system security plans, and privacy impact assessments were not completed properly and did not reflect the current system environment. In addition, security controls were not effectively monitored and adequately documented, and system assessments and authorizations were not performed in accordance with Federal standards.
- Key financial application system security plans had not been updated to reflect current information security controls in accordance with National Institute of Standards and Technology (NIST) Special Publication 800-53 "*Security and Privacy Controls for Federal Information Systems and Organizations*, Revision 4." This version of the NIST Special Publication was updated on February 19, 2014, with an April 1, 2014, implementation deadline for executive agencies.
- Background reinvestigations were not performed timely and tracked effectively. In addition, personnel were not receiving the proper levels of investigation for their position sensitivity levels.
- Plans of Action and Milestones (POA&Ms) were not completed by their milestone dates and were not updated to reflect changes to milestones. POA&M closures were not supported with adequate documentation. Additionally, POA&Ms did not contain sufficient detail to describe the control weaknesses or the corrective actions taken to close the findings. Furthermore, weaknesses identified, as part of security control assessments were not entered within the GRC Tool in a timely manner and corresponding POA&Ms were not developed timely to track corrective actions or remediation.

Contingency Planning

- Backup tapes were not encrypted prior to sending to offsite storage at selected facilities and data centers.
- Contingency plans did not reflect the current operating environment. Specifically, contingency plans had not been updated to reflect changes in system boundaries, roles and responsibilities, and did not clearly identify alternate processing and storage sites.
- Contingency plans were not tested for the capability to failover to alternate processing sites.

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."

EXHIBIT A

Material Weakness

The Federal Information Security Management Act of 2002 (FISMA), as amended,¹ 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 for 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:

Dispersed locations, continued reorganization, and diversity of applications have impacted facilities' and management's ability to consistently remediate IT security deficiencies across the enterprise. For example, VA's complex and disjointed financial system architecture has resulted in a lack of common system security controls and inconsistent maintenance of IT mission-critical systems. Consequently, VA continues to be challenged with consistent and proactive enforcement of established policies and procedures throughout its geographically dispersed portfolio of legacy applications and newly implemented systems. The continued reorganization of components within VA, such as the centralization of data centers and the shift of control from the medical centers to regional levels, has caused delays in communicating established policies with personnel throughout VA. In addition, VA lacks an effective and consistent corrective action process for addressing and monitoring known internal security vulnerabilities on databases and network infrastructures.

¹ The Federal Information Security Modernization Act of 2014 - Amends the FISMA Act of 2002 to: (1) reestablish the oversight authority of the Director of the Office of Management and Budget (OMB) with respect to agency information security policies and practices, and (2) set forth authority for the Secretary of Homeland Security (DHS) to administer the implementation of such policies and practices for information systems.

EXHIBIT A

Material Weakness

Effect:

By not effectively 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. Further, key financial management systems use outdated technology that hinders mitigation of certain vulnerabilities.

Recommendations:

The Assistant Secretary for the Office of 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:

1. Implement a process to ensure all VA organizations are included in the vulnerability management program and implement improved mechanisms to continuously identify and remediate security deficiencies on VA's network infrastructure, database platforms, and Web application servers.
2. Strengthen patch and vulnerability management program to address security deficiencies identified during our assessments of VA's database platforms and network infrastructure.
3. Develop and implement a strategic plan to address outdated technology that is no longer supported by the vendor.
4. Strengthen processes and controls to ensure medical devices are appropriately protected from other networks.
5. Consolidate the security responsibilities for non-OIT systems under a common control for each site and ensure vulnerabilities are remediated in a timely manner.
6. Maintain up-to-date, complete, accurate, and readily available baseline configurations and ensure that all baselines are appropriately implemented, tested, and checked for compliance with established VA security standards.
7. Implement improved change control procedures to ensure the consistent testing and approval of system changes for VA financial applications and networks.
8. Fully develop a comprehensive list of approved and unapproved software and implement continuous monitoring processes to identify and prevent the use of unauthorized software on agency devices.
9. Implement improved processes to ensure compliance with VA policy for password and security configuration baselines on domain controls, operating systems, databases, applications, and network devices.
10. Fully implement two-factor authentication for remote and local system access throughout the agency.
11. Implement improved processes for the periodic review of network and financial applications to identify and remove generic and inactive accounts on systems and networks. Recertify that access remains appropriate and is restricted to necessary personnel.
12. Implement improved processes to ensure the proper completion and retention of user access request forms that enforce principles of least system privilege, prior to granting system access.
13. Implement improved processes to ensure the proper completion of exit checklists for separated employees to verify that VA property, including access badges, is returned.
14. Implement access monitoring within production environments for individuals with elevated system privileges.

EXHIBIT A
Material Weakness

15. Strengthen agency-wide incident response procedures to ensure timely notification and resolution of computer security incidents in accordance with VA standards. In addition, continue to develop and document a system of metrics that can objectively measure organizational incident response capabilities, such as timeframes for remediation and closure of security events, with an emphasis on higher risk security-related incidents.
16. Implement a process for monitoring system audit logs for unauthorized or unusual activities. Implement procedures for analyzing audit logs and ensuring such logs are maintained in accordance with VA 6500 policy.
17. Implement an improved continuous monitoring program in accordance with the NIST Risk Management Framework; specifically regarding evaluating the effectiveness of security controls and ensuring systems are authorized to operate prior to connecting to such systems VA networks.
18. Implement improved processes for reviewing and updating key security documentation, including risk assessments, system security plans, and privacy impact assessments on an annual basis. Such updates will ensure all required information is included and accurately reflects the current environment, new security risks, and applicable federal standards.
19. Strengthen processes to ensure appropriate levels of background investigations are completed for all applicable VA employees and contractors in a timely manner.
20. Strengthen processes to ensure local facilities track reinvestigations for employees and contractors in high-risk positions and the Security Investigation Center initiates all reinvestigations in a timely manner. Additionally, implement processes for local facilities to accurately and timely report any changes in position sensitivity levels. Furthermore, local facilities should ensure position descriptions are appropriately marked for position risk and sensitivity levels in accordance with the Office of Personnel Management Position Designation Automation Tool.
21. Strengthen processes to ensure that POA&Ms include sufficient detail to describe the control weaknesses, corrective actions, target completion dates, and milestone progress. Additionally, implement improved processes to ensure closed POA&Ms are adequately supported with appropriate documentation.
22. Implement improved processes to ensure that all identified weaknesses are incorporated into the GRC Tool timely and corresponding POA&Ms are developed to track corrective actions and remediation.
23. Implement processes to ensure the encryption of backup data prior to transferring storage media offsite.
24. Strengthen processes for periodic reviews and updates of contingency plans to ensure all required information is included and plans accurately represent the current environment and critical components.
25. Implement improved processes for the testing of contingency plans and failover capabilities for financial applications and general support systems to ensure that critical components can be recovered at an alternate site in the event of a system failure or disaster.

EXHIBIT A
Material Weakness

2. Procurement, Undelivered Orders and Reconciliations

Background:

VA obligates its budgetary resources when it enters into a binding legal agreement, such as a contract with a third party, or through an estimation process using VA Form 1358, *Obligation or Change in Obligation* (referred to as “1358s” or “miscellaneous obligations”). After the receipt of goods and services or at the end of the agreement period, any previously obligated but undisbursed amounts, also known as undelivered orders (UDOs), should be de-obligated, enabling the unused funds to potentially become available for other agency program needs. When the unneeded obligations continue to remain on VA’s books, they are considered to be inactive and invalid obligations.

Condition:

VA had weaknesses in the design and implementation of controls over procurement processes related to VA’s financial reporting, from transaction inception to liquidation of unused obligations. The key elements of the control deficiencies are as follows:

A. Pervasive and Long Standing Procurement Related Issues Affecting Financial Reporting

We observed instances of the following across VHA from our sample testing that affect the accuracy of financial reporting:

- *Untimely liquidation of inactive UDOs* – Delays ranged from nine months to four years and six months.
- *Untimely recording of contracts or modifications into the general ledger system (FMS)* – Delays ranged from approximately one month to over four months.
- *Recording of obligations prior to contract execution* – Obligations were recorded in FMS up to approximately eight months prior to execution of the contract amendments.
- *Over-obligation of funds* – Recorded obligations exceeded the contract or purchase order amounts.
- *Lack of support for 1358 obligations* – Amounts obligated using 1358s were not supported.
- *Proper procurement procedures were not followed in obtaining goods or services* – We noted a variety of exceptions.
- *Obligations were recorded months or years after receiving goods or services* – In addition, the subsequent contract ratification caused further delay in payment to the vendors ranging from several weeks up to two years.

B. Lack of Control Surrounding the Extensive Use of 1358s

As previously reported by the Government Accountability Office (GAO), VA has used 1358s for over 60 years and utilizes them for the procurement of goods and services extensively. As of September 30, 2015, VA’s use of 1358s exceeded \$10 billion. VA allows 23 different categories of use, and they are integral to the operation of some large VA programs. In some cases, 1358s bypass conventional contracting controls by design in order to support program circumstances or needs. However, we noted several weaknesses in the extensive use of 1358s. Frequently, these obligations in VA’s general ledger were based on estimates that were difficult or not possible to trace to the underlying transactions or were not based on a consistent estimation process. They

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were used when contracts and interagency agreements would have provided stronger internal control through the oversight of contracting officers. Further, 1358 transactions were not closely monitored and validated by management to ensure obligations incurred and accrued expenses were not overstated. These estimates for 1358s did not follow a consistent methodology, were not monitored for their reasonableness throughout the year and adjusted in a timely manner based on actual spending patterns, and were not reconciled to source documentation or FMS.

C. Reconciliations

VA utilizes the IFCAP system to initiate and authorize requests for goods and services, monitor status of funds, establish obligations, confirm receipt of goods and services, and record vendor payments. In addition, VA also utilizes the Electronic Contract Management System (eCMS) to maintain procurement documentation. As reported in previous years, VA does not perform a complete reconciliation of all outstanding obligations and expenditures between IFCAP, eCMS, and FMS at the transaction level. Not performing periodic cumulative reconciliations between these subsidiary systems and FMS increases the risk that all activities are not accurately reflected in the financial records, and ultimately, in the financial statements.

Criteria:

The FMFIA requires agencies to implement controls that ensure obligations and costs are in compliance with applicable laws and that revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports. According to 31 U.S.C. 1501 (a), an amount shall be recorded an obligation of the United States Government only when supported by documentary evidence of a binding agreement between an agency and another person.

Cause:

These conditions were due to a highly decentralized organization accompanied by the lack of effective oversight and monitoring controls, system limitations, policy weaknesses, and lack of adequate training for personnel involved in the financial reporting processes. In addition, communication between business lines and administrative offices within VA did not always take place in a timely manner.

Effect:

Material misstatements of obligations incurred and UDOs may occur and not be detected timely as a result of these control weaknesses.

Recommendations:

We recommend that the VA Interim Assistant Secretary for Management/Interim Chief Financial Officer:

1. In coordination with appropriate program officials, reassess the use of 1358s to:
 - Ensure their use is extremely limited and complies with law, and responsibility for their use is properly delegated to appropriate officials as it is similar to the financial responsibility associated with an executed contract.

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- Provide guidance on appropriate estimation methodologies and supporting documentation.
- 2. Periodically monitor the extent and nature of 1358s used throughout VA and as appropriate, require the automatic liquidation of outstanding 1358 obligations within a reasonable timeframe.
- 3. Perform monthly reconciliations of obligations and expenditures recorded in IFCAP, eCMS, and FMS for all open documents to ensure the accounting information is valid and proper. Develop a plan to overcome system limitations to the extent possible.
- 4. Provide training to 1358 preparers on the use of contracts and interagency agreements in place of 1358s.

We recommend that the Under Secretary for Health in coordination with the Principal Executive Director for Office of Acquisition, Logistics, and Construction and Interim Assistant Secretary for Management:

- 5. Monitor adherence to key controls over the recording of procurement transactions in the financial systems.
- 6. Monitor all open projects in IFCAP to determine the validity of the outstanding UDOs.

3. Purchased Care Processing and Reconciliations

Background:

VHA purchases medical services for veterans from community health care providers under the Purchased Care Program (also known as the “Non-VA Medical Care Program” and “Care in the Community Program”). Approximately \$7.6 billion was budgeted for FY 2015. Additionally, VA hired two contractors in September 2013 – TriWest Healthcare Alliance Corporation (TriWest) and Health Net Federal Services, LLC (Health Net) – to establish the Patient Centered Community Care (PC3) program. Under PC3, these contractors were to establish a network of community providers and coordinate care between veterans and the network. The Contractors pay the providers directly for services and then bill VA at rates agreed-upon per the contracts, plus an administrative fee.

In August 2014, Congress passed the Veterans Access, Choice, and Accountability Act of 2014 (Choice Act), thereby establishing the Veterans Choice Program (Choice). Under Choice, veterans who either live 40 miles or more from the nearest VA medical facility or have clinical waiting period for needed care shorter than VA’s wait-time goals, are eligible to receive care. To implement Choice, VA modified the existing PC3 contracts to include requirements imposed by the Choice Act. The primary duties of the Contractors are to maintain a network of Non-VA providers, coordinate with veterans eligible for Choice to schedule appointments with these providers, maintain a call center, and distribute Choice Cards, which inform veterans that they may be eligible for Choice.

Section 106 of the Choice Act transferred authority to pay for non-VA care to VHA’s Chief Business Office (CBO). VHA uses the Fee Basis Claims System (FBCS) to authorize, process

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and pay for purchased care. FBCS was utilized in a decentralized manner in that each Medical Center or Veterans Integrated Service Network (VISN) had its own instance of FBCS.

Conditions:

VHA had weaknesses in its design and implementation of controls over the Purchased Care Program, from transaction authorization to liquidation of unfulfilled authorizations. The key elements of the control deficiencies are as follows:

A. Manual Nature of Transaction Processing for Purchased Care

We noted the following deficiencies with respect to the manual nature of purchased care transactions:

- Purchased care authorizations were manually entered into FBCS upon medical approval in another system, the Veterans Health Information Systems and Technology Architecture (VistA). The lack of transaction interface and integration between VistA and FBCS created inefficiency and increased the risk for error.
- Costs for purchased care authorizations were manually estimated and entered into FBCS, leading to inconsistencies in the application of estimation methodologies. The Outpatient Cost Estimation Tool resided in each localized FBCS database, allowing for a greater degree of cost deviation and implementation variance among the medical centers.
- Necessary adjustments to initial cost estimates were not performed in a timely manner to ensure greater accuracy in the reporting of budgetary resources status.
- Centralized, consolidated, and consistent monitoring of cost estimate accuracy, transaction recording, and timely liquidation of expired authorizations was not performed.
- A “look-back” analysis to validate the reasonableness of cost estimation was not conducted.
- Additionally, for the Choice program, the process for gathering and compiling veteran appointment and authorization data was provided to VHA by the Contractors via a weekly Excel spreadsheet, which was manually intensive and increased the risk of error. The lists of veterans provided by the Contractors varied from week to week, and the process required to register the veterans based on those lists also relied on manual input, which was inefficient, redundant, and left room for error.

B. Financial Transactions Recorded in FBCS Not Reconciled with FMS

Purchased care authorizations were recorded in FBCS, exceeding \$5.3 billion as of September 30, 2015. However, VHA used another redundant and manual process to estimate purchased care related costs in IFCAP, which were then transmitted as obligations to FMS. For the majority of obligations, amounts recorded in VA’s general ledger could not be directly tied to individual purchased care authorizations in FBCS. Centralized and complete reconciliations were not performed for amounts recorded in FBCS, IFCAP, and FMS for obligations and disbursements.

C. Contractor Invoice Not Validated Prior to Payment

According to VHA’s contracts with TriWest and Health Net, these contractors were to pay non-VA providers directly for services provided to veterans. The contractors then billed VHA for

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those services, based on contract rates. Evidence of supporting documentation, such as medical records from the non-VA providers, was not required prior to payment to the contractors. VHA received an invoice from the contractors and reimbursed them based on the amounts billed. Contractor invoices were sometimes paid without VHA validating whether the rates, patients receiving services (including those with or without third party insurance), and registration fees were accurate.

D. Inadequate Contractor Oversight when Key Financial Management Controls Were Heavily Relied Upon

VHA placed a high degree of reliance on self-certifications by TriWest and Health Net regarding their adherence to contract terms. VHA did not have procedures in place to verify that the contractors' key processing controls related to services provided to veterans, appointment scheduling, reimbursements, and billing were effectively and efficiently designed and implemented. CBO performed only desk reviews of contractor monthly reports and invoices. As an alternative, contractors were also not required to undergo an independent examination of their controls, such as one performed in accordance with Statement on Standards for Attestation Engagements, No. 16, *Reporting on Controls at a Service Organization*, published by the American Institute of Certified Public Accountants.

Criteria:

Under OMB Circular A-123, *Management's Responsibility for Internal Control*, management is 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. Appendix D of this circular, *Compliance with the Federal Financial Management Improvement Act of 1996*, defines financial reporting objectives to include reliable, timely, and accurate financial information for managing day-to-day operations and reporting on an agency's financial condition, and maintaining internal control over financial reporting. Effective and efficient operations objectives are defined as including the maintaining of cost effective financial operations.

Cause:

The Choice Act required the Veterans Choice Program to be implemented in a relatively short time frame, from passage of the Choice Act in August 2014 to program implementation in November 2014. In addition, all Purchased Care programs were consolidated under CBO in FY 2015 pursuant to the legislation. As such, CBO did not have adequate time to implement efficient and effective procedures, both manual and system, and ensure proper controls were in place. Many of the processes are consequently performed manually by CBO personnel. In addition, the manual processes are exacerbated by system limitations. For example, since each medical center has a separate instance of VistA, a veteran registered in one medical center's VistA does not appear in another's instance, which results in manual re-entry.

CBO had not developed and disseminated standardized and comprehensive policies and procedures for medical centers to follow with respect to purchased care processing, accounting, budgeting, and internal control functions. CBO also did not have adequate policies and procedures for its own monitoring activities. CBOs activities were not integrated with VA and VHA CFO responsibilities under the CFO Act to develop and maintain integrated accounting and financial management systems; oversee recruitment, selection, and training of personnel to carry out agency financial management functions; and direct, manage, and provide policy

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guidance and oversight of all agency financial management personnel, activities, and operations. The VA CFO and VHA CFO were not actively involved in CBO's implementation of the Purchased Care programs.

Significant system limitations also hindered effective and efficient operations and controls for the Purchased Care programs. For example, FBCS generally does not directly interface with IFCAP and FMS.

Effect:

These conditions could cause balances for obligations, expenses, and UDOs, as reported in the financial statements, to be misstated. CBO also may not be able to adequately assess its budgetary needs for the various Purchased Care programs.

Recommendations:

We recommend that the Under Secretary for Health:

1. Centralize, or at a minimum, integrate all purchased care accounting and financial management functions with the VHA CFO's responsibilities to support good communication, policy development and implementation, and monitoring.
2. Work with the VA CFO and VA Chief Information Officer to ensure that implementation and deployment of the Healthcare Claims Processing System (HCPS), the new system to replace FBCS, eliminates manual entries, enforces consistent cost estimation, and monitors timely liquidation of expired authorizations. Functionality should include:
 - Linkage to the veterans' registration information from the enrollment system via the look-up and import functions to eliminate duplicate manual registration. Such information should also include the veterans' third party insurance information.
 - Cost estimation for the authorization that is based on agreed upon or standard rates by category of care and by geographic location when the initial authorization is issued by VA.
 - Ability for non-VA providers' feedback for recommended care and procedures to be performed on the veteran and VA's approval or rejection for the recommended care upon review.
 - Controls to ensure adjustment of the authorization when needed.
 - Notification by non-VA providers of appointment fulfillment and actual procedures performed to update the costs for the purchased care.
 - Drop down menu for how long the authorization is good and automatic liquidation of authorization the day after it expires.
 - Two way interface with FMS from the inception of the purchased care authorization to payment processing and support for monthly centralized, consolidated, complete, and timely obligation and disbursement reconciliations between FMS and HCPS, once implemented.
3. Until HCPS is fully implemented, develop policies and procedures to ensure authorization estimates are based on contractual rates and consistently applied, expired authorization estimates are liquidated from both FBCS and IFCAP, claims submitted by TriWest and Health Net are approved for payment based on agreed-upon rates, and that transaction level details in FBCS, IFCAP, and FMS are reconciled monthly.

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4. Perform periodic look-back analyses on cost estimates and obligation balances to ensure accuracy of financial reporting and to maximize budgetary resources.
5. Implement mandatory training for VHA staff involved in the Purchased Care programs to efficiently standardize the programmatic and accounting procedures.
6. Require that Health Net and TriWest undergo an independent examination of their processing controls. In the meantime, CBO should implement its own monitoring controls to avoid over-reliance on contractor-provided data.
7. Develop and implement controls to ensure payments to TriWest and Health Net are made in accordance with applicable laws and contract provisions, and in a timely manner to the non-VA providers in order to ensure veterans receive the necessary quality of care.
8. Obtain the tools necessary to perform comprehensive audits over Purchased Care claims for accuracy and share results with all relevant parties.

4. Financial Reporting

Condition:

The FMS is VA's legacy core financial management and general ledger system. Due to FMS' limited functionality to meet current financial management and reporting needs, VA utilizes another application, the Management Information Exchange (MinX) system, to consolidate general ledger activities from FMS and create financial statements for external reporting. However, this process still requires significant manual intervention and workarounds to ensure accurate financial reporting. These limitations increase the risk of errors in the financial reporting process and become more apparent over time as additional reporting requirements accrue. Although VA has been working diligently to identify root causes and has made necessary improvements to address the various financial reporting, business process, and FMS limitation issues in FY 2015, more improvement is needed. Through FY 2015, VA's financial reporting issues continued to exist in the following areas:

A. Over Reliance and Use of Journal Vouchers:

VA makes a substantial number of adjustments, called journal vouchers (JVs), to its accounts in order to prepare VA's financial statements. Most of these adjustments are due to FMS limitations and are "top-side" entries into MinX. Top-side entries are those entries that VA makes directly into MinX when consolidating and preparing VA's financial statements. These entries do not flow through VA's general or subsidiary ledgers and are not subject to normal financial system controls. Although legitimate reasons exist for top-side entries, their overuse is indicative of system or control problems.

The substantial use of top-side entries in MinX, in particular by the VBA, which recorded approximately 70 percent of the overall JVs' absolute value, creates a complicated and labor-intensive financial reporting environment. For example, each accounting period in MinX is independent, which requires that numerous JVs, manual reconciliations, and analyses be

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reperformed and reentered to produce VA's quarterly financial statements and trial balances for the U.S. Department of the Treasury (Treasury). Additionally, JVs were often posted with limited descriptions and supporting documentation. We also noted that VA administrations and business lines did not use JV categories and entry descriptions consistently. JVs were used primarily for the following reasons:

- To fix inaccuracies in the budgetary accounts due to limitations in the FMS Budget Execution Module and to properly reflect balances in the SF-133, *Report On Budget Execution And Budgetary Resources*.
- To correct errors made in FMS and to clear identified abnormal balances that had remained uncorrected and unresolved for years.
- To adjust for Federal/Non-Federal and trading partner reclassifications.

Use of manual adjustments such as top-side entries increases the risk of introducing errors into financial reporting and requires a high level of review and analysis to mitigate the risk of material errors in the financial statements.

B. Inadequate Flux Analyses for Financial Reporting

A key control in the financial reporting process is the quarterly review of financial statements to identify trends and fluctuations in financial statement balances using analytical procedures. Analytical procedures validate the relationship among accounts and financial statement line items, as well as verify management's expectations. VA's internal controls over financial reporting require a quarterly analysis of the financial statements by each of the CFO at the Administration levels, as well as an overall VA consolidated level analysis to be performed by the central office. Even though the VA CFO issued guidance and provided training in FY 2015 to Administration staff on preparing and properly documenting explanations for variances, continued improvement is needed. Throughout FY 2015, numerous gaps were identified in the analytical process as follows:

- Appropriate comparative analysis over accounts in the financial statements was still lacking. There were no management documented expectations as to anticipated account performance at either the consolidated level or business line level that could then be compared to actual results in the financial statements.
- Management provided an incomplete financial statement analysis and did not have a centralized process to perform a quality control review to ensure that the analysis provided by its various administrations was reasonable and validated.
- Amounts at the business line level fluctuation analysis did not tie back to the consolidated and consolidating financial statements.
- Explanations provided by the business lines for large variances were inconsistent with the dollar value of the changes. Explanations either exceeded or did not sufficiently cover the amount of the fluctuation by significant amounts. This issue was more prevalent in the VBA analytics.

C. Budgetary to Proprietary Analyses Contained Material Differences

VA instituted a process to perform "Budgetary to Proprietary" analysis by Treasury Fund Symbol to determine and fix out of balance accounts during FY 2015. This analysis compares budgetary accounts with closely related proprietary accounts to ensure consistency and accuracy. The exercise was incomplete as some of the tie points with significant differences were either under

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review by VBA and VHA, or awaiting response from other business lines. Necessary research to determine what caused those significant differences and resolve them was not completed at September 30, 2015.

D. Significant Abnormal Balances Reported

An abnormal balance is an account balance that shows a debit balance when it should be a credit balance and vice versa. VA sent out a data call request to the administrations with instructions on how to perform the abnormal balance review for the third quarter of FY 2015. The e-mail requested explanations for abnormal balances over \$10 million. Significant abnormal balances at the fund level and gaps in the implementation by the administrations were noted. For significant abnormal balances identified at the fund level from the VBA and VHA business lines, no explanations were provided and no research was conducted to promptly resolve those abnormal balances. Many of those balances have remained in the accounts for years.

E. Issues with Intra-governmental Agreements and Reconciliations

VA does not have a centralized repository for all active intra- and inter-agency agreements. As a result,

- Accounts involving intra-governmental transactions, such as the Unobligated Balance Brought Forward, or Spending Authority from Offsetting Collections recorded in the Statement of Budgetary Resources (SBR), were not complete and accurate.
- Management may not be able to properly identify and support intra-governmental transactions and balances with trading partners and may be required to post adjustments to be consistent with trading partner balances. Throughout FY 2015, management recorded significant JVs under the “Adjust to Trading Partner Category” to meet Treasury’s Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) reporting requirements.

In addition, FMS does not have the functionality to meet new GTAS reporting requirements at the time of transaction processing. Currently, high-volume, high dollar JVs are entered into MinX to adjust trading partner and general ledger attributes in order for the VA’s trial balance submission to pass GTAS edits. The JVs recorded by management included categories such as “No Trading Partner,” “IntraVA,” “Unknown,” etc.

VA management has a corrective action plan in place to develop a centralized repository database to house interagency agreements. As of September 30, 2015, the action was not complete to ensure a complete identification, recording, and reconciliation of all intra-governmental transactions.

F. Recording of Prior Year Budgetary Recoveries

VA initially reported approximately \$3.6 billion as recoveries of prior year unpaid obligations (recoveries) at September 30, 2015. Many of the transactions reported as recoveries were not true recoveries, but were related to error corrections for valid, existing obligations, such as vendor name changes and reclassification of budget object class codes, vendor codes, accounting strings, etc. No de-obligation of excess funds actually occurred in these instances. In addition, some of the recovery transactions were not recorded in a timely manner with de-

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obligation delays ranging from 11 months to 1 year and 7 months between the last activity date of the obligation in FMS and the date the recovery transaction was processed.

G. Internal Use Software Costs Not Properly Captured and Capitalized in Accordance with Federal Accounting Standards No. 4 and 10

VA did not properly capitalize project costs for its internal use software in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 4, *Managerial Cost Accounting*, and No. 10, *Accounting For Internal Use Software*.

Due to limitations with VA's project management scheduling system, Primavera, management did not properly record its internal labor costs and associated benefits involving VA employees to the Internal Use Software in Development account. SFFAS No. 10 requires the capitalized value of internally developed software to include these costs when incurred during the software development stage. We also noted that Primavera:

- Did not interface with FMS or with VA's Project Management Accountability System (PMAS)
- Required manual data input based on weekly staff time cards, increasing the risk that data might not be complete
- Did not code labor costs by project phase (i.e., Preliminary Design, Development, and Post Implementation/Operational phases)

Further, management did not properly capture associated project contract, hardware, and software costs during FY 2015. Towards year-end, management reclassified approximately \$647 million from expense accounts to the Internal Use Software in Development account, which represented a 189 percent increase.

H. Accounting and Reporting of Real Property Transferred from the Navy

VA received a transfer of 624 acres of land in June 2014 from the Department of the Navy, which was not recorded until FY 2015. Of the 624 acres transferred, 282 acres were assigned to VHA and 342 acres to the National Cemetery Administration (NCA). VHA recorded its share of 282 acres of land at the fair market value of \$423 million in April 2015. NCA did not record their portion of the land transfer as of June 30, 2015. VA subsequently reversed the recorded value of the entire land transfer down to \$1.4 million in September 2015. In addition, VA did not provide significant source documentation for our review until October 2015, such as the original deed and the discounted value of the property in accordance with SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*.

Criteria:

OMB Circular A-123, *Management's Responsibility for Internal Control*, makes management 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.

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Cause:

The FMS system limitations caused VA to record numerous manual JVs and implement extensive manual processes and controls to prepare its financial statements for external reporting purposes. In addition, adequate internal controls were lacking for the review and approval of JVs to avoid erroneous JVs from being recorded in FMS. Further, many of the long standing JV recording and financial reporting issues could have been eliminated through increased oversight, monitoring, coordination, and communication by the VA CFO and among various VA groups. Lastly, VBA and VHA did not implement significant portions of the VA CFO's guidance on financial reporting, and the VA CFO did not ensure information provided by the administrations was complete, accurate, and properly validated prior to consolidation.

Effect:

The extensive use of manual JVs and lack of fully developed manual reconciliations, periodic analyses and centralized oversight and monitoring of financial data increased the risk of errors in the financial reporting process.

Recommendations:

We recommend that the Interim Assistant Secretary for Management/Interim Chief Financial Officer:

1. With respect to JVs:
 - Work with VA Administrations and business lines to limit the use of manual JVs to transactions such as quarterly accruals and unusual one-time entries. Standardize journal entry categories throughout VA, establish policies on recording them, and monitor their use quarterly. Eliminate multi-function JVs. Perform a pro forma analysis of the effects of adjusting entries prior to recording them and consult with budget officials for budgetary adjustments.
 - Conduct an analysis of the FMS Budget Execution model to identify gaps in functionality and develop corrective actions.
 - Resolve and clean up legacy data issues in FMS.
 - Update FMS general ledger account titles and descriptions, USSGL attributes and invalid posting combinations; remove invalid or inactive entries; and analyze VBA and VHA interfaces for needed improvements.
2. With respect to flux analysis, budgetary to proprietary analysis, and abnormal balances:
 - Ensure flux analysis at the administrations is performed from period to period for all financial statement line items, not just those identified at the consolidated level. Follow up with the administrations when significant and unusual fluctuations or relationships are not properly supported and explained.
 - Perform account relationship tests at the Treasury Fund Symbol on a quarterly basis to verify that proper relationships exist between budgetary and proprietary accounts, and resolve abnormal account balances.
3. With respect to intra-governmental agreements and reconciliations:
 - Work with the administrations and business lines to complete the inventory of interagency agreements. Perform a review of them to determine whether balances are recorded in FMS accurately. Produce reports on transactions with other Federal

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agencies with sufficient detail to link those transactions to relevant interagency agreements to facilitate reconciliations with trading partners.

4. With respect to prior year budgetary recoveries:
 - Perform an assessment to validate the transactions included in the total population of prior year budgetary recoveries, and develop a process to estimate and record any necessary adjusting entries.
5. With respect to Internal Use Software:
 - Work with OIT to develop a complete inventory of all costs to be capitalized. Perform a reconciliation of costs captured in Primavera and FMS to ensure the accuracy of reported balances in FMS.

We recommend that the VBA and VHA CFOs:

6. Work with the VA CFO to identify reasons for JVs and institute the necessary controls and system improvements to eliminate the extensive use of JVs.
7. Ensure the timely review of quarterly financial statements in accordance with the VA CFO's guidance. The analysis should include management's expectations and adequate detailed explanations.
8. Work with their budget and program offices to identify all classes of transactions that require intra-agency agreements, ensure the agreements are up to date, and upload the agreements to the VA's central repository.

EXHIBIT B Significant Deficiencies

1. Accrued Operating Expenses

Background:

Accrued operating expenses are comprised of two components—invoices received but not yet paid, and goods and services received but not yet invoiced. VA estimates the amount of goods and services received but not yet invoiced using either an automatic calculation by FMS or a manual process. The auto-accrual process uses the transaction's period of performance, the amount obligated, and the amount expended to calculate an accrued amount at the end of the reporting period, which is then subsequently reversed at the beginning of the following month.

Generally, obligations that are expected to have goods or services performed ratably over the life of the contract are flagged in FMS to be auto-accrued. Those types of transactions are defined by management as those with a budget object class code of 2600 or lower. A manual accrual is calculated quarterly for major and minor construction projects, and non-recurring maintenance (NRM) projects, based on amount expended and percentage of completion. This manual entry is necessary as those construction projects are not included in the auto-accrual process. Major construction, minor construction, and NRM projects with an outstanding UDO balance greater than \$5 million, \$2 million, and \$800 thousand, respectively, are evaluated manually for accruals based on their percentage of completion estimated by the on-site engineers at the medical centers.

Condition:

We noted a significant number of exceptions that demonstrated the limitations of the estimation process when the contract monitoring and timely financial data review did not exist:

- FMS automatically calculated an accrual when no goods or services were provided at period end. FMS accrued the entire outstanding balance of an obligation when the end date for the contractual performance period had passed. However, without manual review and adjustment, this accrual occurred even if performance was not complete or if the obligated funds were no longer needed. Although the automatic process helped mitigate the risk of accruing too little, it also increased the risk of accruing too much when VA did not monitor actual performance under contracts and adjust FMS accordingly. We noted that existing outstanding accruals expected to be liquidated were not sufficiently monitored.
- We noted many instances where outstanding accruals remained in FMS from prior years, but were not reversed at the beginning of the fiscal year.

VHA did not have a formalized and comprehensive process to subsequently validate the reasonableness of its accrual estimates by using actual payment data from FMS. It only performed limited look-back analysis for minor programs. Management did not have an effective process to reasonably assess the liabilities owed at the end of the reporting period.

Criteria:

SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, states, "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."

EXHIBIT B

Significant Deficiencies

Cause:

VA does not have an effective validation process for the accrued expenses balance, including a look-back analysis.

Effect:

Without an effective process, VA's estimates of its accrued expense liability and related expense and budgetary accounts could be significantly misstated.

Recommendations:

We recommend that the Interim Assistant Secretary for Management/Interim Chief Financial Officer:

1. Develop procedures for validating the completeness and accuracy of the accrual estimate, including review of contract performance periods, an analysis of subsequent payments, and acceptable levels of precision. Such validation should be performed for all program elements with transactions subject to accrual and over a few years to show a trend of the estimates. Unusual fluctuations, if any, should be investigated and research conclusions documented by management. Work with contracting personnel to help align the methodology to actual spending patterns.
2. Continue to reevaluate the automatic accrual methodology against actual cost patterns. Refine the accrual methodology to closely align with the actual spending patterns when warranted.

We recommend that the Under Secretary for Health in coordination with the Interim Assistant Secretary for Management/Interim Chief Financial Officer:

3. Strengthen controls to ensure an accrual is properly recorded to account for the goods or services received. Accruals should be recorded when services are received, regardless of when they are paid for. Conversely, a system-generated accrual should not be executed if no work is being performed on a project. In addition, management should continue to evaluate the accrual flag system methodology, as well as the accuracy of the manual accruals, based on the actual cost patterns to ensure that the resulting accruals are materially consistent with actual costs incurred.

2. CFO Organizational Structure for VHA and VA

Background:

The Chief Financial Officers Act of 1990 (CFO Act) requires each executive department to have a CFO to support more effective general and financial management practices. Each CFO is to report directly to the head of the agency and is responsible for key financial activities within the department, including:

- Overseeing all financial management activities relating to the programs and operations of the agency;

EXHIBIT B Significant Deficiencies

- Developing and maintaining an integrated agency accounting and financial management system, including financial reporting and internal controls; and
- Directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations.

Condition:

Although the CFO Act does not require a particular organizational structure, we observed that VA has a decentralized and fragmented financial management and reporting structure that does not operate in a fully integrated manner. In such an environment, necessary communication, coordination, and accountability across internal organizational boundaries can be more difficult to achieve and increase the risk of gaps in internal control over financial reporting.

We observed the following fragmentation of financial management responsibilities and accountability within VA that has led to control weaknesses or increased the risk of such gaps.

A. Fragmentation within VHA

VHA's financial management structure is extremely fragmented with financial personnel reporting up various chains of authority, with only one comparatively small group reporting to the VHA CFO. Overall, VHA's financial management functions are currently managed by three groups – the VHA CFO, the CBO CFO, and the 21 VISN CFOs. VHA does not have one CFO with overall authority to direct or coordinate VHA's financial management activities. Instead, each organization has separate responsibilities and management reporting lines that finally converge with the Principal Deputy Under Secretary for Health.

In particular, the VHA CFO has primary responsibility for the oversight of VHA's budget formulation and execution, accounting policies, financial statements and other duties, but not for financial operations. Instead, CBO CFO is responsible for the financial management of the Purchased Care program, and VISN CFOs oversee the activities of medical center CFOs. This division of responsibilities, as operating within VHA, results in a fragmented structure where communication and monitoring controls are affected. For example, the VHA CFO did not have knowledge or information related to Purchased Care business processes or financial management controls developed and implemented by CBO. Such "stovepiping" is not consistent with the CFO Act. Further, correcting the two material weaknesses directly attributable to VHA will require more coordination and more centralized monitoring of financial management functions among the different CFO organizations, which the current structure makes more difficult to achieve.

B. VA CFO Roles and Responsibilities

The Assistant Secretary for Management is VA's statutory CFO, as required under the CFO Act, and heads VA's Office of Management (OM). OM is responsible for providing leadership for the Department's budget, financial management, capital asset management, and business oversight functions.

Similar to other Federal agencies, VA has major business components, such as VHA, VBA, and NCA, which perform key business and financial management operations. Those components have CFOs to manage their day to day accounting and financial management functions. These CFOs have reporting lines of authority to the heads of their components, not to the VA CFO. As

EXHIBIT B

Significant Deficiencies

such, accounting and financial management polices established by the VA CFO were left to the component CFOs for their implementation, which was not always consistent.

Criteria:

The CFO Act identifies the responsibilities of an agency's CFO with respect to financial management, including internal control. GAO's *Standards for Internal Control in the Federal Government* identifies the importance of clear assignments of responsibility, accountability mechanisms, communication lines, and monitoring.

Cause:

VA and VHA have historically been decentralized organizations. As funding for VHA continues to increase and as a result of the Choice Act, CBO has received more budget execution and financial management monitoring responsibilities, which has allowed it to become a financial management authority separate from the VHA CFO.

Effect:

The lack of consolidated financial management authority within VHA can lead to communication and coordination difficulties, duplication of efforts, inefficiencies, and inconsistencies in how financial management policies are executed and monitored. This could also lead to internal control deficiencies, which in turn could cause errors in the financial statement balances. Similarly, the current accountability structure for VA financial management as a whole can lead to inconsistent implementation of policy, ineffective processes, and uncorrected internal control weaknesses.

Recommendations:

We recommend that the VA Secretary and Deputy Secretary evaluate VA's financial management structure to ensure clear assignments of responsibility, strong accountability mechanisms, effective communication lines, and appropriate monitoring with respect to internal control over VA's financial management, and to ensure the fulfillment of the VA CFO's responsibilities under the CFO Act.

EXHIBIT C Compliance Findings

1. FFMIA

Financial Management Systems

VA's complex, disjointed, and legacy financial management system architecture has continued to deteriorate and no longer meets the increasingly stringent and demanding financial management and reporting requirements mandated by the Treasury and OMB. VA continues to be challenged in its efforts to apply consistent and proactive enforcement of established policies and procedures throughout its geographically dispersed portfolio of legacy applications and systems. As a result, VA's financial management systems do not substantially comply with the Federal financial management systems requirements and the USSGL at the transaction level, as required by FFMIA Section 803(a). These conditions should be read in conjunction with all material weaknesses reported in Exhibit A.

A. Federal Financial Management System Requirements

VA's core accounting system, FMS, was implemented in the 1990s. Since that time, Federal financial reporting requirements have become more complicated and the level of financial information needed by Congress and other oversight bodies has become increasingly demanding and complex. Some of the effects of FMS' limited functionality are described in the material weakness, "Financial Reporting." Due to these limitations, VA utilizes MinX to consolidate general ledger activities from FMS to produce auditable financial statements and GTAS trial balances. Further, each accounting period in MinX is independent and thus numerous manual JVs, reconciliations, and analyses must be reperformed and reentered in each period to produce VA's financial statements and GTAS trial balances. FMS' functionality limitations are further exacerbated by operational and security vulnerabilities as VA continues to operate FMS on a database that is no longer supported by the vendor.

In addition, the following subsidiary systems are not interfaced with FMS. Complete and consolidated reconciliations between FMS and these subsidiary systems were not performed throughout FY 2015:

- *Veterans Integrated Systems Technology Architecture (VistA)*. VistA is VHA's decentralized system utilized for patient billing and collection transactions. Each medical center has its own instance of VistA that must be separately maintained and updated. VistA contains the detailed subsidiary records that support the FMS general ledger control accounts.

In the case of the Medical Care Collections Fund (MCCF), VistA does not provide management with the ability to effectively and efficiently monitor MCCF activities at the transaction level. In particular, although billing and collection functions have been centralized at the Consolidated Patient Accounting Centers (CPACs), CPAC personnel still cannot generate combined reports for all the facilities under their purview. Reports are generated separately for individual medical centers, which leads to inefficiencies in operations and revenue management. Further, a nationwide report at a sufficient level of detail cannot be generated. For financial reporting, MCCF revenues are recorded in FMS through a lump-sum journal entry based on station-by-station data. This complicates reconciliation of revenue transactions to collections and the supporting audit trail. In addition, as VistA is not able to produce a consolidated accounts receivable aging report at a sufficient level of detail, management does not have the tools to

EXHIBIT C Compliance Findings

properly assess the reasonableness of its allowance for loss provision or perform a retrospective analysis to ascertain the reasonableness of its allowance methodology.

- *Integrated Funds Distribution Control Point Activity, Accounting and Procurement System (IFCAP)*. IFCAP is a module within VistA that is used by VHA, contracting officers, and other VA personnel to initiate and authorize purchase requisitions for goods and services, as well as to accumulate vendor invoices for payment. Because the commitment accounting module was not activated during the implementation of FMS, obligations in FMS are recorded based on approved purchase requisitions or Miscellaneous Obligating Documents (1358s) from IFCAP instead of valid contracts or purchase orders. Further, transactions initiated and recorded in IFCAP cannot be centrally and completely reconciled to those in FMS or to the procurement source documentation maintained in the eCMS.
- *Fee Basis Claims System (FBCS)*. FBCS is used to manage the authorization and payment processes for VHA's purchased care program. FBCS sits "on top" of VistA and is run in a decentralized manner similar to VistA. Transactions initiated in FBCS were not completely reconciled to those in IFCAP and in FMS.
- *Electronic Contract Management System (eCMS)*. eCMS is an intranet-based contract management system mandated by VA policy. Source documentation of all actions pertaining to open-market procurements over \$25 thousand must be maintained in eCMS. However, VA does not utilize eCMS to electronically process the approval and reviews performed for its acquisitions. Obligation of funds and assignment of purchase order numbers are still performed in IFCAP.

In addition, VA has not implemented a standard procurement file structure in eCMS to maintain acquisition documentation in a consistent and efficient manner. It is often left to the preference of individual contracting officers, and as a result, it was difficult at times to find acquisition documentation to support the procurement process followed by VA. The information in this system is incomplete and can be unreliable.

B. USSGL at the Transaction Level

FMS did not substantially comply with the USSGL at the transaction level for the following:

- Configuration setup issues caused an incorrect year-end account close that required JVs to adjust the beginning balances by over \$500 billion (absolute value).
- Budgetary execution transaction code and interface issues resulted in incorrect data in accounts that have long remained unresolved in FMS. Significant JVs were needed to correct the balances. During our review of JVs, we noted that VA adjusted budgetary account balances based on proprietary account balances.
- FMS lacked functionality to meet GTAS reporting requirements. We noted that VA was unable to record certain intragovernmental transactions in accordance with USSGL attributes at the individual transaction level. This situation also created the need for VA to record significant JVs. FMS also lacks the appropriate edit checks to ensure the proper posting of intragovernmental transactions. As a result, VA recorded over \$100

EXHIBIT C Compliance Findings

billion (absolute value) in trading partner-related adjustments as part of its GTAS submission to the Treasury.

2. Federal Managers' Financial Integrity Act

Improvement is needed with respect to the process for preparing the Secretary's signed statements of assurance on internal control that are required by the FMFIA and OMB Circular A-123, *Management's Responsibility for Internal Control*. These assurances are summarized by OMB Circular A-136, *Financial Reporting Requirements*, according to the following categories:

- Effectiveness of internal control over operations (FMFIA § 2)
- Conformance with financial management system requirements (FMFIA § 4)
- Effectiveness of internal control over financial reporting (FMFIA § 2, Appendix A)

We noted the following areas in need of improvement in order to fully comply with the intent of FMFIA:

A. Supporting Documentation Not Available for Self-Certifications

VA relies on self-certifications from its component and business line managers to prepare the Secretary's assurance statement on the effectiveness of internal control over operations and conformance with financial management system requirements (FMFIA § 2 & 4). Most of the responses provided by line managers did not identify internal control issues. Supporting documentation was not available to validate many of these self-certifications. VA has not fully implemented a process to monitor or validate the support behind these self-certifications.

B. VA Business Lines Should Perform their Own Internal Reviews to Support Assurance Statement

When business lines reported internal control deficiencies (FMFIA § 2 & 4), many were based on findings identified by the Office of Inspector General or other independent auditors. The various administrations and business lines did not perform their own entity-wide assessment of internal control in a complete manner that corresponded to their program, operation and management risks.

C. Improvements Needed to Support Assurance Statement on Financial Reporting

OMB Circular A-123, Appendix A, requires VA to take additional steps to support the assertion on the effectiveness of internal control over financial reporting. We noted the following exceptions:

- Internal Control Testing
 - Management tested controls on a four-year cycle, or not at all for those rated as low risk. According to the implementation guide for OMB Circular A-123, Appendix A, (Implementation Guide) prepared by the Chief Financial Officers Council and posted on OMB's website, tests of internal control should be performed, at a minimum, every three years when the risk is low, controls are stable, and there are no deficiencies.

EXHIBIT C Compliance Findings

- Management did not apply a “life cycle” approach to the testing of transactions within a business cycle; i.e., tracing a transaction for a particular business process from initiation through reporting in the financial statements. Instead, selected attributes within a transaction cycle were tested, resulting in incomplete control assessments for business cycles relevant to the financial statements.
- Management did not use materiality thresholds to determine an exception’s dollar impact on financial statements or consider whether a material weakness existed.

We note that VA’s testing program did not report the material differences and the related material weaknesses that we identified from our testing.

- Coordination of Internal Control Reviews: VA’s Senior Assessment Team (SAT) is responsible for oversight of VA’s internal control over financial reporting, including an annual assessment supporting the required assurance statement. Under the SAT charter, the Internal Control Service (ICS) within OM is responsible for the assessment of internal control over financial reporting. However, current practice is for OALC and the OIT to separately perform their own internal control reviews. Active oversight of the OALC and OIT reviews or their coordination with ICS by the SAT to ensure proper coverage of all areas falling under OMB Circular A-123, Appendix A was not implemented.
- Business Process Documentation: According to the Implementation Guide, management should document key financial reporting processes and controls. VA does this through process narratives. We observed that several narratives were not updated in a timely manner to reflect actual operations, or they contained errors. In addition, some process narratives did not focus on key controls or missed the opportunity to discuss gaps in the design of controls. For example, the financial reporting narrative did not mention the inherent limitations existing in FMS that resulted in significant JVs to enable proper financial reporting of budgetary accounts.

3. 38 USC 5315

Consistent with previous years, our testing of a sample of receivables from debtors continued to note the following exceptions:

- In a sample of compensation and pension receivables, 22 of the 45 items tested were outstanding over 90 days. VBA did not charge interest on any of the delinquent receivables.
- In a sample of 45 education receivables, 41 of the 45 items tested were outstanding over 90 days. VBA did not charge interest or administrative costs on these 41 delinquent receivables.

The requirement to charge interest and administrative costs on receivables not paid “within a reasonable period of time” after notification is specified in 38 USC Sec 5315, *Interest and administrative cost charges on delinquent payments of certain amounts due the United States*. Additional Government-wide procedures for charging interest and administrative costs are specified in 31 USC 3717, *Interest and penalty on claims*, but as to VA, those provisions are largely superseded by 38 U.S.C. 5315. VA’s policy to not charge interest has been long-standing and is based on a former VA Deputy Secretary’s July 1992 instruction.

EXHIBIT C

Compliance Findings

With regards to education receivables, the failure to charge interest and administrative costs occurred when these types of receivables were assigned to the Debt Management Center (DMC) for processing. The DMC technicians did not have the capability to apply the interest charge in the system.

As a result of the directive and DMC system limitations, VA is noncompliant with 38 USC 5315.

Other Matters

4. Actual and Potential Violations of the Antideficiency Act

VA is engaged in investigating three possible violations of the Antideficiency Act, 31 U.S.C. 1341(a), and is in the process of reporting two other violations. Two of the investigations involve the combination of minor construction projects. The combined total project values exceeded the \$10 million ceiling, beyond which Congressional approval for use of funds is required. Another investigation involves obligation of a contract in the wrong fund. Two of the violations in the process of being reported also involve the combination of minor construction projects.

5. Improper Payments Elimination and Recovery Act

On May 14, 2015, the VA Office of Inspector General reported that VA did not fully comply in FY 2014 with the Improper Payments Elimination and Recovery Act, 31 U.S.C. 3321. (VA Office of Inspector General report, *FY 2014 Review of VA's Compliance with the Improper Payments Elimination and Recovery Act*, Report No. 14-03380-356.)

EXHIBIT D
Status of Prior Year Findings

Our assessment of the current status of the recommendations from the prior year audit is presented below.

| <i>Type of Finding</i> | <i>FY 2014 Finding</i> | <i>Fiscal Year 2015 Status</i> |
|------------------------|--|---|
| Material Weakness | Information Technology Security Controls | Repeat – See FY 2015 Material Weakness Finding 1 |
| Significant Deficiency | Financial Reporting | Repeat – See FY 2015 Material Weakness Finding 4 |
| Significant Deficiency | Accrued Operating Expenses | Repeat – See FY 2015 Significant Deficiency Finding 1 |
| Compliance Finding | Noncompliance with FFMIA | Repeat – See Compliance Finding 1 |
| Compliance Finding | Noncompliance with the Debt Collection Improvement Act | Repeat – See Compliance Finding 3 |

Section II

Agency Comments

- **Secretary's Letter**
- **Letter from the Interim Chief Financial Officer**
- **Management's Response to Auditors' Report**



THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

November 16, 2015

To the President of the United States, President of the Senate, Speaker of the House of Representatives, and the President Pro Tempore of the Senate:

This report highlights the Department of Veterans Affairs' (VA) accomplishments and challenges in providing health care and benefits delivery to our Veterans according to our mission as provided by President Lincoln: "To care for him who shall have borne the battle, and for his widow and his orphan." To accomplish this mission, we provide timely access to earned health care and benefits for millions of Veterans. It is a responsibility that we do not take lightly.

In the last year, VA has been capturing lessons learned as we continued to increase options to Veterans in pursuing health services through VA facilities and care in the community. VA has increased its capacity to serve Veterans' health-care needs by focusing on four pillars: staffing, space, productivity, and VA community care. At VA facilities, we have increased net staffing and the number of primary care exam rooms. We have extended the number of clinic hours to nights and weekends. We also leveraged care in the community options for Veterans, including those pertaining to the Choice Act.

Even as we increase access and transform, important challenges remain, and there will be more in the future as Veteran demographics evolve. Health services and benefits sought by Veterans often peak years after conflicts end, and the demands increase as Veterans age and exit the workforce. Looking forward, the VA Budget and Choice Improvement Act codified the Department's initiative to develop a plan to consolidate all non-Department provider programs by establishing a single new program for furnishing hospital care and medical services to enrolled Veterans. We are committed to simplifying the complex array of programs through which VA delivers care in the community.

Additionally, we are transforming our way of doing business by putting the Veteran first in all we do through a new overarching initiative we call MyVA. The MyVA vision is to provide a seamless, unified Veteran Experience across the entire organization and throughout the country. Our five initial priorities are:

- Improving the Veteran experience;
- Improving the employee experience;
- Achieving support services excellence;
- Establishing a culture of continuous performance improvement; and
- Enhancing strategic partnerships.

CliftonLarsonAllen (CLA), an independent public accounting firm reviewed our financial statements and provided an unmodified opinion for the 17th consecutive year, thus demonstrating our successful efforts to ensure that taxpayer resources are used effectively and efficiently in support of Veterans and their families. Although VA received an unmodified audit opinion, we must continue to improve our financial management in fiscal year (FY) 2016, as CLA has cited VA with four material weaknesses and two significant deficiencies.

This year's audit continued to identify a repeat material weakness related to information technology systems configuration management controls, access controls, security management, and systems contingency planning. In July 2015, the new Chief Information Officer (CIO) established an Enterprise Cybersecurity Strategy Team to review VA's cybersecurity posture. The team delivered a strategy and implementation plan in late September 2015 that will transform CIO's focus on cybersecurity with a goal of resolving the material weakness in 2016.

VA received two related material weaknesses, one pertaining to procurement, undelivered orders, and reconciliation processes and the other centered on care in the community transaction processing and reconciliation processes. Issues found related to untimely recording of obligations in the accounting system and obligations of funds without valid Federal Acquisition Regulation, and the lack of reconciliation processes between referrals for Veterans receiving care and related transactions recorded in the accounting system. VA is currently seeking a legislative proposal to better facilitate care in the community. In FY 2016, VA is also focusing on reforming and improving how we purchase care in the community but challenges will remain in the absence of legislative change.

Additionally, VA received a material weakness on financial reporting because our antiquated accounting system lacks current Federal functionalities and controls. VA plans to replace its accounting system and will embark on a multi-year initiative to migrate to a Federal shared service provider starting in FY 2016. In the meantime, VA will continue to improve our business processes and reliability of our data.

VA received two significant deficiencies. The first addresses the accrual process for financial reporting. This finding occurred when estimated expenses did not align with the actual payments. In FY 2016, VA plans to work with program offices to perform analysis of existing processes, review historical data, and evaluate the timing of services received and payments processed.

The second significant deficiency related to the Chief Financial Officer organizational structure. The current structure is fragmented and results in ineffective financial management systems and controls. VA will perform an assessment of the current reporting structure by the end of second quarter FY 2016, determine the need for reorganization and/or realignment, and provide recommendations for the optimal solution to senior leadership.

In addition to the material weaknesses and significant deficiencies, VA experienced a dramatic increase in our improper payment rate in FY 2015. This was due to the VA Office of Inspector General citing VA for inconsistent compliance with Federal laws in providing care in the community to Veterans in the May 2015 Improper Payments Elimination and

Recovery Act compliance review. This is a departure from how VA has historically reported the care in the community payments. In the past, the payments were deemed proper if they were made in accordance with negotiated prices/regulation and paid to the correct party who provided the services requested. These instances were cited even though VA did not waste taxpayer money by paying too much for services or pay the wrong parties but instead, provided Veterans access to health care when it could not be provided at a VA facility. We are committed to stopping inconsistent compliance with laws and regulations and reduce the improper payment rate through legislative proposals and business process re-engineering in FY 2016.

Based on internal evaluations, I can provide reasonable assurance that the financial and performance information contained in this report is complete, reliable and accurately describes VA results for FY 2015. The Agency Performance Plan and Report, due in February 2016, will contain more detail on VA's performance measures.

Caring for our Nation's Veterans is the highest honor and privilege for the men and women who serve VA. I thank you for your consideration of our annual report and appreciate your continued support of our mission.

Sincerely,

A handwritten signature in blue ink, appearing to read "Robert A. McDonald".

Robert A. McDonald

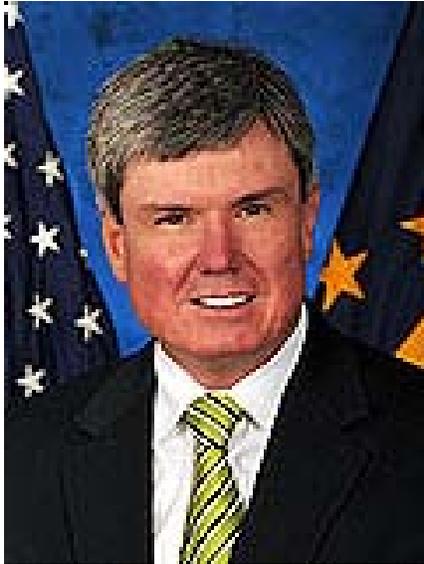
Enclosure



Section II. Financial Results Section

Letter from the Interim Chief Financial Officer

November 16, 2015



The Department of Veterans Affairs (VA) is pleased to announce that it has received its 17th consecutive unmodified (“clean”) audit opinion on the Department’s consolidated financial statements. The enclosed audit provides an assessment of the Department’s detailed financial information and stewardship of taxpayer resources in support of our mission to fulfill President Lincoln’s charge to care for those “who shall have borne the battle” and their families. Entrusted to serve our Nation’s 23 million living Veterans, as well as memorialize those who have died, we believe the Department must be transparent and accountable to Veterans and its broad community of stakeholders.

In fiscal year (FY) 2015, VA faced a number of significant financial management challenges. The independent public accounting firm, CliftonLarsonAllen LLP (CLA), found four material weaknesses in: (1) Information Technology (IT) Controls (repeat finding); (2) Procurement, Undelivered Orders and Reconciliations; (3) Purchased Care Processing and Reconciliations; and (4) Financial Reporting. VA has also identified a long-standing problem in the way the Department has purchased care in the community for Veterans, and has reported it as a material weakness in its internal controls.

In addition, CLA found two significant deficiencies: (1) in Accrued Expenses (repeat finding), and (2) in the Chief Financial Officer Organizational Structure. VA was found to be inconsistent in its compliance with a number of federal laws and regulations including the Federal Financial Management Improvement Act, the Federal Manager’s Financial Integrity Act of 1996, and the Improper Payments Elimination and Recovery Act (IPERA).

VA has also experienced a sizable increase in our improper payment rate in FY 2015 due to the VA Office of Inspector General citing VA for inconsistent compliance with federal laws in providing care in the community to Veterans in the May 2015 IPERA compliance review. These instances were cited even though VA did not waste taxpayer money by paying too much for services or pay the wrong parties, but instead provided Veterans access to health care when it could not be provided at a VA facility. We are dedicated to stop inconsistent compliance with laws and regulations and reduce the improper payment rate in FY 2016 through legislative proposals and business process re-engineering.



VA is committed to working vigorously to address these significant challenges and improve its financial stewardship.

A handwritten signature in black ink, reading "Edward J. Murray", is written in a cursive style.

Edward J. Murray



Management's Response to Auditor's Report

Department of
Veterans Affairs

Memorandum

Date:

From: Interim Assistant Secretary for Management and Interim Chief Financial Officer (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2015 and 2014

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 (VA) Consolidated Financial Statements for Fiscal Years (FY) 2015 and 2014 and we are pleased with the receipt of an unmodified opinion. We are also pleased that we met the 2015 reporting timeline established by the Office of Management and Budget. Please extend to your staff and the staff of CliftonLarsonAllen LLP, our appreciation for their detailed planning, hard work, and cooperation during this year's audit.
2. Thank you again for your efforts in another successful conclusion of the audit cycle.

A handwritten signature in black ink, reading "Edward J. Murray".

Edward J. Murray

Section III

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,

| | 2015 | 2014 |
|---|--------------------|--------------------|
| ASSETS (Note 2) | | |
| INTRAGOVERNMENTAL | | |
| Fund Balance with Treasury (Note 3) | \$ 60,183 | \$ 57,887 |
| Investments (Notes 5 and 19) | 7,022 | 7,827 |
| Accounts Receivable (Note 6) | 46 | 40 |
| Other Assets | 310 | 352 |
| TOTAL INTRAGOVERNMENTAL ASSETS | 67,561 | 66,106 |
| PUBLIC | | |
| Cash (Note 4) | 4 | 5 |
| Investments (Note 5) | 178 | 178 |
| Accounts Receivable, Net (Note 6) | 2,182 | 2,631 |
| Direct Loans and Loan Guarantees, Net (Note 7) | 1,806 | 1,838 |
| Inventory and Related Property, Net (Note 8) | 49 | 49 |
| General Property, Plant and Equipment, Net (Note 9) | 24,068 | 22,283 |
| Other Assets | 12 | 20 |
| TOTAL PUBLIC ASSETS | 28,299 | 27,004 |
| TOTAL ASSETS | \$ 95,860 | \$ 93,110 |
| Heritage Assets (Note 10) | | |
| LIABILITIES (Note 12) | | |
| INTRAGOVERNMENTAL | | |
| Accounts Payable | \$ 372 | \$ 290 |
| Debt (Note 11) | 681 | 697 |
| Other Liabilities (Notes 13, 15, 16 and 18) | 1,166 | 1,300 |
| TOTAL INTRAGOVERNMENTAL LIABILITIES | 2,219 | 2,287 |
| PUBLIC | | |
| Accounts Payable | 10,948 | 11,740 |
| Loan Guarantee Liability (Note 7) | 9,913 | 8,908 |
| Federal Employee and Veteran Benefits (Note 13) | 2,020,844 | 2,009,364 |
| Environmental and Disposal Liabilities (Note 14) | 860 | 789 |
| Insurance Liabilities (Note 17) | 8,380 | 9,145 |
| Other Liabilities (Note 15) | 5,575 | 4,759 |
| TOTAL PUBLIC LIABILITIES | 2,056,520 | 2,044,705 |
| TOTAL LIABILITIES | 2,058,739 | 2,046,992 |
| Commitments and Contingencies (Note 18) | | |
| NET POSITION | | |
| Unexpended Appropriations – All Other Funds | 37,376 | 36,398 |
| Cumulative Results of Operations – Funds from Dedicated Collections (Note 19) | 906 | 1,008 |
| Cumulative Results of Operations – All Other Funds | (2,001,161) | (1,991,288) |
| TOTAL NET POSITION | (1,962,879) | (1,953,882) |
| TOTAL LIABILITIES AND NET POSITION | \$ 95,860 | \$ 93,110 |

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, | 2015 | 2014 |
| NET PROGRAM COSTS BY ADMINISTRATION (Note 21) | | |
| Veterans Health Administration | | |
| Gross Cost | \$ 68,984 | \$ 64,997 |
| Less Earned Revenue | (4,252) | (3,811) |
| Net Program Cost | 64,732 | 61,186 |
| Veterans Benefits Administration | | |
| Gross Cost | | |
| Program Costs | 93,368 | 88,037 |
| Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13) | 24,400 | 54,400 |
| Less Earned Revenue | (958) | (1,237) |
| Net Program Cost | 116,810 | 141,200 |
| National Cemetery Administration | | |
| Gross Cost | | |
| Program Costs | 304 | 310 |
| Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13) | 100 | - |
| Less Earned Revenue | - | - |
| Net Program Cost | 404 | 310 |
| Indirect Administrative Program Costs | | |
| Gross Cost | 1,762 | 1,831 |
| Less Earned Revenue | (351) | (292) |
| Net Program Cost | 1,411 | 1,539 |
| NET PROGRAM COSTS BY ADMINISTRATION BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITY ASSUMPTIONS | | |
| | 183,357 | 204,235 |
| CHANGES IN ACTUARIAL LIABILITY ASSUMPTIONS (Note 13) | | |
| COMPENSATION: | | |
| Changes in Discount Rate Assumption | 79,900 | (37,400) |
| Changes in COLA Rate Assumption | (72,200) | 15,400 |
| Changes in Other Assumptions | (20,700) | - |
| TOTAL COMPENSATION | (13,000) | (22,000) |
| BURIAL: | | |
| Changes in Discount Rate Assumption | 200 | (100) |
| Other Changes | (200) | - |
| TOTAL BURIAL | - | (100) |
| NET (GAIN)/LOSS FROM ACTUARIAL LIABILITY ASSUMPTIONS | (13,000) | (22,100) |
| NET COST OF OPERATIONS (Note 21) | \$ 170,357 | \$ 182,135 |

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, 2015

| | Funds from Dedicated Collections (Note 19) | All Other Funds | Eliminations | 2015 Consolidated Total |
|--|---|-----------------------|--------------|-------------------------------|
| Cumulative Results of Operations | | | | |
| Beginning Balances | \$ 1,008 | \$ (1,991,288) | \$ - | \$ (1,990,280) |
| Budgetary Financing Sources | | | | |
| Appropriations Used | - | 158,742 | - | 158,742 |
| Nonexchange Revenue | - | (1) | - | (1) |
| Donations and Forfeitures of Cash and Cash Equivalents | 21 | - | - | 21 |
| Transfer In/Out Without Reimbursement | (3,409) | 3,676 | - | 267 |
| Other Financing Sources (Nonexchange) | | | | |
| Donations and Forfeitures of Property | 35 | - | - | 35 |
| Transfers In/Out Without Reimbursement | (2) | (1) | - | (3) |
| Imputed Financing | - | 1,880 | - | 1,880 |
| Other | - | (559) | - | (559) |
| Total Financing Sources | (3,355) | 163,737 | - | 160,382 |
| Net Cost/(Benefit) of Operations | (3,253) | 173,610 | - | 170,357 |
| Net Change | (102) | (9,873) | - | (9,975) |
| Ending Balance – Cumulative Results | 906 | (2,001,161) | - | (2,000,255) |
| Unexpended Appropriations | | | | |
| Beginning Balance | - | 36,398 | - | 36,398 |
| Budgetary Financing Sources | | | | |
| Appropriations Received | - | 161,872 | - | 161,872 |
| Appropriations Transferred In/Out | - | 188 | - | 188 |
| Other Adjustments | - | (2,342) | - | (2,342) |
| Appropriations Used | - | (158,740) | - | (158,740) |
| Total Budgetary Financing Sources | - | 978 | - | 978 |
| Total Unexpended Appropriations | - | 37,376 | - | 37,376 |
| Total Net Position | \$ 906 | \$ (1,963,785) | \$ - | \$ (1,962,879) |

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, 2014

| | Funds from Dedicated Collections (Note 19) | All Other Funds | Eliminations | 2014 Consolidated Total |
|--|---|-----------------------|--------------|-------------------------------|
| Cumulative Results of Operations | | | | |
| Beginning Balances | \$ 843 | \$ (1,960,540) | \$ - | \$ (1,959,697) |
| Budgetary Financing Sources | | | | |
| Appropriations Used | - | 149,628 | - | 149,628 |
| Nonexchange Revenue | - | 9 | - | 9 |
| Donations and Forfeitures of Cash and Cash Equivalents | 27 | - | - | 27 |
| Transfer In/Out Without Reimbursement | (3,038) | 3,173 | - | 135 |
| Other Financing Sources (Nonexchange) | | | | |
| Donations and Forfeitures of Property | 40 | 1 | - | 41 |
| Transfers In/Out Without Reimbursement | - | 14 | - | 14 |
| Imputed Financing | - | 2,169 | - | 2,169 |
| Other | - | (471) | - | (471) |
| Total Financing Sources | (2,971) | 154,523 | - | 151,552 |
| Net Cost/(Benefit) of Operations | (3,136) | 185,271 | - | 182,135 |
| Net Change | 165 | (30,748) | - | (30,583) |
| Ending Balance – Cumulative Results | 1,008 | (1,991,288) | - | (1,990,280) |
| Unexpended Appropriations | | | | |
| Beginning Balances | - | 21,211 | - | 21,211 |
| Budgetary Financing Sources | | | | |
| Appropriations Received | - | 166,963 | - | 166,963 |
| Appropriations Transferred In/Out | - | 138 | - | 138 |
| Other Adjustments | - | (2,286) | - | (2,286) |
| Appropriations Used | - | (149,628) | - | (149,628) |
| Total Budgetary Financing Sources | - | 15,187 | - | 15,187 |
| Total Unexpended Appropriations | - | 36,398 | - | 36,398 |
| Total Net Position | \$ 1,008 | \$ (1,954,890) | \$ - | \$ (1,953,882) |

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



DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2015

| | Budgetary | Non- Budgetary Credit Reform Financing Account |
|--|-------------------|--|
| Budgetary Resources (Note 22) | | |
| Unobligated Balance, brought forward, October 1 | 26,446 | 7,529 |
| Recoveries of Prior Year Unpaid Obligations | 2,993 | - |
| Other Changes in Unobligated Balance | (440) | (88) |
| Unobligated Balance from Prior Year Budget Authority, Net | 28,999 | 7,441 |
| Appropriations (Discretionary and Mandatory) | 164,536 | - |
| Borrowing Authority (Discretionary and Mandatory) | - | 106 |
| Spending Authority from Offsetting Collections (Discretionary and Mandatory) | 5,602 | 4,372 |
| Total Budgetary Resources | \$ 199,137 | \$ 11,919 |
| Status of Budgetary Resources | | |
| Obligations Incurred | \$ 170,586 | \$ 3,090 |
| Unobligated Balance, End of Year: | | |
| Apportioned | 16,331 | - |
| Unapportioned | 12,220 | 8,829 |
| Total Unobligated Balance, End of Year | 28,551 | 8,829 |
| Total Budgetary Resources | \$ 199,137 | \$ 11,919 |
| Change in Obligated Balance | | |
| Unpaid Obligations: | | |
| Unpaid Obligations, brought forward, October 1 | 28,205 | 342 |
| Obligations Incurred | 170,586 | 3,090 |
| Outlays (Gross) | (169,122) | (3,114) |
| Recoveries of Prior Year Unpaid Obligations | (2,993) | - |
| Other Adjustments | - | - |
| Unpaid Obligations, End of Year | \$ 26,676 | \$ 318 |
| Uncollected Payments: | | |
| Uncollected Payments, Fed Sources, brought forward, October 1 | (1,905) | - |
| Change in Uncollected Payments, Fed Sources | 233 | - |
| Uncollected Payments, Fed Sources, End of Year, | \$ (1,672) | \$ - |
| Memorandum (Non-Add) Entries: | | |
| Obligated Balance, Start of Year | \$ 26,300 | \$ 342 |
| Obligated Balance, End of Year | 25,004 | 318 |
| Budget Authority and Outlays, Net | | |
| Budget Authority, Gross (Discretionary and Mandatory) | \$ 170,138 | \$ 4,478 |
| Actual Offsetting Collections (Discretionary and Mandatory) | (5,905) | (4,406) |
| Change in Uncollected Payments, Fed Sources (Discretionary and Mandatory) | 233 | - |
| Budget Authority, Net (Total) (Discretionary and Mandatory) | \$ 164,466 | \$ 72 |



| DEPARTMENT OF VETERANS AFFAIRS | | |
|--|--------------------------|--------------------------|
| COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions) | | |
| FOR THE YEAR ENDED SEPTEMBER 30, 2015 | | |
| Outlays, Gross (Discretionary and Mandatory) | \$ 169,122 | \$ 3,114 |
| Actual Offsetting Collections (Discretionary and Mandatory) | <u>(5,905)</u> | <u>(4,406)</u> |
| Outlays, Net (Total) (Discretionary and Mandatory) | 163,217 | (1,292) |
| Distributed Offsetting Receipts | <u>(3,731)</u> | <u>(269)</u> |
| Agency Outlays, Net (Discretionary and Mandatory) | <u>\$ 159,486</u> | <u>\$ (1,561)</u> |

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



DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2014

| | Budgetary | Non-Budgetary Credit Reform Financing Account |
|--|-------------------|--|
| Budgetary Resources (Note 22) | | |
| Unobligated Balance brought forward, October 1 | \$ 10,901 | \$ 5,167 |
| Recoveries of Prior Year Unpaid Obligations | 2,510 | - |
| Other Changes in Unobligated Balance | (297) | (96) |
| Unobligated Balance from Prior Year Budget Authority, Net | 13,114 | 5,071 |
| Appropriations (Discretionary and Mandatory) | 169,136 | - |
| Borrowing Authority (Discretionary and Mandatory) | - | 126 |
| Spending Authority from Offsetting Collections (Discretionary and Mandatory) | 4,862 | 5,253 |
| Total Budgetary Resources | \$ 187,112 | \$ 10,450 |
| Status of Budgetary Resources | | |
| Obligations Incurred | \$ 160,666 | \$ 2,921 |
| Unobligated Balance, End of Year: | | |
| Apportioned | 7,305 | - |
| Unapportioned | 19,141 | 7,529 |
| Total Unobligated Balance, End of Year | 26,446 | 7,529 |
| Total Budgetary Resources | \$ 187,112 | \$ 10,450 |
| Change in Obligated Balance | | |
| Unpaid Obligations: | | |
| Unpaid Obligations, brought forward, October 1 | \$ 27,644 | \$ 346 |
| Obligations Incurred | 160,666 | 2,921 |
| Outlays (Gross) | (157,604) | (2,925) |
| Recoveries of Prior Year Unpaid Obligations | (2,510) | - |
| Other Adjustments | 9 | - |
| Unpaid Obligations, End of Year | \$ 28,205 | \$ 342 |
| Uncollected Payments: | | |
| Uncollected Payments, Fed Sources, brought forward, October 1 | (2,094) | - |
| Change in Uncollected Payments, Fed Sources | 189 | - |
| Uncollected Payments, Fed Sources, End of Year | \$ (1,905) | \$ - |
| Memorandum (Non-Add) Entries: | | |
| Obligated Balance, Start of Year | \$ 25,550 | \$ 346 |
| Obligated Balance, End of Year | 26,300 | 342 |

(continues on next page)



DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions) (continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2014

| | Budgetary | Non-Budgetary Credit Reform Financing Account |
|---|-------------------|--|
| Budget Authority and Outlays, Net | | |
| Budget Authority, Gross (Discretionary and Mandatory) | \$ 173,998 | \$ 5,379 |
| Actual Offsetting Collections (Discretionary and Mandatory) | (5,066) | (5,342) |
| Change in Uncollected Payments, Fed Sources (Discretionary and Mandatory) | 189 | - |
| Budget Authority, Net (Total) (Discretionary and Mandatory) | \$ 169,121 | \$ 37 |
| | | |
| Outlays, Gross (Discretionary and Mandatory) | \$ 157,604 | \$ 2,925 |
| Actual Offsetting Collections (Discretionary and Mandatory) | (5,066) | (5,342) |
| Outlays, Net (Total) (Discretionary and Mandatory) | 152,538 | (2,417) |
| Distributed Offsetting Receipts | (3,418) | (46) |
| Agency Outlays, Net (Discretionary and Mandatory) | \$ 149,120 | \$ (2,463) |

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



Notes to Consolidated Financial Statements

For the Years Ended September 30, 2015 and 2014, (dollars in millions, unless otherwise noted)

1. Summary of Significant Accounting Policies

Organization

The mission of the Department of Veterans Affairs (VA) is to serve America's Veterans, their dependents, and beneficiaries with dignity and compassion, and to be their principal advocate in ensuring that they receive medical care, benefits, social support, and lasting memorials [(38 U.S.C. Section 301(b) 2011)]. The Department is organized under the Secretary of VA (SECVA). The Secretary's office includes a Deputy Secretary and a Chief of Staff. The SECVA has direct lines of authority over the Under Secretary for Health, the Under Secretary for Benefits, and the Under Secretary for Memorial Affairs. Additionally, seven Assistant Secretaries, an Inspector General, a General Counsel, and the chairman of the Board of Veterans' Appeals support the Secretary.

Reporting Entity and Basis of Presentation

VA's 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 (CFO) Act 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 understanding that VA is a component of the U.S. Government, a sovereign entity. VA 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. VA's fiscal year end is September 30th.

Basis of Accounting

The principal financial statements are prepared in accordance with GAAP as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and OMB Circular No. A-136, *Financial Reporting Requirements*, as revised. The Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally*



Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board, establishes a hierarchy of GAAP for Federal financial statements. The principal financial statements, prepared in accordance with GAAP, include the consolidated financial statements prepared on an accrual basis of accounting and the combined statements of budgetary resources which reflect the appropriation and consumption of budget and spending authority and other budgetary resources before eliminations.

The consolidated financial statements include the balance sheets, statements of net cost, and statements of changes in net position. In order to prepare reliable consolidated financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements. However, to remain consistent with the aggregate of the account-level information presented in budgetary reports, the statements of budgetary resources are not consolidated but combined; therefore elimination of intra-entity transactions is not permitted.

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 (SBR) are the basic financial statements that report the Department's Budgetary Resources, Status of Budgetary Resources, Change in Obligated Balance as of year-end and Budget Authority and Outlays, Net for the year ended. Specific forms of budget authority that the Department receives are appropriations, borrowing authority and spending authority from offsetting collections. Details on the amounts shown in the Combined SBR are included in the Required Supplementary Information (RSI) section on the Schedule of Budgetary Activity shown by major account. The Combined SBR is prepared on a combined basis, not a consolidated basis, and therefore, does not include intra-entity eliminations.

See Note 22 for further disclosure on Budgets and Budgetary Accounting.

Revenues and Other Financing Sources

Exchange revenue, which is primarily medical revenue, is 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 are provided and are billable to the first party (Veterans) and third party insurance companies. Under chapter 17, title 38, United States Code, VHA is authorized to bill a Veteran's third-party health



insurer for health care provided at VA and non-VA medical facilities. Generally, VA considers a Veteran's health care billable if the treatment is not for a service-connected disability.

Billable amounts are based on reasonable charges by locality for services provided as determined under the methodology prescribed by 38 CFR Regulation 17.101. Under this methodology, the billable amounts for services provided by VA represent the 80th percentile of nationwide average rates developed from commercial and Medicare statistical data by locality throughout the nation. The statistical data is adjusted by the Consumer Price Index (CPI) to account for the historical nature of the data being utilized. The billable amounts by service provided are developed based on the classification of services as inpatient, outpatient, professional and surgical or non-surgical. The nationwide average rates used to determine billable amounts for services provided for inpatient care are updated annually effective October 1st and nationwide average rates for billable amounts for outpatient and professional care are updated annually effective January 1st. The updated charges are published by a Notice in the Federal Register and the charges are available on the VHA Chief Business Office (CBO) website [Reasonable Charges \(Rates\) Information](http://www1.va.gov/CBO/apps/rates/) or (<http://www1.va.gov/CBO/apps/rates/>). Revenue earned but unbilled is estimated using historical average data. An allowance for contractual adjustments from insurance companies and uncollectible amounts is determined using historical average data.

Exchange revenue consists of: benefits revenue from reimbursement of education benefit programs from Servicemember contributions that are transferred to the general fund account with the Department of the Treasury (Treasury); insurance revenue from insurance policy premiums paid by policyholders; and housing revenue from interest earned on direct loans.

Nonexchange revenue (e.g., donations) is recognized when received, and the related receivables, refunds, and offsets are recognized when measurable and legally collectible. Nonexchange revenue consists of: benefits revenue from reimbursement of education benefit programs by the Department of Defense (DoD); insurance revenue from interest earned from Treasury on investments of insurance policy premiums; and housing revenue from interest earned from Treasury on uninvested balances in financing accounts and reestimates of subsidy.

Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by the Treasury Judgment Fund and post-retirement benefits for VA employees paid by the Office of Personnel Management (OPM).

Transferring Budget Authority to Other Agencies

VA, as the transferring (parent) entity, is a party to allocation transfers with DoD, the transferee (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A



separate fund account (transfer appropriation 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 transfer appropriation 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.

Federal Credit Reform Act of 1990

Direct loan obligations and loan guarantee commitments made after 1991, are governed by the Federal Credit Reform Act of 1990 (the Credit Reform Act). The financial statement disclosures herein are in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 2, *Accounting for Direct Loans and Guarantees*, as amended. The Credit Reform Act provides that the present value of the estimated net cash flows to be paid by VA for subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the loan is disbursed as a result of its borrowing from Treasury. Direct loans and guaranteed loans receivable are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value.

The subsidy costs related to direct loans and guaranteed loans receivable consist of the interest rate differential between the loans to Veterans and the borrowing from Treasury, estimated default costs, net of recoveries, offsets from fees and collections, and other estimated subsidy costs affecting cash flows. Adjustments to the allowance for subsidy costs affecting cash flows consist of fees received, foreclosed property acquired, loans written off, subsidy allowance amortization and reestimates of interest rates, and application of loan technical/default provisions approved by OMB.

When the present value of cash inflows is less than the present value of cash outflows, a subsidy cost is incurred and reported as an allowance for subsidy costs that reduces direct loans and guaranteed loans receivable reported in the consolidated balance sheet. However, a negative subsidy occurs when the present value of cash inflows to VA exceeds the present value of cash outflows made by VA. The resulting negative subsidy is reported as an allowance for subsidy costs that increases direct loans and guaranteed loans receivable reported in the consolidated balance sheet.

The cash flow costs used to calculate the present value of the liability for loan guarantees and loan sale guarantees consist of the estimated default costs, net of recoveries, fees and other collections, adjustments for fees received, foreclosed property and loans acquired, claim payments to lenders, interest accumulation on the liability balance, modifications, changes in reestimates of interest rates and application of loan technical/default provisions approved by OMB.



Direct loans obligated before October 1, 1992, are not subject to the Federal Credit Reform Act and are recorded at the net realizable value given the remaining balance of amounts disbursed plus accrued and unpaid interest receivable. The allowance for loan losses on direct loans obligated before October 1, 1992, is recognized when it is more likely than not that the direct loans will not be totally collected. The allowance of the uncollectible amounts is reestimated each year as of the date of the financial statements. Loan losses are reestimated by program.

Risk factors are evaluated for each program and separate loan year disbursed. Risk factors include historical loan experience, regional economic conditions, financial and relevant characteristics of borrowers, value of collateral to loan balance, changes in recoverable value of collateral and new events that would affect the loans' performance. A systematic methodology based on an econometric model is used to project default costs by risk category. Actual historical experience includes actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Fund Balance with Treasury

Treasury performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury (FBWT) represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Veterans Educational Assistance Program (VEAP) 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.

Revolving funds, used by the Supply Fund and Franchise Fund, finance a cycle of business-like operations through amounts received from the sale of products or services. The collections are used to finance its spending, usually on a self-sustaining basis. Revolving funds record the collections and the outlays in the same Treasury account. A revolving fund is a form of permanent appropriation receiving authority to spend collections and do not generally receive appropriations.

Appropriated funds are general fund expenditure accounts established to record amounts appropriated by law for the general support of Federal Government activities and the subsequent expenditure of these funds. It includes spending from both annual and permanent appropriations.

Special funds are an appropriation account established to record appropriations, obligations, and outlays financed by the proceeds of special fund receipts which are dedicated collections by law for a specific purpose or program. Medical Care Collections Fund and Lease of Land and Building (NCA Facilities Operation Fund) are special funds.



The section 'Status of Fund Balance with Treasury' in the Note 3 table represents VA's unobligated balances, obligated balances and deposit and clearing accounts. The unobligated and obligated balances presented in that section may not equal related amounts reported on the Combined SBR. The unobligated and obligated balances reported on the SBR are supported by FBWT, as well as other budgetary resources that do not affect FBWT, primarily expired authority.

Cash

Cash consists of Canteen Service and Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Occasionally, cash includes cash held by non-federal trusts. 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 2030), 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 housing trust certificates. No securities have been reclassified as securities available for sale or early redemption. Additionally, no permanent impairments of securities have occurred. See Note 19 for additional disclosure of intragovernmental investments in Treasury securities from dedicated collections.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in housing trust certificates. The estimated allowance computations are based upon discounted cash flow analysis. VA continues to use the income from these subordinated housing trust certificates to fund the 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 reported at net realizable value measured as the carrying amount less an allowance for loss provision or contractual adjustment for medical care as considered necessary. Contractual adjustments are estimated for Medical Care Collection Fund (MCCF) receivables due from patients and insurance companies using the allowance method. The allowance is determined based on VA's historical



experience and collection efforts and the contractual nature of the balance due. 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.

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, pension debts and certain education benefits based on a July 1992 decision by the then-VA Deputy Secretary.

Loans Receivable

Loans receivable consist of direct loans and defaulted guaranteed loans receivable. Included in direct loans are vendee loans, acquired loans, and Native American direct loans. These three types of loans receivable are part of the VA Loan Guaranty Program. Direct loans also include loans on Veterans' insurance policies. The loans receivable are secured by the underlying real estate and insurance policies. The present value of the cost VA will bear as guaranteed loans default is an element of the mortgage loan benefit that VA provides to Veterans. This cost is reflected in the financial statements as the liability for guaranteed loans and the allowance for subsidy for defaulted guaranteed loans included in the balance of loans receivable.

Vendee loans are direct loans issued to a third party borrower for the acquisition price of foreclosed real estate sold by VA after the transfer of the property by a private sector mortgage lender upon default of a loan subject to the VA Loan Guaranty Program. Acquired loans are VA guaranteed loans in default that VA purchases from the private sector mortgage lender and services the loan with the Veteran directly after VA determines that the Veteran can service the debt service payments. Native American direct loans are special financing that enables Native Americans to purchase or construct a home on federally recognized trust land.



Veterans that are government life insurance policyholders with permanent plan coverage or paid-up additional insurance can borrow against the cash value of their policy, creating an insurance policy direct loan. The loan amount may not exceed 94 percent of the cash surrender value of the policy or the paid-up additional insurance. Prior to November 2, 1987, policy loans were issued at fixed rates depending on the fund and time period. The remaining fixed rate loans are at 4 percent and 5 percent. All policy loans issued since November 2, 1987, have a variable interest rate with a minimum of 5 percent and a maximum of 12 percent. Rate changes are tied to the ten-year constant maturities, U.S. Treasury Securities Index and may only change on October 1. The variable rate has been 5 percent since October 1, 2001.

The interest due is equal to the interest rate times the loan balance as of the loan anniversary date. Any interest for the year not paid within 20 days of the anniversary date is added to the loan balance. Policyholders may repay loans at their discretion as long as the loan amount plus accumulated interest does not exceed 94 percent of the cash surrender value. If this occurs, the policyholder is notified that their policy will be surrendered unless a minimum payment is received within 90 days. At the policyholder's death or the maturity of the policy, any loan indebtedness is deducted from the insurance proceeds.

Loans receivable for direct loans are recorded as funds are disbursed. The carrying amount of direct loans receivable includes the remaining balance of the amount disbursed, interest receivable, an allowance for loan losses using the allowance method for pre-1992 loans, the present value of an allowance for subsidy costs for post-1991 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property.

Loans receivable for defaulted guaranteed loans are recorded when amounts are disbursed by VA to fund its guaranty with the lender for defaulted loans and represents the net value of the assets related to the pre-1992 and post-1991 guaranteed loans that defaulted. The carrying amount of the guaranteed loans receivable includes the amount dispersed by VA for its guaranty under the defaulted loans, an allowance for loan losses using the allowance method for pre-1992 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property.

For loans obligated prior to October 1, 1991, the loan loss allowance is estimated based on past experience and an analysis of outstanding balances. For loans obligated after September 30, 1991, the allowance for subsidy costs 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.



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 the VA's outstanding vendee or direct loans will default over a 12-year period. For 2015 and 2014, 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.

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. To determine the future cash flows from a foreclosed property, VA obtains an independent appraisal of the property to determine fair market value which is reduced by estimated future carrying and disposal costs such as acquisition, management, selling and transfer costs and estimated gains or losses on property resale.

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. Payments that are received from the debtor are applied first to penalties and administrative costs, second to interest receivable and third to outstanding debt principal.

The recorded value of loans receivable, net, and the value of assets related to direct loans receivable are not the same as the proceeds that VA would expect to receive from selling its loans. 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 receivable and the underlying value of their related assets resulting in a realized gain or loss on sale.

Inventories

Inventories consist primarily of items such as Canteen Service retail store stock held for current sale and are reported at cost using the weighted-average cost method. Inventory that is excess, obsolete or unserviceable is reported at its estimated net realizable value. Upon disposal, any difference between the inventory's recorded amount and the value received for the inventory will be recognized as a gain or loss.

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 are used to provide medical care to Veterans. Property, plant, and equipment, including transfers from other federal agencies, leasehold improvements, other structures not classified as buildings and capital leases are valued at net carrying cost. Multi-use heritage assets are recognized and presented with general property, plant and equipment in the basic financial statements and additional information for the multi-use heritage assets with only incidental government use are classified as and included with the heritage assets information in Note 10. When the capitalization criteria are met, major additions, replacements, and alterations are capitalized, whereas routine maintenance and repairs are expensed when incurred.

VA has a significant construction program for medical facilities, national cemeteries, and other veteran related projects. VA submits its major construction project plans for medical facilities and national cemeteries to Congress for approval prior to receiving appropriated funds. VA maintains separate appropriated fund accounts for each type of project, as authorized, for major and minor construction and non-recurring maintenance projects.

Construction project costs incurred during the design and development phases are recorded in the appropriate Construction Work-in-Process (WIP) accounts including all materials, supplies, services, capital equipment, transportation costs, incremental overhead or support costs, and other construction-related costs directly attributable to the project. The assets are transferred to either capitalized or non-capitalized property, plant, and equipment, as appropriate, when placed in service. Construction projects completed in multiple phases are recorded as Construction WIP until the project phase is placed in service. Personal property and equipment not meeting the capitalization criteria is expensed upon being placed in service.

Individual items are capitalized if the useful life is two years or more and the unit price is \$1 million or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is depreciated on a straight-line basis over its useful life, usually 5 to 20 years.

Internal use software is also subject to the \$1 million threshold for capital assets. The costs subject to capitalization are incurred during the software development phase, and include the design of the chosen path, programming development, installation of hardware and testing, and are accumulated in Software in Development until a project is successfully tested and placed in service. The capitalized 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, which generally ranges from 2 to 4



years. Preliminary design phase costs and post implementation costs are expensed as incurred.

Property, plant and equipment, including construction WIP, internal use software and capitalized lease assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying value of the long-lived asset or asset group is not recoverable, an impairment loss is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including quoted market values and third party independent appraisals, as considered necessary.

VA follows Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which clarifies existing SFFAS 6, *Accounting for Property, Plant, and Equipment*, requirements to account for the disposal, retirement, or removal from service of general property, plant, and equipment (G-PP&E), as well as, the recognition and measurement of disposal related cleanup costs. The guidance differentiates between permanent and other than permanent removal from service of G-PP&E assets and delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

The removal from service is considered other than permanent; unless there is evidence of management's documented decision to permanently remove the asset from service and the asset's use is terminated. Permanent removal from service is evident from management's documented decision to dispose of an asset by selling, scrapping, recycling, donating or demolishing the asset. If only the termination of use or management's decision to permanently remove an asset from use occurs, but not both business events, then permanent removal from service has not occurred and there is no change in the G-PP&E reported value and depreciation continues. Likewise, in the case of G-PP&E cleanup costs, if only one of the two business events has occurred, permanent removal from service has not occurred and any cleanup costs associated with disposal, closure, and/or shutdown should continue to be expensed and accumulate as a liability.

When VA documents its decision to permanently remove an asset from service by selling, scrapping, recycling, donating or demolishing the asset and the asset's use is terminated, depreciation and amortization ceases in anticipation of disposal, retirement, or permanent removal from service; the G-PP&E accounts along with associated accumulated depreciation/amortization is removed from the G-PP&E accounts and recorded in an appropriate asset account at its expected net realizable value. Any difference in the book value of the G-PP&E and its expected net realizable value is recognized as a gain or a loss in the period of adjustment. The expected net realizable value is adjusted at the end of each accounting period and any further adjustments in value are recognized as a gain or a loss.



There are no restrictions on the use or convertibility of G-PP&E. For disclosure regarding Heritage Assets see Note 10.

SFFAS No. 40, *Definitional Changes to Deferred Maintenance; Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*, was adopted by VA for the year ended September 30, 2012. This standard clarifies that repair activities should be included to better reflect asset management practices and improve reporting on deferred maintenance and repairs activities not performed when they should have been, or were scheduled to be, therefore, are put off or delayed for a future period.

FASAB issued SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standard 6, 14, 29 and 32*, which is effective for periods beginning after September 30, 2014. This standard requires expanded qualitative and quantitative disclosure of the deferred maintenance and repairs, including (1) maintenance and repair policies and how they are applied, (2) ranking and prioritizing maintenance and repair activities among other activities, (3) determining acceptable condition standards, (4) whether deferred maintenance and repairs are related solely to capitalized G-PP&E and stewardship property, plant and equipment or to non-capitalized or fully depreciated G-PP&E, (5) G-PP&E excluded from measurement and/or reporting of deferred maintenance and repairs and the rationale for the exclusion of other than non-capitalized or fully depreciated G-PP&E, (6) beginning and ending deferred maintenance and repair balances by category of G-PP&E, and (7) explanation of significant changes from the prior year. Management does not believe that implementation will have a material effect on financial position, results of operations or disclosures. For additional disclosures on deferred maintenance and repairs of G-PP&E, see RSI.

SFFAS No. 44, *Accounting for Impairment of General Property, Plant and Equipment Remaining in Use*, is effective for periods after September 30, 2014. This Statement establishes accounting and financial reporting standards for impairment of G-PP&E remaining in use, except for internal use software. G-PP&E is considered impaired when there is a significant and permanent decline in the service utility of G-PP&E or expected service utility for construction WIP and management has no reasonable expectation that the lost service utility will be replaced or restored. Existing processes and internal controls are expected to reasonably assure identification and communication of potential material impairments, such as those related to deferred maintenance and repairs, and VA will not be required to conduct annual or other periodic surveys solely for the purpose of applying impairment standards.

The loss from impairment is recognized and reported in the statement of net cost in program costs or costs not assigned to programs. Reversals of impairment losses are not recognized. Where an impairment loss is not recognized, adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates may be



appropriate. In the period the impairment loss is recognized, disclosure of the G-PP&E remaining in use for which an impairment loss is recognized, the nature and amount of the impairment, and the financial statement classification of the impairment loss will be provided in the notes to the financial statements. Management does not believe that implementation will have a material effect on financial position and results of operations.

Other Assets

Intragovernmental Other Assets are reported at cost and consist primarily of Intragovernmental Advances - Federal and are primarily advances to the Army Corps of Engineers (Corps) and the General Services Administration (GSA). Public Other Assets are reported at cost and consist of Public Advance Payments made by 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

Accounts payable are amounts owed by VA for goods and services received from, progress in contract performance made by, and rents due to other entities and scheduled compensation, pension and education benefits payable to Veterans. Accounts payable do not include liabilities related to on-going continuous expenses such as employee's salaries, benefits, annuities for insurance programs, interest payable and loan guarantee losses and Veterans compensation, pension and education benefits payable, which are covered by other liabilities. When VA accepts title to goods, whether the goods are delivered or in transit, or incurs costs for services received, VA recognizes a liability for the unpaid amount of the goods and services. If invoices for those goods and services are not available when financial statements are prepared, the amounts owed are estimated.

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. Intragovernmental and public accounts payable are covered by budgetary resources.

Loan Guarantees

VA provides loan guarantees using two types of guaranty programs. Under one program, a loan may be made to an eligible Veteran borrower 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 a default by the Veteran borrower results in a loss by the loan holder. If the loan holder acquires the property which had secured the guaranteed loan at the liquidation sale, the loan holder can elect to convey the property to VA, which then attempts to resell the property at the best possible price and terms.

VA reports the liability on the guarantee of loans in accordance with the requirements of the Credit Reform Act. For these loans, the Liability for Loan Guarantees represents



the present value of the estimated net cash outflows considered most likely to be paid by VA as a result of a claim against the guarantee on a defaulted loan. 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.

The second loan guaranty program involves the sale of direct loans. VA has the authority to bundle vendee and acquired loans and sell them to a third party investor (Trust) pursuant to a sale agreement. Under the sale agreement, the Trust owns the mortgage loans acquired in the sale and will issue certificates backed by the mortgage loans and installment contracts. The certificates represent interests in the assets of the Trust and investors 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. It is at least reasonably possible that the proceeds from the sale of VA's loans will differ from the reported carrying value of those loans and the underlying value of their related assets resulting in a realized gain or loss on sale. 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.

VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs in accordance with the requirements of the Credit Reform Act. For these loans, the Liability for Loan Guarantees represents the present value of the estimated net cash outflows considered most likely to be paid by VA arising from a claim against the guarantee. These loan 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 will be paid by the 15th of each month. If the payment is not made by the borrower, VA allows the loan servicer to take funds from a cash reserve account for the amount of the deficiency. VA also guarantees the loans against loss at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

Loan Guarantee Modifications

OMB Circular No. A-11, section 185, specifies that modifications to existing loan guarantee subsidy costs result from the government's decision to alter the percentage of the loan it will guarantee. The subsidy cost of a modification is the difference between the net present value of the remaining estimated cash flows before and after the modification (i.e., post-modification liability minus pre-modification liability) and the change in carrying amount is recognized as a gain or a loss. A reduction in the loan guarantee liability due to a modification reflects as savings to VA resulting in a modification gain being recognized. An increase in the loan guarantee liability due to a modification reflects increased costs to VA resulting in a modification loss being recognized. The carry amount of the loan guarantee liability reflects the post-modification liability balance.



VA and loan servicers perform loan modifications under current laws without the need to modify executed subsidy estimates for existing loan guarantees from 1992 to 2015.

Insurance Liabilities

Insurance Liabilities for VA's life insurance programs include: policy reserves; unearned premiums; insurance dividends left on deposit and related interest payable; accrued interest payable on insurance policies and dividends payable to policyholders.

Actuarial reserve liabilities for VA's insurance programs for 2015 and 2014 are based on mortality and interest rate assumptions that vary by fund, type of policy, and type of benefit. The interest rate assumptions range from 2.25 to 4.0 percent. The mortality assumptions include the American Experience Table, the X-18 Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, the 1980 CSO Basic Table, and the 2001 Valuation Basic Male (VBM) Table.

National Service Life Insurance (NSLI) basic policy reserves for permanent plans are based on the American Experience Table with 3 percent interest, except for the Modified Life plans, which are based on the 1958 CSO Basic Table with 3 percent interest, and paid-up additions purchased by dividends, which are based on the 2001 VBM Table with 4 percent interest. The reserve for Term policies is based on the 2001 VBM Table with 4 percent interest and the age 70 rate (the capped premium) of \$6.18 per month per \$1,000 face amount.

United States Government Life Insurance (USGLI) permanent plan policy reserves are based on the American Experience Table with 2.5 percent interest and are held on a net single premium basis.

Veterans Special Life Insurance (VSLI) permanent plan policy reserves are based on the X-18 Table at 2.5 percent interest, except for paid-up additions, which are based on the 2001 VBM Table with 4 percent interest. The reserve for Term policies is based on the 2001 VBM Table with 4 percent interest and the age 70 rate (the capped premium) of \$5.87 per month per \$1,000 face amount.

Service-Disabled Veterans Insurance (S-DVI) permanent plan policy reserves are based on the 1941 CSO Table at 3.5 percent interest using rate book premiums. The reserve for 5-Year Term policies is based on varying ratios of the 1941 CSO Table at 3.5 percent interest using rate book premiums and is computed on a complete contract basis. The mortality ratios start at 250 percent for ages 50 and below and grade down to 100 percent of the table for ages 65 and older. The reserve for Term policies renewed at age 70 and over is based on the 1941 CSO Table with 3.5 percent interest and the age 70 Term capped premium of \$5.87 per month per \$1,000 face amount.



Veterans Reopened Insurance (VRI) basic policy reserves are based on an interest rate of 3.5 percent and a mortality basis that varies by segment ("J", "JR" or "JS") and by rating code within the "JR" segment. For "J", the basis is 100 percent of the 1958 CSO Basic Table. For "JR", the basis is the same as the rating code (150, 175, 200, 250, 300, 400 or 500 percent) of the Basic Table. For "JS", the basis is the American Experience Table, and the reserve is a single premium. Reserves for paid-up additions are based on the 2001 VBM Table and 4 percent interest for "J", the 1958 CSO Basic Table and 4 percent interest for "JR", and 150 percent of the 1958 CSO Basic Table and 4 percent interest for "JS".

The Veterans' Mortgage Life Insurance (VMLI) program is operated through the Veterans' Insurance & Indemnities (VI&I) fund. The reserve for VMLI policies is based on 500 percent of the 1958 CSO Basic Table at 2.5 percent interest.

A reserve for unearned premiums is held for premiums paid for coverage past the date of the statement. It is comprised of an estimate for premiums paid less than one month in advance that are unearned at the end of the reporting period, and a reserve for premiums paid one month or more in advance computed from in-force master records.

Insurance dividends that are left on credit or deposit with VA, accrue interest at a rate that varies by fund relative to the fund's investment portfolio earnings. For 2015 and 2014, the interest rates ranged from 3.5 percent to 5.0 percent.

The SECVA determines annually the excess funds available for dividend payment. 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. Policies in four of the administered programs are eligible for dividends: NSLI, USGLI, VSLI and VRI. The dividend authorization is based on an actuarial analysis of each program's claims and investment experience, compared to the mortality and interest assumptions utilized in that program at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. 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.

The reserve for Dividends Payable is an estimate of the present value of dividends accrued as of the valuation date. In accordance with GAAP requirements, VA records only that portion of the estimated policy dividend that applies to the current reporting period as a dividend liability. For 2015 and 2014, a discount rate of 4 percent (2.5 percent for USGLI), along with the appropriate accrual factor, was used. The methodology employed by VA to estimate the dividend liability reflects expected dividends to be paid by quarter using percentages that are based on the actual distribution of dividend anniversaries at the end of the prior year.



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, and therefore, these liabilities are not covered by budgetary resources.

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. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds.

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's 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 total number of Veterans, estimated future military separations, the number of Veterans and dependents receiving payments, discount rates, cost of living adjustments, presumptive service conditions resulting in disability benefits coverage and life expectancy, impact the amount of the liability.

Discount rates used to measure the actuarial liabilities are based on spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities at September 30 of each year for the 10-year historical period with maturities consistent with the period of expected future payments. As a result, each year for which expected future payments are projected has a separate discount rate associated with it. However, a single weighted average discount rate is also disclosed that may be used for all projected future payments that results in a present value that is not materially different than the resulting present value using multiple-rates.

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 known material 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, Cost-of-Living Adjustment (COLA), and the other economic assumptions. For 2015, valuation techniques or their application used to measure the fair value of the actuarial liabilities were consistently applied compared to the previous year.

From time to time, VA may determine it is preferable to make refinements to the valuation techniques or their application used to measure the fair value of the actuarial liabilities because VA management concludes that the resulting measurements are equally or more representative of fair value of the actuarial liabilities in the circumstances and were due to improved computer software modeling capability and/or improved information. The resulting changes in fair value of the actuarial liabilities from the changes in valuation techniques or their application are treated as a change in estimate and accounted for on a prospective basis.

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. The SECVA



relying on independent studies by the Institute of Medicine (IOM) determines whether presumptions of service connection are warranted and presumptive disability benefit payments are due. Upon determination by the SECVA that presumptive disability benefit payments are due, there is a waiting period and a final regulation is issued. In accordance with the Agent Orange Act, the adjudication of cases based on the new presumption has begun and a liability has been recognized.

SFFAS 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) applies to the actuarial liabilities recognized for Veterans compensation and burial obligations reported in VA's financial reports prepared pursuant to 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 Cost. 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.

Commitments and 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 resolution of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations other than as disclosed in Note 18, Commitments and Contingencies.

Non-Federal Trusts

VA has entered into enhanced-use leases to maximize use of underutilized VA property. Certain enhanced-use leases were entered into with non-federal trusts. VA leased back the assets developed by the non-federal trusts under long-term leases. The assets developed by the non-federal trusts include cogeneration plants, office buildings, or parking garages and were financed with public bonds. The public bonds are repaid from the cogeneration fees and lease payments made by VA under the leases as long as VA utilizes these facilities. Under the lease arrangements, VA is the primary beneficiary of the trust assets with the obligation to absorb the majority of any expected losses and receive the majority of the residual returns that could be significant. As a result, VA has a controlling financial interest in the non-federal trust assets under the enhanced-use leases. Accordingly, the assets, liabilities, and results of operations of



these six trusts under the enhanced-use leases are consolidated with VA operations in the accompanying consolidated financial statements.

Application of Critical Accounting Estimates

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

Subsequent Events

Subsequent events have been evaluated through the auditors' report date which is the date the financial statements were available to be issued, and management determined that there are no other items to disclose.

2. Non-Entity Assets

Entity and Non-Entity assets have been combined on the balance sheet. Non-Entity assets relate primarily to state and local taxes and other employee payroll withholdings and personal funds of patients included in FBWT; downward reestimates for the Veterans Housing Program included in Intragovernmental Accounts Receivable; and amounts due to Treasury for medical costs billed to Veterans included in Public Accounts Receivable.

There are offsetting liabilities in the consolidated balance sheet for the non-entity assets reported below. Offsetting liabilities are included in Intragovernmental Other Liabilities and Accounts Payable and Public Other Liabilities, Insurance Liabilities and Accounts Payable. There is no balance in the consolidated net position from the non-entity assets.

Non-Entity Assets as of September 30,

| | 2015 | 2014 |
|---------------------------------------|---------------|---------------|
| Fund Balance with Treasury | \$ 138 | \$ 118 |
| Intragovernmental Accounts Receivable | 349 | 1 |
| Public Accounts Receivable | 38 | 73 |
| Total Non-Entity Assets | \$ 525 | \$ 192 |



3. Fund Balance with Treasury

Fund Balance with Treasury

as of September 30,

| | 2015 | 2014 |
|---|------------------|------------------|
| Entity Assets | | |
| Trust Funds | \$ 78 | \$ 91 |
| Revolving Funds | 9,664 | 8,360 |
| Appropriated Funds | 49,820 | 48,850 |
| Special Funds | 430 | 407 |
| Other Fund Types | 53 | 61 |
| Total Entity Assets | <u>60,045</u> | <u>57,769</u> |
| Non-Entity Assets | | |
| Other Fund Types | 138 | 118 |
| Total Non-Entity Assets | <u>138</u> | <u>118</u> |
| Total Entity and Non-Entity Assets | <u>\$ 60,183</u> | <u>\$ 57,887</u> |
| Reconciliation of VA General Ledger Balances with Treasury | | |
| Balance per VA General Ledger | \$ 60,212 | \$ 52,992 |
| Reconciled Differences, Principally Timing | (29) | 4,792 |
| Unreconciled Differences | - | 103 |
| Fund Balance with Treasury | <u>\$ 60,183</u> | <u>\$ 57,887</u> |
| Status of Fund Balance with Treasury | | |
| Unobligated Balance | | |
| Available | \$ 16,203 | \$ 7,267 |
| Unavailable | 19,566 | 25,071 |
| Obligated Balance Not Yet Disbursed | 23,932 | 25,085 |
| Deposit /Clearing Account Balances | 482 | 464 |
| Fund Balance with Treasury | <u>\$ 60,183</u> | <u>\$ 57,887</u> |

4. Cash

Cash

as of September 30,

| | 2015 | 2014 |
|-----------------------|-------------|-------------|
| Canteen Service | \$ 2 | \$ 2 |
| Agent Cashier Advance | 2 | 3 |
| Total Cash | <u>\$ 4</u> | <u>\$ 5</u> |



5. Investments

Investment Securities as of September 30, 2015

| | Cost | Amortization Method | Amortized (Premium) / Discount | Interest Receivable | Investments, Net | Market Value |
|---|-----------------|---------------------|--------------------------------|---------------------|------------------|-----------------|
| Intragovernmental Securities (Note 19) | | | | | | |
| Non-Marketable: Special Bonds | \$ 6,865 | N/A | \$ - | 49 | 6,914 | \$ 6,914 |
| Treasury Notes | 108 | Effective Interest | (1) | 1 | 108 | 108 |
| Total | \$ 6,973 | | \$ (1) | 50 | 7,022 | \$ 7,022 |
| Public Securities | | | | | | |
| Trust Certificates (Loan Guaranty) | \$ 140 | N/A | \$ - | - | 140 | \$ 140 |
| Mutual Funds (Non-Federal Trusts) | 45 | Straight-line | (7) | - | 38 | 38 |
| Total | \$ 185 | | \$ (7) | - | 178 | \$ 178 |

as of September 30, 2014

| | | | | | | |
|---|-----------------|--------------------|---------------|-----------|--------------|-----------------|
| Intragovernmental Securities (Note 19) | | | | | | |
| Non-Marketable: Special Bonds | \$ 7,700 | N/A | \$ - | 60 | 7,760 | \$ 7,760 |
| Treasury Notes | 67 | Effective Interest | (1) | 1 | 67 | 67 |
| Total | \$ 7,767 | | \$ (1) | 61 | 7,827 | \$ 7,827 |
| Public Securities | | | | | | |
| Trust Certificates (Loan Guaranty) | \$ 140 | N/A | \$ - | - | 140 | \$ 140 |
| Mutual Funds (Non-Federal Trusts) | 44 | Straight-line | (6) | - | 38 | 38 |
| Total | \$ 184 | | \$ (6) | - | 178 | \$ 178 |

6. Accounts Receivable, Net

Accounts Receivable, Net as of September 30,

| | 2015 | 2014 |
|---|--------------|--------------|
| Intragovernmental Accounts Receivable | \$ 46 | \$ 40 |
| Public Accounts Receivable | | |
| Medical Care | \$ 2,803 | \$ 2,655 |
| Contractual Adjustment and Allowance for Loss Provision | (1,613) | (1,113) |
| Net Medical Care | 1,190 | 1,542 |
| Compensation and Pension | 1,298 | 1,281 |
| Allowance for Loss Provision | (633) | (564) |
| Net Compensation and Pension | 665 | 717 |
| Education Benefits | 431 | 419 |



**Accounts Receivable, Net
as of September 30,**

| | | |
|---|-----------------|-----------------|
| Allowance for Loss Provision | (175) | (150) |
| Net Education Benefits | 256 | 269 |
| Other | 126 | 124 |
| Allowance for Loss Provision | (55) | (21) |
| Net Other | 71 | 103 |
| Total Public Accounts Receivable | 4,658 | 4,479 |
| Total Contractual Adjustment and Allowance for Loss Provision | (2,476) | (1,848) |
| Public Accounts Receivable, Net | \$ 2,182 | \$ 2,631 |

The Total Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Public Accounts Receivable was approximately 47 percent and 41 percent at September 30, 2015 and 2014, respectively. The Medical Care Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Medical Care related accounts receivable was approximately 47 percent and 42 percent at September 30, 2015 and 2014, respectively.

Included in the Medical Care Contractual Adjustment and Allowance for Loss Provision is an Allowance for Contractual Adjustment of \$747 million and \$697 million or approximately 56 percent and 55 percent, respectively of MCCF third party receivables of \$1.34 billion and \$1.27 billion at September 30, 2015 and 2014, 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 49 percent and 45 percent at September 30, 2015 and 2014, respectively. The Education Benefits Allowance for Loss Provision as a percentage of Total Education Benefits and Readjustment Benefit Overpayment-related accounts receivable was approximately 41 percent and 36 percent at September 30, 2015 and 2014, respectively. Post-Vietnam Era, Veterans Education Account Allowance for Loss Provision as a percentage of Total Post-Vietnam Era, Veterans Education Account Overpayment-related accounts receivable was approximately 98 percent and 99 percent at September 30, 2015 and 2014, respectively.

7. Direct Loans and Loan Guarantees

As more fully discussed in Note 1 under the Loans Receivable and Loan Guarantees sections, the accounting for direct loans receivable and loan guarantee liabilities made after 1991 is governed by the Credit Reform Act. Disclosure of direct loans receivable and loan guarantee liabilities is provided in accordance with SFFAS 2, *Accounting for Direct Loans and Guarantees*, as amended.

VA operates the following direct loan and loan guaranty programs:

- Home Loans



- Vocational Rehabilitation and Employment
- Insurance

The VA Home Loan program is the largest of the loan programs. It provides loan guarantees and direct loans to Veterans, Servicemembers, qualifying dependents, and limited non-Veterans to purchase homes and retain homeownership with favorable market terms.

VA operates in the broader mortgage marketplace. As a result, the housing program is affected by overall housing market conditions. The current mortgage market has demonstrated steady improvements; and homeowner equity is recovering. VA and loan servicers will be better able to use foreclosure-resolution and avoidance tools to improve the outcomes of servicing efforts offered to borrowers with delinquent VA guaranteed home loans.

VA projects, funds, and reports the long-term direct costs for these loans, which includes estimates of loan lifetime costs incurred by the government from making VA loans. These estimates of long-term costs are updated annually and represent capital required to cover expected lifetime loan losses. Some drivers for the reestimated capital required are as follows:

1. Service-connected home loans are a larger proportion of new home loan guarantees in 2015. Purchase home loans, however, are a smaller proportion of new home loan guarantees in 2015. Service-connected home loans have lower funding fee rates compared to purchase home loans and generate less collection for the government.
2. A lower projected recovery rate in 2016 for existing home loans based on actual recoveries in 2015. The lower recovery rate generates less property sales proceeds, or recoveries on defaulted loans.
3. Interest expense on additional cash set aside to cover future mortgage losses. Additional cash is set aside because of more service-connected refinance home loans and the owner home loan recovery rate.

VA performs economic modeling and analysis using available loan portfolio data and economic assumptions correlated with some key loan data (foreclosures, outlays and collections, home prices, interest rates, and loan prepayments and terms). These estimates are based on current conditions that may change in the future. Actual results may differ materially from estimated amounts.

The Vocational Rehabilitation and Employment direct loans provide temporary financial assistance to eligible beneficiaries. Loans provided under this program are interest free and must be repaid within 10 months.

Veterans that are government life insurance policyholders with permanent plan coverage or paid-up additional insurance can borrow against the cash value of their



policy, creating an insurance policy direct loan. The loan amount may not exceed 94 percent of the cash surrender value of the policy or the paid-up additional insurance.

Direct Loans

The following tables summarize the carrying amount of loans receivable related to pre-1992 and post-1991 direct loans. The carrying amount of direct loans receivable includes the remaining balance of the amount disbursed, interest receivable, an allowance for loan losses using the allowance method (estimated uncollectible loans) for pre-1992 loans, the present value of an allowance for subsidy costs for post-1991 loans, and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property. 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 and Insurance Policy Loans From Direct Loans as of September 30, 2015

| | Loans Receivable, Gross | Interest Receivable | Allowance for Loan Losses | Foreclosed Property | Value of Assets Related to Direct Loans, Net |
|--|-------------------------|---------------------|--|---------------------|--|
| Direct Loans Obligated | | | | | |
| Prior to 1992 (Allowance for Loss Method) | \$ 3 | 6 | - | - | \$ 9 |
| Insurance Policy Loans | 308 | 8 | - | - | 316 |
| Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net | | | | | \$ 325 |
| | Loans Receivable, Gross | Interest Receivable | Allowance for Subsidy Cost (Present Value) | Foreclosed Property | Value of Assets Related to Direct Loans, Net |
| Direct Loans Obligated After 1991 | \$ 471 | 20 | 58 | 25 | \$ 574 |
| Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net | | | | | \$ 899 |



**Loans Receivable and Related Foreclosed Property and Insurance Policy Loans From Direct Loans
as of September 30, 2014**

| | Loans Receivable, Gross | Interest Receivable | Allowance for Loan Losses | Foreclosed Property | Value of Assets Related to Direct Loans, Net |
|--|-------------------------------|------------------------|---------------------------------|------------------------|---|
| Direct Loans Obligated | | | | | |
| Prior to 1992 (Allowance for Loss Method) | \$ 5 | 6 | - | - | \$ 11 |
| Insurance Policy Loans | 345 | 8 | - | - | 353 |
| Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net | | | | | \$ 364 |

| | Loans Receivable, Gross | Interest Receivable | Allowance for Subsidy Cost (Present Value) | Foreclosed Property | Value of Assets Related to Direct Loans, Net |
|---|-------------------------------|------------------------|---|------------------------|---|
| Direct Loans Obligated After 1991 | \$ 512 | 19 | 58 | 27 | \$ 616 |
| Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net | | | | | \$ 980 |

Direct Loans Disbursed

The total amount of new direct loans disbursed for the years ended September 30, 2015 and 2014, was \$9.6 million and \$4.8 million, respectively.

Subsidy Expense for Post-1991 Direct Loans

Subsidy expense reflected no material change over the prior year and the methodology used to compute the subsidy expense was consistent with the prior year.

Input data and assumptions were changed based on analysis of loan performance and economic conditions in 2015. Actual borrower collections were better than anticipated, which translated into increased funding for direct loans in 2015. The fund's outstanding mortgage interest rates were revised downward, based on 2015 financial results. The changes in economic assumptions were marginal drivers in analysis of change in subsidy estimates for future potential bad loans. Actual home price appreciation, mortgage rate, and Treasury bond yield were better than their predicted values. The combination of extra actual collections and revised mortgage rates should produce lower future mortgage interest income.

The subsidy expense for direct loans is as shown:

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

| | 2015 | 2014 |
|-----------------------|------------|------------|
| Interest Differential | \$ (2) | \$ (2) |
| Defaults | 1 | 1 |
| Subtotal | (1) | (1) |



Direct Loan Subsidy Expense

for the years ended September 30,

| | | |
|--|-------------|----------------|
| Interest Rate Reestimates | 6 | 3 |
| Technical Reestimates | (3) | (25) |
| Total Direct Loan Subsidy Expense | <u>\$ 2</u> | <u>\$ (23)</u> |

Budgetary 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 both current year loans and prior year(s) loans. The subsidy expense reported in the current year also includes reestimates.

Budgetary Subsidy Rates for Direct Loans by Component

| | |
|-----------------------|----------|
| Interest Differential | (37.12%) |
| Defaults | 12.06% |
| Fees | (1.60%) |
| Other | .81% |

Allowance for Subsidy for Direct Loans (Post-1991)

For these loans, the allowance for subsidy represents the difference between the balance of the direct loan and the present value of the estimated net cash flows to be paid by VA. The allowance for subsidy 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 2015, the subsidy rate is (20.79) percent for Veterans Housing Direct – Vendee Loans, (5.06) percent for Veterans Housing Direct – Acquired Loans, and (17.04) percent for Native American Direct. For 2014, the subsidy rate is (24.13) percent for Veterans Housing Direct – Vendee Loans, (5.00) percent for Veterans Housing Direct – Acquired Loans, and (16.75) percent for Native American Direct. The negative balances related to the allowance for subsidy shown below represent an increase in the post -1991 direct loan balances reported in the direct loan table.

Schedule for Reconciling Subsidy Cost Allowance Balances

Beginning Balance, Changes and Ending Balance

| | 2015 | 2014 |
|---|------------|------------|
| Beginning balance of the allowance | \$ (59) | \$ (56) |
| Subsidy expense for direct loans disbursed during the reporting years by component: | | |
| Interest subsidy costs | (2) | (2) |
| Default costs (net of recoveries) | 1 | 1 |
| Total of the above subsidy expense components | <u>(1)</u> | <u>(1)</u> |
| Adjustments: | | |
| Foreclosed property acquired | (7) | (11) |
| New Loans | 1 | - |
| Loans written off | 8 | (3) |
| Subsidy allowance amortization | (3) | 2 |
| Change in reestimate approved by OMB | - | 32 |
| Total Adjustments | <u>(1)</u> | <u>20</u> |



Beginning Balance, Changes and Ending Balance

| | | |
|---|---------|---------|
| Ending balance of the allowance before reestimates | (61) | (37) |
| Subsidy reestimates by component | | |
| Interest rate reestimate | 6 | 3 |
| Technical/default reestimate | (3) | (25) |
| Total of the above reestimate components | 3 | (22) |
| Ending balance of the allowance | \$ (58) | \$ (59) |

Loan Guarantees

The following tables summarize the carrying amount of loans receivable related to pre-1992 and post-1991 defaulted guaranteed loans. The carrying amount of the guaranteed loans receivable includes the amount dispersed by VA for its guaranty under the defaulted loans, an allowance for loan losses using the allowance method (estimated uncollectible loans) for pre-1992 loans, and the fair market value less the cost to dispose of foreclosed property based on the present value of future cash flows from the property.

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, 2015

| | Loans Receivable, Gross | Interest Receivable | Allowance for Loan Losses | Foreclosed Property | Value of Assets Related to Loans |
|--|----------------------------|------------------------|------------------------------|------------------------|-------------------------------------|
| Defaulted Guaranteed Loans – Pre-1992 Guarantees (Allowance for Loss Method) | \$ 22 | - | 8 | 2 | \$ 32 |
| Defaulted Guaranteed Loans - Post-1991 Guarantees | 9 | - | - | 866 | 875 |
| Total Loans Receivable and Related Foreclosed Property from Loan Guarantees | | | | | <u>\$ 907</u> |

Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30, 2014

| | Loans Receivable, Gross | Interest Receivable | Allowance for Loan Losses | Foreclosed Property | Value of Assets Related to Loans |
|--|----------------------------|------------------------|------------------------------|------------------------|-------------------------------------|
| Defaulted Guaranteed Loans- Pre-1992 Guarantees (Allowance for Loss Method) | \$ 28 | - | 5 | 3 | \$ 36 |
| Defaulted Guaranteed Loans – Post-1991 Guarantees | 5 | - | - | 817 | 822 |
| Total Loans Receivable and Related Foreclosed Property from Loan Guarantees | | | | | <u>\$ 858</u> |

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 or a delegated Staff Appraisal Reviewer to substantiate 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.

There has been no change in the methodology for calculating the amount recorded for foreclosed property and there are no restrictions on the use or disposition of foreclosed property for the years ended September 30, 2015 and 2014.

Real Estate Owned as of September 30,

| | 2015 | 2014 |
|-------------------------------|---------------|---------------|
| Opening Balance | \$ 846 | \$ 1,048 |
| Acquisitions Direct Loans | \$ 14 | \$ 30 |
| Acquisitions Guaranteed Loans | \$ 1,501 | \$ 1,528 |
| Gain/Loss on Sale | \$ (263) | \$ (368) |
| Proceeds from Sale | \$ (1,415) | \$ (1,649) |
| Property Management Expense | \$ 210 | \$ 257 |
| Ending Balance | <u>\$ 893</u> | <u>\$ 846</u> |

As of September 30, 2015 and 2014, the number of residential properties in VA's inventory was approximately 7,645 and 8,180, respectively. For 2015 and 2014, the average holding period from the date properties were conveyed to VA until the date properties were sold was approximately 6 months and 9 months, respectively. The number of properties for which foreclosure proceedings are in process was approximately 29,649 and 29,900 as of September 30, 2015 and 2014, respectively.

Guaranteed Loans as of September 30,

| | 2015 | 2014 |
|---|-------------|-------------|
| <u>Guaranteed Loans Outstanding:</u> | | |
| Outstanding Principal of Guaranteed Loans, Face Value | \$ 453,877 | \$ 389,272 |
| Amount of Outstanding Principal Guaranteed | \$ 117,375 | \$ 101,506 |
| Loan Principal Collections, New Guaranteed Loans | \$ (1,337) | \$ (756) |
| Termination of Outstanding Principal Guaranteed, Face Value | \$ (69,702) | \$ (36,793) |
| <u>New Guaranteed Loans Disbursed:</u> | | |
| Outstanding Principal of Guaranteed Loans, Face Value | \$ 134,307 | \$ 86,819 |



Guaranteed Loans

as of September 30,

| | | | | |
|--|----|----------------|----|----------------|
| Amount of Outstanding Principal Guaranteed | \$ | 33,776 | \$ | 22,043 |
| Number of New Loans Disbursed | | <u>558,434</u> | | <u>386,872</u> |

Liabilities for Pre-1992 and Post-1991 Loan Guarantees, Excluding Loan Sale Guarantees (Present Value Method)

| | | | |
|----|--------------|----|--------------|
| \$ | <u>9,772</u> | \$ | <u>8,753</u> |
|----|--------------|----|--------------|

Subsidy Expense for Post-1991 Loan Guarantees

Pursuant to the Credit Reform Act, subsidy costs for new loan guarantees, net of up front funding fees, must be obligated at the time the loan is disbursed. The current and prior year upward reestimate was principally caused by increasing claim payments following the housing crisis, increasing demand for new refinance loan guarantees resulting from lower mortgage rates, higher home sale prices and a recovering housing market. Specifically, the Loan Guarantee Financing Account (4129) operating income deteriorated on higher foreclosure claim payments that were inconsistent with rising home prices. The loan guarantee average funding fee rate deteriorated on higher demand for refinance loan guarantees. Deterioration in the average funding fee rate relative to budget contributed to upward reestimates. 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,

| | | 2015 | | 2014 |
|---|----|----------------|----|----------------|
| Defaults | \$ | 2,566 | \$ | 1,384 |
| Fees | | <u>(2,161)</u> | | <u>(1,404)</u> |
| Subtotal | | <u>405</u> | | <u>(20)</u> |
| Interest Rate Reestimates | | 43 | | 58 |
| Technical Reestimates | | <u>57</u> | | <u>367</u> |
| Total Guaranteed Loan Subsidy Expenses | \$ | <u>505</u> | \$ | <u>405</u> |

Budgetary 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.

Budgetary Subsidy Rates for Loan Guarantees

| | |
|----------|---------|
| Defaults | 1.69% |
| Fees | (1.42)% |



Liability for Loan Guarantees (Post-1991)

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 subsidy rate for 2015 was 0.27 percent. In the table below, the current year and prior year upward reestimate was principally caused by a higher proportion of new refinance loan guarantees and unanticipated increase claim payment rates for some older loan guarantees with steady improvements in housing market conditions.

Schedule for Reconciling Loan Guarantee Liability Balance Beginning Balance, Changes and Ending Balance

| | 2015 | 2014 |
|---|----------|----------|
| Beginning balance of the liability | \$ 8,532 | \$ 7,559 |
| Subsidy expense for guaranteed loans disbursed during the reporting years by component: | | |
| Default costs (net of recoveries) | 2,566 | 1,384 |
| Fees and other collections | (2,161) | (1,404) |
| Total of the above subsidy expense components | 405 | (20) |
| Adjustments: | | |
| Fees received | 1,804 | 1,366 |
| Foreclosed property | (645) | (352) |
| Claim payments to lenders | (972) | (940) |
| Interest accumulation on the liability balance | 181 | 162 |
| Change in reestimate approved by OMB | 138 | 332 |
| Total Adjustments | 506 | 568 |
| Ending balance of the liability before reestimates | 9,443 | 8,107 |
| Subsidy reestimates by component | | |
| Interest rate reestimate | 43 | 58 |
| Technical/default reestimate | 57 | 367 |
| Total of the above reestimate components | 100 | 425 |
| Ending balance of the liability | \$ 9,543 | \$ 8,532 |

Schedule for Reconciling Pre-1992 Loan Guarantee Liabilities Beginning Balance, Changes and Ending Balance

| | 2015 | 2014 |
|---|--------|--------|
| Beginning balance of the liability | \$ 222 | \$ 208 |
| Claims | 1 | (1) |
| Foreclosed Properties | (2) | (1) |



| | | |
|-----------------------------------|---------------|---------------|
| Veteran Liability Debts | 4 | 20 |
| Amortization of Liability Balance | 4 | (4) |
| Total | \$ 229 | \$ 222 |

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 has the authority to 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 1992 through 2014, the total loans sold amounted to \$14.2 billion. VA recognized no loan sale proceeds or gain or loss on sale of loans during 2015. The components of the outstanding balance for guaranteed loans sold are summarized in the table below:

| Outstanding Balance of Loan Sale Guarantees - Guaranteed Loans Sold as of September 30, | | |
|--|-----------------|-----------------|
| | 2015 | 2014 |
| Outstanding Balance Guaranteed Loans Sold, Start of Year | \$ 1,415 | \$ 1,597 |
| Payments, Repayments, and Terminations | (207) | (182) |
| Outstanding Balance Guaranteed Loans Sold, End of Year | \$ 1,208 | \$ 1,415 |

Subsidy Expense for Loan Sale Guarantees

Pursuant to the Credit Reform Act, subsidy costs for new loan sale guarantees must be obligated at the time the loan sale is closed. The subsidy expense for loan sale guarantees is below:



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

| | 2015 | 2014 |
|---|----------------|----------------|
| Defaults | \$ - | \$ - |
| Fees | - | - |
| Other | - | - |
| Subtotal | <u>-</u> | <u>-</u> |
| Interest Rate Reestimates | (21) | 2 |
| Technical Reestimates | (7) | (13) |
| Total Loan Sale-Guaranteed Subsidy Expense | <u>\$ (28)</u> | <u>\$ (11)</u> |

Schedule for Reconciling Loan Sale Guarantee Liability Balances

| Beginning Balance, Changes and Ending Balance | 2015 | 2014 |
|---|---------------|---------------|
| Beginning balance of the liability | \$ 154 | \$ 166 |
| Adjustments: | | |
| Claim payments to lenders | (3) | (24) |
| Interest accumulation on the liability balance | 9 | 9 |
| Change in reestimate approved by OMB | 9 | 14 |
| Total Adjustments | <u>15</u> | <u>(1)</u> |
| Ending balance of the liability before reestimates | <u>169</u> | <u>165</u> |
| Subsidy reestimates by component | | |
| Interest rate reestimate | (21) | 2 |
| Technical/default reestimate | (7) | (13) |
| Total of the above reestimate components | <u>(28)</u> | <u>(11)</u> |
| Ending balance of the liability | <u>\$ 141</u> | <u>\$ 154</u> |

Program Totals

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

| | 2015 | 2014 |
|--|-----------------|-----------------|
| Total Direct Loans | \$ 899 | \$ 980 |
| Total Guaranteed Loans | 907 | 858 |
| Total Loans Receivable and Related Foreclosed Property, Net | <u>\$ 1,806</u> | <u>\$ 1,838</u> |

Total Subsidy Expense
for the years ended September 30,

| | 2015 | 2014 |
|------------------------------|---------------|---------------|
| Total Direct Loans | \$ 2 | \$ (23) |
| Total Guaranteed Loans | 505 | 405 |
| Total Loan Sales | (28) | (11) |
| Total Subsidy Expense | <u>\$ 479</u> | <u>\$ 371</u> |

Total Liabilities for Loan Guarantees
as of September 30,

| | 2015 | 2014 |
|---|----------|----------|
| Total Loan Guarantee Liability | \$ 9,543 | \$ 8,532 |
| Total Pre-1992 Loan Guarantee Liability | 229 | 222 |



**Total Liabilities for Loan Guarantees
as of September 30,**

| | 2015 | 2014 |
|--|-----------------|-----------------|
| Total Loan Sale Guarantee Liability | 141 | 154 |
| Total Liabilities for Loan Guarantees | \$ 9,913 | \$ 8,908 |

Administrative Expense

Administrative expense for direct and guaranteed loans for the fiscal years ended September 30, 2015 and 2014, was \$161 million and \$160 million, respectively.

8. Inventory and Related Property, Net

Inventory

as of September 30,

| | 2015 | 2014 |
|--------------------------|--------------|--------------|
| Purchased for Resale | \$ 49 | \$ 49 |
| Total Inventories | \$ 49 | \$ 49 |

9. General Property, Plant and Equipment

**General Property, Plant and Equipment
as of September 30, 2015**

| | Cost | Accumulated Depreciation /Amortization | Net Book Value |
|---|------------------|---|------------------|
| Land and Improvements | \$ 1,425 | \$ (373) | \$ 1,052 |
| Buildings | 29,424 | (15,811) | 13,613 |
| Equipment | 4,236 | (2,657) | 1,579 |
| Other Structures and Capital Leases | 4,128 | (2,293) | 1,835 |
| Internal Use Software | 1,441 | (1,060) | 381 |
| Construction Work in Progress | 4,620 | - | 4,620 |
| Internal Use Software in Development | 988 | - | 988 |
| Total Property, Plant, and Equipment | \$ 46,262 | \$ (22,194) | \$ 24,068 |

**General Property, Plant and Equipment
as of September 30, 2014**

| | Cost | Accumulated Depreciation /Amortization | Net Book Value |
|---|------------------|---|------------------|
| Land and Improvements | \$ 1,345 | \$ (298) | \$ 1,047 |
| Buildings | 27,253 | (15,035) | 12,218 |
| Equipment | 4,371 | (2,568) | 1,803 |
| Other Structures and Capital Leases | 3,941 | (2,153) | 1,788 |
| Internal Use Software | 1,033 | (784) | 249 |
| Construction Work in Progress | 4,855 | - | 4,855 |
| Internal Use Software in Development | 323 | - | 323 |
| Total Property, Plant, and Equipment | \$ 43,121 | \$ (20,838) | \$ 22,283 |



Depreciation and amortization expense totaled \$1.7 billion and \$1.7 billion in 2015 and 2014, respectively. Loss on disposition of assets totaled \$281 million and \$476 million in 2015 and 2014, 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, Regional Offices and National Cemeteries that meet the criteria for heritage assets. Historic 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 and withdrawals of VA's heritage assets inventory result from field station condition assessment surveys, which identify items such as new collections or newly designated assets. There were no heritage assets transferred between Federal entities or acquired through donation or devise that were considered material to the consolidated financial statements for 2015 and 2014, therefore, fair value disclosure is not required for heritage assets acquired by donation or devise. 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, but excluding multi-use buildings); 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.

VA has 1,289 multi-use heritage assets that are included in General PP&E (and not a part of the count shown below). These multi-use heritage assets are being utilized as administration, operation, engineering and maintenance buildings.

VA expensed \$4.3 million and \$7.9 million of heritage asset costs associated with acquisition, construction, renovation and/or modification of VA-owned personal property and buildings and structures declared as heritage assets for the years ended September 30, 2015 and 2014, respectively.

| Heritage Assets in Units | | | | |
|---------------------------------|-------------------------|---------------------------|-----------------------------|-------------------------|
| as of September 30, | 2014 Balance | 2015 Additions | 2015 Withdrawals | 2015 Balance |
| Art Collections | 13 | 14 | - | 27 |
| Buildings and Structures | 562 | 153 | - | 715 |
| Monuments/Historic Flag Poles | 1,293 | - | (17) | 1,276 |
| Other Non-Structure Items | 515 | 275 | - | 790 |



Heritage Assets in Units

| as of September 30, | 2014 Balance | 2015 Additions | 2015 Withdrawals | 2015 Balance |
|---------------------------------------|-----------------|-------------------|---------------------|-----------------|
| Archaeological Sites | 4 | 9 | - | 13 |
| Cemeteries | *164 | 5 | - | *169 |
| Total Heritage Assets in Units | 2,551 | 456 | (17) | 2,990 |

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

11. Debt

Intragovernmental Debt

as of September 30,

| | 2014 Beginning Balance | 2014 Net Borrowing | 2014 Ending Balance | 2015 Net Borrowing | 2015 Ending Balance |
|--|------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| Loan Guaranty Debt | | | | | |
| Debt to the Treasury | \$ 749 | \$ (58) | \$ 691 | \$ (16) | \$ 675 |
| Debt to the Federal Financing Bank | 5 | - | 5 | - | 5 |
| Total Loan Guaranty Debt | 754 | (58) | 696 | (16) | 680 |
| Direct Loans Debt – Vocational Rehabilitation Program | | | | | |
| Debt to the Treasury | 2 | (1) | 1 | - | 1 |
| Debt to the Federal Financing Bank | - | - | - | - | - |
| Total Direct Loans Debt | 2 | (1) | 1 | - | 1 |
| Total Debt | | | | | |
| Debt to the Treasury | 751 | (59) | 692 | (16) | 676 |
| Debt to the Federal Financing Bank | 5 | - | 5 | - | 5 |
| Total Debt | \$ 756 | \$ (59) | \$ 697 | \$ (16) | \$ 681 |

At September 30, 2015 and 2014, all debt is classified as intragovernmental debt. Except as noted above, VA had no debt due to any other Federal agency and all debt is covered by budgetary resources.

Loan Guaranty Program debt has 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 on debt issued in 2015 ranged from 3.20 to 3.70 percent and 1.65 to 2.75 percent for debt issued in 2014. The interest rates on all outstanding debt issued ranged from 1.00 to 7.59 percent in 2015 and 1.00 to 7.59 percent in 2014. Interest expense was \$24 million for 2015 and \$27 million for 2014.

Vocational Rehabilitation Program Direct Loan debt has 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 on debt issued was 1.00 percent in 2015 and 2014. The interest rate



on all outstanding debt issued is 1.00 percent in 2015 and 1.00 percent in 2014. Interest expense was \$42 million for 2015 and \$37 million for 2014.

Net borrowings related to the Loan Guaranty Program debt and Direct Loans Program debt do not include any amounts that result from refinancing debt.

No debt was held by the public during 2015 or 2014. There were no redemptions or calls of debts before maturity or write-offs of debt owed to the Treasury.

12. Liabilities Not Covered By Budgetary Resources

Liabilities Not Covered By Budgetary Resources

as of September 30,

| | 2015 | 2014 |
|--|---------------------|---------------------|
| Workers' Compensation (FECA)* | \$ 2,721 | \$ 2,728 |
| Annual Leave | 2,071 | 1,987 |
| Judgment Fund | 2,029 | 1,692 |
| Environmental and Disposal Liabilities | 860 | 789 |
| Veterans Compensation and Burial | 2,018,600 | 2,007,100 |
| Insurance | 1,519 | 1,442 |
| Amounts due to Non-Federal Trust | 125 | 134 |
| Total | \$ 2,027,925 | \$ 2,015,872 |

* The actuarial estimate for workers' compensation provided by DOL was computed using an interest rate of 3.13 percent for wage benefits and 2.49 percent for medical benefits to discount the projected annual benefit payments as of September 30, 2015. For September 30, 2014, an interest rate of 3.46 percent was used for wage benefit and 2.86 percent was used for medical benefits.

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided.

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 \$477 million and \$464 million at September 30, 2015 and 2014, respectively.

13. Federal Employee and Veteran Benefits Liabilities

Federal Employee Benefits

VA is the employer entity that generates employee costs to be funded, not the administrative entity responsible for managing and accounting for VA employees' retirement, health insurance and life insurance benefit plans. As a result, VA recognizes the benefit costs for the reporting period in its financial statements in an



amount equal to the service cost for its employees based on the benefit plan's actuarial cost method and assumptions applied to VA and provided by the administrative entity, OPM. The offset to the expense is an increase to an intragovernmental imputed financing source entitled, Imputed Financing under Other Financing Sources (Nonexchange) in the Consolidated Statement of Changes in Net Position, representing the amount being financed directly through the benefit plan's administrative entity. The table below summarizes the imputed expenses reported by VA for its employees' benefit plans

Federal Employee Benefits: Imputed Expenses-Employee Benefits
Years ended September 30,

| | 2015 | 2014 |
|--|-----------------|-----------------|
| Civil Service Retirement System | \$ 339 | \$ 714 |
| Federal Employees Health Benefits | 1,424 | 1,318 |
| Federal Employees Group Life Insurance | 4 | 4 |
| Total Imputed Expenses-Employee Benefits* | <u>\$ 1,767</u> | <u>\$ 2,036</u> |

*The total imputed expenses in the table above, when combined with the Imputed Financing – Paid by Other Entities reported in the table reconciliation of judgment fund operating expense in Note 18 reconciles to Imputed Financing Costs reported in the Consolidated Statement of Changes in Net Position.

Veteran Benefits

Eligible Veterans who die or are disabled during active military service-related causes, as well as their dependents, receive compensation benefits and are provided a burial flag, headstone/marker, and grave liner 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 Veteran Benefits Liabilities

as of September 30,

| | 2015 | 2014 |
|--|---------------------|---------------------|
| Workers' Compensation (FECA) | \$ 2,244 | \$ 2,264 |
| Compensation | 2,014,000 | 2,002,600 |
| Burial | 4,600 | 4,500 |
| Total Federal Employee and Veteran Benefits Liabilities | <u>\$ 2,020,844</u> | <u>\$ 2,009,364</u> |

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, 2015 and 2014, was \$94.1 billion and \$102.8 billion, respectively.



Assumptions Used to Calculate the Veteran Benefits Liability

Several significant actuarial assumptions were used in the valuation of compensation 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 program; 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.

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, 2015 and 2014, were based on the 10-year average historical spot rates derived from quarterly Yield Curves for Treasury *Nominal Coupon Issues* published by the US Treasury at the end of each quarter for the periods June 30, 2014, to March 31, 2015, and June 30, 2013, to March 31, 2014, for September 30, 2015 and 2014, respectively. The spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities for each year of expected future payments range from 1.59 percent to 4.19 percent and from 0.40 percent to 4.39 percent as of September 30, 2015 and 2014, respectively. These spot rates produced a single weighted average discount rate of 4.08 percent and 4.29 percent as of September 30, 2015 and 2014, respectively, that could be applied to the expected future cash flows to produce a present value that is not materially different than the present value using multiple rates.

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

The Veterans benefit liability is impacted by interest on the liability balance, changes in experience, changes in actuarial assumptions, prior service costs and amounts paid for costs included in the liability balance. Interest on the liability balance is based on the prior year liability balance multiplied by the single weighted average discount rate used to compute the Veterans benefit liability balance for the prior year. Changes in experience include the number of Veterans and dependents receiving payments, changes in degree of disability connected with military service, changes in the number of presumptive conditions, the on-going incidence rate and the prevalence of the presumptive conditions in the Veteran population and the impact of those changes on future years. Changes in actuarial assumptions include changes in the spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities, cost of living adjustments, presumptive service conditions resulting in benefits coverage, mortality and disability claims rates and backlog of Veterans claims



to be processed. Prior service costs relate to new benefits due to administrative, judicial or legislative changes.

The total number of Veterans, estimated future military separations and total number of beneficiary participants are determined through actual record level data and projected American Community Survey 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 revised factors based on current year actual data related to the incidence and prevalence of presumptive service conditions in existence in the Veteran population at September 30, 2015 and 2014, respectively, 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, 2015 and 2014, was 2.44 percent and 2.61 percent, respectively. Beginning in 2015, COLA rates for future years are based on Treasury Breakeven Inflation Rates published by the US Treasury.

Life expectancies of beneficiaries collecting benefits from the Compensation program 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 rates developed by the Social Security Administration and published in the 2015 Trustees Report. 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 projection only reflects benefits associated with military service through September 30, 2015.

VA has a unique program that is not a defined benefit plan and has no plan assets set aside to fund future costs. VA funds the current year costs of Veterans service related disability compensation and burial costs through its annual appropriations that are recognized in Program Costs under Veterans Benefits Administration in the Statements of Net Cost and in Amounts Paid in the Reconciliation of Veterans Compensation and Burial Actuarial Liabilities table that follows below.

The reconciliation table that follows the narrative below shows that the total liability for 2015 of \$2.02 trillion increased \$11.5 billion from the 2014 liability of \$2.01 trillion.

The change in liability was primarily due to an \$80 billion increase from the change in the discount rate assumption largely offset by a decrease of \$72 billion in the COLA assumption. The reduction in average interest rates during the current year accounts for both of those changes. The weighted average discount rate decreased from 4.29 percent to 4.08 percent in 2015. This change resulted in an increase in costs related to the discount rate assumption. The average COLA rate used for all future years at September 30, 2015 and 2014, was 2.44 percent and 2.61 percent, respectively.



Beginning in 2015, COLA rates for future years are based on Inflation Rates published by the US Treasury.

**Reconciliation of Veterans Compensation and Burial Actuarial Liabilities
For the Year Ended September 30,**

| | <u>Compensation</u> | <u>Burial</u> | <u>TOTAL</u> |
|---|---------------------|-----------------|---------------------|
| Liability at October 1, 2013 | \$ 1,970,200 | \$ 4,600 | \$ 1,974,800 |
| Expense: | | | |
| Interest on the Liability Balance* | 82,700 | 200 | 82,900 |
| Actuarial (Gain)/Loss from Current Year Activity | | | |
| Changes in Experience (Veterans Counts, Status)* | 36,800 | - | 36,800 |
| Changes in Assumptions: | | | |
| Changes in Discount Rate Assumption | (37,400) | (100) | (37,500) |
| Changes in COLA Rate Assumption | 15,400 | - | 15,400 |
| Net (Gain)/Loss from Changes in Assumptions | (22,000) | (100) | (22,100) |
| Prior Service Costs (Adjustment to Benefits)* | - | - | - |
| Total Expense | 97,500 | 100 | 97,600 |
| Less Amounts Paid* | (65,100) | (200) | (65,300) |
| Net Change in Actuarial Liability | 32,400 | (100) | 32,300 |
| Liability at September 30, 2014 | 2,002,600 | 4,500 | 2,007,100 |
| Expense: | | | |
| Interest on the Liability Balance** | 85,900 | 200 | 86,100 |
| Actuarial (Gain)/Loss from Current Year Activity | | | |
| Changes in Experience (Veterans Counts, Status)** | 9,500 | 100 | 9,600 |
| Changes in Assumptions: | | | |
| Changes in Discount Rate Assumption | 79,900 | 200 | 80,100 |
| Changes in COLA Rate Assumption | (72,200) | (200) | (72,400) |
| Changes in Other Assumptions | (20,700) | | (20,700) |
| Net (Gain)/Loss from Changes in Assumptions | (13,000) | - | (13,000) |
| Total Expense | 82,400 | 300 | 82,700 |
| Less Amounts Paid** | (71,000) | (200) | (71,200) |
| Net Change in Actuarial Liability | 11,400 | 100 | 11,500 |
| Liability at September 30, 2015 | \$ 2,014,000 | \$ 4,600 | \$ 2,018,600 |

* The sum of these changes represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2014.

** The sum of these changes represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2015.

14. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of \$860 million and \$789 million as of September 30, 2015 and 2014, 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. As of September 30, 2015, the liabilities for friable and non-friable asbestos removal were \$235 million and \$410 million, respectively.

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 basis 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.

It is at least reasonably possible that the estimated liabilities will change, possibly materially, as a result of changes in applicable laws and regulations; technology; future location requirements or plans; budgetary resources; and changes in future economic conditions, including inflation and deflation.

15. Other Liabilities

Other liabilities are liabilities not reported elsewhere in the Consolidated Balance Sheets. 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,

| | 2015 | 2014 |
|---|---------------|---------------|
| Deposit and Clearing Account Liabilities | \$ 1 | \$ 268 |
| Accrued Expenses - Federal | 7 | 13 |
| Deferred Revenue | 56 | 52 |
| Custodial Liabilities | 43 | 74 |
| Credit Reform Act Subsidy Reestimates* | 347 | 246 |
| Accrued VA Contributions for Employee Benefits | 235 | 183 |
| Total Other Intragovernmental Funded Liabilities | \$ 689 | \$ 836 |

*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 to Treasury.

Other Intragovernmental Unfunded Liabilities as of September 30,

| | 2015 | 2014 |
|---|-----------------|-----------------|
| Accrued FECA Liability | \$ 472 | \$ 458 |
| Unfunded Employee Liability | 5 | 6 |
| Total Other Intragovernmental Unfunded Liabilities | \$ 477 | \$ 464 |
| Total Other Intragovernmental Liabilities | \$ 1,166 | \$ 1,300 |



Other Public Funded Liabilities

as of September 30,

| | 2015 | 2014 |
|--|-----------------|---------------|
| Accrued Funded Annual Leave | \$ 22 | \$ 21 |
| Accrued Expenses | 165 | 168 |
| Accrued Salaries and Benefits | 911 | 747 |
| Capital Lease Liability | 2 | 11 |
| Other | 246 | (5) |
| Total Other Public Funded Liabilities | \$ 1,346 | \$ 942 |

Other Public Unfunded Liabilities

as of September 30,

| | 2015 | 2014 |
|--|-----------------|-----------------|
| Accrued Unfunded Annual Leave* | \$ 2,071 | \$ 1,987 |
| Amounts due to non-Federal trust | 125 | 134 |
| Other | 4 | 4 |
| Judgment Fund-Unfunded** | 2,029 | 1,692 |
| Total Other Public Unfunded Liabilities | \$ 4,229 | \$ 3,817 |

Total Other Public Liabilities

\$ 5,575 \$ 4,759

* 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 18, Contingencies).

16. Leases

VA has both capital and operating leases. The net capital lease liability was \$2 million and \$11 million as of September 30, 2015 and 2014, respectively. Capital leases consist primarily of information and computer technology, medical equipment, office equipment and real property. The capital lease liabilities are classified as Other Public Funded Liabilities in Note 15 since capital leases entered into after 1991 are required to be fully funded by budgetary resources in the first year of the lease.

The following is an analysis of the leased property under capital leases by major classes that is included in G-PP&E as disclosed in Note 9 (in millions of dollars):

Capital Lease Assets as of September 30, 2015

| | Cost | Accumulated Amortization | Net Book Value |
|--|----------------|--------------------------|----------------|
| Real Property | \$ 17.7 | \$ (16.7) | \$ 1.0 |
| Equipment | 31.6 | (23.9) | 7.7 |
| Leased Property Under Capital Lease | \$ 49.3 | \$ (40.6) | \$ 8.7 |
| Amortization Expense | | \$ 3.3 | |



**Capital Lease Assets
as of September 30, 2014**

| | Cost | Accumulated Amortization | Net Book Value |
|--|----------------|---------------------------------|-----------------------|
| Real Property | \$ 17.7 | \$ (16.1) | \$ 1.6 |
| Equipment | 39.4 | (28.9) | 10.5 |
| Leased Property Under Capital Lease | \$ 57.1 | \$ (45.0) | \$ 12.1 |
| Amortization Expense | | \$ 3.8 | |

Operating leases consist of equipment and real property leases that are funded annually and expensed as incurred. Operating equipment leases generally consist of medical and office equipment with terms of five years or less and level payments over the lease term. Operating real property leases generally consist of Veterans medical facilities and clinics, regional and district benefits offices and administrative facilities that enable VA to fulfill its mission to care for and provide benefits to Veterans.

For the year ended September 30, 2015, VA had 1,954 real property leases in effect consisting of approximately 24 million square feet and base annual minimum rental obligations of approximately \$682 million. Of the operating real property leases, VHA accounts for 85.2 percent, VBA accounts for 10.0 percent, Indirect Administrative Program offices account for 4.5 percent and NCA accounts for the balance. These real property leases generally have lease terms ranging from one year to fifty years and all operating leases are funded annually by appropriation of funds by Congress. Approximately 68 percent of the real property leases have an initial lease term of five years or less; approximately 25 percent have initial lease terms of six to ten years; approximately 4 percent have initial lease terms of eleven to fifteen years; and approximately 3 percent have initial lease terms of sixteen years and more. Certain leases contain renewal, termination and cancellation options.

Approximately 85 percent of VA leases are executed directly with third party commercial property owners (third party direct leases) with the balance of the leases executed by GSA on behalf of VA. GSA charges rental rates for space that approximates commercial rental rates for similar properties. The terms of occupancy agreements (OAs) with GSA vary according to whether the underlying assets are owned directly by the Federal Government or rented by GSA from third party commercial property owners. VA executes cancellable and non-cancellable OAs with GSA. GSA OAs can be cancellable with varying periods of notice required (generally four to six months). For OAs executed after October 2011, periods of occupancy are generally one year. GSA OAs that are cancelled require a payment of all unamortized tenant improvements and rent concessions not yet earned. GSA OAs may also be non-cancellable, where VA would be financially responsible for rent payments on vacated space until the expiration of the OA, the termination of the OA permitted under the lease terms, or the occupancy by a replacement tenant covers the total rent obligation of VA. However, VA normally occupies the leased properties for an extended period of time without exercising cancellation or termination clauses in the leases.



Annual base rent for operating real property leases is generally flat over the lease term; however, certain GSA OAs and third party direct leases contain rent abatement and rent escalation clauses. For certain GSA OAs, the base rent is set for periods up to but not beyond 5 years. For certain GSA OAs with occupancy terms in excess of 5 years or that incur capitalized building improvement or replacement costs, the base rental rate will be reassessed every 5 years to reflect current market rental rates and additional real property investments. The GSA OAs and third party direct leases also require VA to reimburse increases in common area maintenance costs and operating costs over base year amounts annually based on increases in the Consumer Price Index (CPI), reimburse increases in real estate taxes over a base year amount at least annually and, in certain cases, VA may pay the common area maintenance costs, operating costs and real estate taxes directly.

Future commitments for real property and equipment operating leases are based on leases in effect as of September 30, 2015. VA normally occupies leased real property for the entire initial lease term without exercising cancellation and termination options. As a result, the operating lease commitment table that follows includes real property leases over the noncancellable initial lease term. Real property lease data is maintained in a centralized database and does not capture future fixed rent increases which are considered immaterial to the financial statements taken as a whole and are therefore excluded from the operating lease commitment table that follows.

Due to the number of equipment operating leases and the decentralization of equipment lease records, the future commitments for equipment leases have been estimated using the expense from 2015 in lieu of actual lease terms being reflected for the 5-year period in the disclosure table below. VA does not believe this disclosure method produces information that is materially different than using actual equipment lease terms.

VA's 2015 operating lease rental costs were \$678 million for real property rentals and \$166 million for equipment rentals. The 2014 operating lease costs were \$658 million for real property rentals and \$148 million for equipment rentals.

Excluded from the following table are leases of properties that have expired as of September 30, 2015, and prior, but are still occupied by VA. On occasion, VA will retain occupancy of properties once the full term of the lease has expired and continue to remit rent on a monthly basis in accordance with the holdover provisions of the expired lease agreement. These commitments are excluded from the 5-year lease commitment table pending a long-term lease renewal contract or the vacancy of the space by VA. The rent expense associated with holdover leases is reflected in the 2015 expense in the statements of net costs. The following table represents VA's projected future operating lease commitments (in millions of dollars):



Projected Future Operating Lease Commitments

| Years Ending September 30, | GSA | Third Party | Total | |
|------------------------------------|---------------|-----------------|-----------------|---------------|
| | OAs | Direct Leases | Real Property | Equipment |
| 2016 | \$ 181 | \$ 407 | \$ 588 | \$ 166 |
| 2017 | 172 | 380 | 552 | 166 |
| 2018 | 156 | 355 | 511 | 166 |
| 2019 | 124 | 323 | 447 | 166 |
| 2020 | 105 | 289 | 394 | 166 |
| 2021 and Thereafter (in total) | 214 | 2,180 | 2,394 | - |
| Total Future Lease Payments | \$ 952 | \$ 3,934 | \$ 4,886 | \$ 830 |

VA is a lessor of certain underutilized real estate properties within the Department under its enhanced-use lease (EUL) program authorized by Congress. Title 38, U.S.C. 8161-8169, Enhanced-Use Leases of Real Property, authorizes VA to lease real property under VA's control or jurisdiction to other public and private entities on a long-term basis (up to 75 years) only for the provision of supportive housing, in return for cash consideration or no consideration. VA's previous EUL authority expired on Dec. 31, 2011 and was reauthorized under Public Law 112-154 Section 211, limited to supportive housing. The previous authority under which all of the current operational leases were executed allowed VA to enter into EULs for receipt of rental income or in-kind consideration (such as cost avoidance, cost savings, and enhanced services benefitting Veterans) as all or part of the consideration for the lease to further its mission to effectively serve Veterans and was not limited to supportive housing.

The leases related to the EUL and NCA's leasing of excess land and buildings at cemeteries are more fully described in Note 20 under the caption, Public Exchange Transactions. The EUL program consists of 58 operational leases of land and/or buildings to the public and private sector, including the Non-Federal Trusts discussed in Note 1. The rental income recognized from the EUL program and the NCA leasing program for the years ended September 30, 2015 and 2014, respectively, are immaterial to the financial statements. VA believes that the future rental income to be recognized over the next 5 years from the EUL program and NCA leasing program described above will continue to be immaterial; therefore, the table of future minimum rental income commitments is not presented.

17. Insurance Programs

Through VA, the Government administers six life insurance programs: the United States Government Life Insurance (USGLI) program; the National Service Life Insurance (NSLI) program; the Veterans Special Life Insurance (VSLI) program; the Veterans Reopened Insurance (VRI) program, which covers Veterans who served during World Wars I, II, and the Korean Conflict eras; the Service-Disabled Veterans Insurance (S-DVI) program, which was established in 1951 to meet the insurance



needs of Veterans who received a service-connected disability rating and is open to new issues; and the Veterans Mortgage Life Insurance (VMLI) program, which covers severely disabled Veterans and are open to new issues. VMLI is part of the Veterans Insurance and Indemnities (VI&I) fund.

In addition, VA supervises the Servicemembers Group Life Insurance (SGLI) and the Veterans Group Life Insurance (VGLI) programs, which provides coverage to members of the uniformed armed services, reservists, and post-Vietnam Veterans and their families. All SGLI insureds are automatically covered under the Traumatic Injury Protection (TSGLI) program, which provides for insurance payments to Veterans who suffer a serious traumatic injury in service. VA has entered into a group policy with the Prudential Insurance Company of America to administer these programs.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their families are deducted from the Servicemember's pay by the Armed Services components through the 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 SECVA 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 SECVA are paid by the uniformed services, not from the Servicemembers' premiums, as are all other programs costs.

The insurance reserves for the administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and 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. United States Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.



Actuarial reserve liabilities for the administered life insurance programs are based on the mortality and interest assumptions that vary by fund, type of policy, and type of benefit. The interest assumptions range from 2.25 to 4 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, the 2001 CSO Table and the 2001 Valuation Basic Male (VBM) Table.

**Insurance Liability (Reserve) Balances
as of September 30, 2015**

| Program | Insurance Death Benefits | Death Benefit Annuities | Disability Income & Waiver | Reserve Totals |
|--|--------------------------|-------------------------|----------------------------|----------------|
| NSLI | \$ 3,847 | \$ 49 | \$ 22 | \$ 3,918 |
| USGLI | 1 | 1 | - | 2 |
| VSLI | 1,343 | 5 | 9 | 1,357 |
| S-DVI | 610 | 6 | 787 | 1,403 |
| VRI | 130 | 1 | 1 | 132 |
| VI&I | 229 | - | - | 229 |
| Subtotal | \$ 6,160 | \$ 62 | \$ 819 | \$ 7,041 |
| Unearned Premiums | | | | 44 |
| Insurance Dividends Left on Deposit and Related Interest Payable | | | | 1,245 |
| Dividends Payable to Policyholders | | | | 48 |
| Unpaid Policy Claims | | | | 2 |
| Insurance Liabilities reported on the Consolidated Balance Sheet | | | | 8,380 |
| Less Liability not Covered by Budgetary Resources | | | | (1,519) |
| Liability Covered by Budgetary Resources | | | | \$ 6,861 |

**Insurance Liability (Reserve) Balances
as of September 30, 2014**

| Program | Insurance Death Benefits | Death Benefit Annuities | Disability Income & Waiver | Reserve Totals |
|--|--------------------------|-------------------------|----------------------------|----------------|
| NSLI | \$ 4,448 | \$ 57 | \$ 27 | \$ 4,532 |
| USGLI | 2 | 2 | - | 4 |
| VSLI | 1,408 | 6 | 11 | 1,425 |
| S-DVI | 575 | 6 | 777 | 1,358 |
| VRI | 155 | 1 | 1 | 157 |
| VI&I | 213 | - | - | 213 |
| Subtotal | \$ 6,801 | \$ 72 | \$ 816 | \$ 7,689 |
| Unearned Premiums | | | | 49 |
| Insurance Dividends Left on Deposit and Related Interest Payable | | | | 1,346 |
| Dividends Payable to Policyholders | | | | 59 |
| Unpaid Policy Claims | | | | 2 |
| Insurance Liabilities reported on the Consolidated Balance Sheet | | | | 9,145 |
| Less Liability not Covered by Budgetary Resources | | | | (1,442) |
| Liability Covered by Budgetary Resources | | | | \$ 7,703 |

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 at the end of the fiscal year. It includes any paid-up additional coverage provided under these policies.



The supervised programs' policies and face value 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. As a result, the information provided below under the Supervised Programs is for informational purposes only and is unaudited.

Prudential and its reinsurers provided coverage to 5,567,448 and 5,739,444 policy holders with a face value of \$1.2 trillion and \$1.3 trillion for 2015 and 2014, respectively.

The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in-force for both 2015 and 2014. The number of policies represents the number of active policies remaining in the program at the end of the fiscal year.

| | 2015 Policies | 2014 Policies | 2015 Face Value | 2014 Face Value |
|---|------------------|------------------|---------------------|---------------------|
| Supervised Programs (UNAUDITED) | | | | |
| SGLI Active Duty | 1,425,000 | 1,461,000 | \$ 547,671 | \$ 563,681 |
| SGLI Ready Reservists | 745,500 | 753,500 | 247,637 | 253,499 |
| SGLI Post Separation | 95,000 | 91,000 | 35,023 | 33,798 |
| SGLI Family - Spouse | 973,000 | 1,037,000 | 95,903 | 102,200 |
| SGLI Family - Children | 1,901,000 | 1,972,000 | 19,010 | 19,720 |
| TSGLI* | - | - | 217,050 | 221,450 |
| VGLI | 427,948 | 424,944 | 68,699 | 66,002 |
| Total Supervised | 5,567,448 | 5,739,444 | \$ 1,230,993 | \$ 1,260,350 |
| Administered Programs | | | | |
| NSLI | 370,281 | 438,252 | \$ 4,655 | \$ 5,462 |
| VSLI | 120,466 | 130,637 | 1,730 | 1,847 |
| S-DVI | 266,840 | 260,895 | 2,794 | 2,725 |
| VRI | 14,515 | 17,492 | 154 | 185 |
| USGLI | 672 | 1,071 | 1 | 2 |
| VMLI | 2,567 | 2,485 | 333 | 313 |
| Total Administered | 775,341 | 850,832 | \$ 9,667 | \$ 10,534 |
| Total Supervised and Administered Programs | 6,342,789 | 6,590,276 | \$ 1,240,660 | \$ 1,270,884 |

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

Policy Dividends

The SECVA determines annually the excess funds available for dividend payment. Policy dividends for 2015 and 2014 were \$109 million and \$129 million, respectively.



18. 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 by 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 30 percent and 88 percent of the amounts funded on behalf of VA by the Judgment Fund in 2015 and 2014, respectively. Contract dispute payments for 2015 and 2014 were \$225 million and \$5.8 million, respectively. The discrimination case payments for 2015 and 2014 were \$5.5 million and \$2.4 million, respectively. The liability from existing medical malpractice claims is estimated using generally accepted actuarial standards and procedures. The estimated future payments related to these existing claims are discounted using Treasury spot rates as of September 30, 2015 and 2014.

VA 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 and was \$2 billion for 2015 and \$1.69 billion for 2014.

There were 46 contract and personnel law cases, where there was at least a reasonable possibility that a loss may occur, with financial exposure ranging from \$654 million to \$1.9 billion in aggregate for 2015. Within that range, \$401 million is considered probable and is recorded as a liability. In 2014, the range of exposure was \$245 million to \$1.3 billion, from 27 cases, of which \$93 million was probable and recorded as a liability.

VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. The Judgment Fund accounting is shown below:

| Judgment Fund | | | | |
|--|-------------|------------|-------------|------------|
| For the Years Ended September 30, | | | | |
| | 2015 | | 2014 | |
| Fiscal Year Settlement Payments | \$ | 343 | \$ | 141 |
| Less Contract Dispute and "No Fear" Payments | | (230) | | (8) |
| Imputed Financing-Paid by Other Entities* | | 113 | | 133 |
| Increase (Decrease) in Liability for Claims | | 337 | | 299 |
| Operating Expense | \$ | 450 | \$ | 432 |

*The Imputed Financing-Paid by Other Entities in the table above, when combined with the Total Imputed Expenses – Employee Benefits reported in Note 13 reconciles to total Imputed Financing costs reported in the Consolidated Statement of Changes in Net Position.



It is the opinion of management that resolution of pending legal actions as of September 30, 2015, will not materially affect operations or the financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. The 2015 tort payments were \$112.3 million and 2014 tort payments were \$133 million.

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, 2015 and 2014, was \$514.2 and \$286.6 million, 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), the SECVA makes an annual enrollment decision that identifies which Veterans, by priority, 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 2011-2015, the average medical care cost per year was \$44 billion.

19. Funds from Dedicated Collections

SFFAS 43, *Funds from Dedicated Collections: Amending SFFAS 27, Identifying and Reporting Earmarked Funds*, defines funds from dedicated collections as an individual fund with explicit authority to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the Federal Government's general revenues. The fund's sources of revenue and other financing sources are non-federal sources that are material and that require disclosure of all funds from dedicated collections for which VA has program management responsibility. The Treasury does not set aside assets to pay future expenditures associated with funds from dedicated collections. VA's funds from dedicated collections consist of trusts, special and revolving funds that 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 discussed in Note 1 and presented in Note 5) are assets of funds from dedicated collections that are issued as evidence of specific dedicated receipts from fund activities by the fund and that provide the fund the authority to draw upon the Treasury for future authorized expenditures related to the fund's specific purpose. The investments (Treasury Securities) are not general fund



assets of the Federal Government, since their use is restricted to the funds' purpose, and are not non-entity assets. When the fund redeems its Treasury Securities to make expenditures, the Treasury will finance those expenditures in the same manner that it finances all other expenditures.

VA's Funds from Dedicated Collections are as follows and the classification of each fund into the grouping of Insurance, Medical Care, Benefits and Burial as shown in the condensed financial statements that follow is designated in the "Purpose of Fund" column below:

| Dedicated Collections Fund Name | Treasury Symbol | Authority | Purpose of Fund | Financing Sources |
|---|-----------------|--------------------------|---|--------------------------------------|
| Servicemen's Group Life Insurance | 36x4009 | 38 U.S.C 1965 | 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 | Insurance - Provides insurance to World War II and Korea Veterans. | Public, Veterans |
| Service-Disabled Veterans Insurance Fund | 36x4012 | 38 U.S.C. 1922 | Insurance - Provides insurance to Veterans with service-connected disabilities. | Public, Veterans |
| National Service Life Insurance Fund | 36x8132 | 38 U.S.C. 1920 | Insurance - Premiums insure WWII Veterans. | Public, Veterans |
| U.S. Government Life Insurance | 36x8150 | 38 U.S.C. 1955 | Insurance - Premiums insure WWI Veterans. | Public, Veterans |
| Veterans Special Life Insurance Fund | 36x8455 | 38 U.S.C. 1923 101-228 | Insurance - Premiums insure Korean conflict Veterans. | Public, Veterans |
| Canteen Service Revolving Fund | 36x4014 | 38 U.S.C. 78 | Medical Care -Operates the canteen services at hospitals. | Revenue from product sales |
| Medical Care Collections Fund | 36x5287 | P.L. 105-33 111 Stat 665 | Medical Care - Third-party and patient co-payments for medical services. | Public, primarily insurance carriers |
| Enhanced-Use Lease Trusts | N/A | 38 U.S.C 8162 | Medical Care - Lease underutilized VA property. | Public |
| General Post Fund, National Homes | 36x8180 | 38 U.S.C. 101-228 | Medical Care - Donations for patient benefits. | Public, mostly Veterans |
| Post-Vietnam Era Education Assistance Program | 36x8133 | 38 U.S.C. 3222 | Benefits - Subsidizes the cost of education to Veterans. | Veterans, DoD |
| Cemetery Gift Fund | 36x8129 | 38 U.S.C. 2407 | Burial - Donations for Veterans cemeteries. | Public donors |
| National Cemetery Administration Facilities Operation Fund | 36x5392 | P.L. 108-454 | Burial - Proceeds benefit land and buildings. | Proceeds from buildings/land leases |



The following tables provide consolidated condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances related to Cumulative Results of Operations – Funds from Dedicated Collections in the Consolidated Statements of Changes in Net Position:

| Balance Sheet – Funds from Dedicated Collections | | | | | |
|---|------------------|---------------------|-----------------|---------------|---|
| as of September 30, 2015 | | | | | |
| | Insurance | Medical Care | Benefits | Burial | Funds from Dedicated Collections |
| Assets: | | | | | |
| Fund Balance with Treasury | \$ 64 | \$ 367 | \$ 64 | \$ 2 | \$ 497 |
| Investments with Treasury (Note 5) | 6,914 | 108 | - | - | 7,022 |
| Other Assets | 341 | 1,612 | - | 14 | 1,967 |
| Total Assets | \$ 7,319 | \$ 2,087 | \$ 64 | \$ 16 | \$ 9,486 |
| Liabilities and Net Position: | | | | | |
| Payables to Beneficiaries | \$ 221 | \$ 51 | \$ 1 | \$ - | \$ 273 |
| Other Liabilities | 8,159 | 148 | - | - | 8,307 |
| Total Liabilities | 8,380 | 199 | 1 | - | 8,580 |
| Unexpended Appropriations | - | - | - | - | - |
| Cumulative Results of Operations | (1,061) | 1,888 | 63 | 16 | 906 |
| Total Liabilities and Net Position | \$ 7,319 | \$ 2,087 | \$ 64 | \$ 16 | \$ 9,486 |

| Statement of Net Cost – Funds from Dedicated Collections | | | | | |
|---|---------------|-------------------|-------------|-------------|-------------------|
| for the Year Ended September 30, 2015 | | | | | |
| Gross Program Costs | \$ 708 | \$ 646 | \$ - | \$ 1 | \$ 1,355 |
| Less Earned Revenues | 588 | 4,020 | - | - | 4,608 |
| Net Program Costs | 120 | (3,374) | - | 1 | (3,253) |
| Costs Not Attributable to Program Costs | - | - | - | - | - |
| Net Cost/(Benefit) of Operations | \$ 120 | \$ (3,374) | \$ - | \$ 1 | \$ (3,253) |

| Statement of Changes in Net Position – Funds from Dedicated Collections | | | | | |
|--|-------------------|-----------------|--------------|--------------|-----------------|
| for the Year Ended September 30, 2015 | | | | | |
| Net Position Beginning of Period | \$ (977) | \$ 1,916 | \$ 63 | \$ 6 | \$ 1,008 |
| Budgetary and Other Financing Sources | 36 | (3,402) | - | 11 | (3,355) |
| Net Cost/(Benefit) of Operations | 120 | (3,374) | - | 1 | (3,253) |
| Change in Net Position | (84) | (28) | - | 10 | (102) |
| Net Position End of Period | \$ (1,061) | \$ 1,888 | \$ 63 | \$ 16 | \$ 906 |



| Balance Sheet – Funds from Dedicated Collections | | | | | |
|---|------------------|---------------------|-----------------|---------------|---|
| as of September 30, 2014 | | | | | |
| | Insurance | Medical Care | Benefits | Burial | Funds from Dedicated Collections |
| Assets: | | | | | |
| Fund Balance with Treasury | \$ 58 | \$ 388 | \$ 64 | \$ 2 | \$ 512 |
| Investments with Treasury (Note 5) | 7,760 | 67 | - | - | 7,827 |
| Other Assets | 382 | 1,680 | - | 4 | 2,066 |
| Total Assets | \$ 8,200 | \$ 2,135 | \$ 64 | \$ 6 | \$ 10,405 |
| Liabilities and Net Position: | | | | | |
| Payables to Beneficiaries | \$ 244 | \$ 63 | \$ 1 | \$ - | \$ 308 |
| Other Liabilities | 8,933 | 156 | - | - | 9,089 |
| Total Liabilities | 9,177 | 219 | 1 | - | 9,397 |
| Unexpended Appropriations | - | - | - | - | - |
| Cumulative Results of Operations | (977) | 1,916 | 63 | 6 | 1,008 |
| Total Liabilities and Net Position | \$ 8,200 | \$ 2,135 | \$ 64 | \$ 6 | \$ 10,405 |

| Statement of Net Cost – Funds from Dedicated Collections | | | | | |
|---|---------------|-------------------|-------------|-------------|-------------------|
| for the Year Ended September 30, 2014 | | | | | |
| Gross Program Costs | \$ 811 | \$ 321 | \$ - | \$ - | \$ 1,132 |
| Less Earned Revenues | 662 | 3,607 | - | - | 4,269 |
| Net Program Costs | 149 | (3,286) | - | - | (3,137) |
| Costs Not Attributable to Program Costs | - | - | - | - | - |
| Net Cost/(Benefit) of Operations | \$ 149 | \$ (3,286) | \$ - | \$ - | \$ (3,137) |

| Statement of Changes in Net Position – Funds from Dedicated Collections | | | | | |
|--|-----------------|-----------------|--------------|-------------|-----------------|
| for the Year Ended September 30, 2014 | | | | | |
| Net Position Beginning of Period | \$ (877) | \$ 1,652 | \$ 63 | \$ 5 | \$ 843 |
| Budgetary and Other Financing Sources | 49 | (3,022) | - | 1 | (2,972) |
| Net Cost/(Benefit) of Operations | 149 | (3,286) | - | - | (3,137) |
| Change in Net Position | (100) | 264 | - | 1 | 165 |
| Net Position End of Period | \$ (977) | \$ 1,916 | \$ 63 | \$ 6 | \$ 1,008 |

20. Exchange Transactions

Exchange Revenues

Exchange revenue is an inflow of resources to VA that is recognized when earned from exchange transactions with other federal agencies or the public where each party to the transaction sacrifices value and receives value in return. Exchange revenue consists primarily of: medical revenue recognized when earned from other federal agencies or the public as a result of costs incurred or services performed on their behalf; benefits



revenue from reimbursement of education benefit programs from Servicemember contributions that are transferred to the general fund account with the Department of the Treasury (Treasury); insurance revenue from insurance policy premiums paid by policyholders; and housing revenue from interest earned on direct loans. Exchange revenues are discussed further in Note 1 under Revenues and Other Financing Sources.

Exchange revenue is usually based on the full cost associated with the goods exchanged or services performed. Although VA recognizes full cost per SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, 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.

Public Exchange Transactions

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

The loan guarantee funding fees collected for 2015 and 2014 were \$1.8 billion and \$1.4 billion, respectively. The loan guarantee lender participation fees collected for 2015 and 2014 were \$2.2 million and \$2.1 million, respectively.

NCA leases lodges at five cemeteries to not-for-profit groups at no cost, four for historic preservation and one for office space. These groups are required to provide the upkeep and pay the costs for utilities, insurance, minor repairs, maintenance and any other costs associated with the lodges. NCA has agricultural licenses at eleven cemeteries with private sector entities, for which it receives rental payments. Two permits are licensed to the Federal Aviation Administration and Department of Interior at no cost. Total rental revenues earned under the contracts above were \$104 thousand and \$120 thousand for 2015 and 2014, respectively.

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 care services, 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 DoD 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.

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. Classification of preceding transactions in a product's life cycle will not have an impact on classification of subsequent transactions. The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

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

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. Interagency



billing rates are determined from cost and workload data in the Decision Support System.

21. Net Program Costs by Administration

| Schedule of Net Program Costs by Administration | | | | | |
|---|--------------------------------|----------------------------------|----------------------------------|---------------------------------------|------------|
| For the Period Ending September 30, 2015 (Dollars in Millions) | Veterans Health Administration | Veterans Benefits Administration | National Cemetery Administration | Indirect Administrative Program Costs | Total |
| Program Costs | | | | | |
| Intragovernmental Costs | \$ 9,207 | \$ 716 | \$ 43 | \$ 443 | \$ 10,409 |
| Less Earned Revenues | (64) | (552) | - | (162) | (778) |
| Net Intragovernmental Program Costs | 9,143 | 164 | 43 | 281 | 9,631 |
| Public Costs | 59,777 | 92,652 | 261 | 1,318 | 154,008 |
| Veterans Benefits Actuarial Costs, Excluding Changes in Actuarial Assumptions (Note 13) | - | 24,400 | 100 | - | 24,500 |
| Less Earned Revenues | (4,188) | (406) | - | (188) | (4,782) |
| Net Public Program Costs | 55,589 | 116,646 | 361 | 1,130 | 173,726 |
| Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions | 64,732 | 116,810 | 404 | 1,411 | 183,357 |
| Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13) | - | (13,000) | - | - | (13,000) |
| Net Cost of Operations | \$ 64,732 | \$ 103,810 | \$ 404 | \$ 1,411 | \$ 170,357 |



| Schedule of Net Program Costs by Administration | | | | | |
|---|--------------------------------|----------------------------------|----------------------------------|---------------------------------------|------------|
| For the Period Ending September 30, 2014 (Dollars in Millions) | Veterans Health Administration | Veterans Benefits Administration | National Cemetery Administration | Indirect Administrative Program Costs | Total |
| Program Costs | | | | | |
| Intragovernmental Costs | \$ 8,938 | \$ 656 | \$ 40 | \$ 489 | \$ 10,123 |
| Less Earned Revenues | (67) | (611) | - | (224) | (902) |
| Net Intragovernmental Program Costs | 8,871 | 45 | 40 | 265 | 9,221 |
| Public Costs | 56,059 | 87,381 | 270 | 1,342 | 145,052 |
| Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13) | - | 54,400 | - | - | 54,400 |
| Less Earned Revenues | (3,744) | (626) | - | (68) | (4,438) |
| Net Public Program Costs | 52,315 | 141,155 | 270 | 1,274 | 195,014 |
| Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions | 61,186 | 141,200 | 310 | 1,539 | 204,235 |
| Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13) | - | (22,000) | (100) | - | (22,100) |
| Net Cost of Operations | \$ 61,186 | \$ 119,200 | \$ 210 | \$ 1,539 | \$ 182,135 |

22. Disclosures Related to the Statements of Budgetary Resources

Budgetary Accounting

Budgetary resources, which include new budget authority, unobligated balances, direct spending authority, and obligation limitations, are forms of authority given to VA allowing it to incur obligations. Budget authority is provided by Federal law to enter into financial obligations that will result in immediate or future outlays involving Federal Government funds. Budget authority may be classified by the period of availability (1-year, multiple-year, no-year or available until expended), by the timing of congressional action (current or permanent), or by the manner of determining the amount available (definite or indefinite).



Budget authority from appropriations is the most common form of providing for the specific amount of money authorized by Congress for approved work, programs, or individual projects. Appropriations do not represent cash actually set aside in the Treasury for purposes specified in the appropriation act; they represent amounts that VA may obligate during the period of time specified in the respective appropriation acts. An appropriation may make funds available from the general fund, special funds, or trust funds.

Borrowing authority is budget authority enacted to permit VA to borrow money and then to obligate against amounts borrowed. It may be definite or indefinite in nature. The funds are borrowed from the Treasury and Federal Financing Bank.

Spending authority from offsetting receipts and collections is budget authority that permits VA to obligate and expend funds from sources that are not appropriated. Offsetting collections are authorized by law to be credited to appropriation or fund expenditure accounts. They result from (1) business-like transactions or market-oriented activities with the public, (2) intragovernmental transfers, and (3) collections from the public that are governmental in nature but required by law to be classified as offsetting. Collections resulting from business-like transactions with the public and other government accounts are also known as reimbursements. Laws authorizing offsetting collections make them available for obligation to meet the account's purpose without further legislative action.

Offsetting collections include reimbursements, transfers between federal and trust fund accounts, offsetting governmental collections, and refunds. For accounting purposes, earned reimbursements are also known as revenues. These offsetting collections are netted against gross outlays in determining net outlays from such appropriations.

Offsetting receipts are collections that are offset against gross outlays but are not authorized to be credited to expenditure accounts. Offsetting receipts are deposited in receipt accounts. Like offsetting collections, they result from (1) business-like transactions or market oriented activities with the public, (2) intragovernmental transfers, and (3) collections from the public that are governmental in nature but required by law to be classified as offsetting receipts.

The Status of Budgetary Resources reflects the obligations incurred, the unobligated balances at the end of the period that remain available, and unobligated balances at the end of the period that are unavailable except to adjust or liquidate prior year obligations. Unobligated balances currently unavailable may become available subject to apportionment by OMB and allotment by VA.

Apportionments are distributions made by OMB of amounts available for obligation in an appropriation or fund account. Apportionments divide amounts available for obligation by specific time periods (usually quarters), activities, projects, objects, or a combination



thereof. The amounts so apportioned limit the amount of obligations that may be incurred.

Upon apportionment and allotment, obligations can be incurred. Obligations represent a commitment that creates a legal liability for VA to pay for goods and services ordered or received, or a legal duty on the part of VA that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of VA. An obligation is the amount of orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payments during the same or future period.

Obligational authority is an amount carried over from one year to the next if the budget authority is available for obligation in the next fiscal year. Not all obligational authority that becomes available in a fiscal year is obligated and paid out in that same year. Balances are described as (1) obligated, (2) unobligated, or (3) unexpended.

An obligated balance is the amount of obligations already incurred for which payment has not yet been made, including undelivered orders and other unliquidated obligations. Budget authority that is available for a fixed period expires at the end of its period of availability, but the obligated balance of the budget authority remains available to liquidate obligations for 5 additional fiscal years. At the end of the fifth fiscal year, the account is closed and any remaining balance is cancelled.

An unobligated balance is the portion of obligational authority that has not yet been obligated. For an appropriation account that is available for a fixed period, the budget authority expires after the period of availability ends but its unobligated balance remains available for 5 additional fiscal years for recording and adjusting obligations properly chargeable to the appropriations period of availability such as to record previously unrecorded obligations or to make upward or downward adjustments in previously recorded obligations, such as contract modifications properly within scope of the original contract. At the end of the fifth fiscal year, the account is closed and any remaining balance is cancelled.

The unexpended balance represents the sum of the obligated and unobligated balances.

An outlay is the amount of checks, disbursement of cash, or electronic transfer of funds to liquidate a Federal obligation. Under the Credit Reform Act, the credit subsidy cost is recorded as an outlay when a direct or guaranteed loan is disbursed. Outlays during a fiscal year may be for payment of obligations incurred in prior years (prior-year obligations) or in the same year.

The caption, Appropriations under Budgetary Resources, in the Combined Statements of Budgetary Resources (SBR), does not agree to the caption Budgetary Financing



Sources – Appropriations Received in the Consolidated Statements of Changes in Net Position. The amount in the Combined SBR includes appropriations from the General Fund and Special Receipt Funds, while the Consolidated Statements of Changes in Net Position includes appropriations from the General Fund only.

The caption, Spending Authority from Offsetting Collections under Budgetary Resources in the Combined SBR, does not agree to the caption Earned Revenue in the Consolidated Statements of Net Cost. The amount in the Combined SBR includes Credit Reform subsidies for interest, fees and principal as required by Treasury reporting requirements, while the Consolidated Statements of Net Cost includes interest only.

**Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations
For the Years Ended September 30,**

| | 2015 | 2014 |
|-----------------------------------|-------------------|-------------------|
| Category A, Direct | \$ 158,658 | \$ 148,452 |
| Category B, Direct | 10,251 | 9,978 |
| Category A, Reimbursable | 854 | 803 |
| Category B, Reimbursable | 3,913 | 4,354 |
| Total Obligations Incurred | <u>\$ 173,676</u> | <u>\$ 163,587</u> |

Category A, consists of amounts requested to be apportioned by each calendar quarter in the fiscal year. Category B, 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. Direct obligations are for statutory work, programs or projects. Reimbursable obligations are for business-like transactions with the public or other government agencies. The amounts by year and category reconcile to the SF 132, Apportionment and Reapportionment Schedule, the SF 133, Report on Budget Execution and Budgetary Resources, and the Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) as required by OMB Circular No. A-11, Section 120.

Adjustments to Budgetary Resources and Prior Year Recoveries

The recoveries of prior year unpaid obligations were \$3.0 billion and \$2.5 billion for 2015 and 2014, respectively.

For both 2015 and 2014, VA appropriations were subjected to a \$1.8 billion rescission each year under the provisions of P.L. 113-235, *Consolidated and Further Continuing Appropriations Act, 2015* and P.L. 113-6, *Consolidated and Further Continuing Appropriations Act, 2014*, respectively.

Borrowing Authority

The Loan Guaranty Program had borrowing authority of \$466 million and \$356 million as of September 30, 2015 and 2014, respectively. The interest rates on the borrowing authority ranged from 1.00 to 2.60 percent for 2015 and 2014. 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 \$2.2 million and \$2.5 million as of September 30, 2015 and 2014, respectively. The interest rate on the borrowing authority was 1.00 percent for 2015 and 2014. Principal repayment is expected over a 2-year period from the date of issuance of debt. The Loan Guaranty Program 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 Program loans generally had a duration of one year, and repayment was made from offsetting collections.

Permanent Indefinite Appropriations

VA has four housing benefit programs that have permanent and indefinite appropriations to cover unexpected losses.

Explanations of Differences Between the SBR and the Budget of the US Government

The table below documents the material differences between the 2014 SBR and the actual amounts reported in the 2016 Budget of the United States Government. The 2017 Budget of the United States with the actual 2015 SBR amounts will not be available until February 2016. Once published, the 2015 actual data will be available on the OMB website at: www.whitehouse.gov/omb.

Explanations of Differences Between the SBR and the Budget of the US Government Year Ended September 30, 2014

| | Budgetary Resources | Obligations Incurred | Distributed Offsetting Receipts | Net Outlays |
|--|---------------------|----------------------|---------------------------------|-------------------|
| 2014 Actual Balances per the 2016 Budget of the U.S. Government (in millions) | 193,284 | \$ 161,085 | \$ (3,463) | \$ 150,121 |
| Reconciling Items: | | | | |
| Prior Year Recoveries of Unpaid Obligations | 2,510 | 2,510 | | |
| Expired accounts not in the US Budget | 1,760 | | | |
| Recovery Act, Special, and Trust Funds not in the US Budget | 428 | | | |
| Refunds and drawbacks not in the US Budget | (383) | | | |
| Miscellaneous Differences | (36) | (8) | (1) | |
| Per the 2014 Statement of Budgetary Resources | 197,563 | \$ 163,587 | \$ (3,464) | \$ 150,121 |

Use of Unobligated Balances of Budget Authority

Available unobligated balances on the 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 2015 use and appropriated unobligated amounts that have expired, 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 2015 Appropriation Law (P.L. 113-235). These purposes include: Veterans medical care, research, education, construction and maintenance of VA buildings, Veterans and dependents benefits, Veterans life insurance, loan guaranty programs, Veterans burial benefits, and administrative functions. Various obligation limitations are imposed on individual VA appropriations.

Undelivered Orders at the End of a Period

The amount of budgetary resources obligated for unpaid undelivered orders for the years ended 2015 and 2014 was \$14.9 billion and \$16.4 billion, respectively.

Contributed Capital

The amount of contributed capital received during 2015 consisted of donations in the amount of \$44.3 million to the General Post Fund, \$0.4 million to the Supply Fund and \$11.1 million to the National Cemetery Gift Fund. The amount of contributed capital received during 2014 consisted of donations in the amount of \$65.8 million to the General Post Fund, \$0.5 million to the Supply Fund and \$0.5 million to the National Cemetery Gift Fund.

23. 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,

2015

2014

Resources Used to Finance Activities

| | | |
|---|----------------|----------------|
| Obligations Incurred | \$ 173,676 | \$ 163,587 |
| Less Offsetting Collections, Receipts and Adjustments | (16,854) | (16,193) |
| Net Obligations | 156,822 | 147,394 |
| Donations of Property | 35 | 41 |
| Transfers Out | (3) | 14 |
| Imputed Financing | 1,880 | 2,169 |
| Other Financing Sources | (559) | (471) |
| Total Resources Used to Finance Activities | 158,175 | 149,147 |

Resources That Do Not Fund Net Cost of Operations

| | | |
|---|----------------|----------------|
| Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided | 515 | 181 |
| Resources that Finance the Acquisition of Assets | (6,739) | (5,378) |
| Resources that Fund Expenses Recognized in Prior Periods | (1,138) | (2,412) |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations | 4,540 | 5,562 |
| Total Resources that Do Not Fund Net Cost of Operations | (2,822) | (2,047) |
| Total Resources Used to Finance the Net Cost of Operations | 155,353 | 147,100 |

Costs That Do Not Require Resources in the Current Period

| | | |
|---|---------------|---------------|
| Increase in Annual Leave Liability | 84 | 80 |
| Increase (Decrease) in Environmental and Disposal Liability | 70 | (34) |
| Increase (Decrease) to Judgement Fund Future Funded Expense | 562 | - |
| Reestimates of Credit Subsidy Expense | (194) | 346 |
| Increase in Exchange Revenue Receivable from the Public | 106 | (501) |
| Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities | 11,620 | 32,722 |
| Depreciation and Amortization | 1,656 | 1,731 |
| Bad Debt Related to Uncollectible Non-Credit Reform Receivables | 810 | 98 |
| Loss on Disposition of Assets | 281 | 476 |
| Undistributed Offsetting Receipts | (4) | - |
| Other | 13 | 117 |
| Total Costs That Do Not Require Resources in the Current Period | 15,004 | 35,035 |

Net Cost (Benefit) of Operations

\$ 170,357 \$ 182,135



Required Supplementary Stewardship Information (Unaudited)

(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, | 2015 | 2014 | 2013 | 2012 | 2011 |
| State Extended Care Facilities | \$ 105 | \$ 92 | \$ 180 | \$ 66 | \$ 54 |
| Veterans Cemeteries (NCA) | 47 | 52 | 36 | 47 | 44 |
| Total Grant Program Costs | \$ 152 | \$ 144 | \$ 216 | \$ 113 | \$ 98 |

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, 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 five fiscal years, the State Home Construction Grant Program has awarded grants in excess of \$500 million. VA also provides per diem payment for the care of eligible Veterans in state homes.

Since the cemetery program was established in 1980, it helped establish, expand, improve, operate and maintain 95 Veterans cemeteries in 47 states and territories including Tribal trust lands, Northern Mariana Islands, and Guam, which provided more than 35,000 burials in 2015. VA awarded grants totaling more than \$664 million. State or Tribal organizations provide the land and agree to operate the cemeteries.

2. Human Capital

Investment in human capital is comprised of expenses for education and training programs for eligible Servicemembers, Veterans, and family members, and 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,

| | 2015 | 2014 |
|--|------------------|------------------|
| Program Expenses | | |
| Education and Training-Dependents of Veterans | \$ 493 | \$ 518 |
| Vocational Rehabilitation and Education Assistance | 13,543 | 14,206 |
| Administrative Program Costs | 512 | 502 |
| Total Program Expenses | <u>\$ 14,548</u> | <u>\$ 15,226</u> |
| Program Outputs (Participants) | | |
| Dependent Education | 91,755 | 90,641 |
| Veterans Rehabilitation | 86,928 | 93,363 |
| Veterans Education | 922,497 | 970,765 |

Veterans and Dependents Education

Years Ended September 30,

| | 2013 | 2012 |
|--|------------------|------------------|
| Program Expenses | | |
| Education and Training-Dependents of Veterans | \$ 487 | \$ 444 |
| Vocational Rehabilitation and Education Assistance | 12,693 | 11,727 |
| Administrative Program Costs | 372 | 389 |
| Total Program Expenses | <u>\$ 13,552</u> | <u>\$ 12,560</u> |
| Program Outputs (Participants) | | |
| Dependent Education | 89,618 | 94,618 |
| Veterans Rehabilitation | 89,708 | 85,436 |
| Veterans Education | 971,597 | 871,188 |

Veterans and Dependents Education

Years Ended September 30,

| | 2011 |
|--|------------------|
| Program Expenses | |
| Education and Training-Dependents of Veterans | \$ 567 |
| Vocational Rehabilitation and Education Assistance | 11,259 |
| Administrative Program Costs | 370 |
| Total Program Expenses | <u>\$ 12,196</u> |
| Program Outputs (Participants) | |
| Dependent Education | 96,078 |
| Veterans Rehabilitation | 81,097 |
| Veterans Education | 822,808 |



Program Outcomes

VA's education and training programs are intended to provide higher education to dependents that might not be able to participate otherwise. The rehabilitation and employment programs are provided to service-disabled Veterans, and 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 a 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,

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Program Expenses | | | | | |
| Physician Residents and Fellows | \$ 689 | \$ 748 | \$ 692 | \$ 663 | \$ 637 |
| Associated Health Residents and Students | 168 | 157 | 164 | 153 | 114 |
| Instructional and Administrative Support | 851 | 905 | 856 | 851 | 819 |
| Total Program Expenses | \$ 1,708 | \$ 1,810 | \$ 1,712 | \$ 1,667 | \$ 1,570 |
| Program Outputs | | | | | |
| Health Professions Rotating Through VA: | | | | | |
| Physician Residents and Fellows | 41,534 | 40,420 | 38,106 | 37,104 | 36,984 |
| Medical Students | 22,931 | 21,541 | 20,218 | 21,502 | 20,516 |
| Nursing Students | 27,275 | 29,067 | 25,948 | 32,349 | 25,931 |
| Associated Health Residents and Students | 28,663 | 27,771 | 33,228 | 25,839 | 31,869 |
| Total Program Outcomes | 120,403 | 118,799 | 117,500 | 116,794 | 115,300 |

Program Outcomes

Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. 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 partnerships between VA and the Nation's



academic institutions, VA plays a leadership role in defining the education of future health care professionals to meet the changing needs of the Nation's health care delivery system.

VA's education mission contributes to high quality health care of Veterans by providing a climate of scientific inquiry and evidence-based practice; rapid application of medical advances; supervised trainees who provide clinical care; and the recruitment of highly qualified health care professionals.

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. In October 2015, the Research and Development program was decremented \$20.2 million as its share of the bill for the construction of the Denver Replacement Medical Center. That decrement was applied proportionally among the programs.

Program Expense

Year Ended September 30, 2015

| | Basic | Applied | Development | Total |
|--|-----------------|-----------------|----------------|-------------------|
| Medical Research Service | \$ 195.1 | \$ - | \$ - | \$ 195.1 |
| Rehabilitative Research and Development | - | 88.3 | 15.6 | 103.9 |
| Health Services Research and Development | - | 99.0 | - | 99.0 |
| Cooperative Studies Research Service | - | 170.3 | - | 170.3 |
| Medical Research Support | 172.0 | 315.3 | 13.7 | 501.0 |
| Total Program Expenses | \$ 367.1 | \$ 672.9 | \$ 29.3 | \$ 1,069.3 |

Program Expense

Year Ended September 30, 2014

| | Basic | Applied | Development | Total |
|--|-----------------|-----------------|----------------|-------------------|
| Medical Research Service | \$ 218.6 | \$ 102.4 | \$ - | \$ 321.0 |
| Rehabilitative Research and Development | 8.0 | 59.3 | 36.7 | 104.0 |
| Health Services Research and Development | - | 90.1 | - | 90.1 |
| Cooperative Studies Research Service | 18.8 | 66.3 | - | 85.1 |
| Medical Research Support | - | 586.0 | - | 586.0 |
| Total Program Expenses | \$ 245.4 | \$ 904.1 | \$ 36.7 | \$ 1,186.2 |

Program Expense

Year Ended September 30, 2013

| | Basic | Applied | Development | Total |
|--|----------|---------|-------------|----------|
| Medical Research Service | \$ 192.0 | \$ 90.0 | \$ - | \$ 282.0 |
| Rehabilitative Research and Development | 7.0 | 52.0 | 36.3 | 95.3 |
| Health Services Research and Development | - | 90.0 | - | 90.0 |



**Program Expense
Year Ended September 30, 2013**

| | Basic | Applied | Development | Total |
|--------------------------------------|-----------------|-----------------|--------------------|-------------------|
| Cooperative Studies Research Service | 40.6 | 75.0 | - | 115.6 |
| Medical Research Support | - | 581.9 | - | 581.9 |
| Total Program Expenses | \$ 239.6 | \$ 888.9 | \$ 36.3 | \$ 1,164.8 |

**Program Expense
Year Ended September 30, 2012**

| | Basic | Applied | Development | Total |
|--|-----------------|-----------------|--------------------|-------------------|
| Medical Research Service | \$ 191.0 | \$ 92.0 | \$ - | \$ 283.0 |
| Rehabilitative Research and Development | 6.7 | 52.0 | 36.6 | 95.3 |
| Health Services Research and Development | - | 88.6 | - | 88.6 |
| Cooperative Studies Research Service | 40.4 | 75.2 | - | 115.6 |
| Medical Research Support | - | 581.0 | - | 581.0 |
| Total Program Expenses | \$ 238.1 | \$ 888.8 | \$ 36.6 | \$ 1,163.5 |

**Program Expense
Year Ended September 30, 2011**

| | Basic | Applied | Development | Total |
|--|-----------------|-----------------|--------------------|-------------------|
| Medical Research Service | \$ 166.1 | \$ 80.0 | \$ - | \$ 246.1 |
| Rehabilitative Research and Development | 8.7 | 68.6 | 47.4 | 124.7 |
| Health Services Research and Development | - | 85.3 | - | 85.3 |
| Cooperative Studies Research Service | 43.2 | 80.3 | - | 123.5 |
| Medical Research Support | - | 579.8 | - | 579.8 |
| Total Program Expenses | \$ 218.0 | \$ 894.0 | \$ 47.4 | \$ 1,159.4 |

In addition, VHA researchers received grants from the National Institutes of Health in the amount of \$386 million in 2015. During this same period, grants totaling \$233 million came from other organizations. The grants received 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 Outcomes

For 2015, VA's R&D general goal related to stewardship was to ensure that Pre-clinical Research and Clinical Research Programs (excluding Cooperative Studies Program (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,

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|--|-------------|-------------|-------------|-------------|-------------|
| 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 | 2,224 | 2,184 | 2,241 | 2,249 | 2,200 |

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 (Unaudited)

(dollars in millions, unless otherwise noted)

1. Deferred Maintenance and Repairs

Deferred maintenance and repairs are maintenance and repair activities not performed when they should have been or were scheduled to be, therefore, are put off or delayed for a future period. Activities include preventive maintenance; replacement of parts, systems or components; and other activities needed to preserve or maintain an asset. Maintenance and repair estimates are recorded for capitalized assets and are distinguished from capital improvements which expand the capacity of an asset or otherwise upgrade it to serve needs different from, or significantly greater than, its current use.

In April 2012, FASAB issued SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standard 6, 14, 29 and 32*, which is effective for periods beginning after September 30, 2014. The standard required expanded qualitative and quantitative disclosure of deferred maintenance and repairs.

Management determines the level of service and condition that is acceptable to carry out VA's mission, which may vary by VA components which include VHA, VBA, NCA, and Indirect Administrative Program Costs. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained, repaired and managed in a safe and effective manner; therefore, deferred maintenance and repairs are not applicable to them.

VA facilities reported their cost estimates for deferred maintenance and repairs by performing periodic Facility Condition Assessment (FCA) Surveys, which are inspections of property, plant and equipment based on generally accepted methods and standards consistently applied, to assign condition ratings and estimate costs for each fixed asset to correct deficiencies. An independent interdisciplinary professional contractor team tours and evaluates every VA building on a 3-year cycle, assessing all components. Each property, plant, and equipment component is given a description, an estimate of remaining useful life, and a grade from "A" to "F" based on VA's standard evaluation guidelines. Any building component graded "D" (poor) and "F" (critical) is given an estimated correction cost and recorded in Deferred Maintenance and Repairs, except where deficiencies will be replaced by capital expenditures. See Notes 1, 9 and 10 to the consolidated financial statements for additional information on general PP&E and heritage assets.

VA is experiencing an upward trend in Deferred Maintenance and Repairs as a result of (1) increased maintenance and repair costs as buildings age, (2) maintenance and

repair budgets that have not grown in proportion with increasing portfolio of owned space, and (3) expanded scope of FCA survey requirements significantly increase cost estimates when sites are reevaluated.

| Deferred Maintenance and Repairs | | |
|---|------------------|-------------------|
| as of September 30, 2015 | Ending Balance | Beginning Balance |
| General PP&E | \$ 9,166 | \$ 8,477 |
| Heritage Assets | 883 | 672 |
| Total Deferred Maintenance and Repairs | \$ 10,049 | \$ 9,149 |

2. Schedule of Budgetary Activity Year Ended September 30, 2015

| | 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 | | | | | | |
| 0152 Medical Admin | \$ 6,413 | \$ 5,817 | \$ 344 | \$ 1,135 | \$ 790 | \$ 5,818 |
| 0160 Medical Care | 54,192 | 48,970 | 1,823 | 8,582 | 5,383 | 50,346 |
| 0162 Medical Facilities | 6,957 | 5,574 | 354 | 2,772 | 2,927 | 5,065 |
| 0167 Information Technology | 4,825 | 4,146 | 276 | 1,894 | 1,948 | 3,815 |
| 0172 Veterans Choice Fund | 10,000 | 3,499 | - | - | 2,264 | 1,235 |
| All Other | 6,551 | 2,960 | 749 | 3,409 | 2,716 | 2,904 |
| Total | \$ 88,938 | \$ 70,966 | \$ 3,546 | \$ 17,792 | \$ 16,028 | \$ 69,183 |
| Veterans Benefits Administration | | | | | | |
| 0102 Compensation, Pension, Burial Benefits | \$ 81,857 | \$ 76,039 | \$ 310 | \$ 5,540 | \$ 6,038 | \$ 75,231 |
| 0137 Readjustment Benefits | 16,140 | 13,820 | 560 | 688 | 713 | 13,236 |
| 0151 General Operating Expenses | 3,246 | 3,118 | 573 | 403 | 346 | 2,602 |
| 4127 Direct Loan Financing | 176 | 82 | 101 | 1 | - | (18) |
| 4129 Guaranteed Loan Financing | 11,524 | 2,966 | 4,259 | 340 | 316 | (1,269) |
| 8132 National Service Life Insurance Fund | 955 | 955 | 48 | 1,053 | 947 | 1,013 |
| All Other | 4,424 | 2,307 | 1,119 | 491 | 477 | 1,201 |
| Total | \$ 118,322 | \$ 99,287 | \$ 6,970 | \$ 8,516 | \$ 8,837 | \$ 91,996 |
| National Cemetery Administration | | | | | | |
| Total | \$ 329 | \$ 308 | \$ 8 | \$ 165 | \$ 151 | \$ 314 |
| Indirect Administrative Program Costs | | | | | | |
| 0142 General Admin | 749 | 708 | 393 | 179 | 180 | 314 |



| | Total Budgetary Resources | Obligations Incurred | Spending Authority from Offsetting Collections and Adjustments | Obligated Balance Net, Oct. 1 | Obligated Balance Net, Sept. 30 | Total Outlays |
|-------------------------------------|--|---------------------------------|---|--|--|--------------------------|
| 1122 Board Veterans' Appeals | 99 | 96 | - | - | 7 | 89 |
| 4537 Supply Fund | 1,566 | 1,403 | 1,337 | (153) | (11) | (76) |
| All Other | 1,053 | 908 | 817 | 143 | 130 | 106 |
| Total | \$ 3,467 | \$ 3,115 | \$ 2,547 | \$ 169 | \$ 306 | \$ 433 |
| Total of all Administrations | \$ 211,056 | \$ 173,676 | \$ 13,071 | \$ 26,642 | \$ 25,322 | \$ 161,926 |

Report Distribution

VA Distribution

Office of the Secretary
Veterans Health Administration
Veterans Benefits Administration
National Cemetery Administration
Assistant Secretaries
Office of General Counsel

Non-VA Distribution

House Committee on Veterans' Affairs
House Appropriations Subcommittee on Military Construction, Veterans Affairs,
and Related Agencies
House Committee on Oversight and Government Reform
Senate Committee on Veterans' Affairs
Senate Appropriations Subcommittee on Military Construction, Veterans Affairs,
and Related Agencies
Senate Committee on Homeland Security and Governmental Affairs
National Veterans Service Organizations
Government Accountability Office
Office of Management and Budget

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