VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS

Department of Veterans Affairs

Audit of VA's Financial Statements for Fiscal Years 2016 and 2015

November 15, 2016
16-01484-82

To Report Suspected Wrongdoing in VA Programs and Operations:

Telephone: 1-800-488-8244

E-Mail: vaoighotline@va.gov

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

Audit of VA's Financial Statements for Fiscal Years 2016 and 2015

Why We Did This Audit

We contracted with the independent public accounting firm, CliftonLarsonAllen LLP (CLA), to audit VA's FY 2016 financial statements. This audit is an annual requirement of the Chief Financial Officers Act (CFO) of 1990. The results of CLA's audit are presented in the attached report. This report can also be found in VA's FY 2016 Agency Financial Report published on November 15, 2016.

What We Found

CLA provided an unmodified opinion on VA's FY 2016 and FY 2015 financial statements and identified six material weaknesses: information technology security controls; education benefits accrued liability; control environment surrounding the compensation, pension, and burial actuarial estimates; community care obligations, reconciliations, and accrued expenses; financial reporting; and CFO organizational structure for VA and VHA.

CLA also identified two significant deficiencies: procurement, undelivered orders, accrued expenses, and reconciliations; and loan guaranty liability. VA restated its prior period financial statements to correct a material error related to an accrued liability for its education benefit programs.

CLA also reported VA's substantial noncompliance with 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 sections 5315 and 3733, title 38, United States Code, pertaining to the charging of interest and administrative costs and the vendee loan program, and six violations of the Antideficiency Act identified by VA.

What We Recommended

CLA made recommendations for correcting the various material weaknesses and significant deficiencies. CLA is responsible for the attached audit report dated November 15, 2016, 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 address VA's significant challenges and improve its financial stewardship. The independent auditors will follow up on actions taken during the FY 2017 audit.

Larry M. Reinkemeyer

LARRY M. REINKEMEYER
Assistant Inspector General
for Audits and Evaluations

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http://www.va.gov/finance/afr/index.asp

Section I

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Department of Veterans Affairs

Memorandum

Date: November 15, 2016

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

Subj: Audit of VA's Financial Statements for Fiscal Years 2016 and 2015

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, 2016 and 2015, and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act (CFO) of 1990. The results of CliftonLarsonAllen LLP's audit are presented in the attached report.

2. CliftonLarsonAllen LLP provided an unmodified opinion on VA's fiscal years (FYs) 2016 and 2015 financial statements. With respect to internal control, CliftonLarsonAllen LLP identified six material weaknesses.

- Information technology security controls, which is a repeat condition
- Education benefits accrued liability, which is a new condition
- Control environment surrounding the compensation, pension, and burial actuarial estimates, which is a new condition
- Community care obligations, reconciliations, and accrued expenses, which is a combination of previously reported conditions
- Financial reporting, which is a repeat condition
- CFO organizational structure for VA and VHA, which is elevated from a significant deficiency

3. CliftonLarsonAllen LLP also identified two significant deficiencies.

- Procurement, undelivered orders, accrued expenses, and reconciliations, which is a combination of previously reported conditions
- Loan guaranty liability estimate, which is a new condition

4. VA restated its prior period financial statements to correct a material error related to an accrued liability for its education benefit programs. As a result, CliftonLarsonAllen LLP withdrew its previously issued auditors' report dated

November 16, 2015 and replaced it with the attached Independent Auditors' Report that covers the restated financial statements. The matter is described in the attached auditors' report in the paragraph titled "Emphasis-of-Matter Regarding a Correction of an Error" and in the material weakness titled "Education Benefits Accrued Liability." Note 24 to the financial statements also describes the matter.

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

- Substantial noncompliance with 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 noncompliance with section 5315, title 38, United States Code, pertaining to the charging of interest and administrative costs
- Noncompliance with section 3733, title 38, United States Code, pertaining to the vendee loan program
- Six violations of the Antideficiency Act, as reported to CliftonLarsonAllen LLP by VA, two of which have been reported to Congress and four of which VA is in the process of reporting
- Noncompliance with the Improper Payments Elimination and Recovery Act for FY 2015, as reported by the Office of Inspector General

6. CliftonLarsonAllen LLP is responsible for the attached audit report dated November 15, 2016 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 2017 audit of VA's financial statements.

Larry M. Reinkemeyer

LARRY M. REINKEMEYER

Attachment

CliftonLarsonAllen

CliftonLarsonAllen LLP
www.claconnect.com

INDEPENDENT AUDITORS' REPORT

To the Secretary
And Inspector General
United States Department of Veterans Affairs

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States Department of Veterans Affairs (VA), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, 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.; 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 auditors consider 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.

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 financial statements referred to above present fairly, in all material respects, the financial position of the VA as of September 30, 2016 and 2015, 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.

Emphasis-of-Matter Regarding a Correction of an Error

As discussed in Note 24 to the financial statements, certain errors resulting in understatement of amounts previously reported for Federal Employee and Veterans Benefits, and Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions, and overstatement of amounts previously reported for Cumulative Results of Operations – All Other Funds as of September 30, 2015, were discovered during the current year. Accordingly, amounts reported for Federal Employee and Veterans Benefits, Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions, and Cumulative Results of Operations – All Other Funds have been restated in the fiscal year (FY) 2015 financial statements now presented, and an adjustment has been made to Cumulative Results of Operations – All Other Funds and Federal Employee and Veterans Benefits as of September 30, 2014, to correct the material misstatement. Our previously issued auditors' report dated November 16, 2015, is withdrawn and replaced by this Independent Auditors' Report on the restated financial statements. A material weakness in Education Benefits Accrued Liability is included in the Report on Internal Control Over Financial Reporting. Our opinion is not modified with respect to this matter.

Other Matters

<u>Required Supplementary Information</u>
Accounting principles generally accepted in the U.S. require that the information in the VA's Management Discussion and Analysis (MD&A), 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 the Federal Accounting Standards Advisory Board (FASAB), which 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 required supplementary information 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 audits of the financial statements. We do not express an opinion or provide any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

<u>Other Information</u>
Our audits were 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, 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. In addition, management has included references to information on websites or other data outside of the Agency Financial

Report. This information has not been subjected to the auditing procedures applied in the audits 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 audits 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 management's assertion on internal control included in the MD&A.

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 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.

<u>Information Technology Security Controls</u>

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

<u>Education Benefits Accrued Liability</u>

The Veterans Benefit Administration's (VBA) accounting and financial reporting for veterans' education benefits did not comply with FASAB Statement of Federal Financial Accounting Standard (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*.

<u>Control Environment Surrounding the Compensation, Pension and Burial Actuarial Estimates</u>

Succession planning for VA's Office of the Actuary did not exist. The lack of a qualified and resident Chief Actuary managing and taking full responsibility for VA's compensation, pension and burial modelling resulted in a lack of segregation of duties and in issues related to outdated assumptions used for the model and errors in its calculations.

Community Care Obligations, Reconciliations, and Accrued Expenses

The Veterans Health Administration (VHA) continues to have weaknesses in its design and implementation of controls over the Community Care programs - from transaction obligations, liquidation of unfulfilled authorizations, and reconciliations to the related accrued expenses.

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. VA continues to have various financial reporting issues though some improvements have occurred since the prior year in certain areas.

CFO Organizational Structure for VA and VHA

VA's long history of decentralization and lack of financial management accountability in its Chief Financial Officer (CFO) organizational structure have led to continued challenges with entity-level accounting, financial management, oversight, and financial reporting controls, as illustrated in the matters reported above.

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.

Procurement, Undelivered Orders, Accrued Expenses, and Reconciliations

VA does not perform a consolidated and centralized reconciliation for procurement obligations recorded in its procurement subsidiary systems with its general ledger system. In addition, VA lacks adequate controls surrounding its extensive use of Miscellaneous Obligating Documents, accrued expenses, and other pervasive and long standing procurement related issues continue to exist.

Loan Guaranty Liability

VBA's loan guaranty liability estimation model has consistently shown significant differences between its forecasts and actual program results that lead to concerns about the reliability of the model estimates.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

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 discussed below, disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards* or OMB Bulletin 15-02. The results of our tests disclosed instances of noncompliance or other matters, described below and in Exhibit C, that are required to be reported in accordance with *Government Auditing Standards*.

We also performed tests of compliance with certain provisions of the Federal Financial Management Improvement Act (FFMIA). However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. Under FFMIA, each agency must implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. As described in Exhibit C, the results of our tests disclosed instances in which VA's financial management systems did not substantially comply with (1) Federal financial management systems requirements and (2) the USSGL at the transaction level.

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 Federal Managers' Financial Integrity Act (FMFIA), (2) providing a statement of assurance on the overall effectiveness on internal control over financial reporting, (3) ensuring VA's financial management systems are in substantial compliance with FFMIA requirements, and (4) complying 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 to certain provisions of laws, regulations, contracts, and grant agreements noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. 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.

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 16, 2015. 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

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance 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

CliftonLarsonAllen LLP

Calverton, Maryland
November 15, 2016

EXHIBIT A
Material Weaknesses

1. Information Technology Security Controls (Repeat Condition)

Background:

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. Many of VA's legacy systems have been obsolete for several years. For example, VA's core financial accounting system, FMS, is coded in Common Business Oriented Language (COBOL) - a programming language developed in the late 1950s and VA's system employed at the medical centers - Veterans Health Information Systems and Technology Architecture (VistA) - was built in the late 1970s. Because of their age, legacy systems are more burdensome and costly to maintain, cumbersome to operate, and difficult to adapt to meet today's operational requirements. 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. In addition, VA implemented the Enterprise Cybersecurity Strategy Team to serve as the core for enhancing strategic security priorities and coordinating remediation activities. As part of these initiatives, we noted continued improvements related to reducing the number of individuals with outdated background investigations, improving the use of two-factor authentication, implementing an enhanced audit log tool 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 domains. 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 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 security patches; however, older patches and previously identified vulnerabilities related to configuration weaknesses and outdated system software continue to persist on its networks. While some progress was made in these areas, VA needs to improve deployment of security patches, system upgrades, and system configurations that will mitigate significant security vulnerabilities and enforce a consistent process 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 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. Furthermore, VA did not have a complete inventory of the devices connected to its networks and thus we could not verify that all of VA's computers undergo continuous 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. While VA has purchased extended support for some of its software, we noted many instances of unsupported software that did not have extended vendor support. This has resulted in numerous unresolved security issues that expose other VA systems to possible security breaches stemming from unmitigated software vulnerabilities.
- VA needs to strengthen its methodologies for monitoring medical devices and ensuring they are properly segregated from other networks.
- VA did not effectively scan all medical devices and other systems connected to VA's network to mitigate security risks posed by these devices. Additionally, Office of Information and Technology (OIT) did not accept responsibility to manage the configuration and security of these devices in accordance with VA policy.
- Several VA organizations shared the same local network at some medical centers and data centers; however, not all systems were under the common control of the local site. Consequently, some non-OIT controlled networks had significant critical or high risk vulnerabilities that weaken the overall security posture of the local sites.
- There were weaknesses in the process for developing, approving, and implementing configuration baseline standards. Specifically, VA was in the process of reviewing its systems environment, identifying systems that did not have secure baseline configuration guides in place and developing baseline configuration guides for those systems.

- 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 was not fully 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. Specifically, we identified default passwords, easily guessed passwords, and blank passwords. In addition, multi-factor authentication for remote and local system access had not been fully implemented across the agency.
- Inconsistent reviews of user access resulting in numerous generic, system, terminated, and inactive user accounts that were not removed from the applications and networks. In addition, inconsistent exit clearance processes for employees contributed to an increase number of separated employees with active system user accounts.
- Proper completion of user access requests was not consistently performed to eliminate conflicting roles and enforce principles of least system privilege. In addition, technical access controls were not implemented in key financial applications to ensure access is based on defined roles and adequate separation of duties.
- 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 and application security event logs, which provide audit trails, were not consistently maintained, encrypted or reviewed across all facilities.

Security Management

- VA had not implemented effective processes to ensure that system Authority to Operates (ATOs) were conducted and completed in accordance with the National Institute of Standards and Technology (NIST) Risk Management Framework and VA policy. Specifically, existing processes allowed certain system ATOs to expire and allowed certain systems to be improperly reauthorized by an official without the proper authority. In addition, we identified several systems without valid ATOs. Furthermore, VA has not implemented processes for conducting security control assessments of medical devices, minor applications, facility special purpose systems, and industrial control systems before allowing such systems to connect to VA's network or the Internet. As a result, OIT has not fully considered the security risks of these systems and devices that are not managed by OIT but are connected to VA's general network.
- 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.
- Background reinvestigations were not performed timely and tracked effectively. In addition, some personnel did not receive the proper level of investigation for their position sensitivity levels. However, we did note some improvement over last year.
- Plans of Action and Milestones (POA&Ms) were not closed in a timely manner, not consistently updated to reflect changes to milestones, did not contain scheduled

completion dates, and documentation was inadequate to support closed actions. In addition, functionality limitations with the GRC Tool caused an unnecessary use of manual resources to record and monitor the status of POA&Ms when re-accrediting systems.

Contingency Planning

- Contingency plans did not reflect the current operating environment. Specifically, contingency plans did not clearly identify alternate processing sites, did not contain a complete system inventory or backup procedures, and detailed recovery procedures were not documented in the contingency plans. In addition, contingency plans were not updated to incorporate the lessons learned from contingency planning testing.
- Contingency plans were not tested to ensure failover capability to alternate processing sites.

Criteria:

OMB Circular A-130, *Appendix I, Responsibilities for Protecting and Managing Federal Information Resources* (OMB Circular A-130) states that, “Federal agencies must implement information security programs and privacy programs with the flexibility to meet current and future information management needs and the sufficiency to comply with Federal requirements and manage risks. As technologies and services continue to change, so will the threat environment. Agency programs must have the capability to identify, respond to, and recover from current threats while protecting their information resources and the privacy of the individuals whose information they maintain. The programs must also have the capability to address new and emerging threats. To be effective, information security and privacy considerations must be part of the day-to-day operations of agencies. This can best be accomplished by planning for the requisite security and privacy capabilities as an integral part of the agency strategic planning and risk management processes, not as a separate activity. This includes, but is not limited to, the integration of Federal information security and privacy requirements (and security and privacy controls) into the enterprise architecture, system development life cycle activities, systems engineering processes, and acquisition processes.”

OMB Circular A-130 also states that, “Agencies shall implement an agency-wide risk management process that frames, assesses, responds to, and monitors information security and privacy risk on an ongoing basis across the three organizational tiers (i.e., organization level, mission or business process level, and information system level).”

The Federal Information Security Modernization Act of 2014 (FISMA), amended the FISMA Act of 2002 that requires each agency to 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 disparate financial system architecture has resulted in a lack of common system security controls and inconsistent maintenance of IT mission-critical systems. Further, key financial management systems use outdated technology that hinders mitigation of certain security vulnerabilities. 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 local sites 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.

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. Without remediating all significant security vulnerabilities, systems could be compromised resulting in potential harm to confidentiality, integrity, and availability of VA financial and sensitive data.

Recommendations:

The Assistant Secretary for Information and Technology and Chief Information Officer 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 and systems 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.

EXHIBIT A
Material Weaknesses

2. Implement an improved 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 unsupported technology.

4. Strengthen processes and controls to monitor medical devices and ensure they are properly segregated from other networks.

5. Implement processes to consolidate the security responsibilities for local facility systems not currently managed by OIT and ensure security vulnerabilities are remediated in a timely manner.

6. Maintain up-to-date, complete, accurate, and readily available security baseline configurations for all platforms. Ensure that all baselines are appropriately implemented, tested, and monitored 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 controllers, 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 reviews of network and financial applications to ensure appropriate user access rights. Remove generic and inactive accounts on systems and networks.

12. Implement improved processes to ensure the proper completion of termination exit checklists for separated employees. Verify that VA property, including access badges, are returned and system accounts are disabled.

13. 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.

14. Implement technical access controls that will restrict user access based on defined roles and enforce adequate separation of duties principles.

15. Implement improved access monitoring within production environments for individuals with elevated system privileges.

EXHIBIT A
Material Weaknesses

16. Strengthen agency-wide incident response procedures to ensure timely notification and resolution of computer security incidents in accordance with VA standards.

17. Implement improved processes for monitoring system audit logs for unauthorized or unusual activities across all systems and platforms. Implement improved procedures for analyzing audit logs and ensure audit logs are maintained and protected in accordance with VA Handbook 6500, *Risk Management Framework for VA Information Systems – Tier 3: Information Security Program*.

18. Implement processes to ensure all VA systems and devices are authorized to operate and system security controls are properly evaluated before allowing such systems to connect to VA's general network or the Internet.

19. Implement an improved continuous monitoring program in accordance with the NIST Risk Management Framework; specifically regarding evaluating the effectiveness of security controls.

20. 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 should ensure all required information is included and accurately reflects the current environment, new security risks, and applicable federal standards.

21. Strengthen processes to ensure appropriate levels of background investigations are completed for all applicable VA employees and contractors in a timely manner.

22. Strengthen processes to ensure local facilities track background reinvestigations for employees and contractors in high-risk positions and the Security Investigation Center initiates all reinvestigations in a timely manner. Additionally, implement improved 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.

23. 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.

24. Implement system enhancements to the GRC Tool to address the issue of re-opening closed POA&Ms.

25. 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.

26. 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 Weaknesses

2. Education Benefits Accrued Liability

Background:

VBA manages several education benefit programs with total disbursements of $14.5 billion in FY 2016. The Post-9/11 GI Bill is the largest program (over 80 percent of disbursements) and is available for individuals who served in active duty after September 10, 2001. Since the establishment of this program in FY 2009, the total education benefits paid by VBA have experienced steady increases, while the other education programs have experienced decreases.

Prior to FY 2016, management viewed education benefit payments as non-exchange transactions and did not consider them to be post-employment benefits. Consequently, management only recorded a liability for the amounts that were due for payment but had not yet been disbursed at the period end.

Conditions:

VBA's consideration of education benefits as non-exchange transactions did not comply with FASAB SFFAS 5, *Accounting for Liabilities of the Federal Government.* SFFAS No. 5 states *"An exchange transaction arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future."* The education benefit is an exchange transaction because the veterans perform service and in return, received a promise of deferred compensation such as future education benefits.

In addition, VBA's position that education benefits were not post-employment benefits was not consistent with SFFAS No. 5, which states, *"Postemployment benefits other than pensions (OPEB) include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. OPEB include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity."* SFFAS No. 5 states that for OPEB, the expense should be recognized at the time the accountable event occurs and any part of that cost unpaid at the end of the period is a liability.

VBA management, upon its subsequent recognition of the education benefits as exchange transactions and OPEB, provided its initial calculation model to estimate the education benefit accrued liability. However, that calculation did not define the accountable event that made the OPEB liability probable and measurable, and as a result, was not compliant with SFFAS No. 5, which states, "*FASAB believes that an accrual based on the occurrence of an actual event, such as a job-related injury or a decision to reduce the entity's workforce generally, is a reasonable approach. Such an event makes the future outflow of resources probable and measurable*." VA then defined the accountable event as when it has approved an original enrollment certification in its Long-Term Solution system.

An education benefits accrued liability for approximately $59.6 billion was reported by management as of September 30, 2016, along with the necessary restatement of prior year reported balances. Management asserted that the estimated amount was based on the existing available data with a conservative assumption that all eligible education benefits will be used by the veterans or their beneficiaries who were enrolled with the education institutions as of the end of the reporting period. In addition, management asserted that due to the relatively short duration of the program, an experience study could not have been performed to confirm the aforementioned assumption or the assumption that each approved veteran or beneficiary will continue to use the benefits in a consistent pattern for six months per year until all the benefits are exhausted. Management did not provide an actuarial report that complies with actuarial standards of practice and signed by an accredited actuary.

Criteria:

OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (OMB Circular A-123), revised on July 15, 2016, provides guidance to Federal managers on improving accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, and reliable financial reporting.

Effect:

The accrued liability for education benefits and related expenses on VA's financial statements were materially misstated.

Recommendations:

We recommend that the VBA Chief Financial Officer in coordination with the Interim Assistant Secretary for Management and Interim Chief Financial Officer:

1. Establish internal controls to periodically review and assess VBA's operations that have financial impact to ensure proper accounting and financial reporting of those programs and operations.

2. Perform an experience study to confirm the validity of the key assumptions used in the calculation model. Key assumptions to be validated should include, at the minimum:
   - The percentage of students who are expected to use all eligible benefits within the 15-year eligibility period, compared to those who are not.
   - The pattern of those who do and do not re-enroll with an education institution within the eligibility period (by duration from the original date of enrollment).
   - Experience data that supports management's six month benefit use per year assumption. The latter should consider all eligible students with remaining coverage months, and not focus solely on those students that are taking courses.

   As part of the study, management should focus on trending patterns based on available data and comparison with similar programs or studies, and consideration of outliers so as not to distort the overall results of the study.

3. Perform periodic look-back analyses on assumptions and other relevant factors used in the calculation, as well as the total cost estimated to ensure accuracy of financial reporting. Segregation of those already enrolled versus new entrants and by each of the applicable education programs should be maintained in the analysis.

4. Document the following key elements related to management's assessment of the estimate and assumptions:
   - Consideration of alternative assumptions or outcomes and why management has rejected them or how management has otherwise addressed estimation uncertainty in making the accounting estimate (e.g., a sensitivity study, etc.).
   - Refinement of its current accrual methodology and calculation for other education benefit programs by separately accounting for them.
   - Sources of data used by management in its calculation and any data limitations of which financial statement readers should be made aware.
   - Assessment that the significant assumptions used by management are reasonable.

5. Revise and update policies, procedures, and process narratives relevant to VBA's accounting and financial reporting of education benefits.

6. Produce an actuarial report that complies with Actuarial Standard of Practice No. 41, *Actuarial Communications* that is signed by an accredited actuary.

3. Control Environment Surrounding the Compensation, Pension and Burial Actuarial Estimates

Conditions:

VA provides compensation, pension and burial (C&P) benefits to eligible Veterans and their beneficiaries. The VA Office of Policy and Planning's (OPP) Office of the Actuary (OACT) estimates the present value of the future C&P liabilities at the end of the fiscal year. The unfunded Veterans compensation and burial liability amount reported in VA's Balance Sheet as of September 30, 2016, was approximately$2.5 trillion.

OACT's Chief Actuary left VA in July 2016. OACT did not have a successor Chief Actuary with the appropriate qualifications and experience to take full responsibility and manage the C&P actuarial model. Management initially proposed to use an actuary that had the appropriate credential but lacked employee benefits experience to manage the C&P actuarial model assumptions and review the related calculations. Experience with employee benefits liability modelling is necessary to ensure appropriate judgments are used in developing the estimates. During September 2016, management placed a credentialed actuary who was on detail from another agency to be the responsible actuary signing the year end C&P actuarial report. OACT did not have an effective succession plan to ensure the required expertise was available and that a succession candidate was properly trained to assume the key role when the Chief Actuary left. In addition, the lack of succession planning resulted in the lack of segregation of duties causing various modelling errors to occur during the interim period.

OACT also identified at year end that its disability compensation new case rate assumption was outdated. The last experience study was performed in FY 2012 covering the period FY 2006 to FY 2011. However, VBA has since experienced growth in its total compensation counts from FY 2012 to FY 2016, and such increase was not considered in its initial modelling. In addition, OACT did not review the actuary report issued by the Department of Defense (DoD) to ensure its key assumptions are reasonable in light of DoD's experience which could ultimately affect VA. OACT revised its new case rate, which resulted in an additional $277 billion adjustment to

VA's reported amount. Due to the short time frame, a more thorough study was not performed and presented in an actuarial report.

Criteria:

The Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* provides criteria for designing, implementing and operating an effective internal control system and such criteria is defined through five components and seventeen principles. One of the principles, Demonstrate Commitment to Competence, states "Management should demonstrate a commitment to recruit, develop, and retain competent individuals. The following attributes contribute to the design, implementation, and operating effectiveness of this principle:

- Expectations of Competence
- Recruitment, Development, and Retention of Individuals
- Succession and Contingency Plans and Preparation"

Effect:

The lack of an effective succession plan placed the timely estimation of VA's largest liability at risk, and the lack of implementation and monitoring controls over the C&P modelling resulted in a material adjustment to the liability estimate late in the audit process.

Recommendations:

We recommend the Interim Assistant Secretary for Management and Interim Chief Financial Officer and the VBA Chief Financial Officer work with the Assistant Secretary for Policy and Planning to:

1. Develop a succession plan to ensure the required expertise is available before personnel with highly technical and specialized skills leave the agency. Such succession planning is key to helping VA continue achieving its internal and external reporting objectives.

2. Develop a team with the necessary expertise to estimate the Veterans compensation, pension and burial liabilities, and prepare the related footnote disclosures. This should include appointing or engaging a responsible actuary with a qualified actuary to perform peer review of the work performed by the responsible actuary. In this context, "peer review" can only be performed by an individual with qualifications equal or superior to the responsible actuary.

3. Strengthen controls to ensure the C&P modelling is performed by the appropriate level of personnel to:
    - Conduct the appropriate analysis and validation of data sources.
    - Review and ensure the reasonableness of assumptions used and document the rationale behind these assumptions.
    - Consider changes in conditions or programs that require further research and analysis. Update the assumptions when necessary.
    - Compare estimates with subsequent results to assess the reliability of the assumptions and data used to develop estimates.

- Compare the relevant assumptions used in the DoD actuary report to VA's model assumptions, and assess their impact, if any. Update the assumptions when necessary.

4. Conduct a more thorough study of the new case rates that supports management's assumptions and present the results in the actuarial report that complies with Actuarial Standard of Practice No. 41, *Actuarial Communications*.

4. Community Care Obligations, Reconciliations and Accrued Expenses

Background:

VHA purchases medical services for veterans from community health care providers under the Community Care programs, which are comprised primarily of the Veterans Choice Program (Choice), and the "Fee Basis" Care program (Fee Basis), along with several other smaller programs. Approximately $5.7 billion was budgeted for Choice and $6.5 billion was budgeted for Fee Basis in FY 2016. Actual payments in the amounts of $4.3 billion were expended for Choice while $4.6 billion were expended for Fee Basis as of September 30, 2016.

When Congress passed the Veterans Access, Choice, and Accountability Act of 2014 (Choice Act), VA modified the existing Patient Centered Community Care (PC3) program contracts, serviced by TriWest Healthcare Alliance Corporation (TriWest) and Health Net Federal Services, LLC (Health Net), to include requirements imposed by the Choice Act. Under the PC3 program, 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. Under the Choice program, 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, pay providers for services provided to the veterans, maintain a call center, and distribute Choice Cards, which inform veterans that they may be eligible for Choice.

Under Section 106 of the Choice Act, VHA's Office of Community Care (OCC) was authorized to manage all VA Community Care (VACC) programs. VHA traditionally uses the Fee Basis Claims System (FBCS) to authorize, process and pay for community care claims. FBCS was utilized in a decentralized manner in that each medical center or Veterans Integrated Service Network (VISN) had its own instance of FBCS. This decentralized structure remained for the Fee Basis programs, while OCC centralized the Choice program and managed it through a single instance of FBCS.

Conditions:

VHA continued to have weaknesses in its design and implementation of controls over the VACC programs, specifically with transaction authorization and obligation, monitoring and timely liquidation of unfulfilled authorizations, reconciliations, and the related accrued expenses. Key control deficiencies were as follows:

A. <u>Manual and Inconsistent Nature of Estimating Costs of Care Across VHA</u>

The process for estimating costs of care was manual and amounts estimated were entered into FBCS by the VACC staff at each medical center. The current pricing tools developed were not consistently used by VACC staff at the medical centers and by OCC, resulting in the VACC staff using their subjective judgement in deploying their own costing methods and causing a wide variation in amounts estimated. We noted numerous examples of obligations being overstated compared to the actual payments made during our testing. As a result, VA management performed its own analysis and recorded journal entries in the approximate amount of $1.9 billion to liquidate the overstated Choice obligations and $2.6 billion to liquidate the overstated Fee Basis obligations in VA's general ledger at September 30, 2016.

B. <u>Lack of Authorization and Obligation Monitoring</u>

OCC did not have a centralized and consolidated process to validate or monitor the obligation amounts recorded for Choice or Fee Basis programs. A "look-back" analysis to validate the reasonableness of cost estimation was not conducted. In addition, $204 million of Fee Basis obligations had no activity for over 90 days at June 30, 2016. These obligations were not validated or monitored at a centralized, nation-wide level. As a result, funds were being held as obligated when they should have been closed out. Furthermore, untimely liquidation of obligations due to patients having other health insurance also contributed to obligations being overstated for the Choice program during FY 2016.

C. <u>Pervasive Overstatement of Obligations Resulting in the Overstatement of Accrued Expenses</u>

FMS accrued the entire outstanding balance of an obligation when the end date for the contractual performance period had passed, regardless of whether goods or services were provided at period end. As a result, the overestimation of medical care obligations resulted in an overstatement of accrued expenses at period end. Management performed its own review and recorded "topside" journal entries in the amount of $1.1 billion to reverse the Choice over accrued expenses and $1.9 billon to reverse the Fee Basis over accrued expenses at September 30, 2016. We also noted that existing outstanding accruals expected to be liquidated were not sufficiently monitored and properly adjusted in FMS.

D. <u>Consolidated Reconciliation of Transactions Recorded in FBCS with FMS Was Not Performed on a Monthly Basis</u>

Authorizations in FBCS were manually calculated and compared against obligations in the Integrated Funds Distribution, Control Point Activity Accounting and Procurement (IFCAP) system and FMS. Obligations in these systems were based on VA Form 1358, *Obligation or Change in Obligation* (referred to as "1358s" or "miscellaneous obligations"). This manual process increased the risk of errors to the financial statements.

A nationwide consolidated reconciliation for community care authorizations recorded in FBCS—exceeding $4.9 billion as of September 30, 2016—was not performed with the amounts recorded in FMS for obligations and disbursements throughout most of the year. Material differences for obligations were noted between FBCS and FMS. OCC eventually provided a preliminary nationwide manual reconciliation from FBCS to IFCAP and FMS for all VACC programs as of June 30, 2016. However, the data quality and accuracy, as well as material differences identified in the reconciliations require further research and still need great improvement.

In addition, liquidation of invalid obligations occurred only at the FMS level, and not at the FBCS level. Transactions processed in FBCS do not have two-way interface with FMS. As a result, financial adjustments made in FMS were not automatically updated in the FBCS, creating further reconciliation issues. Consequently, year-end reconciliations between FBCS, IFCAP, and FMS could not be relied upon.

E. <u>Other Transaction Processing Related Issues Affecting Financial Reporting</u>

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

- *Untimely Claim Processing and Payment* – A backlog of 120,000 claims due to the delay in registering veterans for Choice existed as of late July 2016, as stated by VA.
- *Inadequate Contractor Oversight when Key Financial Management Controls Were Heavily Relied Upon* – One contractor did not 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. As such, procedures were not in place in FY 2016 to verify that the contractors' key financial controls were effectively and efficiently designed and implemented, including contractors' management and timely payment of claims.

Criteria:

OMB Circular A-123 provides guidance to Federal managers on improving accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. 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.

Cause:

Significant system limitations hindered effective and efficient operations and controls for the VACC programs. For example, FBCS generally does not directly interface with IFCAP and FMS. Also, since each medical center has a separate instance of FBCS, it was difficult to consolidate information and manage programs from the overall perspective. FMS' auto-accrual function did not operate effectively.

In addition, OCC did not have adequate policies and procedures for its own monitoring activities. OCC's activities also were not integrated with VA and VHA CFO responsibilities under the Chief Financial Officers Act of 1990 (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 guidance and oversight of all VACC financial management personnel, activities, and operations. The VA and VHA CFOs were not actively involved in OCC's implementation of the VACC programs.

EXHIBIT A
Material Weaknesses

Effect:

These conditions could cause balances for obligations, accrued expenses, and undelivered orders (UDOs), as reported in the financial statements, to be misstated. OCC also may not be able to adequately asses its budgetary needs for the various VACC programs.

Recommendations:

We recommend that the Under Secretary for Health:

1. Implement Enterprise Risk Management (ERM) principles for VACC programs in accordance with OMB Circular A-123, especially given the high risks associated with these programs.

2. Ensure the close coordination and integration between the CFOs, OCC, VISN, and medical centers so key accounting and financial management controls are properly designed, implemented and monitored for VACC programs.

3. Implement policies, procedures, and a reliable and accepted pricing tool to ensure:
   - FBCS authorization estimates are reliable and consistent cross all medical centers.
   - Expired authorization estimates are promptly liquidated from both FBCS and IFCAP.
   - Transaction level details in FBCS, IFCAP, and FMS for obligations and disbursements are reconciled monthly in a complete and nationwide consolidated manner (including the month-end cut-off date to be on the last date of the month).

4. Perform periodic look-back validations and analyses on obligation and accrual balances reported for all VACC programs against subsequent activity to:
   - Ensure accuracy of financial reporting and to maximize budgetary resources.
   - Identify significant differences to be investigated and researched.
   - Adjust the accrual methodology to reflect actual VACC spending patterns.

5. Ensure that management's monitoring controls include:
   - Detailed reviews and validation of cost estimations and reconciliations performed.
   - Timely liquidation of long outstanding or canceled appointments.
   - Measurement of the number of days for financial events, such as appointment fulfillment, provider invoicing, and payments to be completed.

6. Use existing reports, such as the "Top 1,000 Outliers" and "High Cost Authorizations" reports, reports detailing inactivity, and reports on actual disbursements of claims paid, to identify necessary adjustments due to erroneous or otherwise incorrect estimates, and to monitor trends over time.

7. Develop a process that:
   - Validates that bills from Health Net and TriWest do not include costs chargeable to other health insurance.

- Ensures other health insurance information maintained by VA is shared with the contractors to facilitate the accuracy of their billing.
- Makes cumulative adjustments to Choice obligations based on other health insurance payments and evaluates the need to continue to make such adjustments on either a monthly or quarterly basis.

8. Improve estimation of accrued amounts by:
   - Finalizing accrual methodologies for the Choice and other VACC programs.
   - Considering the use of an actuarial model, if appropriate.
   - Developing a process to electronically and consistently monitor patient appointment and provider billing status on a real time basis to better its data gathering and analysis of claims data. Such information should be used for "incurred but not reported" claim estimates and forecasting of budgetary resource needs as those programs continue to grow.

9. Work with OIT to modernize the IT infrastructure supporting key VACC programs to:
   - Facilitate data transparency from inception (authorization) to completion (payment and receipt of medical records) that also can be interfaced with the general ledger system.
   - Consider web-based management and real-time interactive engagement with providers on consults, authorizations, receipt of claims and medical records, adjudication of claims, and notification of provider payments.
   - Decrease manual processes where possible.

10. Regarding claims payments:
    - Clear the current backlog of Choice claims waiting for payment by the Financial Services Center.
    - Automate controls over Choice registration and claims processing at the Financial Services Center.

11. Ensure both contractors undergo an annual independent examination of their controls that include VA specific procedures, and provide examination results in a timely fashion for VA's reliance as a system user.

5. Financial Reporting

Conditions:

VA's legacy core financial management and general ledger system, FMS, was implemented in 1992. Since that time, Federal financial reporting requirements have become more complicated and the level of financial information needed by management, Congress, and other oversight bodies has become increasingly demanding and complex. FMS's outdated chart of accounts and transaction codes are not USSGL compliant. 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 continue to accumulate. Although VA has been working diligently to identify root causes and has made necessary improvements in areas such as reduced use of journal vouchers (JVs) and fluctuation analysis, many of these issues have existed for years and require extensive efforts to change existing business processes, research legacy differences and implement solutions to resolve them. VA's CFO has taken the lead in addressing many of the reported matters since the prior year. However, those long standing issues require time and sustained VA wide efforts to ensure their proper implementation. Through FY 2016, VA's financial reporting issues continued to exist or emerge in the following areas:

A. <u>Lack of FMS Reconciliations with Subsidiary Systems</u>

VA has several legacy subsidiary systems that no longer meet financial management system requirements and do not have a two-way interface with FMS. Key VBA and VHA subsidiary systems - including VistA, IFCAP, Benefits Delivery Network (BDN), the Veterans Service Network (VETSNET), Insurance General Ledger (IGL), and Centralized Administrative Accounting Transaction System (CAATS) - only have a one way interface with FMS. Reconciliations between the subsidiary systems where the financial transactions were initiated and FMS were either not performed, partially performed, performed decentrally, or performed manually. As a result, VA's accounting and financial reporting is severely hindered by system and business process limitations.

B. <u>Extensive Use of Journal Vouchers:</u>

Despite significant improvements, VA still recorded a large 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 VBA, which recorded approximately 77 percent of the overall MinX JVs' absolute value, created a complicated and labor-intensive financial reporting environment. Transactions from VBA's subsidiary systems, BDN and VETSNET, were not completely cross-mapped to accounts in FMS and the necessary cleanup to reconcile and resolve long standing cumulative differences was not performed timely. As a result, the MinX JVs were used to achieve VA's financial reporting requirements. In addition, JVs posted in prior years and housed in a default account (i.e., Station 151) were not reclassified to the proper fund symbols or accounts after the financial reporting periods were closed resulting in large accumulated balances in FMS, which further increased the risk of misstatements in financial reporting.

Further, each accounting period in MinX is independent, which requires numerous JVs, manual reconciliations, and analyses to be reperformed and reentered to produce VA's quarterly financial statements and trial balances for the U.S. Department of the Treasury (Treasury).

Use of manual adjustments such as top-side entries often bypass controls instituted for ordinary transaction processing and increases the risk of introducing errors into financial reporting. The use of JVs requires a high level of review and analysis to mitigate the risk of material errors in the financial statements.

EXHIBIT A
Material Weaknesses

C. Inadequate Fluctuation 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 CFO at the administration level, as well as an overall VA consolidated level analysis to be performed by the central office. VA made significant improvements in this area in FY 2016; however, continued enhancements are required by VA management and its Administrations and staff offices to develop a consistent and appropriate comparative analysis and to identify the underlying cause of unusual variances or unexpected changes.

D. Budgetary to Proprietary Analyses Contained Material Differences

VA instituted a process to perform "Budgetary to Proprietary" account analysis by Treasury Fund Symbol to fix out of balance accounts during FY 2015. This analysis compared budgetary accounts with closely related proprietary accounts to ensure consistency between them. Due to FMS and subsidiary system limitations, and timing issues, significant differences continued to exist throughout FY 2016.

E. 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. Significant abnormal balances continued to exist at the fund level at September 30, 2016. Significant abnormal balances identified at the fund level from the VBA and VHA business lines are not being researched and cleared from VA's trial balance in a timely manner. Many of those balances have remained in the accounts for years.

F. Issues with Inter-Agency 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 obligations, unfilled customer orders, and offsetting collections recorded in FMS did not agree to the inter-agency agreement amounts and no reconciliation was performed to ensure their agreements.

In addition, due to FMS system limitations, transactions were mapped to the incorrect Federal or Non-Federal attributes as a default. FMS does not have the functionality to meet new Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) reporting requirements at the time of transaction processing. High-volume, high dollar JVs were 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.

G. VBA Beginning Balance Adjustment

VBA processed a beginning balance adjustment in the amount of $836 million in FMS to address an abnormal balance. That adjustment resulted in an out of balance condition between the beginning FY 2016 and ending FY 2015 balances for Unexpended Appropriations and Cumulative Results of Operations in the Statement of Changes in Net Position.

H. Recording of Prior Year Budgetary Recoveries

VA initially reported approximately $4.2 billion as recoveries of prior year unpaid obligations (recoveries) at September 30, 2016. 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. As a result of those conditions, VA recorded top side entries in the total amount of approximately $1.5 billion to adjust the recovery balances recorded in FMS.

I. Lack of Reconciliation and Timely Clearing of Deposit/Clearing Account Activities

VA did not have a centralized and consolidated process to properly report, reconcile, and monitor the deposit/clearing account balances and related activities reported in the net value of $496 million in Note 3, Fund Balance with Treasury, to the financial statements during FY 2016.

J. Internal Use Software Costs Not Properly Captured and Capitalized in Accordance with SFFAS No. 4 and 10

VA did not properly capitalize project costs for its internal use software in accordance with 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
- Required manual data input based on weekly staff time cards, increasing the risk that data might not be accurate or complete
- Did not code labor costs by project phase (i.e., Preliminary Design, Development, and Post Implementation/Operational phases)

Further, management did not properly record indirect costs in FMS in accordance with SFFAS No. 4, and No.10 to capitalize the full costs of the project during the software development phase.

K. Late Capitalization of Assets

Assets with a gross cost of approximately $673 million were acquired prior to FY 2016, but not recorded until the current fiscal year by VHA medical centers and OIT.

Criteria:

OMB Circular A-123 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.

Cause:

EXHIBIT A
Material Weaknesses

The age and limitations of VA's various financial management systems caused VA to record numerous manual JVs and implement extensive manual processes and controls to prepare its financial statements for external reporting purposes. 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. In addition, adequate internal controls were lacking in the following key areas: 1) centralized and consolidated reconciliations for key accounts, 2) account fluctuation and budgetary to proprietary analyses, 3) researching and clearing of abnormal balances and Deposit/Clearing account activities, 4) timely capitalization of acquired assets, and 5) software capitalization in accordance with FASAB standards. Lastly, VBA and VHA did not implement significant portions of the 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:

These weaknesses increased the risk of errors in the financial reporting process.

Recommendations:

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

1. With respect to FMS reconciliations with subsidiary systems:
    - Perform an ERM review that includes all of VA's subsidiary systems to inventory all of VA's financial transactions and how they are interfaced or recorded in FMS. Such an analysis can be performed in conjunction with the Digital Accountability and Transparency Act of 2014 (i.e., DATA Act) implementation efforts.
    - After such mapping is performed, management should establish its risk register for each of those systems and prioritize their system modernization or institute system fix efforts by working with OIT and the relevant Business Administrations to ensure the complete and consolidated reconciliations between those subsidiary systems and FMS are performed on a monthly basis. This ERM assessment should be done in a consolidated and integrated manner.

2. With respect to JVs:
    - Establish or continue to implement policies and procedures:
        - To ensure that VA centralizes the JV recording process and sets controls surrounding the research and review of account differences and subsequent adjustments. The process and controls should include:
            - Standardized categories of JVs, including the type of journal entries to be recorded throughout VA.
            - Guidance for recording and reporting JVs, and monitoring and analyzing their use in order to reduce the volume.
            - Requirement that budgetary entries initially recorded in FMS be consistent with amounts in Treasury warrants, Standard Form (SF)-132, *Apportionment and Reapportionment Schedule*, and SF-133, *Report on Budget Execution and Budgetary Resources.*
            - Requirement to review significant entries to ensure their accuracy and appropriateness before posting.

  - Once the JV process has been standardized, monitoring should be performed to ensure that the policies and procedures are being implemented properly.
- Continue efforts to correct and establish missing FMS transaction posting logic to minimize the use of manual JVs. Manual JVs should be used only for unusual transactions, as a general rule (e.g., quarterly accruals, timing differences, or unusual one-time entries, etc.).
- Perform the following analyses:
  - An analysis over recurring, monthly MinX JVs used to adjust FMS balances to the SF-132 and the SF-133.
  - A pro forma analysis to ensure that post-closing effects are considered prior to recording adjusting entries into the general ledger system. Upon the recording of significant or material adjustments for budgetary entries, financial managers should review the entries with the budget officials to ensure both are in agreement prior to posting. The review should include JVs proposed by financial management as well as JVs proposed by the VA budget staff to ensure consistency with all financial reporting documents (i.e., SF-132 and SF-133, and Continuing Resolutions funding calculations).
  - Routinely review all JVs recorded in the FMS Station 151 default account and reclassify them to the proper funds and accounts timely.
  - Consider revising the financial reporting and closing memorandum to move up the dates for periods 13, 14, and 15 to allow for a more timely year-end close process. In addition, an analysis should be performed to determine how period 14 and 15 entries can be eliminated by instituting tighter controls surrounding the financial reporting process at year-end.
- Implement a control log to track all activities performed in the updated MinX software environment. This will ensure that a history and audit trail of transactions processed is readily available and accessible for analysis, research needs, and general reference.

3. With respect to account fluctuation analysis:
   - Formalize policy for fluctuation analysis and include:
     - At the consolidated and administration levels, quarter to quarter and year to year comparisons, and comparisons to budgeted amounts and projected needs to detect anomalies, emerging trends, and to facilitate funds management. Some of the analysis (i.e., with the Statements of Net Cost, Budgetary Resources, and Changes in Net Position) should be performed in conjunction with the program or budget offices' input.
     - Setting the administrative and staff office analysis threshold at a sufficiently low level to provide coverage for fluctuations at the consolidated level.
     - Procedures for Administrations and staff offices to report on inconsistencies and unexpected fluctuations. Explanations for fluctuations that meet the materiality thresholds should be required, and those fluctuations should be described in terms of operational changes or trends and not just increases or decreases in subsidiary accounts.
     - Quality control reviews of the components' analyses performed by the Office of Management's Office of Financial Policy (OFP). Components should address OFP feedback earnestly and timely. OFP should hold periodic training workshops to share lessons learned or best practices.
4. With respect to budgetary to proprietary analysis and abnormal balances:

- Perform budgetary to proprietary account relationship tests and the abnormal balance review at the Treasury Fund Symbol level by fund type on a quarterly basis and resolve discrepancies.
- Research discrepancies and tie points that do not work, determine the cause, and document resolutions. A reconciliation of the numbers included in the analysis to the MinX trial balance should be performed to support the validity of the analysis.

5. With respect to intra-governmental agreements and reconciliations:
   - Continue to work with all VA Administrations to fully implement a centralized repository of all intragovernmental agreements.
   - Perform an inventory review of those agreements to:
     - Determine whether balances are recorded in FMS accurately.
     - Ensure that agreements in the repository reflect an active or closed status.
     - Consider whether closed agreements need to be renewed, maintained in the repository or archived.
   - Produce reports on transactions with other Federal agencies with sufficient detail to link those transactions to relevant interagency agreements to facilitate reconciliations with trading partners.

6. With respect to prior year budgetary recoveries:
   - Continue to perform an assessment to validate the transactions included in the total population of prior year budgetary recoveries, and improve the process to estimate and record any necessary adjusting entries.
   - Establish transaction codes for prior year budgetary recoveries that are consistent with USSGL as part of VA's system modernization efforts.

7. With respect to Deposit/Clearing account activities:
   - Develop a centralized process to identify and reconcile all Deposit/Clearing activities. Unreconciled differences should be researched and resolved within 60 days pursuant to management policy. This should be performed as part of the Fund Balance with Treasury reconciliation to ensure completeness.

8. 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.

9. With respect to late capitalization of assets:
   - Enhance communication among the logistics, engineering, contracting, and fiscal offices to improve and formalize the flow of information in a timely manner to ensure accurate accounting and reporting of fixed asset transactions.
   - Strengthen controls to ensure that the construction work-in-process projects are reviewed at least quarterly to identify completed projects that should be capitalized and depreciated as fixed assets in accordance with VA's Financial Policy and Procedures.

10. Update the OMB Circular A-123 cycle narratives to remove outdated financial reporting information and document current procedures performed in the financial reporting process, including, but not limited to, the use of MinX and FMS JVs, fluctuation review

analysis, budgetary to proprietary analysis, abnormal balance review, and use of the central repository for inter-agency agreements.

We recommend that the VBA and VHA Chief Financial Officers:

11. Work with the Assistant Secretary for Management and Chief Financial Officer to identify reasons for JVs and institute the necessary controls including the appropriate and effective communication channels, and system improvements to eliminate the extensive use of JVs. Unusual JVs must be elevated to upper management for their review and approval.

6. CFO Organizational Structure for VA and VHA

Background:

The CFO Act requires each executive department to have a CFO to assess, direct, and manage the entity's overall financial management risks to enable efficient and effective business operations and meet the entity's internal and external financial reporting needs.

Condition:

VA's decentralized and fragmented organizational structure for financial management and reporting does not operate in a fully integrated manner. Based on our observations of the overall control environment, and through the results of our testing, we noted that overall accounting and financial reporting risks are not being effectively managed at the highest level of governance.

A. <u>Responsibility and accountability for VA's financial management is divided</u>

The Assistant Secretary for Management is VA's CFO. The VA CFO has particular responsibility for establishing financial policy, systems and operating procedures for all VA financial entities; providing guidance on all aspects of financial management; and producing VA's consolidated financial reports. VA administrations and other offices are responsible for implementing those policies and producing the financial information that the VA CFO's office consolidates. Business components, such as VHA, VBA, and National Cemetery Administration (NCA), have their own CFOs, who oversee financial management operations and follow the chain of command within those organizations.

Most of VA's budget authority and financial statement accounts are under the operational control of its major administrations and offices. The reliability of VA's financial reporting as a whole, therefore, is dependent, in a large part, on the quality of financial management at these organizations.

Under the CFO Act and VA policy, the VA CFO has responsibility for strategically planning and overseeing all financial management activities relating to the programs and operations of VA. However, the current organizational structure diminishes the VA CFO's ability to fulfill that role. In particular, the VA CFO has limited direct authority over financial management at these organizations. For example, VA's CFO does not have any formal authority to manage VA's financial and business operations from top down, integrate various but similar business operations to achieve consistency and efficiency, establish and manage accountability for financial management functions deployed throughout VA, and to ensure the proper recruitment, placement and retention of key financial personnel who affect VA's financial reporting as a whole. As such, VA's governance structure does not include strong accountability controls for financial management at the enterprise level.

In addition, VHA's financial management structure, in particular, is very fragmented with financial personnel reporting up to the Principal Deputy Under Secretary for Health through three different CFO organizational structures—the VHA CFO, the VA OCC CFO, and the 19 Veterans Integrated Service Networks CFOs through the Deputy Under Secretary for Health for Operations and Management. The VHA CFO's responsibilities are limited and do not cover the activities of the other CFOs.

B. <u>Examples of Difficulties in Financial Management Governance and Coordination</u>

We observed numerous instances where VA's decentralized organizational structure contributed to material weaknesses cited in this report.

- *Veterans Education Benefits Accrued Liability*: We did not observe cooperation and coordination between the VA and VBA CFO organizations on this matter that affected VA's consolidated financial statements until very late in the audit. VBA's position on the issue, presented in August, was inadequate and incorrect, and resulted in a rushed and very late effort to develop an acceptable estimation methodology with supporting data.

- *Control Environment Surrounding Veterans Benefits Compensation, Pension and Burial Actuarial Estimates:* The Compensation and Burial actuarial estimate is the largest number in VA's consolidated financial statements—over $2.5 trillion. VA's OACT, within VA's OPP, prepares the estimate based on information and data provided by VBA. The VA CFO, VBA CFO, and the OPP did not ensure an acceptable succession and contingency plan for key personnel, which became evident upon the sudden departure of the primary, certified actuary responsible for the calculation.

- *Financial Reporting:* The VA CFO's office is responsible for producing VA's consolidated financial statements, but it must consolidate accounts that are mostly under the operational control of other organizations. Therefore, the VA CFO's office is dependent upon VA's major components to perform adequate reconciliations, data clean-up and reviews of those accounts, such as fluctuation analysis, budgetary to proprietary account comparisons, and research and resolution of abnormal balances. We observed numerous instances where VA's major components had not implemented or completed these procedures.

  Further, a breakdown in communication occurred when VBA adjusted beginning balances for unexpended appropriations and cumulative results of operations, resulting in an out of balance condition affecting the financial statements.

  We also noted the worsening of late capitalization of assets by VHA medical centers and OIT, and the untimely reconciliation and monitoring of aged suspense account activities by VA components. The VA CFO has no direct reporting lines of authority to ensure these matters are corrected.

- *Community Care Obligations, Reconciliations and Accrued Expenses:* The obligations and accrued expenses for VACC programs are material to VA's consolidated financial statements. Primary financial management responsibility rests with the OCC. Neither the VHA CFO nor VA CFO has any formal authority over financial practices in this office. We observed many financial management difficulties faced by this office, particularly in accounting for accurate obligations, transaction reconciliations, and the estimation of accrued expenses.

C. <u>Noncompliance with the CFO Act</u>

VA's decentralized and fragmented organizational structure for financial management and reporting is not organizationally structured, and does not operate in, a fully integrated manner, as described above. As such, VA does not provide sufficient organizational authority for the VA CFO to perform fully the following responsibilities under the CFO Act:

- Oversee all financial management activities relating to the programs and business operations of the agency
- Direct, manage, and provide policy guidance and oversight of agency financial management personnel, activities, and operations, including the recruitment, selection, and training of personnel to carry out agency financial management functions
- Develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which:
  - Complies with applicable accounting principles, internal control standards, and OMB policies and requirements
  - Provides for complete, reliable, consistent, and timely information, which is prepared on a uniform basis and responsive to the financial information needs of agency management

We also observed that VA has collaborative committees, such as the Senior Assessment Team and the Financial Policy Steering Group, where internal control, reporting, and policy matters are considered and decisions are made on a consensus basis. Such collaboration is recommended to ensure that components are fully involved in those matters that affect them, their collective expertise is utilized, their concerns are recognized and addressed, and they can agree with the decisions made. However, such collaborative decision-making cannot negate or overrule the VA CFO's responsibilities as delineated above under the CFO Act. Regardless of the committee structure, the VA CFO has primary responsibility for the department's proper adherence to accounting principles, standards and requirements.

Criteria:

The Chief Financial Officers Act of 1990, GAO's *Standards for Internal Control in the Federal Government*, and OMB Circular A-123*.*

Cause:

VA's CFO organizational structure has historically been decentralized. We also observed that as funding for VHA continues to increase, it appears that more budget execution and financial management monitoring responsibilities are given to the OCC instead of the VHA CFO, resulting in further erosion in VHA's CFO responsibilities and VHA's noncompliance with the intent and principles of the CFO Act.

Effect:

The decentralization of financial management functions among the VA component entities without organizational reporting and accountability back to the VA CFO has decreased the VA CFO's ability to affect financial management at the components and across the VA enterprise. This weakness also presents a significant risk to VA's planned conversion to a shared service provider in order to modernize its financial systems.

In addition, due to the decentralization of VHA CFO responsibilities, there is a lack of effective centralized and consolidated monitoring, oversight and accountability over VHA's overall accounting and financial reporting functions. This can lead to duplication of efforts, inefficiencies, waste of resources, and inconsistencies on how financial management directives and policies are executed and monitored. This could also cause a breakdown of internal controls, which could lead to material errors in the financial statement balances.

Recommendations:

We recommend that the VA Secretary and Deputy Secretary:

1. Provide the VA CFO office with sufficient authority to oversee all financial management activities relating to the business operations of the agency. At a minimum, the VA CFO should have specific formal authority for:
    - Approving job descriptions and skill requirements for those who head VA components' financial management activities and operations.
    - Participating in the selection of those individuals.
    - Participating in their annual performance evaluation.

2. Implement ERM in accordance with OMB Circular A-123. As part of this implementation:
    - Enable the VA CFO's office to centralize and consolidate its oversight and monitoring role.
    - Establish a sound and integrated governance structure that engages all members within VA management, and focuses on having the right competencies in place across accounting, financial reporting, and financial management roles.
    - Work to develop a transparent and accountable culture to:
        - Openly share information regarding potential risks.
        - Implement corrective actions to timely address and mitigate the identified risks.
        - Encourage communication and collaboration under the CFO's leadership to resolve any identified accounting, financial management and financial reporting issues.

We recommend that the Under Secretary for Health:

3. Consolidate VHA's CFO responsibilities such that the VHA CFO's office has the necessary authority to oversee all VHA's accounting, budgeting, and financial management activities relating to all VHA business operations. All medical center CFOs should be accountable to the VISN CFOs who then are accountable to the VHA CFO office. In addition, the OCC CFO and all other program CFOs should be accountable to the VHA CFO's office. The VHA CFO should in turn, be accountable to the VA CFO as well as the Deputy Under Secretary for Health. The VHA CFO's responsibilities, in

conjunction with the VA CFO, should be consistent with the CFO Act and include the following:

- Developing and maintaining integrated accounting and financial management systems;
- Directing, managing, and providing policy guidance and oversight of all VHA financial management personnel, activities, and operations;
- Approving and managing VHA financial management systems design and enhancement projects;
- Developing VHA's budgets for financial management operations and improvements;
- Overseeing the recruitment, selection, and training of VHA personnel to carry out agency financial management functions;
- Implementing VHA asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control; and
- Monitoring the financial execution of the VHA budget in relation to actual expenditures.

EXHIBIT B
Significant Deficiencies

1. Procurement, Undelivered Orders, Accrued Expenses 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 1358s. After the receipt of goods and services or at the end of the agreement period, any previously obligated but undisbursed amounts, i.e., 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 has made progress in its overall monitoring of obligations during FY 2016 excluding the VACC program, which is reported as a material weakness in Exhibit A. However, certain control deficiencies continued to exist as the year-end adjustments to de-obligate invalid delivered or undelivered obligations were projected to be approximately $822 million as follows:

A. <u>Reconciliations</u>

VA utilizes the IFCAP and CAATS 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 and in the Financial Reporting material weakness, VA does not perform a complete reconciliation of all outstanding obligations and expenditures between IFCAP, CAATS, 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.

B. <u>Lack of Control Surrounding the Extensive Use of 1358s</u>

As previously reported by the GAO, VA has used 1358s for over 60 years and utilizes them for the procurement of goods and services extensively. As of September 30, 2016, VA's UDOs based on 1358s approximated $5.6 billion. VA allows 23 different categories of use, and they are integral to the operation of some large VA programs. In most 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 were used when contracts and inter-agency 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.

C. <u>Lack of Comprehensive Look-back Analysis</u>

VA's 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. VA did not have an adequate process to validate these estimates against actual payment data from FMS. As a result, the overestimation of obligations resulted in an overstatement of accrued expenses at period end. A comprehensive look-back analysis or validation of its accrual methodology was not performed throughout the year resulting in an overstatement of accounts payable at the approximate amount of $709 million as of September 30, 2016.

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

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

- *Untimely liquidation of inactive UDOs* – Delays ranged from one month to one year and three months.
- *Untimely recording of contracts or modifications into the general ledger system (FMS)* – Delays ranged from approximately one month to one year and six months.
- *Recording of obligations prior to contract execution* – Obligations, including purchases through the National Acquisition Center (NAC), were recorded in FMS up to three years and ten months prior to the execution of the contract amendments.
- *Over-obligation of funds* – Recorded obligations exceeded the contract or purchase order amounts.
- *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 four years.

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 as 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 requisitions and financial reporting processes. Communication between business lines and administrative offices within VA did not always take place in a timely manner. In addition, an effective validation process for the accrued expenses balance, including a look-back analysis, was lacking.

Effect:

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

EXHIBIT B
Significant Deficiencies

Recommendations:

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

1. Work with OIT to ensure the two-way interface of financial data between the procurement subsidiary systems and the general ledger system is part of the VA's ongoing systems modernization efforts. Develop common data elements and fields to facilitate the reconciliation and flow of information between the general ledger system and subsidiary procurement systems, including IFCAP, eCMS, and CAATS, to enable a consolidated and comprehensive reconciliation.

2. In coordination with appropriate procurement and program officials, assess whether key controls established for 1358 obligations, are adequately designed to ensure that the use of 1358s is extremely limited and for obligations immaterial in dollar amounts as the use of 1358s often bypasses the procurement processes outlined in the Federal Acquisition Regulation (FAR). In addition, establish controls to ensure that the responsibility of those utilizing 1358s is properly delegated to the appropriate officials as the obligation is similar to the financial responsibility associated with an executed contract.

3. Evaluate the design and execution of controls around the use of 1358s as follows:
    - Work in coordination with the administrations to perform a complete assessment of existing goods and services procured through 1358s to determine whether contract execution/ratification is necessary.
    - Include a standard methodology within policies and procedures that the users of 1358s should follow to support the amounts obligated by type of transaction, including guidance on how to perform a look-back analysis to ascertain the validity of the estimation process.
    - Engage the help of the Office of Acquisition, Logistics, and Construction (OALC) and the Budget Office to review and develop policies and procedures for 1358s to ensure the documentation supports the use of 1358s and is compliant with VA's appropriations law and the FAR.
    - Work with OALC to establish the necessary acquisition structure and provide training to 1358 preparers and approvers on the use of contracts and inter-agency agreements in place of 1358s.
    - Establish a policy that requires the automatic liquidation of remaining balances on 1358s within a reasonable timeframe. In addition, this policy needs to be implemented in coordination with the automated accrual methodology within FMS to ensure the accrued expenses balance reflects the actual liability incurred and can be substantiated.

4. Closely monitor the use of 1358 obligations, particularly when the Form 1358 is used as a vehicle for recording inter-agency agreements. For any instances where the "MISCN" vendor code is associated with a Federal obligation, review transaction activity to ensure that the appropriate trading partner codes are used. If Federal trading partner codes are not associated with the obligation, evaluate for potential misclassification between Federal and non-Federal activity and evaluate the impact, if any, on management's Treasury's GTAS reporting.

5. Perform monthly consolidated reconciliations of obligations and expenditures recorded in IFCAP, CAATS, eCMS, and FMS for all open documents to ensure the accounting information is valid and proper. Develop a plan to research and adjust the balances based on documentary evidence.

6. With respect to accrued expenses:
   - Develop procedures for validating the completeness and accuracy of underlying data used in preparing the accrual estimate, including contract performance periods, an analysis of subsequent payments, and acceptable levels of precision.
   - Develop a process to validate accounts payable accrual methodology by comparing the estimates with subsequent payments. Such validation should be performed for all program elements included in the accrual process and over a few years to show a trend of the estimates. Unusual fluctuations, if any, should be investigated and research conclusions documented.

We recommend that the Under Secretary for Health, Under Secretary for Benefits, and the Principal Executive Director, OALC in coordination with the Interim Assistant Secretary for Management and Interim Chief Financial Officer:

7. Implement the existing procurement and contracting controls to ensure that all acquisitions, obligations, and procurement-related documents are maintained in accordance with the FAR to support acquisition decisions made by management and the obligation amount recorded in VA's financial statements.
   - The contract documents should be maintained in eCMS following a consistent filling schema so they can be readily retrieved for examination. All documentation to support the procurement process, procurement decisions, and the amounts reported in VA's financial statements, should be properly completed, maintained, and readily available for examination.
   - Contracting personnel, along with each Administration's CFO, should develop a process to periodically and proactively monitor all open projects in IFCAP, CAATS, etc. to ensure their understanding of the order's status and determine the validity of the outstanding UDOs.
   - Fiscal staff should work closely with Contracting to ensure that contract or purchase order modifications, if reasonably justified, are executed prior to the project end date previously agreed upon.

8. Continue to implement VA's Financial Policies and Procedures to ensure the following:
   - Dollar amounts in FMS accurately reflect the status of the obligation.
   - Timeframe for the obligation recorded in FMS is valid (i.e., both the beginning and end dates are correctly reflected in the obligation).
   - Obligations are supported by sufficient detail (documentary evidence), which should also include the project performance period in the contract/purchase order and in their subsequent modifications to ensure proper accounting.
   - Obligations are reconciled to source documents, to include obligating documents, receiving reports, invoices and payments.
   - Aged obligations are valid and recorded correctly.

9. Strengthen controls to ensure that facility asset acquisition and planning is well-coordinated among all key parties involving capital asset management, construction and facilities management, contracting, logistics, fiscal service, etc., so that funds are

obligated when the facility is ready to execute the service, construction, purchase, etc.; and that all relevant source documentation is maintained for record (e.g., procurement files, signed contracts, etc.).

10. Provide the necessary periodic training and implement controls at the facility level to strengthen staff's knowledge and compliance with the appropriations law, to reinforce the importance of reviewing the obligating documentation and relevant files, including invoices prior to payment certification, so that payments are made properly, recorded promptly, represent authorized services, and are posted to the correct obligation.

11. Strengthen controls to minimize instances of unauthorized commitments. When situations are identified that require contract ratification, fiscal, contracting, and the originating service line should act together to timely process and obligate funds in the appropriate budget fiscal year. New obligations should not be paid for and recorded against prior year expired funds per OMB Circular A-11, *Preparation, Submission, and Execution of the Budget* (OMB Circular A-11).

12. Ensure that when changes to an obligation's internal cost accounting structure – such as a modification to the Budget Object Class code or transaction code (i.e., MO to SO) – are made, the accounting treatment is properly reflecting the activity per USSGL and OMB Circular A-11.

13. Implement controls to record transactions timely only based on executed contracts in FMS in the correct funding year and ensure that contractor performance does not begin without the official contract.

14. Establish a mechanism in which the Contracting Officer's Technical Representative and the Contracting Officer can receive advance notification upon the contract's expiration to renew, extend or close out the expiring contract before the performance period ends. Controls should be implemented to ensure timely processing of contract amendments so that contract performance periods remain current and accurate, and that inputs for calculating accruals and other contract milestones with financial impact are tracked appropriately.

15. Monitor active interagency agreements where VA is either the buyer or the seller to ensure timely and accurate recording of revenues, accounts receivable, obligations, undelivered orders, expenses, unfilled customer orders, etc. Officially signed interagency agreements should be dated to indicate the effective date of the agreement.

We recommend that the Under Secretary for Health, Under Secretary for Benefits, and the Principal Executive Director, OALC:

16. Ensure obligations are not being incurred without the bona fide need that derives from robust acquisition planning and procurement for services. In addition, work with NAC to ensure that high tech medical equipment acquisitions are executed in a timely manner, to prevent delinquent obligations or obligations that are unsupported by contract activity. Provide the necessary medical center training to ensure documentation for requisition requests is complete and compliant with NAC's procurement policies and procedures. Consider a mechanism to allow NAC to directly record obligations on medical center's books upon signing of the contract/purchase order with the vendor.

17. Implement controls that stations liquidate their excess obligations upon the issuance of NAC purchase orders to ensure the amounts obligated in VA's general ledger, including both the equipment cost and the NAC surcharge, agree to the amounts on the signed purchase order with the vendor.

2. Loan Guaranty Liability

Background:

VA's Home Loan Guaranty program provides a guaranty to commercial lenders against losses from veterans' mortgage loan defaults. VBA uses complex models (regression-based variable default model and cash flow-model) to estimate future cash flows and determine the cost of these guarantees on a present value basis for budgetary and reporting purposes.

Condition:

VBA did not have a defined and documented process for engaging and involving senior leadership outside of the budget office for critical decisions and oversight over various loan guaranty subsidy modelling activities, including; model development, risk assessment, assumption development and review, and model validation. Our audits have identified a number of structural deficiencies in the design of VA's variable default model and cash flow model that have impacted VA's ability to effectively forecast future program cash flows following the housing crisis. As a result, VA's models have consistently shown significant differences between the model forecasts and actual program performance, which led to concerns about the reliability of the model estimates. These differences are mostly evident in the cohorts after the housing crisis (FY 2010 and later years), which comprise approximately 84 percent of the future cash flows supporting the Loan Guaranty Liability.

In addition, VBA provided limited comment notes within the model to explain various model revisions, but there was no evidence that these items were reviewed and approved by someone outside of the Budget office. Similarly, evidence of management's review and analysis of the model's assumptions and outputs to include an actual to estimate analysis, and the review of the currency and appropriateness of the assumptions, were not documented.

Based on discussions with management regarding this issue, VBA revised certain model assumptions, reducing the Loan Guaranty Liability as of September 30, 2016, by $830 million.

Criteria:

Federal Financial Accounting and Auditing Technical Release No. 6*: Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*, states that:

- Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance.
- Preparing reliable and timely direct loan and loan guarantee subsidy estimates must be a joint effort between the budget, CFO and program offices at each agency.
- *Special emphasis for programs that have peak periods* – Where applicable, an acceptable monitoring process should provide extra emphasis during periods when cohorts are experiencing significant increases or decreases in defaults, prepayments, recoveries, or other cash flows.

- If the most recent estimated cash flows of a cohort are different from the actual experience, these differences and the reasons for these differences may affect the future estimated cash flows of that cohort. The effects on the future cash flows of that cohort need to be assessed and included in the reestimate, and the reasons for the estimated effects need to be documented.

Cause:

VBA has not updated its documented set of policies and procedures outlining key aspects of its model risk management activities and how they are to be performed since 2008. It did not have a formalized annual process, to include senior management outside of the budget office, to review the design of its cash flow models, fully evaluate the comparison of actual cash flows to forecasted cash flows, and analyze the effects of program attributes or operations that could identify potential errors in their estimates caused by changing programmatic or macroeconomic variables.

In addition, VBA obtained an independent validation review of the model in FY 2012 but did not implement any of the recommendations from that review.

Effect:

A lack of a current, clearly defined, and documented (1) governance structure, (2) internal controls framework, and (3) policies and procedures over the housing modelling development and activities may result in:

- Significant misstatement of the liability within the financial statements.
- Ineffective monitoring and oversight by those parties ultimately responsible for these estimates.

Recommendations:

We recommend that the Interim Assistant Secretary for Management and Interim Chief Financial Officer work with the VBA Chief Financial Officer to:

1. Perform an annual comparison of the actual program cash flows to modeled cash flows and document management’s analysis as to the resulting reasonableness of future model forecasts and any compensating model adjustments that may be considered necessary.

2. Design and implement a set of policies and procedures for a model risk management oversight and governance structure, with a control framework that defines the roles and responsibilities for program, budget, department and government stakeholders.

EXHIBIT C
Compliance Findings

1. Noncompliance with 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 1992. 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 due to the age of FMS.

In addition, complete and consolidated reconciliations between FMS and the following subsidiary systems were not performed throughout FY 2016:

- *Integrated Funds Distribution Control Point Activity, Accounting and Procurement System (IFCAP)*. IFCAP is a module within *Veterans Integrated Systems Technology Architecture (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 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.

- 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 fully implemented a standard procurement file structure in eCMS to maintain acquisition documentation in a consistent and efficient manner. 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.

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

- *Fee Basis Claims System (FBCS)*. FBCS is used to manage the authorization and payment processes for VHA's VACC programs. 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 for the majority of FY 2016.

Furthermore, the following subsidiary systems do not have two-way interface amongst key systems that share financial data or with FMS:

- The Centralized Administrative Accounting Transaction System (CAATS)
- The Benefits Delivery Network (BDN)
- The Veterans Services Network (VETSNET)
- The interface from the Long Term Solutions system to BDN is a one-way process. Education benefit payments were determined and processed in LTS and transferred through the system interface to BDN for payments by the VBA. However, the payment data in BDN did not feed back into LTS to show the entire history from eligibility and entitlement determinations, to actual payment processed. No reconciliation is performed to ensure consistency of relevant data in both systems.

B. <u>USSGL at the Transaction Level</u>

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.

- The FMS Year-End Accounting Table (YACT) continued to close into improper subsidiary general ledger accounts that were not compliant with USSGL, which led to significant unresolved legacy abnormal balances. As a result, FMS or MinX JVs were required to adjust or reclassify balances in the general ledger to make the financial statements auditable or to pass GTAS reporting edit checks.
- Certain USSGL transaction codes continue to be missing from FMS. For example,
  - o USSGL transaction code A468, required to record Anticipated Non Expenditure Transfers, was not available in FMS.
  - o VA cannot record in its financial system, USSGL transaction code A118. As a result, a workaround is required to put anticipated funds apportioned into the proper account 4590 - Apportionments - Anticipated Resources - Programs Subject to Apportionment.
- FMS is outdated and unable to keep up with the existing Treasury reporting requirements.
  - o The existing FMS posting logic was not updated for required Treasury accounting attributes established in the USSGL. As a result, work arounds were necessary to address missing required attributes defined by Treasury Financial Manual. An example of VA's work around is the modification of the FMS chart of accounts to incorporate letters and general ledger numbers in subsidiary ledger accounts to classify Federal and non-Federal transactions. This situation created the need for VA to record significant JVs.
  - o FMS also lacks the appropriate edit checks to ensure the proper posting of intragovernmental transactions. As a result, VA recorded over $102 billion (absolute value) in trading partner-related adjustments as part of its GTAS submission to the Treasury.

2. FMFIA

VA management made progress in FY 2016 by creating a new office to lead VA wide OMB Circular A-123 efforts. OMB Circular A-123 provides implementing guidance for FMFIA. A new process was established to assess VA wide entity level risk and to consolidate various on-going assessment efforts throughout VA to increase efficiency. Based on management's timeline, these implementation efforts are expected to take two years to develop with incremental changes expected for FY 2016, and the full operational capability realized in FY 2018. As a result of this new undertaking, improvement is still needed with respect to the process for preparing the Secretary's signed statements of assurance on internal control that are required by the FMFIA in FY 2016. These assurances are summarized by OMB Circular A-136, *Financial Reporting Requirements*, according to the following categories:

- Effectiveness and efficiency of internal control over programmatic operations (FMFIA § 2)
- Conformance with financial systems 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:

- Management continued to report internal control deficiencies (FMFIA §2, §4 and Appendix A) based on findings identified by the Office of Inspector General or other independent auditors.
- Documentation and procedures to support how VA validated its 16 Reportable Entities' (REs') internal controls in a complete manner that corresponded to their program,

operation, and financial management risks lacked consistency and was incomplete. In addition, there was a lack of integration regarding the information being relied upon by the various REs to develop their assurance statements as consideration was not given to Material Weaknesses reported by other REs based on their operations.
- Management's understanding and assessment of the controls implemented by its service organizations was incomplete and inadequately documented. In addition, several service organizations' Statement on Standards for Attestation Engagement No. 16 reports for FY 2016 were not obtained and reviewed, and necessary user controls were not instituted by management.
- Clear alignment of the results and the key risks identified through management's OMB Circular A-123, Appendix A, assessment did not exist. Results of the control assessment could not be linked to the risks identified to formulate a conclusion as to whether key risks identified were being mitigated by effective internal controls.
- Key controls that impacted VA's operations were not tested timely.
- Several process 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 and implementation of controls.

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, 15 of the 30 items tested were outstanding over 90 days. VBA did not charge interest on any of the delinquent receivables.
- In a sample of 15 education receivables, 9 of the 15 items tested were outstanding over 90 days. VBA did not charge interest or administrative costs on 7 of the 9 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*. VA's policy to not charge interest has been long-standing and is based on a former VA Deputy Secretary's July 1992 instruction.

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.

4. 38 USC 3733

When a defaulted mortgage loan guaranteed by VA goes to foreclosure, the property associated with the loan may be conveyed by the lender back to VA. Properties conveyed to VA can then be sold for cash, or sold by VA with VA "Vendee" Loan financing. VA offers Vendee loan financing as a tool to reduce the amount of time that property remains in its inventory, thereby reducing the cost of maintaining the property.

VA did not comply with 38 USC 3733, which requires VA to offer loan financing for the sale of no less than 50 percent of VA owned foreclosed properties. The buyers of VA's foreclosed property were denied approximately $3 billion in VA financing for foreclosed properties from FY 2013 through September FY 2016. VA issued a stop-work order to its servicer on August 27, 2012, to stop the origination of Vendee loans until such time the stop-work order was lifted. Since 2012, VA has not completed its rulemaking process to reactivate the Vendee loan program.

The Vendee loan program was set to expire on September 30, 2016, but Public Law 114-228 extended the program through FY 2017.

Other Matters

5. Actual and Potential Violations of the Antideficiency Act

VA reported two violations of the Antideficiency Act, 31 U.S.C. 1341(a) in August 2016, and is in the process of reporting four other violations. VA is also investigating two possible violations of the Antideficiency Act.

One of the reported violations involves VHA's use of Medical Support and Compliance (MS&C) funds in the approximate amount of $93 million for the development of the Health Care Processing System. The other reported violation involves the obligation of funds from the Joint Department of Defense/VA Medical Facility Demonstration Fund in excess of an apportionment in FY 2012.

Two of the violations in the process of being reported involve the combination of minor construction projects and one is related to the combination of non-recurring maintenance projects. The fourth violation in the process of being reported involves the use of MS&C funds to pay for the Service-Oriented Architecture Research and Development software instead of the congressionally mandated IT Systems appropriations.

The two investigations are related to the combination of minor construction projects. The combined total project values exceeded the $10 million ceiling, beyond which Congressional approval for the use of funds is required.

6. Noncompliance with Improper Payments Elimination and Recovery Act

On May 12, 2016, the VA Office of Inspector General reported that VA did not fully comply in FY 2015 with the Improper Payments Elimination and Recovery Act, 31 U.S.C. 3321.

EXHIBIT D
Status of Prior Year Findings

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

Type of Finding	***FY 2015 Finding***	***Fiscal Year 2016 Status***
Material Weakness	Information Technology Security Controls	Repeat – See FY 2016 Material Weakness Finding 1
Material Weakness	Procurement, Undelivered Orders and Reconciliations	Repeat – See FY 2016 Material Weakness Finding 4 and Significant Deficiency Finding 1
Material Weakness	Purchased Care Processing and Reconciliations	Repeat – See FY 2016 Material Weakness Finding 4
Material Weakness	Financial Reporting	Repeat – See FY 2016 Material Weakness Finding 5
Significant Deficiency	Accrued Operating Expenses	Repeat – See FY 2016 Material Weakness Finding 4 and Significant Deficiency Finding 1
Significant Deficiency	CFO Organizational Structure for VHA and VA	Repeat – See FY 2016 Material Weakness Finding 6
Compliance Finding	Noncompliance with FFMIA	Repeat – See Compliance Finding 1
Compliance Finding	Noncompliance with Federal Managers' Financial Integrity Act (FMFIA)	Repeat – See Compliance Finding 2
Compliance Finding	Noncompliance with 38 USC 5315	Repeat – See Compliance Finding 3
Compliance Finding	Actual and Potential Violations of the Antideficiency Act	Repeat – See Compliance Finding 5
Compliance Finding	Noncompliance with Improper Payments Elimination and Recovery Act	Repeat – See Compliance Finding 6

Section II

Agency Comments

- **Letter From the VA Secretary**
- **Message From the Chief Financial Officer**

THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

November 15, 2016

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 duty to care for those who "shall have borne the battle" and for their families. To accomplish this sacred 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.

During fiscal year (FY) 2016, VA made great strides towards reaching our goal to become the number one customer service agency in the Federal Government. To achieve this goal, we applied the best practices and standards of top customer-service businesses. We conceived and organized a transformation initiative called MyVA, because that's exactly how we want Veterans to see us—a VA they are proud to call their own. We are building a high-performing organization into an integrated, customer-centric enterprise by leveraging VA's vast scope and scale on behalf of every Veteran we serve.

This year, VA accomplished the launch of the Million Veteran Program, a new initiative designed to study how genes impact health, in order to improve care for Veterans by establishing one of the largest databases of genetic, military exposure, lifestyle, and health information. In addition, we increased access to care. In March 2016, Veterans set a record for completed appointments—5.3 million inside VA, which is 730,000 more than March 2014; and VA issued 268,000 authorizations for Care in the Community—twice as many as in March 2014. In September 2016, VA completed 96.49 percent of appointments within 30 days of the clinically indicated or Veteran's preferred date; 90.78 percent within 14 days; 85.18 percent within 7 days; and 22.25 percent are actually completed on the same day. We are working to ensure that by the end of the calendar year 2016, Veterans will receive same-day services in primary care and mental health at all Veterans Health Administration (VHA) medical centers. As of September 30, 2016, 52 medical centers provided same-day services, and VHA is expected to attain these same-day service capabilities in 87 medical centers by the end of October 2016.

For the seventh year in a row, the Veterans Benefits Administration completed more than 1 million disability compensation rating claims. We have reduced pending claims (those over 125 days) by almost 90 percent, and the average wait time to complete a claim has dropped by 65 percent to 123 days. We paid insurance death claims in an average of 4 days with 100 percent accuracy. We distributed nearly $68 billion in Post-9/11 GI Bill benefits to 1.67 million Veterans and their dependents, since 2009. Additionally, we guaranteed 707,000 home loans and helped a record 97,000 Veterans avoid foreclosure, maintaining one of the lowest foreclosure rates in the industry.

The National Cemetery Administration continued implementation of new burial access policies that underpin the largest expansion of national cemeteries since the Civil War. Omaha and Cape Canaveral National Cemeteries were dedicated in 2016, which serve 280,000 Veterans and their families. VA also issued its 100th grant to open a state Veterans cemetery in Arizona. VA now serves 91.7% of the Veteran population (approximately 20 million Veterans) with convenient burial access. This year, VA interred 130,488 Veterans and eligible family members; cared for 3.6 million gravesites; maintained nearly 9,000 developed acres; processed 365,179 headstone and marker applications for cemeteries throughout the world; and produced 689,587 Presidential Memorial Certificates. To enhance Veterans' memorialization, VA launched the Veterans Legacy Program on Memorial Day. This initiative uses national cemeteries as educational platforms that connect Veterans' stories to educational themes.

In addition to these Veteran-facing improvements, VA recently selected the United States Department of Agriculture (USDA) as our Federal Shared Service Provider to provide a modern financial management solution with standardized business processes and reporting capabilities. Partnering with USDA allows VA to use an established and proven information technology solution to better serve its financial management needs. This partnership demonstrates VA's commitment to work with other agency partners to reduce duplication and redundancy across the government, while also improving both the quality and agility of administrative services. This effort will continue to increase the transparency, accuracy, timeliness and reliability of VA's financial information as a top FY 2017 VA Priority.

CliftonLarsonAllen (CLA), an independent public accounting firm, reviewed our financial statements and provided an unmodified opinion for the 18th 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 FY 2017, as CLA identified a number of areas that require improvement within our Department.

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 2016. The Agency Performance Plan and Report, due in February 2017, 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,

Robert A. McDonald

Robert A. McDonald

Enclosure

SECTION II: FINANCIAL SECTION

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

November 15, 2016

The Department of Veterans Affairs (VA) is pleased to announce that it has received its 18th consecutive unmodified ("clean") audit opinion on its fiscal year (FY) 2016 consolidated financial statements. The enclosed financial statements provide the Department's detailed financial information and stewardship of taxpayer resources in support of its commitment to serve Veterans. We believe that the Department must be transparent and accountable to Veterans and its broad community of stakeholders.

I am especially proud of the steps VA is taking to move toward a Shared Service Provider to modernize VA's outdated financial management system. Achievement of this long-term goal will mitigate the Department's weakness in Financial Reporting. In addition, VA continued to successfully deploy the VA Time and Attendance System (VATAS) to 74,000 employees. This is one of the largest system implementations seen in VA, and it will eventually impact more than 340,000 employees. Since FY 2014, VATAS has deployed to more than 133,000 employees at 276 stations.

As a response to the revised OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, VA has made several organizational changes to strengthen its Internal Controls process and significant improvements to the way the program is managed.

In FY 2016, VA worked on remediating a number of significant financial management challenges. VA's Office of Financial Process Improvement and Audit Readiness has been working diligently with the program offices directly responsible for the four material weaknesses identified in FY 2015 by the independent auditor, CliftonLarsonAllen LLP (CLA). Corrective Action Plans (CAPs) have been developed, and a status of their progress is reported regularly to VA's Senior Assessment Team. VA was successful in downgrading the material weakness in Procurement, Undelivered Orders, and Reconciliations to a significant deficiency. In addition, CLA reported major improvements in addressing VA's financial reporting material weakness, including a large decrease in the number of journal vouchers and improved fluctuation analysis. CLA also highlighted that many of the financial reporting conditions are due to longstanding problems inherent in the legacy financial management system, which will remain until VA completes its migration to a Federal Shared Service Provider.

Despite our efforts to mitigate these audit findings, VA faced a number of significant audit challenges in FY 2016. CLA reissued three of the four material weaknesses from last year's audit: Information Technology Security Controls; Community Care Obligations, Reconciliations and Accrued Expenses; and, Financial Reporting. In addition, CLA elevated last year's significant deficiency in the Chief Financial Officer Organizational Structure to a material weakness and issued two new material weaknesses: (1) Education Benefits Accrued Liabilities and (2) Compensation, Pension and Burial Estimates and Model. Finally, CLA found one new significant deficiency: Loan Guaranty Liability Estimate.

VA's total amount of improper payments increased in FY 2016 despite more than half of the 14 programs reporting reductions in improper payments. The increase was a result of VA's enterprise-wide commitment to applying the improper payment definition correctly. Further, since VA reports improper payments 1 year in arrears, actions taken to reduce improper payments in FY 2015 and FY

2016 have not yet been fully realized. VA continues to enact specific corrective actions to remediate improper payments and strategically strengthen program integrity while ensuring Veteran access to healthcare and benefits.

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

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)**

FINANCIAL STATEMENTS

DEPARTMENT OF VETERANS AFFAIRS				
CONSOLIDATED BALANCE SHEETS (dollars in millions)				
AS OF SEPTEMBER 30,		2016		2015 Restated (Note 24)
ASSETS (Note 2)				
INTRAGOVERNMENTAL				
Fund Balance with Treasury (Note 3)	$	50,459	$	60,183
Investments (Notes 5 and 19)		6,243		7,022
Accounts Receivable (Note 6)		44		46
Other Assets		681		310
TOTAL INTRAGOVERNMENTAL ASSETS		**57,427**		**67,561**
PUBLIC				
Cash (Note 4)		4		4
Investments (Note 5)		178		178
Accounts Receivable, Net (Note 6)		2,796		2,182
Direct Loans and Loan Guarantees, Net (Note 7)		1,636		1,806
Inventories and Related Property, Net (Note 8)		50		49
General Property, Plant and Equipment, Net (Note 9)		25,155		24,068
Other Assets		16		12
TOTAL PUBLIC ASSETS		**29,835**		**28,299**
TOTAL ASSETS	**$**	**87,262**	**$**	**95,860**
Heritage Assets (Note 10)				
LIABILITIES (Note 12)				
INTRAGOVERNMENTAL				
Accounts Payable	$	202	$	372
Debt (Note 11)		572		681
Other Liabilities (Notes 13, 15, 16 and 18)		2,736		1,166
TOTAL INTRAGOVERNMENTAL LIABILITIES		**3,510**		**2,219**
PUBLIC				
Accounts Payable		4,789		10,948
Loan Guarantee Liability (Note 7)		10,019		9,913
Federal Employee and Veterans Benefits (Note 13)		2,558,210		2,073,935
Environmental and Disposal Liabilities (Note 14)		989		860
Insurance Liabilities (Note 17)		7,713		8,380
Other Liabilities (Notes 12 and 15)		5,693		5,575
TOTAL PUBLIC LIABILITIES		**2,587,413**		**2,109,611**
TOTAL LIABILITIES		**2,590,923**		**2,111,830**
Commitments and Contingencies (Note 18)				
NET POSITION				
Unexpended Appropriations – All Other Funds		32,920		37,376
Cumulative Results of Operations – Funds from Dedicated Collections (Note 19)		865		906
Cumulative Results of Operations – All Other Funds		(2,537,446)		(2,054,252)
TOTAL NET POSITION		**(2,503,661)**		**(2,015,970)**
TOTAL LIABILITIES AND NET POSITION	**$**	**87,262**	**$**	**95,860**

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,	2016	2015 Restated (Note 24)
NET PROGRAM COSTS BY ADMINISTRATION (Note 21)		
Veterans Health Administration		
Gross Cost	$ 73,572	$ 68,984
Less Earned Revenue	(4,326)	(4,252)
Net Program Cost	69,246	64,732
Veterans Benefits Administration		
Gross Cost		
Program Costs	96,222	93,368
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	106,498	30,526
Less Earned Revenue	(917)	(958)
Net Program Cost	201,803	122,936
National Cemetery Administration		
Gross Cost		
Program Costs	314	304
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	200	100
Net Program Cost	514	404
Indirect Administrative Program Costs		
Gross Cost	2,054	1,762
Less Earned Revenue	(523)	(351)
Net Program Cost	1,531	1,411
NET PROGRAM COSTS BY ADMINISTRATION BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITY ASSUMPTIONS	**273,094**	**189,483**
CHANGES IN ACTUARIAL LIABILITY ASSUMPTIONS (Note 13)		
COMPENSATION:		
Changes in Discount Rate Assumption	66,900	79,900
Changes in Cost of Living Adjustment (COLA) Rate Assumption	(10,600)	(72,200)
Changes in Other Assumptions	321,100	(20,700)
TOTAL COMPENSATION	**377,400**	**(13,000)**
BURIAL:		
Changes in Discount Rate Assumption	100	200
Other Changes	-	(200)
TOTAL BURIAL	**100**	**-**
NET (GAIN)/LOSS FROM ACTUARIAL LIABILITY ASSUMPTIONS	377,500	(13,000)
NET COST OF OPERATIONS (Note 21)	**$ 650,594**	**$ 176,483**

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, 2016

	Funds from Dedicated Collections (Note 19)	All Other Funds	2016 Consolidated Total
Cumulative Results of Operations			
Beginning Balance	$ 906	$ (2,054,252)	$ (2,053,346)
Budgetary Financing Sources			
Other Adjustments	-	(5)	(5)
Appropriations Used	-	166,595	166,595
Donations and Forfeitures of Cash and Cash Equivalents	20	-	20
Transfers In/Out Without Reimbursement	(3,460)	3,745	285
Other Financing Sources (Nonexchange)			
Donations and Forfeitures of Property	89	-	89
Transfers In/Out Without Reimbursement	(14)	39	25
Imputed Financing	-	2,161	2,161
Other	-	(1,811)	(1,811)
Total Financing Sources	(3,365)	170,724	167,359
Net Cost/(Benefit) of Operations (Note 21)	(3,324)	653,918	650,594
Net Change	**(41)**	**(483,194)**	**(483,235)**
Cumulative Results of Operations	**865**	**(2,537,446)**	**(2,536,581)**
Unexpended Appropriations			
Beginning Balance	-	37,376	37,376
Budgetary Financing Sources			
Appropriations Received	-	164,812	164,812
Appropriations Transferred In/Out	-	135	135
Other Adjustments	-	(2,808)	(2,808)
Appropriations Used	-	(166,595)	(166,595)
Total Budgetary Financing Sources	-	(4,456)	(4,456)
Total Unexpended Appropriations	**-**	**32,920**	**32,920**
Total Net Position	**$ 865**	**$ (2,504,526)**	**$ (2,503,661)**

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, Restated (Note 24)

	Funds from Dedicated Collections (Note 19)	All Other Funds	2015 Consolidated Total
Cumulative Results of Operations			
Beginning Balance	1,008	(1,991,288)	(1,990,280)
Adjustment: Correction of Error	-	(46,965)	(46,965)
Beginning Balance, as adjusted	$ 1,008	$ (2,038,253)	$ (2,037,245)
Budgetary Financing Sources			
Appropriations Used	-	158,742	158,742
Nonexchange Revenue	-	(1)	(1)
Donations and Forfeitures of Cash and Cash Equivalents	21	-	21
Transfers 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 (Note 21)	(3,253)	179,736	176,483
Net Change	**(102)**	**(15,999)**	**(16,101)**
Cumulative Results of Operations	**906**	**(2,054,252)**	**(2,053,346)**
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**	**$ (2,016,876)**	**$ (2,015,970)**

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, 2016

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources (Note 22)		
Unobligated balance brought forward, October 1	$ 28,551	$ 8,829
Adjustment to unobligated balance, brought forward, October 1	(10)	-
Unobligated balance brought forward, October 1, adjusted	28,541	8,829
Recoveries of prior year unpaid obligations	2,663	-
Other changes in unobligated balance	(283)	(82)
Unobligated balance from prior year budget authority, net	30,921	8,747
Appropriations	167,471	-
Borrowing authority	-	10
Spending authority from offsetting collections	4,976	4,750
Total budgetary resources	**$ 203,368**	**$ 13,507**
Status of Budgetary Resources		
New obligations and upward adjustments (total)	$ 182,317	$ 2,973
Unobligated balance, end of year:		
Apportioned, unexpired account	12,537	-
Unapportioned, unexpired accounts	5,297	10,534
Unexpired unobligated balance, end of year	17,834	10,534
Expired unobligated balance, end of year	3,217	-
Unobligated Balance, end of year	21,051	10,534
Total Budgetary Resources	**$ 203,368**	**$ 13,507**
Change in Obligated Balance		
Unpaid Obligations:		
Unpaid obligations, brought forward, October 1	$ 26,676	$ 318
New obligations and upward adjustments	182,317	2,973
Outlays (gross) (-)	(183,968)	(2,928)
Recoveries of prior year unpaid obligations (-)	(2,663)	-
Unpaid Obligations, end of year	**$ 22,362**	**$ 363**
Uncollected Payments:		
Uncollected Payments, Fed Sources, brought forward, October 1 (-)	$ (1,672)	$ -
Change in Uncollected Pymts, Fed Sources (+ or-)	125	-
Uncollected Payments, Fed Sources, end of year (-)	**$ (1,547)**	**$ -**
Memorandum (non-add) entries:		
Obligated balance, start of year (+ or-)	25,004	318
Obligated balance, end of year (+ or-)	20,815	363

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DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2016

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budget Authority and Outlays, Net		
Budget authority, gross (discretionary and mandatory)	$ 172,447	$ 4,760
Actual offsetting collections (discretionary and mandatory) (-)	(5,819)	(4,786)
Change in uncollected pymts, Fed sources (discretionary and mandatory) (+ or -)	125	-
Recoveries of prior year paid obligations (discretionary and mandatory)	708	8
Budget Authority, net	**$ 167,461**	**$ (18)**
Outlays, gross (discretionary and mandatory)	$ 183,968	$ 2,928
Actual Offsetting Collections (discretionary and mandatory)	(5,819)	(4,786)
Outlays, net (total) (discretionary and mandatory)	178,149	(1,858)
Distributed Offsetting Receipts (-)	(3,818)	(313)
Agency Outlays, net (discretionary and mandatory)	**$ 174,331**	**$ (2,171)**

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
Unobligated balance brought forward, October 1, adjusted	26,446	7,529
Recoveries of prior year unpaid obligations	2,993	-
Other changes in unobligated balance	295	(55)
Unobligated balance from prior year budget authority, net	29,734	7,474
Appropriations	164,536	-
Borrowing authority	-	106
Spending authority from offsetting collections	4,867	4,339
Total budgetary resources	**$ 199,137**	**$ 11,919**
Status of Budgetary Resources		
New obligations and upward adjustments (total)	$ 170,586	$ 3,090
Unobligated balance, end of year:		
Apportioned, unexpired account	16,331	-
Unapportioned, unexpired accounts	9,278	8,829
Unexpired unobligated balance, end of year	25,609	8,829
Expired unobligated balance, end of year	2,942	-
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
New obligations and upward adjustments	170,586	3,090
Outlays (gross) (-)	(169,122)	(3,114)
Recoveries of prior year unpaid obligations (-)	(2,993)	-
Unpaid Obligations, end of year	**$ 26,676**	**$ 318**
Uncollected Payments:		
Uncollected Payments, Fed Sources, brought forward, October 1 (-)	$ (1,905)	$ -
Change in Uncollected Pymts, Fed Sources (+ or-)	233	-
Uncollected Payments, Fed Sources, end of year (-)	**$ (1,672)**	**$ -**
Memorandum (non-add) entries:		
Obligated balance, start of year (+ or-)	26,300	342
Obligated balance, end of year (+ or-)	25,004	318

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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
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$	169,403	$	4,445
Actual offsetting collections (discretionary and mandatory) (-)		(5,905)		(4,406)
Change in uncollected pymts, Fed sources (discretionary and mandatory) (+ or -)		233		-
Recoveries of prior year paid obligations (discretionary and mandatory)		735		33
Budget Authority, net	**$**	**164,466**	**$**	**72**
Outlays, gross (discretionary and mandatory)	$	169,122	$	3,114
Actual Offsetting Collections (discretionary and mandatory)		(5,905)		(4,406)
Outlays, net (total) (discretionary and mandatory)		163,217		(1,292)
Distributed Offsetting Receipts (-)		(3,731)		(269)
Agency Outlays, net (discretionary and mandatory)	**$**	**159,486**	**$**	**(1,561)**

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

Formatting changes were made to the FY15 SBR to present comparative statement and to adhere to OMB A-136.

NOTES TO THE FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

A. Organization

The VA's mission is to serve America's Veterans, their dependents, and their beneficiaries with dignity and compassion, and to serve as Veterans' 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.

B. Reporting Entity and Basis of Presentation

VA's consolidated financial statements, including the Combined Statement of Budgetary Resources (SBR), 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, which is a sovereign entity. VA interacts with, and is dependent upon, the financial activities of the Federal Government as a whole. Therefore, the results of all financial decisions reflected in these consolidated financial statements are not the sole decisions of VA as a stand-alone entity. VA's fiscal year end is September 30.

C. 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 statement 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 sheet, statement of net cost, and statement 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 statement of budgetary resources are not consolidated but combined; therefore, elimination of intra-entity transactions is not permitted.

D. 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 SBR is the basic financial statement that reports 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-end. 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.

E. 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 healthcare provided at VA and non-VA medical facilities. Generally, VA considers a Veteran's healthcare 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 under Reasonable Charges (Rates) Information 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.

Non-exchange revenue (e.g., donations) is recognized when received, and the related receivables, refunds, and offsets are recognized when measurable and legally collectible. Non-exchange revenue consists of benefits revenue from reimbursement of education benefit programs by the 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 subsidy re-estimates.

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).

F. 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; 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.

G. Fund Balance with Treasury

Treasury performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury (FBWT) represents VA's right to draw funds from the Treasury for allowable expenditures. These balances in Note 3 are reconciled to Treasury and primarily consist of trust, revolving, special, and appropriated funds.

H. 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. Interest rates for Treasury special securities are initially set based on average market yields for comparable Treasury issues. 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 Federal Securities in funds 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.

I. Accounts Receivable

Accounts receivable are reported in Note 6 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.

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 practice 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.

J. Direct Loans and Loan Guarantees

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 (Note 7) are in accordance with 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 re-estimates 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, reducing 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, 1991, are not subject to the 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, 1991, 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 re-estimated each year as of the date of the financial statements. Loan losses are re-estimated 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 loan's 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.

K. Inventory and Related Property, Net

Inventory consists of two distinct components: (1) primarily, Veterans Canteen Service (VCS) retail stock and (2) operating, medical, and pharmaceutical supplies that are not in the hands of end users.

L. Property, Plant, and Equipment (PP&E)

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 are recorded in Construction Work-in-Process (WIP) accounts. The assets are transferred to either capitalized or non-capitalized PP&E, 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 that do not meet the capitalization criteria are expensed upon being placed in service.

Individual items are capitalized if the useful life is 2 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. 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.

M. Other Assets

Intragovernmental Other Assets are reported at cost, consist primarily of Intragovernmental Advances, 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 Advances.

Payments are 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.

N. 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 ongoing 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.

O. 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.

United States Government Life Insurance (USGLI) permanent plan policy reserves are based on the American Experience Table (with 2.0 percent interest) and are held on a net single premium basis.

National Service Life Insurance (NSLI) basic policy reserves for permanent plans are based on the American Experience Table (with 3.0 percent interest), except for the Modified Life plans, which are based on the 1958 Commissioners Standard Ordinary (CSO) Basic Table (with 3.0 percent interest) and paid-up additions purchased by dividends, which are based on the 2001 Valuation Basic Male (VBM) Table (with 3.0 percent interest). The reserve for Term policies is based on the 2001 VBM Table (with 3.0 percent interest) and the age 70 rate (the capped premium) of $6.18 per month per $1,000 face amount.

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 4.0 percent interest). The reserve for Term policies is based on the 2001 VBM

Table (with 4.0 percent interest) and the age 70 rate (the 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 4.0 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 4.0 percent interest for JS.

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.

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 1 month in advance that are unearned at the end of the reporting period and a reserve for premiums paid 1 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 FY 2016 and FY 2015, the interest rates ranged from 3.5 percent to 4.75 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 FY 2016, a discount rate of 3.0 percent for NSLI (2.0 percent for USGLI, and 4.0 percent for VSLI and VRI), along with the appropriate accrual factor, was used. For FY 2015, a discount rate of 4.0 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.

The financial statement disclosures herein (Note 17) are in accordance with SFFAS 5, Accounting for Liabilities.

P. 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.

Q. 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.

R. 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, 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 contributes 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.

S. 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, and 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 result 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 August 31 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 FY 2016, 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.

The Veterans Education Benefit Liability represents unfunded, unpaid earned education benefits expected to be used by Veterans or their dependents. These amounts relate to Veterans who have met the necessary requirements to earn education benefits as part of the Post-9/11 GI Bill (Chapter 33), and for which VA has approved an original enrollment certification in the Long-Term Solution (LTS) system. See Note 13 for additional information on the Veteran's Education Benefit Liability.

The financial statement disclosures herein (Note 13) are in accordance with SFFAS 33, Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuations Dates.

T. 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.

U. 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.

V. 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.

W. 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 re-estimates 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 (dollars in millions)				
As of September 30,				
		2016		2015
Fund Balance with Treasury	$	145	$	138
Intragovernmental Accounts Receivable		1,606		349
Public Accounts Receivable		43		38
Total Non-Entity Assets	**$**	**1,794**	**$**	**525**

3. Fund Balance with Treasury

Funds with the U.S. Department of the Treasury primarily represent trust, revolving, appropriated, and special funds.

Trust fund balances consist primarily of amounts related to the Post-Vietnam Veterans Educational Assistance Program (VEAP) Trust Fund, the NSLI Fund, the USGLI Fund, the 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 does 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. Examples include Medical Services, Major Construction, and Veterans Choice funds.

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 table below 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 but also including special funds, general receipts, and medical care funds.

Fund Balance with Treasury (dollars in millions)				
As of September 30,				
		2016		2015
Entity Assets				
Trust Funds	$	79	$	78
Revolving Funds		11,396		9,664
Appropriated Funds		38,351		49,820
Special Funds		463		430
Other Fund Types		25		53
Total Entity Assets	**$**	**50,314**	**$**	**60,045**
Non-Entity Assets				
Other Fund Types		145		138
Total Non-Entity Assets		**145**		**138**
Total Entity and Non-Entity Assets	**$**	**50,459**	**$**	**60,183**
Reconciliation of VA General Ledger Balances with Treasury				
Balance per VA General Ledger	$	50,509	$	60,212
Reconciled Differences, Principally Timing		(50)		(29)
Fund Balance with Treasury	**$**	**50,459**	**$**	**60,183**
Status of Fund Balance with Treasury				
Unobligated Balance				
Available	$	12,412	$	16,203
Unavailable		17,653		19,566
Obligated Balance Not Yet Disbursed		19,898		23,932
Deposit /Clearing Account Balances		496		482
Fund Balance with Treasury	**$**	**50,459**	**$**	**60,183**

4. Cash

Unrestricted cash consists of Canteen Service and Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Additionally, restricted cash occasionally includes cash held by non-Federal trust however, as of September 30, 2016, VA does not have any restricted cash.

Cash (dollars in millions)				
As of September 30,				
		2016		2015
Cash				
Canteen Service	$	2	$	2
Agent Cashier Advance		2		2
Total Cash	**$**	**4**	**$**	**4**

5. Investments

Federal Securities, which comprise most of VA's investments, are in non-marketable Treasury special bonds and notes. Special bonds, which mature during various years (through the year 2031), are generally held to maturity unless needed to finance insurance claims and dividends. Treasury notes help finance operations and events supported by the General Post Fund for the benefit of Veterans and their beneficiaries.

Non-Federal securities consist of Loan Guaranty Program investments in housing trust certificates and mutual funds from enhanced-use leases.

Investments (dollars in millions)						
As of September 30, 2016						
	Cost	**Amortization Method**	**Amortized (Premium)/ Discount**	**Interest Receivable**	**Investments, Net**	**Market Value**
Federal Securities (Note 19)						
Non-Marketable: Special Bonds	$ 6,095	N/A	$ -	40	6,135	$ 6,135
Treasury Notes	108	Effective Interest	(1)	1	108	108
Total	**$ 6,203**		**$ (1)**	**41**	**6,243**	**$ 6,243**
Non-Federal 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, 2015						
Federal Securities (Note 19)						
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**
Non-Federal 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**

6. Accounts Receivable, Net

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 account receivables consists primarily of (a) amounts due for Veterans' healthcare; (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.

Accounts Receivable, Net (dollars in millions)
As of September 30,

	2016	2015
Intragovernmental Accounts Receivable	**$ 44**	**$ 46**
Public Accounts Receivable		
Medical Care	$ 3,016	$ 2,803
Contractual Adjustment and Allowance for Loss Provision	(1,480)	(1,613)
Net Medical Care	1,536	1,190
Compensation and Pension	1,469	1,298
Allowance for Loss Provision	(584)	(633)
Net Compensation and Pension	885	665
Education Benefits	488	431
Allowance for Loss Provision	(183)	(175)
Net Education Benefits	305	256
Other	86	126
Allowance for Loss Provision	(16)	(55)
Net Other	70	71
Total Public Accounts Receivable	5,059	4,658
Total Contractual Adjustment and Allowance for Loss Provision	(2,263)	(2,476)
Public Accounts Receivable, Net	**$ 2,796**	**$ 2,182**

The Total Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Public Accounts Receivable was approximately 45 percent and 53 percent at September 30, 2016 and September 30, 2015, 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 VA loan programs. The Home Loan program 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 VA 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 and factors for the favorable net current re-estimates are as follows:

(1) The combined effect of (a) better-than-anticipated recoveries and claims and (b) higher projected recovery rate. A higher projected recovery rate in 2017 for existing home loans, based on actual recoveries in 2016, generated more property sales proceeds or recoveries on defaulted loans.

(2) Actual borrower activity was better-than-anticipated, which translated into increased loan guarantee funding fees and direct loan collections in 2016. Most of the VA loans outstanding are for the recent cohorts 2010-2016. For example, the Loan Guarantee Housing Account for these cohorts accounts for 96 percent of current downward re-estimates. These loans represent substantial increases in VA loan production and market from new borrowers and refinanced loans from its older cohorts.

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

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.

Prior to November 2, 1987, life insurance policy loans were issued at fixed rates depending on the fund and time period. The remaining fixed rate loans are at 4.0 percent and 5.0 percent. All policy loans issued since November 2, 1987, have a variable interest rate with a minimum of 5.0 percent and a maximum of 12 percent. Rate changes are tied to the 10-year constant maturities, U.S. Treasury Securities Index and may only change on October 1. The variable rate has been 5.0 percent since October 1, 2001.

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, which will result in a realized gain or loss on sale.

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 is provided in the tables that follow:

Loans Receivable and Related Foreclosed Property From Direct Loans (dollars in millions)						
As of September 30, 2016						
		Loans Receivable Gross	**Interest Receivable**	**Allowance for Loan Losses**	**Foreclosed Property**	**Value of Assets Related to Direct Loans, Net**
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	$	3	-	-	-	$ 3
Insurance Policy Loans	$	276	7	-	-	$ 283
Total						**$ 286**
		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 FY 1991	$	440	22	23	16	$ 501
Total						**$ 787**

Loans Receivable and Related Foreclosed Property From Direct Loans (dollars in millions)						
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 FY 1992 (Allowance for Loss Method)	$	3	6	-	-	$ 9
Insurance Policy Loans	$	308	8	-	-	$ 316
Total						**$ 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 FY 1991	$	471	20	58	25	$ 574
Total						**$ 899**

Direct Loans Disbursed

The total amount of new direct loans disbursed for the years ended September 30, 2016 and September 30, 2015, was $13.6 million and $9.6 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 2016. 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. In particular, the fund outstanding mortgage interest rates are revised downward, based on 2016 financial results. The combination of extra actual collections and revised mortgage rates should produce lower future mortgage interest income.

The net change in subsidy estimates reflect a steady housing recovery that contributes to favorable cash inflows. In general, a better housing market means less current re-estimates on average, and imply downward re-estimates. These re-estimates are a return of VA cash reserves to the U.S. Treasury to reduce the Federal budget deficit, short term.

Direct Loan Subsidy Expense (dollars in millions)		
As of September 30,		
	2016	2015
Interest Differential	$ (2)	$ (2)
Defaults	1	1
Subtotal	**(1)**	**(1)**
Interest Rate Reestimates	-	6
Technical Reestimates	(1)	(3)
Expense	**$ (2)**	**$ 2**

Budgetary Subsidy Rates for Direct Loans by Component (Post 1991)

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 re-estimates.

Subsidy rates for direct loans	
Interest Differential	(38.16%)
Defaults	15.61%
Fees	(2.00%)
Other	0.68%

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 2016, the subsidy rate is (25.58) percent for Veterans Housing Direct – Vendee Loans, 1.71 percent for Veterans Housing Direct – Acquired Loans, and (18.08) percent for Native American Direct. 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. 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 (dollars in millions)		
Beginning Balance, Changes and Ending Balance		
	2016	2015
Beginning balance of the allowance	$ (58)	$ (59)
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	**(1)**	**(1)**
Adjustments:		
Foreclosed property acquired	(5)	(7)
New Loans	3	1
Loans written off	1	8
Subsidy allowance amortization	25	(3)
Change in execution	12	-
Total Adjustments	36	(1)
Ending balance of the allowance before reestimates	**(23)**	**(61)**
Subsidy reestimates by component		
Interest rate reestimate	-	6
Technical/default reestimate	(1)	(3)
Total of the above reestimate components	(1)	3
Ending balance of the allowance	**$ (24)**	**$ (58)**

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 that 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, which will result 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.

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 (dollars in millions)							
As of September 30, 2016							
		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)	$	23	-	(24)	1	$	-
Defaulted Guaranteed Loans - Post-1991 Guarantees	$	4	-	-	845	$	849
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees						**$**	**849**

Loans Receivable and Related Foreclosed Property from Loan Guarantees (dollars in millions)							
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						**$**	**907**

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, which results in a modification gain being recognized. An increase in the loan guarantee liability due to a modification reflects increased costs to VA, which results in a modification loss being recognized. The carrying 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 2016.

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 (e.g., 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 U.S. 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, 2016 and September 30, 2015.

Real Estate Owned (dollars in millions)		
As of September 30,		
	2016	**2015**
Opening Balance	$ 893	$ 846
Acquisitions Direct Loans	(6)	14
Acquisitions Guaranteed Loans	1,587	1,501
Gain/Loss on Sale	(314)	(263)
Proceeds from Sale	(1,509)	(1,415)
Property Management Expense	211	210
Ending Balance	**$ 862**	**$ 893**

As of September 30, 2016 and September 30, 2015, the number of residential properties in VA's inventory was approximately 7,273 and 7,645, respectively. For 2016 and 2015, the average holding period from the date properties were conveyed to VA until the date properties were sold was approximately 6 months and 6 months, respectively. The number of properties for which foreclosure proceedings are in process was approximately 40,811 and 29,649 as of September 30, 2016 and September 30, 2015, respectively.

Guaranteed Loans (dollars in millions)		
As of September 30,		
	2016	**2015**
Guaranteed Loans Outstanding:		
Outstanding Principal Guaranteed Loans, Face Value	$ 517,184	$ 453,877
Amount of Outstanding Principal Guarantee	132,782	117,375
Loan Principal Collections, New Guaranteed Loans	(1,383)	(1,337)
Termination of Outstanding Principal Guaranteed, Face Value	(88,577)	(69,702)
New Guaranteed Loans Disbursed:		
Outstanding Principal Guaranteed Loans, Face Value	$ 151,884	$ 134,307
Amount of Outstanding Principal Guarantee	38,002	33,776
Number of New Loans Disbursed	609,023	558,434
Liabilities for Pre-1992 and Post-1991 Loan Guarantees, Excluding Loan Sale Guarantees (Present Value Method)	$ 9,896	$ 9,772

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 re-estimate was principally caused by increasing claim payments following the housing crisis, which increased 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 re-estimates. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

Guaranteed Loan Subsidy Expenses (dollars in millions)		
As of September 30,		
	2016	**2015**
Defaults	$ 3,059	$ 2,566
Fees	(2,604)	(2,161)
Subtotal	455	405
Interest Rate Reestimates	(139)	43
Technical Reestimates	(1,407)	57
Total Guaranteed Loan Subsidy Expenses	**$ (1,091)**	**$ 505**

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 re-estimates.

Budgetary Subsidy Rates for Loan Guarantees	
Defaults	1.65%
Fees	(1.40%)

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 2016 was 0.25 percent. In the table below, the current year and prior-year upward re-estimate 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 (dollars in millions)				
Beginning Balance, Changes and Ending Balance				
		2016		**2015**
Beginning balance of the liability	$	9,543	$	8,532
Subsidy expense for guaranteed loans disbursed during the reporting years by component:				
Default costs (net of recoveries)		3,059		2,566
Fees and other collections		(2,604)		(2,161)
Total of the above subsidy expense components	**$**	**455**	**$**	**405**
Adjustments:				
Fees received		1,981		1,804
Foreclosed property and loans acquired		(310)		(645)
Claim payments to lenders		(764)		(972)
Interest accumulation on the liability balance		206		181
Change in reestimate approved by OMB		85		138
Total Adjustments		1,198		506
Ending balance of the liability before reestimates	**$**	**11,196**	**$**	**9,443**
Subsidy reestimates by component				
Interest rate reestimate		(139)		43
Technical/default reestimate		(1,407)		57
Total of the above reestimate components		(1,546)		100
Ending balance of the liability	**$**	**9,650**	**$**	**9,543**

Schedule for Reconciling Pre 1992 Loan Guarantee Liabilities (dollars in millions)				
Beginning Balance, Changes and Ending Balance				
		2016		**2015**
Beginning balance of the liability	$	229	$	222
Claims		1		1
Foreclosed Properties		(1)		(2)
Veteran Liability Debts		14		4
Amortization of Liability Balance		3		4
Total	**$**	**246**	**$**	**229**

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, which will result 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 2012, the total loans sold amounted to $14.2 billion. 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 (dollars in millions)		
As of September 30,		
	2016	**2015**
Outstanding Balance Guaranteed Loans Sold, Start of Year	$ 1,208	$ 1,415
Payments, Repayments, and Terminations	(162)	(207)
Outstanding Balance Guaranteed Loans Sold, End of Year	**$ 1,046**	**$ 1,208**

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 (dollars in millions)		
As of September 30,		
	2016	**2015**
Interest Rate Reestimates	$ (8)	$ (21)
Technical Reestimates	(5)	(7)
Total Loan Sale-Guaranteed Subsidy Expense	**$ (13)**	**$ (28)**

Schedule for Reconciling Loan Guarantee Liability Balances (dollars in millions)		
Beginning Balance, Changes and Ending Balance		
	2016	**2015**
Beginning balance of the liability	**$ 141**	**$ 154**
Adjustments:		
Claim payments to lenders	(18)	(3)
Interest accumulation on the liability balance	8	9
Change in reestimate approved by OMB	5	9
Total Adjustments	(5)	15
Ending balance of the liability before reestimates	**136**	**169**
Subsidy re-estimates by component		
Interest rate reestimate	(8)	(21)
Technical/default re-estimate	(5)	(7)
Total of the above reestimate components	(13)	(28)
Ending balance of the liability	**$ 123**	**$ 141**

Program Totals

Total Loans Receivable and Related Foreclosed Property, Net (dollars in millions)				
As of September 30,				
		2016		**2015**
Total Direct Loans	$	787	$	899
Total Guaranteed Loans		849		907
Total Direct Loans and Loan Guarantees	**$**	**1,636**	**$**	**1,806**

Total Subsidy Expense (dollars in millions)				
As of September 30,				
		2016		**2015**
Total Direct Loans	$	(2)	$	2
Total Guaranteed Loans		(1,091)		505
Total Loan Sales		(13)		(28)
Total Subsidy Expense	**$**	**(1,106)**	**$**	**479**

Total Liabilities for Loan Guarantees (dollars in millions)				
As of September 30,				
		2016		**2015**
Total Loan Guarantee Liability Post 1992	$	9,650	$	9,543
Total Pre-1992 Loan Guarantee Liability		246		229
Total Loan Sale Guarantee Liability		123		141
Total Liabilities for Loan Guarantees	**$**	**10,019**	**$**	**9,913**

Administrative Expense

The administrative expense for direct and guaranteed loans for the fiscal years ended September 30, 2016 and September 30, 2015, was $163 million and $161 million, respectively.

8. Inventory and Related Property, Net

Inventory consists primarily of VCS retail store stock held for current sale, and is reported at cost using the weighted-average cost method. VCS provides retail merchandise, food, and vending services across the country. Inventory also contains operating, medical, and pharmaceutical supplies at cost that are not in the hands of end users. Upon transfer to end users, these supplies are expensed. VA defines an end user as a VA medical center, regional office, or cemetery.

Inventory (dollars in millions)				
As of September 30,				
		2016		**2015**
VCS Retail Store Stock	$	31	$	36
Operating, Medical, and Pharmaceutical Supplies		19		13
Total Inventory	**$**	**50**	**$**	**49**

9. General Property, Plant and Equipment

The majority of general PP&E owned or leased by VA is used to provide medical care to Veterans. PP&E, including transfers from other Federal agencies, leasehold improvements, other structures not classified as buildings, and capital leases are valued at net cost. Multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements.

Depreciation and amortization expense totaled $1.9 billion and $1.7 billion in 2016 and 2015, respectively. Loss on disposition of assets totaled $227 million and $281 million in 2016 and 2015, respectively.

General Property, Plant and Equipment (dollars in millions)
As of September 30, 2016

	Cost	Accumulated Depreciation/ Amortization	Net Book Value
Land and Improvements	$ 1,480	$ (474)	$ 1,006
Buildings	30,574	(16,725)	13,849
Equipment	4,118	(2,751)	1,367
Other Structures and Capital Leases	4,566	(2,485)	2,081
Internal Use Software	2,104	(1,397)	707
Construction Work in Progress	5,273	-	5,273
Internal Use Software in Development	872	-	872
Total Property, Plant, and Equipment	**$ 48,987**	**$ (23,832)**	**$ 25,155**

General Property, Plant and Equipment (dollars in millions)
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**

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 2016 and 2015; 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 1,284 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 $1.5 million and $4.3 million for the years ended September 30, 2016 and September 30, 2015, respectively, 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.

Heritage Assets in Units				
As of September 30,	**2015 Balance**	**2016 Additions**	**2016 Withdrawals**	**2016 Balance**
Art Collections	27	-	(1)	26
Buildings and Structures	715	65	(65)	715
Monuments/Historic Flag Poles	1,276	1	(10)	1,267
Other Non-Structure Items	790	-	(20)	770
Archaeological Sites	13	-	(4)	9
Cemeteries, Soldier's Lots and Monument Sites	167	3	-	170
Total Heritage Assets in Units	2,988	69	(100)	2,957

11. Debt

Intragovernmental Debt (dollars in millions)										
As of September 30,										
		2015 Beginning Balance		2015 Net Borrowing		2015 Ending Balance		2016 Net Borrowing		2016 Ending Balance
Loan Guaranty Debt										
Debt to the Treasury	$	691	$	(16)	$	675	$	(109)	$	566
Debt to the Federal Financing Bank		5		-		5		-		5
Total Loan Guaranty Debt		**696**		**(16)**		**680**		**(109)**		**571**
Direct Loans Debt – Vocational Rehabilitation Program										
Debt to the Treasury		1		-		1		-		1
Total Direct Loans Debt		**1**		**-**		**1**		**-**		**1**
Total Debt										
Debt to the Treasury		692		(16)		676		(109)		567
Debt to the Federal Financing Bank		5		-		5		-		5
Total Debt	**$**	**697**	**$**	**(16)**	**$**	**681**	**$**	**(109)**	**$**	**572**

At September 30, 2016 and 2015, 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 2016 ranged from 3.16 to 3.68 percent and 3.20 to 3.70 percent for debt issued in 2015. The interest rates on all outstanding debt issued ranged from 1.00 to 7.59 percent for both 2016 and 2015. Interest expense was $26 million for 2016 and $24 million for 2015.

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 rate on debt issued was 1.00 percent for both 2016 and 2015. The interest rate on all outstanding debt issued was 1.00 percent for both 2016 and 2015

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 2016 or 2015. 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

Total Unfunded Liabilities include Workers' Compensation, which is comprised of the actuarial Workers' Compensation Liability, Accrued FECA Liability for Department of Labor (DOL) funded costs not yet appropriated and Unfunded Employee Liability. The Accrued FECA Liability and Unfunded Employee Liability are Intragovernmental Liabilities totaling $487 million and $477 million at September 30, 2016 and September 30, 2015, respectively.

Liabilities Not Covered By Budgetary Resources (dollars in millions)		
As of September 30,		
	2016	**2015**
		Restated (Note 24)
Workers' Compensation (FECA)	$ 2,809	$ 2,721
Annual Leave (Note 15)	2,173	2,071
Judgment Fund (Note 15)	1,811	2,029
Environmental and Disposal Liabilities (Note 14)	989	860
Veterans Compensation and Burial (Note 13)	2,496,300	2,018,600
Education Benefits (Note 13)*	59,588	53,091
Insurance (Note 17)	1,582	1,519
Amounts due to Non-Federal Trust (Note 15)	115	125
Other	4	4
Total Liabilities Not Covered By Budgetary Resources	$ 2,565,371	$ 2,081,020
Total Liabilities Covered By Budgetary Resources	25,552	30,810
Total Liabilities*	**$ 2,590,923**	**$ 2,111,830**

*This line item has been restated from the previous year's reported amount to align with the FY 2015 restatement. See Note 24 Restatement.

13. Federal Employee and Veteran Benefits Liabilities

Federal Employee and Veterans Benefits liabilities are comprised of workers' compensation (FECA), compensation and burial benefits paid to Veterans and their beneficiaries, and Education benefits provided to Veterans and their dependents. The table below summarizes employee and Veteran benefit liabilities reported by VA on the Balance Sheet.

Federal Employee and Veterans Benefits Liabilities (dollars in millions)				
As of September 30,				
		2016		**2015**
				Restated (Note 24)
Workers' Compensation (FECA)	$	2,322	$	2,244
Compensation		2,491,400		2,014,000
Burial		4,900		4,600
Education Benefits*		59,588		53,091
Total Federal Employee and Veterans Benefits Liabilities*	$	**2,558,210**	$	**2,073,935**

*This line item has been restated from the previous year's reported amount to align with the FY 2015 restatement. See Note 24 Restatement.

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 (dollars in millions)				
As of September 30,				
		2016		**2015**
Civil Service Retirement System	$	303	$	339
Federal Employees Health Benefits		1,682		1,424
Federal Employees Group Life Insurance		5		4
Total Imputed Expenses-Employee Benefits*	$	**1,990**	$	**1,767**

* The Total Imputed Expenses – Employee Benefits when combined with the Imputed Financing Paid by Other Entities reported in Note 18 reconciles to the total Imputed Financing costs reported in the Consolidated Statement of Changes in Net Position with the difference being Department of Homeland Security (DHS) imputed costs associated with cybersecurity services.

A liability is recorded for estimated and actual future payments to be made for workers' compensation pursuant to the FECA. The FECA component of the Federal Employee and Veteran Benefit liability consists of the actuarial liability for compensation cases to be paid beyond the current year.

Veteran Benefits (Compensation and Burial)

Eligible Veterans who are disabled during active military service-related causes receive compensation benefits, as do their dependents. Eligible Veterans who die during active military service-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.

VA provides eligible Veterans and/or their dependents with pension benefits if the Veteran died or was disabled from non-service-related causes, based on annual eligibility reviews. The actuarial present value of the future liability for pension benefits is a non-exchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2016 and September 30, 2015, was $87.2 billion and $94.1 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 become future beneficiaries of the compensation program; and (3) a proportional share of those on active military service as of the valuation date who will be future Veterans. 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, 2016 and September 30, 2015, were based on the 10-year average historical spot rates derived from quarterly Yield Curves for Treasury *Nominal Coupon Issues* published by Treasury at the end of each quarter for the periods April 1, 2006 to March 31, 2016, and April 1, 2005 to March 31, 2015, for September 30, 2016 and September 30, 2015, 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 1.16 percent to 4.26 percent and from 1.52 percent to 4.37 percent as of September 30, 2016 and September 30, 2015, respectively. These spot rates produced a single weighted average discount rate of 3.93 percent and 4.08 percent as of September 30, 2016 and September 30, 2015, 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, and 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, and presumptive service conditions resulting in benefits coverage, mortality, and disability claims rates. 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 Survey data. The amount of benefits by beneficiary category and age were based on current amounts being paid, future 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, 2016 and September 30, 2015, 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.

Life expectancies of beneficiaries collecting benefits from the Compensation program were based upon studies of mortality experience of those beneficiaries between 2011 and 2015. 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 Office of the Actuary for the Veteran Population Model (VetPop2016). 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, 2016.

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 2016 of $2.5 trillion increased $478 billion from the 2015 liability of $2.0 trillion.

The change in liability was primarily due to a $321 billion increase from the change in assumptions. The average growth in Compensation counts for the next 5 years is 2.1 percent, to reflect the last 5 years increase. This increased the liability of $277 billion, and the other $44 billion was from new mortality rates and mortality improvement factors. The other change in liability was due to a $67 billion increase from the change in the discount rate assumption, largely offset by a decrease of $11 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 4.08 percent to 3.93 percent in 2016. 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, 2016 and September 30, 2015 was 2.30 percent and 2.44 percent, respectively. Beginning in 2015, COLA rates for future years are based on Inflation Rates published by Treasury.

Reconciliation of Veterans Compensation and Burial Actuarial Liabilities (dollars in millions)			
For the Year Ended September 30,			
	Compensation	Burial	TOTAL
Liability at October 1, 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**
Expense:			
Interest on the Liability Balance**	82,200	200	82,400
Actuarial (Gain)/Loss from Current Year Activity			
Changes in Experience (Veterans Counts, Status)**	91,900	200	92,100
Changes in Assumptions:			
Changes in Discount Rate Assumption	66,900	100	67,000
Changes in COLA Rate Assumption	(10,600)	-	(10,600)
Changes in Other Assumptions	321,100	-	321,100
Net (Gain)/Loss from Changes in Assumptions	377,400	100	377,500
Total Expense	551,500	500	552,000
Less Amounts Paid**	(74,100)	(200)	(74,300)
Net Change in Actuarial Liability	477,400	300	477,700
Liability at September 30, 2016	**$ 2,491,400**	**$ 4,900**	**$ 2,496,300**

* The sum of these changes, including the changes in Education Benefits liability shown in the schedule below, represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2015.
** The sum of these changes, including the changes in Education Benefits liability shown in the schedule below, represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2016.

Veterans Education Benefit Liability

Veterans with at least 90 days of aggregate service after September 10, 2001, or individuals discharged with a service-connected disability after 30 days are eligible to receive Post-9/11 GI Bill (Chapter 33) benefits, which includes tuition and fees and a monthly housing allowance. Eligibility for Veterans and/or their beneficiaries to use Chapter 33 benefits continues for 15 years after their last period of 90 consecutive days or more of active duty. Veterans are eligible for up to 36 months of enrollment in an educational institution, which includes a monthly housing allowance, yearly textbook and supplies stipend, and one-time payment for relocation. The Veteran’s eligibility for these amounts is based upon the length of their active duty service. VA recognizes an education benefit liability once

VA has approved an original enrollment certification in the Long Term Solution system. VA estimates the unfunded education benefit liability by including the following assumptions:

(1) As of 9/30/2016 1,668,467 beneficiaries are currently eligible, and have an enrollment certification.
(2) Due to limited experience data, dropout rates were not incorporated into the model. The data from 2009 to 2016 was not sufficient to estimate the dropout rates. As an example, those who have dropped out can reclaim their eligibility for benefits up to the end of the 15-year window of eligibility. As more data becomes available, we will conduct further studies.
(3) For beneficiaries with remaining eligibility who are not using the benefits as of 9/30/2016, the model assumes the beneficiary will start using the benefits beginning in FY 2017.
(4) The model assumes that beneficiaries use the benefits for 6 months each year until all the benefits are exhausted. An experience study shows that the average length of benefit usage per year was 6 months.
(5) The annual payment trend rates used in the model were 4.38%, 4.25%, and 3.16% for FY 2017, FY 2018, and FY 2019 and later, respectively. The rates were estimated using historical data provided by VBA's Budget Office; these trend rates for the following years are:
    - FY 2017 was assumed to be the same as the actual change between FY2015 and FY2016;
    - FY 2018 was determined as the annualized trend rate from FY2014 to FY2016;
    - FY 2019 and later years were estimated as the annualized trend rate from FY2013 to FY 2016.
(6) The average total payment for FY 2016 was $14,565. This amount was computed using the number of eligible beneficiaries and payments made in FY 2016. Any direct DoD contributions (kicker amount) were discounted from the payments.

The Veteran Education Benefit Liability was composed of the following, as of September 30:

Veterans Education Benefits (dollars in millions)		
For the Year Ended September 30, 2014		
Liability for Veterans Education Benefits	$	**46,965**
Estimated Value of FY 15 Enrollment Certifications issued to new Veterans*		17,394
Interest on the Liability*		69
FY 15 Education Benefits Paid*		(11,337)
Total Veterans Education Benefits Liability as of September 30, 2015	**$**	**53,091**

Veterans Education Benefits (dollars in millions)		
For the Year Ended September 30, 2015		
Liability for Veterans Education Benefits	$	**53,091**
Estimated Value of FY 16 Enrollment Certifications issued to new Veterans**		18,010
Interest on the Liability**		196
FY 16 Education Benefits Paid**		(11,709)
Total Veterans Education Benefits Liability as of September 30, 2016	**$**	**59,588**

* The sum of these changes, including the changes in Compensation and Burial Benefits liability shown in the schedule above, represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2015.

** The sum of these changes, including the changes in Compensation and Burial Benefits liability shown in the schedule above, represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2016.

14. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $989 million and $860 million as of September 30, 2016 and September 30, 2015, 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, 2016, the liabilities for friable and non-friable asbestos removal were $231 million and $457 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 within the Intragovernmental and Public categories. Funded liabilities are generally considered to be current liabilities. Unfunded liabilities represent future financial commitments that are currently not funded.

Other Intragovernmental Funded Liabilities (dollars in millions)		
As of September 30,		
	2016	**2015**
Clearing Account Liabilities	$ (2)	$ 1
Accrued Expenses - Federal	9	7
Deferred Revenue	17	56
Credit Reform Act Subsidy Reestimates*	1,598	43
Custodial Liabilities	48	347
General Fund Receipts Liability	257	-
Accrued VA Contributions for Employee Benefits	322	235
Total Other Intragovernmental Funded Liabilities	**$ 2,249**	**$ 689**

*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 from or excess funds are returned to Treasury.

Other Intragovernmental Unfunded Liabilities (dollars in millions)		
As of September 30,		
	2016	**2015**
Accrued FECA Liability	482	472
Unfunded Employee Liability	5	5
Total Other Intragovernmental Unfunded Liabilities	487	477
Total Other Intragovernmental Liabilities	**2,736**	**1,166**

Other Public Funded Liabilities (dollars in millions)		
As of September 30,		
	2016	**2015**
Accrued Funded Annual Leave	$ 22	$ 22
Accrued Expenses	154	165
Accrued Salaries and Benefits	1,191	911
Capital Lease Liability	1	2
Other	222	246
Total Other Public Funded Liabilities	**$ 1,590**	**$ 1,346**

Other Public Unfunded Liabilities (dollars in millions)		
As of September 30,		
	2016	**2015**
Accrued Unfunded Annual Leave*	$ 2,173	$ 2,071
Amounts due to non-Federal trust	115	125
Judgment Fund-Unfunded**	1,811	2,029
Other	4	4
Total Other Public Unfunded Liabilities	**$ 4,103**	**$ 4,229**
Total Other Public Liabilities	**$ 5,693**	**$ 5,575**

*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 Judgement Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgement Fund on behalf of VA (see Note 18, Contingencies).

16. Leases

VA has both capital and operating leases. The net capital lease liability was $1 million and $2 million as of September 30, 2016 and September 30, 2015, 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 general PP&E as disclosed in Note 9.

Capital Lease Assets (dollars in millions)			
As of September 30, 2016			
	Cost	Accumulated Amortization	Net Book Value
Real Property	$ 17.7	$ (17.0)	$ 0.7
Equipment	29.1	(24.1)	5.0
Leased Property Under Capital Lease	**$ 46.8**	**$ (41.1)**	**$ 5.7**
Amortization Expense		**$ 3.0**	

Capital Lease Assets (dollars in millions)			
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**	

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 5 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, 2016, VA had 1,977 real property leases in effect, which consisted of approximately 25 million square feet and base annual minimum rental obligations of approximately $730 million. Of the operating real property leases, VHA accounts for 85.4 percent, VBA accounts for 9.6 percent, Indirect Administrative Program offices account for 4.5 percent, and NCA accounts for 0.5 percent. These real property leases generally have lease terms ranging from 1 to 50 years and all operating leases are funded annually by appropriation of funds by Congress. Approximately 67 percent of the real property leases have an initial lease term of 5 years or less; approximately 26 percent have initial lease terms of 6 to 10 years; approximately 3 percent have initial lease terms of 11 to 15 years; and approximately 4 percent have initial lease terms of 16 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 4 to 6 months). For OAs executed after October 2011, periods of occupancy are generally 1 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) and reimburse increases in real estate taxes over a base year amount at least annually; 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, 2016. 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 non-cancellable 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 2016 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 2016 operating lease rental costs were $790 million for real property rentals and $177 million for equipment rentals. The 2015 operating lease costs were $678 million for real property rentals and $166 million for equipment rentals.

Excluded from the following table are leases of properties that have expired as of September 30, 2016, 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. In other instances, VA enters into a standstill agreement, which simply preserves the terms and conditions of the lease and provides continuation of required rent payments to maintain occupancy. 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 standstill and holdover leases is considered immaterial and is reflected in the 2016 expense in the statements of net costs. The following table represents VA's projected future operating lease commitments.

Projected Future Operating Lease Commitments (dollars in millions)								
For the Years Ending September 30,								
		GSA OAs		Third Party Direct Leases		Total Real Property		Equipment
2017	$	205	$	452	$	657	$	177
2018		189		425		614		177
2019		157		391		548		177
2020		163		355		518		177
2021		98		323		421		177
2022 and Thereafter (in total)		193		2,789		2,982		-
Total Future Lease Payments	**$**	**1,005**	**$**	**4,735**	**$**	**5,740**	**$**	**885**

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 (e.g., 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 60 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, 2016 and September 30, 2015, 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:

(1) United States Government Life Insurance (USGLI) program;
(2) National Service Life Insurance (NSLI) program;
(3) Veterans Special Life Insurance (VSLI) program;
(4) Veterans Reopened Insurance (VRI) program, which covers Veterans who served during World Wars I, II, and the Korean Conflict eras;
(5) 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
(6) Veterans Mortgage Life Insurance (VMLI) program, which covers severely disabled Veterans and is 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 provide 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 2.0 to 4 percent. The mortality assumptions include the American Experience Table, the X-18 Table, the 1941 CSO Table, the 1958 CSO Basic Table, the 1980 CSO Basic Table, and the 2001 VBM Table.

Insurance Liability (Reserve) Balances (dollars in millions)				
As of September 30, 2016				
Program	**Insurance Death Benefits**	**Death Benefit Annuities**	**Disability Income & Waiver**	**Reserve Totals**
NSLI	$ 3,351	$ 42	$ 19	$ 3,412
USGLI	1	1	-	2
VSLI	1,269	4	8	1,281
S-DVI	646	6	788	1,440
VRI	109	1	1	111
VMLI	236	-	-	236
Subtotal	$ 5,612	$ 54	$ 816	$ 6,482
Unearned Premiums				40
Insurance Dividends Left on Deposit				1,149
Dividend Payable to Policy holders				38
Unpaid Policy Claims				4
Insurance Liabilities Reported on the Balance Sheet				7,713
Less Liability not Covered by Budgetary Resources (Note 12)				(1,582)
Liability Covered by Budgetary Resources				$ 6,131

Insurance Liability (Reserve) Balances (dollars in millions)				
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
VMLI	229	-	-	229
Subtotal	$ 6,160	$ 62	$ 819	$ 7,041
Unearned Premiums				44
Insurance Dividends Left on Deposit and Related Interest Payable				1,245
Dividend Payable to Policy holders				48
Unpaid Policy Claims				2
Insurance Liabilities Reported on the Balance Sheet				8,380
Less Liability not Covered by Budgetary Resources (Note 12)				(1,519)
Liability Covered by Budgetary Resources				$ 6,861

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 5,486,309 and 5,567,448 policy holders with a face value of $1.2 trillion and $1.2 trillion for 2016 and 2015, respectively.

The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in force for both 2016 and 2015. The number of policies represents the number of active policies remaining in the program at the end of the fiscal year.

	2016 Policies	2015 Policies	2016 Face Value	2015 Face Value
	(# of policies)		(dollars in millions)	
Supervised Programs (UNAUDITED)				
SGLI Active Duty	1,415,000	1,425,000	$ 541,842	$ 547,671
SGLI Ready Reservists	742,500	745,500	243,913	247,637
SGLI Post Separation	88,000	95,000	32,231	35,023
SGLI Family - Spouse	955,000	973,000	93,998	95,903
SGLI Family - Children	1,855,000	1,901,000	18,550	19,010
TSGLI*	-	-	215,750	217,050
VGLI	430,809	427,948	71,365	68,699
Total Supervised	**5,486,309**	**5,567,448**	**$ 1,217,649**	**$ 1,230,993**
Administered Programs				
NSLI	309,658	370,281	$ 3,914	$ 4,655
VSLI	110,943	120,466	1,607	1,730
S-DVI	272,112	266,840	2,854	2,794
VRI	12,015	14,515	127	154
USGLI	348	672	1	1
VMLI	2,654	2,567	345	333
Total Administered	**707,730**	**775,341**	**$ 8,848**	**$ 9,667**
Total Supervised and Administered Programs	**6,194,039**	**6,342,789**	$ **1,226,497**	$ **1,240,660**

*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 2016 and 2015 were $84 million and $109 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 76 percent and 30 percent of the amounts funded on behalf of VA by the Judgment Fund in 2016 and 2015, respectively. Contract dispute payments for 2016 and 2015 were $35.6 million and $225 million, respectively. The discrimination case payments for 2016 and 2015 were $1.7 million and $5.5 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, 2016 and September 30, 2015.

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 $1.8 billion for 2016 and $2 billion for 2015.

There were 54 contract and personnel law cases, where there was at least a reasonable possibility that a loss may occur, with financial exposure ranging from $350 million to $2.5 billion in aggregate for 2016. Within that range, $276 million is considered probable and is recorded as a liability. In 2015, the range of exposure was reported as $654 million to $1.9 billion, but it should have been reported as $624 million to $3.2 billion, from 46 cases, of which $401 million was probable and recorded as a liability.

In 2016 there was a Court of Appeals for Veterans Claims decision that could change the procedure for Veteran reimbursement or payment of unauthorized private emergency treatment expense. While there is no liability or loss amount currently associated with this event, if there is no appeal, it could potentially result in a programmatic expansion with an estimated budgetary impact of an additional $2.3 billion in healthcare benefits payments over 5 years and $8.2 billion over 10 years.

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 (dollars in millions)				
For the Years Ended September 30,				
		2016		**2015**
Fiscal Year Settlement Payments	$	201	$	343
Less Contract Dispute and “No Fear” Payments		(37)		(230)
Imputed Financing-Paid by Other Entities*		164		113
Increase (Decrease) in Liability for Claims		(125)		337
Operating Expense	**$**	**39**	**$**	**450**

*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 with the difference being Department of Homeland Security (DHS) imputed costs associated with cybersecurity services.

It is the opinion of management that resolution of pending legal actions as of September 30, 2016 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 2016 tort payments were $164 million, and 2015 tort payments were $113 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, 2016 and September 30, 2015 was $990 million and $514.2 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; this is 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 2012-2016, the average medical care cost per year was $47 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 and 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 Source
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. 8301	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 (dollars in millions)
As of September 30, 2016

	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Assets:					
Fund Balance with Treasury	$ 38	$ 398	$ 63	$ 2	$ 501
Investments with Treasury (Note 5)	6,135	108	-	-	6,243
Other Assets	306	1,658	-	13	1,977
Total Assets	**$ 6,479**	**$ 2,164**	**$ 63**	**$ 15**	**$ 8,721**
Liabilities and Net Position:					
Payables to Beneficiaries	$ 208	$ 40	$ 1	-	$ 249
Other Liabilities	7,471	136	-	-	7,607
Total Liabilities	**7,679**	**176**	**1**	**-**	**7,856**
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(1,200)	1,988	62	15	865
Total Liabilities and Net Position	**$ 6,479**	**$ 2,164**	**$ 63**	**$ 15**	**$ 8,721**

Statement of Net Cost – Funds from Dedicated Collections (dollars in millions)
For the Year Ended September 30, 2016

	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Gross Program Costs	$ 701	$ 623	$ -	$ 2	$ 1,326
Less Earned Revenues	518	4,132	-	-	4,650
Net Program Costs	**183**	**(3,509)**	**-**	**2**	**(3,324)**
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost/(Benefit) of Operations	**$ 183**	**$ (3,509)**	**$ -**	**$ 2**	**$ (3,324)**

Statement of Changes in Net Position – Funds from Dedicated Collections (dollars in millions)
For the Year Ended September 30, 2016

	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Net Position Beginning of Period	$ (1,061)	$ 1,888	$ 63	$ 16	$ 906
Budgetary and Other Financing Sources	44	(3,409)	(1)	1	(3,365)
Net Cost/(Benefit) of Operations	183	(3,509)	-	2	(3,324)
Change in Net Position	**(139)**	**100**	**(1)**	**(1)**	**(41)**
Net Position End of Period	**$ (1,200)**	**$ 1,988**	**$ 62**	**$ 15**	**$ 865**

Balance Sheet – Funds from Dedicated Collections (dollars in millions)					
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 (dollars in millions)					
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 (dollars in millions)					
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**

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 the following: 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 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 2016 and 2015 were $2.0 billion and $1.8 billion, respectively. The loan guarantee lender participation fees collected for 2016 and 2015 were $2.3 million and $2.2 million, respectively.

NCA leases lodges at six cemeteries to not-for-profit groups at no cost: four for historic preservation and two 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 ten 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 $90 thousand and $104 thousand for 2016 and 2015, 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 Office of Community Care, Revenue Operations Payer Relations Office (PRO) Rates and Charges 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 healthcare services, non-Federal workers’ compensation, tort, 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 and Inter-Agency per diems are calculated annually to produce rates used to bill for medical care or services provided by VA:

(a) in error or based on tentative eligibility;
(b) in a medical emergency, workers’ compensation (Federal only), 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 the VHA Office of Finance Cost Reports.

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 healthcare 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 Office of Community Care, Revenue Operations PRO Rates and Charges. Interagency billing rates are determined from cost and workload data in the VHA Office of Finance Cost Reports.

21. Net Program Costs by Administration

Schedule of Net Program Costs by Administration (dollars in millions)					
For the Period Ending September 30, 2016 (Dollars in Millions)					
	Veterans Health Administration	**Veterans Benefits Administration**	**National Cemetery Administration**	**Indirect Administrative Program Costs**	**Total**
Program Costs					
Intragovernmental Costs	$ 10,380	$ 1,277	$ 50	$ 482	$ 12,189
Less Earned Revenues	17	(514)	-	(403)	(900)
Net Intragovernmental Program Costs	**$ 10,397**	**$ 763**	**$ 50**	**$ 79**	**$ 11,289**
Public Costs	63,192	94,945	264	1,572	159,973
Veterans Benefits Actuarial Costs, Excluding Changes in Actuarial Assumptions (Note 13)	-	$ 106,498	$ 200	$ -	$ 106,698
Less Earned Revenues	(4,343)	(403)	-	(120)	(4,866)
Net Public Program Costs	**$ 58,849**	**$ 201,040**	**$ 464**	**$ 1,452**	**$ 261,805**
Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	$ 69,246	$ 201,803	$ 514	$ 1,531	$ 273,094
Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13)	-	377,400	100	-	377,500
Net Cost of Operations	**$ 69,246**	**$ 579,203**	**$ 614**	**$ 1,531**	**$ 650,594**

Schedule of Net Program Costs by Administration (dollars in millions), Restated					
For the Period Ending September 30, 2015 Restated (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 Cost, Excluding Changes in Actuarial Assumptions (Note 13)*	$ -	$ 30,526	$ 100	$ -	$ 30,626
Less Earned Revenues	(4,188)	(406)	-	(188)	(4,782)
Net Public Program Costs	**$ 55,589**	**$ 122,772**	**$ 361**	**$ 1,130**	**$ 179,852**
Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	$ 64,732	$ 122,936	$ 404	$ 1,411	$ 189,483
Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13)	-	(13,000)	-	-	(13,000)
Net Cost of Operations*	**$ 64,732**	**$ 109,936**	**$ 404**	**$ 1,411**	**$ 176,483**

*This line item has been restated from the previous year's reported amount to align with the FY 2015 restatement. See Note 24 Restatement.

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 that allow 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 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

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. 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. Obligations incurred for direct and reimbursable obligations by apportionment category are shown below (in millions).

Apportionment Categories of Obligations Incurred (Dollars in Millions)						
For the Years Ended September 30,						
		2016		2015		Change
Category A, Direct	$	89,671	$	156,958	$	(67,287)
Category B, Direct		90,910		11,951		78,959
Category A, Reimbursable		1,114		854		260
Category B, Reimbursable		3,595		3,913		(318)
Total Obligations Incurred	**$**	**185,290**	**$**	**173,676**	**$**	**11,614**

Mandatory program apportionments were allocated to Category B in accordance with OMB guidance in 2016. In the table above, Category A, Direct, and Category B, Direct for 2015, were changed to reflect a late adjustment. Category A, Direct, and Category B, Direct, were previously reported as $158,658 and $10,251, respectively.

Adjustments to Budgetary Resources and Prior Year Recoveries

The recoveries of prior year unpaid obligations were $2.7 billion and $3.0 billion for 2016 and 2015, respectively.

For both 2016 and 2015, VA appropriations were subjected to a $1.8 billion rescission each year under the provisions of P.L. 114-113, *Consolidated Appropriations Act, 2016* and P.L. 113-235*, Consolidated and Further Continuing Appropriations Act, 2015*, respectively.

Borrowing Authority

The Loan Guaranty Program had borrowing authority of $62 million and $466 million as of September 30, 2016 and 2015, respectively. The interest rates on the borrowing authority ranged from 1.00 to 2.95 percent for 2016 and 2015. 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 $3.0 million and $2.2 million as of September 30, 2016 and 2015, respectively. The interest rate on the borrowing authority was 1.00 percent for 2016 and 2015. 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 1 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 2015 SBR and the actual amounts reported in the 2017 Budget of the U.S. Government. The 2018 Budget of the United States with the actual 2016 SBR amounts will not be available until February 2017. Once published, the 2016 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 (dollars in millions)				
For the Year Ended September 30, 2015				
	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
2015 Actual Balances per the 2017 Budget of the US Government (in millions)	**$ 206,900**	**$ 173,922**	**$ 447**	**$ 161,924**
Reconciling Items: *				
Expired Funds	4,167	-	-	1
Recovery Act, Special, and Trust Funds	235	-	(3,552)	-
Special Research Fund	(245)	(245)	-	-
Offsetting Differences	-	-	(895)	-
Miscellaneous Differences	(1)	(1)	-	-
Per the 2015 Statement of Budgetary Resources	**$ 211,056**	**$ 173,676**	**$ (4,000)**	**$ 161,925**

*The material reconciling items are: Expired Unobligated Balances; Recovery Act, Special and Trust Funds; and Distributed Offsetting Receipts. These items are reported in the Statement of Budgetary Resources and the SF 133, Report on Budget Execution and Budgetary Resources, but are not in the Budget of the US Government.

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 2016 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 the 2016 Appropriation Act (P.L. 114-113). 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 undelivered orders for the years ended 2016 and 2015 was $ 15.5 billion and $13.5 billion, respectively. In 2015, the reported amount of $14.9 billion represented only unpaid undelivered orders. The amounts presented above have been updated to include unpaid and paid undelivered orders and prior year recoveries.

Contributed Capital

During 2016, VA received donations totaling $109.1 million: $108 million to the General Post Fund, $0.3 million to the Supply Fund, and $0.8 million to the National Cemetery Gift Fund. In 2015, contributed capital totaled $55.8 million in donations: $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.

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 (dollars in millions)		
As of September 30,	**2016**	**2015**
Resources Used to Finance Activities		Restated (Note 24)
Obligations Incurred	185,290	173,676
Less Offsetting Collections, Receipts and Adjustments	(16,962)	(16,854)
Net Obligations	168,328	156,822
Donations of Property	89	35
Transfers-out	25	(3)
Imputed Financing	2,161	1,880
Other Financing Sources	(1,811)	(559)
Total Resources Used to Finance Activities	**168,792**	**158,175**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	216	515
Resources that Finance the Acquisition of Assets	(6,140)	(6,739)
Resources that Fund Expenses Recognized in Prior Periods	(1,894)	(1,138)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	4,915	4,540
Total Resources that Do Not Fund Net Cost of Operations	(2,903)	(2,822)
Total Resources Used to Finance the Net Cost of Operations	**165,889**	**155,353**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	102	84
Increase in Environmental and Disposal Liability	130	70
Increase (Decrease) to Judgement Fund Future Funded Expense	(194)	562
Reestimates of Credit Subsidy Expense	(1,033)	(194)
Increase in Exchange Revenue Receivable from the Public	(639)	106
Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities*	484,252	17,746
Depreciation and Amortization	1,890	1,656
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	(39)	810
Loss on Disposition of Assets	227	281
Undistributed Offsetting Receipts	(6)	(4)
Other	15	13
Total Costs That Do Not Require Resources in the Current Period	484,705	21,130
Net Cost (Benefit) of Operations*	**$ 650,594**	**$ 176,483**

*This line item has been restated from the previous year's reported amount to align with the FY 2015 restatement. See Note 24 Restatement.

24. Restatements

In FY 2016, VA assessed the application of *Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government*, as it relates to Post- 9/11 GI Bill (Chapter 33) liabilities. The Post- 9/11 GI Bill is an education benefit program for individuals who served on active duty after September 10, 2001.

Prior to FY 2016, the liability recorded for Chapter 33 benefits was limited to funds that had not been disbursed at the end of month and did not include future liability amounts that were probable. Upon further review of SFFAS 5, management determined that accrued Chapter 33 education benefits are most closely aligned to Other Postemployment Benefits (OPEB) and should be recognized at the time an accountable event occurs, and that any portion of costs that remain unpaid at the end of the period should be recorded as a liability. This change in the application of SFFAS 5 resulted in a material adjustment to prior period financial statements and is treated as a correction of an error.

The error correction, and the related effect on the previously issued financial statements, was identified when the subsequent period's audited financial statements were imminent. In accordance with OMB Circular A-136, VA restated the FY 2015 Balance Sheet, Statement of Net Cost, and the Statement of Changes in Net Position in the FY 2016 AFR.

The following table illustrates the effect of the error correction on the impacted prior year financial statements.

Statement of Changes

Restated Balances as of September 30, 2015 (dollars in millions)

	2015 As Previously Reported	Adjustments Increase (Decrease)	2015 As Restated
Consolidated Balance Sheet			
Public			
Federal Employee and Veterans Benefits (Note 13)	$ 2,020,844	$ 53,091	$ 2,073,935
Total Public Liabilities	2,056,520	53,091	2,109,611
Total Liabilities	**$ 2,058,739**	**$ 53,091**	**$ 2,111,830**
Net Position			
Cumulative Results of Operations – All Other Funds	$ (2,001,161)	$ (53,091)	$ (2,054,252)
Total Net Position	(1,962,879)	(53,091)	(2,015,970)
Total Liabilities and Net Position	**$ 95,860**	**$ -**	**$ 95,860**
Consolidated Statements of Net Cost			
Veterans Benefits Administration			
Gross Costs			
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	$ 24,400	$ 6,126	$ 30,526
Net Program Costs	116,810	6,126	122,936
Net Program Costs by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	183,357	6,126	189,483
Net Cost of Operations	**$ 170,357**	**$ 6,126**	**$ 176,483**
Consolidated Statement of Changes in Net Position			
Cumulative Results of Operations – All Other Funds			
Beginning Balance	$ (1,991,288)	$ -	$ (1,991,288)
Correction of Error	-	(46,965)	(46,965)
Beginning Balances, as adjusted	(1,991,288)	(46,965)	(2,038,253)
Net Cost of Operations	173,610	6,126	179,736
Net Change	**$ (9,873)**	**$ (6,126)**	**$ (15,999)**
Cumulative Results of Operations - All Other Funds	(2,001,161)	(53,091)	(2,054,252)
Total Net Position	**$ (1,963,785)**	**$ (53,091)**	**$ (2,016,876)**
Cumulative Results of Operations – Total			
Beginning Balance	(1,990,280)	-	(1,990,280)
Correction of Errors	-	(46,965)	(46,965)
Beginning Balances, as adjusted	(1,990,280)	(46,965)	(2,037,245)
Net Cost of Operations	170,357	6,126	176,483
Net Change	(9,975)	(6,126)	(16,101)
Cumulative Results of Operations	**(2,000,255)**	**(53,091)**	**(2,053,346)**
Total Net Position	**$ (1,962,879)**	**$ (53,091)**	**$ (2,015,970)**

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED)

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 (dollars in millions)					
For the Years Ended September 30,	**2016**	**2015**	**2014**	**2013**	**2012**
State Extended Care Facilities	$ 140	$ 105	$ 92	$ 180	$ 66
State Veterans Cemeteries	49	47	52	36	47
Total Grant Program Costs	**$ 189**	**$ 152**	**$ 144**	**$ 216**	**$ 113**

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day healthcare for Veterans and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, and day healthcare for Veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last 5 fiscal years, the State Home Construction Grant Program has awarded grants in excess of $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 32,000 burials in 2016. VA awarded grants totaling more than $714 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.

Program Outcome

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 to eligible family members.

Veterans and Dependents Education (dollars in millions)				
For the Years ended September 30,				
		2016		**2015**
Program Expenses				
Education and Training-Dependents of Veterans	$	526	$	493
Vocational Rehabilitation and Education Assistance		14,503		13,543
Administrative Program Costs		533		512
Total Program Expenses	**$**	**15,562**	**$**	**14,548**
Program Outputs (Participants)				
Dependent Education		95,477		91,755
Veterans Rehabilitation		107,491		86,928
Veterans Education		931,097		922,497

Veterans and Dependents Education (dollars in millions)				
For the Years ended September 30,				
		2014		**2013**
Program Expenses				
Education and Training-Dependents of Veterans	$	518	$	487
Vocational Rehabilitation and Education Assistance		14,206		12,693
Administrative Program Costs		502		372
Total Program Expenses	**$**	**15,226**	**$**	**13,552**
Program Outputs (Participants)				
Dependent Education		90,641		89,618
Veterans Rehabilitation		93,363		89,708
Veterans Education		970,765		971,597

Veterans and Dependents Education (dollars in millions)		
For the Years ended September 30,		
		2012
Program Expenses		
Education and Training-Dependents of Veterans	$	444
Vocational Rehabilitation and Education Assistance		11,727
Administrative Program Costs		389
Total Program Expenses	**$**	**12,560**
Program Outputs (Participants)		
Dependent Education		94,618
Veterans Rehabilitation		85,436
Veterans Education		871,188

3. Health Professionals Education

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 healthcare 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 healthcare professionals to meet the changing needs of the Nation's healthcare delivery system.

VA's education mission contributes to high quality healthcare 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 healthcare professionals.

Program Outcomes

Health Professions Education										
For the Years Ended September 30,										
		2016		2015		2014		2013		2012
Program Expenses (dollars in millions)										
Physician Residents and Fellows	$	715	$	689	$	748	$	692	$	663
Associated Health Residents and Students		171		168		157		164		153
Instructional and Administrative Support		903		851		905		856		851
Total Program Expenses	**$**	**1,789**	**$**	**1,708**	**$**	**1,810**	**$**	**1,712**	**$**	**1,667**
Program Outputs in units										
Health Professions Rotating Through VA:										
Physician Residents and Fellows		43,400		41,534		40,420		38,106		37,104
Medical Students		24,283		22,931		21,541		20,218		21,502
Nursing Students		28,389		27,275		29,067		25,948		32,349
Associated Health Residents and Students		27,121		28,663		27,771		33,228		25,839
Total Program Outcomes		**123,193**		**120,403**		**118,799**		**117,500**		**116,794**

4. Research and Development (R&D)

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

Program Expense (dollars in millions)

For the Year ended September 30, 2016

	Basic	Applied	Development	Total
Medical Research Service	$ 199.1	$ -	$ -	$ 199.1
Rehabilitative Research and Development	-	91.4	16.1	107.5
Health Services Research and Development	-	107.3	-	107.3
Cooperative Studies Research Service	-	216.8	-	216.8
Medical Research Support	169.2	353.1	13.7	536.0
Total Program Expenses	**$ 368.3**	**768.6**	**29.8**	**1,166.7**

Program Expense (dollars in millions)

For the 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 (dollars in millions)

For the 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 (dollars in millions) For the 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
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 (dollars in millions) For the 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**

In addition, estimates are that VHA researchers received grants of $685 million from the National Institutes of Health and other Federal and non-VA sources in 2016. 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 2016, VA's R&D general goal related to stewardship was to ensure that Pre-clinical Research and Clinical Research Programs, excluding the 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 For the Years ended September 30,	2016	2015	2014	2013	2012
Percent of Funded Research Projects Relevant to VA's Health-Care Mission	100%	100%	100%	100%	100%
Number of Research and Development Projects	2,205	2,224	2,184	2,241	2,249

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)

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 and, 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 that 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; these components 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 PP&E 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 approximately 6,000 VA buildings on a 3-year cycle and assesses all components. Building components assessed include architectural structural, mechanical, plumbing, and electrical systems. Also included for assessment are capitalized, fully depreciated, and non-capitalized elements of general PP&E, heritage assets, and stewardship land. Each PP&E 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) or 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 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 an increasing portfolio of owned space and inflation rates, and (3) expanded scope of FCA survey requirements that significantly increase cost estimates when sites are reevaluated.

SCHEDULE OR DEFERRED MAINTENANCE AND REPAIRS (dollars in millions)				
As of September 30, 2016		**Ending Balance**		**Beginning Balance**
General PP&E	$	9,671	$	9,166
Heritage Assets		996		883
Total Deferred Maintenance and Repairs	**$**	**10,667**	**$**	**10,049**

SCHEDULE OF BUDGETARY ACTIVITY (dollars in millions)
As of September 30, 2016

	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	$ 6,721	$ 6,107	$ 80	$ 730	$ 882	$ 5,875
0160 Medical Care	59,020	55,173	1,318	6,215	7,926	52,144
0162 Medical Facilities	6,093	5,719	273	2,756	2,995	5,207
0167 Medical Facilities	4,871	4,258	271	1,948	2,108	3,827
0172 Veterans Choice Fund	7,736	3,233	635	1,664	1,744	2,518
All Other	6,803	3,691	713	2,716	2,627	3,067
Total	$ 91,244	$ 78,181	$ 3,290	$ 16,029	$ 18,282	$ 72,638
Veterans Benefits Administration						
0102 Compensation, Pension, & Burial Benefits	$ 82,914	$ 80,073	$ 231	$ 6,037	143	85,736
0137 Readjustment Benefits	17,180	14,265	546	713	182	14,250
4127 Direct Loan Financing	96	37	108	-	-	(71)
4129 Guaranteed Loan Financing	13,213	2,880	4,655	316	361	(1,820)
8132 National Service Life Insurance Fund	847	847	26	946	853	914
0151 General Operating Expenses	3,332	3,163	554	346	500	2,455
All Other	4,146	2,435	1,091	477	462	1,359
Total	$ 121,728	$ 103,700	$ 7,211	$ 8,835	$ 2,501	102,823
National Cemetery Administration						
Total	$ 343	$ 320	$ 6	$ 151	$ 151	$ 314
Indirect Administrative Program Cost						
0142 General Administration	$ 793	$ 727	$ 422	$ 181	$ 203	$ 283
1122 Board of Veterans Appeals	114	110	1	7	10	106
4537 Supply Fund	1,526	1,299	1,365	(11)	(59)	(18)
All Other	1,127	953	848	130	90	145
Total	$ 3,560	3,089	$ 2,636	$ 307	$ 244	$ 516
Total of all Administrations	$ 216,875	$ 185,290	$ 13,143	$ 25,322	$ 21,178	$ 176,291

Report Distribution

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