VA Office of Inspector General

OFFICE OF AUDITS AND EVALUATIONS

Department of Veterans Affairs

Audit of
VA's Financial Statements for Fiscal Years 2017 and 2016

November 15, 2017
17-01219-24

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TABLE OF CONTENTS

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Department of Veterans Affairs

Memorandum

Date: November 15, 2017

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

Subj: Audit of VA's Financial Statements for Fiscal Years 2017 and 2016

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, 2017 and 2016, and for the fiscal years (FY) then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of CliftonLarsonAllen LLP's audit are presented in the attached report.

2. CliftonLarsonAllen LLP provided an unmodified opinion on VA's financial statements for FYs 2017 and 2016. With respect to internal control, CliftonLarsonAllen LLP identified six material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

- Compensation, pension, burial, and education actuarial estimates, which is a combination of two material weaknesses reported since FY 2016
- Community care obligations, reconciliations, and accrued expenses, which has been reported as a material weakness since FY 2016
- Financial reporting, which has been reported as a material weakness since FY 2015
- Loan guarantee liability, which was reported as a significant deficiency last year and was elevated to a material weakness this year
- Chief Financial Officer organizational structure, which has been reported as a material weakness since FY 2016
- Information technology security controls, which has been reported as a material weakness for more than 10 years

3. CliftonLarsonAllen LLP identified one significant deficiency. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

- Procurement, undelivered orders, accrued expenses, and reconciliations, which has been reported as a significant deficiency since FY 2016

4. CliftonLarsonAllen LLP identified the following conditions regarding 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, which has been reported in part for more than 10 years

- Improvements needed in complying with the Federal Managers' Financial Integrity Act, which has been reported since FY 2015

- Instances of noncompliance with Title 38 United States Code §5315 pertaining to the charging of interest and administrative costs, which has been reported for 10 years

- Noncompliance with Title 38 United States Code §3733 pertaining to the vendee loan program, which has been reported since FY 2016

- One violation of the Antideficiency Act, as reported to CliftonLarsonAllen LLP by VA, which has been reported to Congress. VA is in the process of reporting five other violations. CLA has reported violations of the Antideficiency Act since FY 2012

- Noncompliance with the Improper Payments Elimination and Recovery Act for FY 2016, as reported by the Office of Inspector General since 2012

6. CliftonLarsonAllen LLP is responsible for the attached audit report dated November 15, 2017 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 2018 audit of VA's financial statements.

Larry M. Reinkemeyer

LARRY M. REINKEMEYER

Attachment

Section I

Independent Auditors' Report

CliftonLarsonAllen LLP
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, 2017 and 2016, 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 audit. We conducted our audit 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. 17-03, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 17-03). Those standards and OMB Bulletin 17-03 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, 2017 and 2016, 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

As discussed in Note 13 to the financial statements, VA provides four education/retraining type programs to eligible veterans and their dependents. VA reported an estimated liability for the Post 9/11 GI Bill in FY 2016 with limited experience studies and assumptions. VA separately developed an estimate for each of the programs in FY 2017. A material weakness in Compensation, Pension, Burial and Education Actuarial Estimates is included in the Report on Internal Control over Financial Reporting. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. All other information 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*

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 have not been 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>Compensation, Pension, Burial and Education Actuarial Estimates</u>

Liability estimates and modeling for certain key education programs, as well as sensitivity analyses were not developed until year-end. In addition, the continued vacancy of a qualified and permanent Chief Actuary managing and taking full responsibility for VA's compensation, pension, and burial and education (CP&E) modeling resulted in a lack of quality control review and errors in accounting estimates.

<u>Community Care Obligations, Reconciliations, and Accrued Expenses</u>

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.

<u>Financial Reporting</u>

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.

<u>Loan Guarantee Liability</u>

The Veterans Benefits Administration's (VBA) loan guarantee 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.

<u>CFO Organizational Structure</u>

> 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.

<u>Information Technology Security Controls</u>

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

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.

<u>Procurement, Undelivered Orders, Accrued Expenses, and Reconciliations</u>

> 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 and accrued expenses, and other pervasive and long standing procurement related issues continue to exist.

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 noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures.

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* or OMB Bulletin 17-03.

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 of these provisions 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 15, 2016. The status of prior year findings is presented in Exhibit D.

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

The purpose of the Report on Internal Control over Financial Reporting and on Compliance 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, 2017

EXHIBIT A
Material Weaknesses

1. Compensation, Pension, Burial and Education Actuarial Estimates

Background:

VA provides compensation, pension, burial and education benefits to eligible Veterans and their beneficiaries. The VA Office of Enterprise Integration's (OEI) Office of Predictive Analytics and Actuary (PAA) and VBA estimate the present value of these future veterans' benefits as of the end of the fiscal year, and VA reports these amounts in its financial statements. VA reported a compensation and burial benefits liability in the amount of approximately $2.8 trillion on its balance sheet as of September 30, 2017. The present value of future pension benefits is reported as a disclosure in the notes to the financial statements. VA also reported an education benefits accrued liability of approximately $50.7 billion on its balance sheet as of September 30, 2017.

VBA manages several education benefit programs with total disbursements of $14.0 billion in FY 2017. The Post-9/11 GI Bill (Chapter 33) is the largest program (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. The other education programs included in the estimate are the (1) Montgomery GI Bill Active Duty (Chapter 30), (2) Vocational Rehabilitation and Employment (Chapter 31), and (3) Survivors' and Dependents' Educational Assistance Program (Chapter 35).

Prior to FY 2016, management did not consider education benefits 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. VBA management began to recognize education benefits as post-employment benefits towards the end of FY 2016 and provided its initial calculation model to estimate the education benefit accrued liability.

Conditions:

A. <u>Education Benefits Actuarial Liability Models for Chapter 30, 31, and 35 Were Not Developed until After Year-End</u>

As described above, in FY 2016 management reported an education benefits actuarial liability for the first time in its financial statements. Management asserted that the estimated amount was based on the existing available data with a conservative assumption and without an experience study to confirm key assumptions. In our Independent Auditors' Report on VA's FY 2016 financial statements, we made several recommendations regarding improvements in VBA's estimation process for the education benefits liability. One of our key recommendations was that management should refine its accrual methodology and calculation to separately account for the smaller education benefit programs. This recommendation became especially important when VBA conducted an experience study only for the Chapter 33 program and planned to adjust its education liability estimate based on that study in FY 2017.

However, VBA management did not develop estimation methodologies and liability estimates for Chapter 30, 31, and 35 programs until October 2017—after year-end and just before the end of the audit. These programs have existed for many years and management was aware of the need to generate data and begin its analyses for these programs as they were deemed to be material to VA's financial statements. Adequate resources were not allocated and priority was not given to address this deficiency in a timely manner during FY 2017. As a result, management did not provide an actuarial report that complied with actuarial standards of practice and that was signed by an accredited actuary for the other education programs (i.e., Chapter 30, 31, and 35) until late October 2017, which also significantly increased the control risk surrounding the estimates; i.e., the risk that a misstatement could occur but not be detected and corrected or prevented by the internal control mechanism. The liability for these education programs amounted to approximately $8.3 billion as of September 30, 2017.

B. Management's Assessment of Estimation Uncertainty for the Post 9/11 GI Bill (Chapter 33) Was Not Performed Until After Year-End

In our Independent Auditors' Report on VA's FY 2016 financial statements, we recommended that VA perform the necessary analyses or studies to confirm the validity of the key assumptions used in VBA's calculation model to estimate the education benefits liability. In FY 2017, VBA performed an experience study for the Chapter 33 program; however, it did not consider how the results of this study would have affected its FY 2016 estimate had such information been available. Such an analysis is important in demonstrating and reconciling change in estimates from a prior year to current year, and it is integral to assessing the reasonableness of the current year's estimate. However, the PAA actuary and VBA management took the initial position that such an analysis was not necessary, which delayed an important internal control that should have been instituted to determine the effect of management's changes in the assumptions on the Chapter 33 portion of the estimate. As a result, this reconciliation, which required a re-estimation process for last year, was not completed until October 2017—after year-end and close to the end of the audit. The lack of such controls as part of management's routine assessment of its estimates from year to year increases the risk of management bias or other error in the accounting estimate that might not be detected and corrected timely to ensure VA's financial statements are free from material misstatements.

C. Continued Vacancy of A Chief Actuary Responsible for Key Estimates and Performing Quality Control Reviews

VA's combined compensation, burial and education actuarial estimate is the largest balance on VA's financial statements. Despite the importance of these estimates to financial reporting for VA and the U.S. government, throughout FY 2017, VA did not execute an effective plan to ensure a candidate was properly recruited and trained to assume the Chief Actuary role. As a contingency plan for FY 2017, credentialed actuaries from other VA departments were used on a temporary basis, along with outside contractors. However, VA lacked a permanent Chief Actuary during FY 2017 to manage and take full responsibility for VA's compensation, pension, burial and education modeling. We further noted the following actuarial modeling errors and observations regarding inconsistencies:

- Mortality rates are one of the assumptions used in the compensation, pension, and burial (C&P) actuarial model. There was an inconsistent use of the mortality assumption throughout the model which resulted in an increase to the total program liability of $1.2 billon.
- Incarceration rates, which are an element of the C&P model, were mistakenly entered as zero percent instead of the actual rates measured by PAA, which resulted in overstating the compensation liability by $1.2 billion.
- Sensitivity testing was performed to highlight the estimation risk associated with

selecting assumptions. The initial sensitivity results for the discount and cost of living adjustment assumptions were misleading. PAA subsequently revised the sensitivity tests to reflect a more realistic measure of the sensitivity of the C&P liabilities to those assumptions.

- The preliminary Chapter 33 liability provided by PAA was approximately $21.8 billion. After auditor inquiries, PAA learned that there was an error in the data extraction for the model and issued a corrected liability in the amount of $42.5 billion.
- In developing average historical Treasury rates to be used as discount rates, the Chapter 33 model used 5 historical rates while the other education programs (Chapter 30, 31, and 35) used 10 historical rates similar to the C&P model. The averaging period used for Chapter 33 versus the C&P and other education programs was different.

Criteria:

The Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* provide 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"

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.

Cause:

VA was not able to hire a Chief Actuary to manage and take full responsibility for VA's compensation, pension, burial and education liability (CP&E) modeling which resulted in a lack of quality control review over the accounting estimates. Management indicated that the lateness of providing the education liability estimate methodologies for the three smaller programs were caused by factors such as limited resources, a hiring freeze, and data limitations.

Effect:

The lack of an established and properly executed internal control structure surrounding these key actuarial estimates, as well as the lack of a Chief Actuary to implement monitoring controls and perform quality control reviews, placed the timely and appropriate estimation of VA's largest liability at risk.

Recommendations:

We recommend that the Acting Assistant Secretary for Management and Acting Chief Financial Officer and the Acting Under Secretary for Benefits in coordination with the Acting Assistant Secretary for Enterprise Integration:

EXHIBIT A
Material Weaknesses

1. Ensure a Chief Actuary is in place to take full responsibility for VA's compensation, burial, pension, and educational actuarial liabilities and the processes surrounding them.

2. Strengthen controls to ensure the modeling for VA's actuarial estimates is performed by the appropriate level of personnel to:
    a) Conduct the appropriate analyses and validation of data sources.
    b) Review and ensure the reasonableness of assumptions used and document the rationale behind these assumptions.
    c) Consider changes in conditions or programs that require further research and analysis and to update the assumptions when necessary.
    d) Compare estimates with subsequent results to assess the reliability of the assumptions and data used to develop estimates.
    e) Compare the relevant assumptions used in the Department of Defense (DoD) actuary report or other relevant reports/studies to VA's model assumptions; assess their impact, if any, to ensure consistency in trending; document the assessment's results; and update the assumptions when necessary.
    f) Perform sensitivity analyses to determine the effect of changes in the assumptions on these accounting estimates.

3. Develop succession and contingency plans to ensure the required expertise is available before personnel with highly technical and specialized skills leave the agency. As part of VA's succession plan to fill the Chief Actuary position, once hired, as described in GAO's *Standard for Internal Control in the Federal Government* (i.e., Principle 4.05), VA needs to train, mentor, and work to retain a successor. In addition, continued cross-training is recommended, as knowledge of the models should not reside in one actuary. Such succession planning is key to helping VA continue achieving its internal and external reporting objectives.

4. Develop a permanent team with the necessary expertise to estimate VA's compensation, pension, burial, and education liabilities. This should include appointing or engaging a responsible actuary with a qualified actuary to perform quality control reviews, such as a peer review, of the work performed by the responsible actuary.

5. 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.

6. Document the following key elements related to management's assessment of the liability estimates and assumptions:
    a) 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.).
    b) Sources of data used by management in its calculation and any data limitations of which financial statement readers should be made aware.
    c) Assessment that the significant assumptions used by management are reasonable.

7. Revise and update policies, procedures, and process narratives relevant to VBA's accounting and financial reporting of education benefits. In addition, ensure the education liability model is adequately documented in the Standard Operating Procedures, including the model's intended applications and limitations and its key parameters, required inputs, and results of any validation analysis performed. Ensure the data

validation (including the actuary's investigation of data sources, anomalies, etc.), judgments and assumptions used in the modelling are adequately and consistently performed and documented.

2. Community Care Obligations, Reconciliations and Accrued Expenses

Background:

VHA purchases medical services for veterans from community health care providers under its VA Community Care (Community Care) programs. VHA's many different Community Care programs and activities are funded through three different appropriation accounts:

0140 – Medical Community Care
0160 – Expenses, Medical Services
0172 – Veterans Choice Fund

Funds from Account 0160 represent Community Care program funds appropriated in prior years. Starting in FY 2017, VA no longer received Community Care funding through Account 0160. Funding came through Account 0172 and the new Account 0140. In FY 2017, approximately $2.1 billion was appropriated for the Choice program (Account 0172) and $7.2 billion was appropriated for the remaining Community Care programs (Account 0140). Programs associated with Account 0140 cover a range of activities, from inpatient and outpatient care to the Community Nursing Home Program and the Civilian Health and Medical Program of the Department of Veterans Affairs. The combined undelivered orders and accrued expenses for all Community Care programs was approximately $10.3 billion as of September 30, 2017, partially due to prior year carried forward balances.

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 – also referred to as third party administrators – 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. VHA medical centers were also given the authority to enter into provider agreements with local health care providers in order to facilitate the veterans' obtaining hospital care or medical services.

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

EXHIBIT A
Material Weaknesses

Conditions:

VHA continued to have weaknesses in its design and implementation of financial reporting controls over the Community Care 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. Manual and Inconsistent Nature of Estimating Costs of Care in FBCS

When a Veteran is approved to receive care, such as outpatient care, from a non-VA provider, an authorization is established in FBCS. An estimated cost for the care is also entered, but the current pricing tools developed were not consistently used by Community Care staff at the medical centers and by OCC, resulting in Community Care staff using their subjective judgment in deploying their own costing methods and causing a wide variation in amounts estimated. During our testing, we noted numerous examples of FBCS authorizations being overstated compared to the actual payments made. Though OCC in conjunction with the Financial Services Center developed a nationwide dashboard reconciliation process to identify overestimates in late August 2017, the dashboard did not take into account all types of authorizations initiated in FBCS. It also did not cover authorizations issued by VA's contractors under the Choice program. These authorizations are important for financial reporting purposes because they provide a basis for obligations reported in VA's accounting records. In addition, the pricing estimates embedded in the dashboard to calculate certain OCC proposed obligation adjustments at year-end could not be fully validated.

B. Limited Centralized Monitoring of Open Authorizations

OCC did not have a centralized and integrated system to track all Community Care consults from authorization (including secondary authorizations) and pricing (including upward and downward adjustments) – to appointment fulfillment and their ultimate payment. A "look-back" analysis to validate the reasonableness of the pricing tool's cost estimates (such as Patch 27, etc.) was not conducted. In addition, numerous authorizations that had no activity were carried forward from prior years. These authorizations were not validated or monitored at a centralized, nationwide level. Although the aforementioned dashboard reconciliation identified authorizations without activity for more than 90 days as potential adjustments to obligations at the medical centers, the proposed adjustments covered limited programs. As already mentioned, the dashboard was limited in the types of authorizations covered.

C. Pervasive Overstatement of Accrued Expenses

VHA generally obligates its Community Care funds through an estimation process using VA Form 1358, "Obligation or Change in Obligation" (1358s) by category of care, such as inpatient, outpatient, dialysis, etc. (See additional detail on 1358s in Significant Deficiency No. 1.) During our testing, we observed that 1358 obligations reported in VA's financial system frequently did not correlate with authorizations in FBCS. Further, based on our testing and analysis at year end, accrued expenses were overstated by $1.4 billion, which resulted in management recording an adjustment for this amount.

Obligations for Community Care using 1358s are generally established for the entire fiscal year, and as such, have a performance period end date set to September 30, the fiscal year-end date. FMS accrued the entire outstanding balance of a 1358 obligation when the year-end date had passed, regardless of whether goods or services were provided as of period end. As a result, accrued expenses were overstated at year end, and VA management recorded “top-side” journal entries in the approximate amount of $179 million to reverse Choice program over- accrued expenses and $1.3 billon to reverse over accrued expenses for the other Community Care programs as of September 30, 2017. Top-side entries are those entries that VA makes directly into MinX when consolidating and preparing VA’s financial statements. We noted that when VA recorded those topside entries to the accrued expenses, those amounts were reversed back to obligations without further analysis as to their continued validity. A process to validate existing obligations and outstanding accruals was not properly implemented routinely at the transaction level throughout FY 2017 to ensure their accuracy in FMS.

D. Consolidated Reconciliations of Transactions Recorded in FBCS with FMS Identified Material Differences

Nationwide reconciliations between authorizations in FBCS to obligations recorded in FMS consistently identified material variances throughout FY 2017. As of September 30, 2017, the reconciliation for Community Care programs (excluding Choice and categories of care included in the FBCS Dashboard) reported a net and absolute value variance of $1.2 billion. The reconciliation for Choice third party administrator obligations reported a net variance of $120 million, and an absolute value variance of $2.1 billion. The continued material differences indicated that VA did not have a thorough and comprehensive process in place to perform complete reconciliations for all Community Care obligations, and to promptly research and correct any potential misstatements that arose as a result of the reconciliations. Additionally, no process was in place to reconcile Community Care 1358 transactions not authorized through FBCS but recorded in the Integrated Funds Distribution, Control Point Activity Accounting and Procurement (IFCAP) system with FMS.

In addition, liquidation of invalid obligations, including adjustments made based on management’s reconciliation process, 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. Other Transaction Processing Related Issues Affecting Financial Reporting

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

- *Service Organization SSAE 18 Reports and User Controls Mapping* – VA’s service providers underwent an independent examination of their controls, in accordance with Statement on Standards for Attestation Engagements (SSAE), No. 18, *Reporting on Controls at a Service Organization*, published by the American Institute of Certified Public Accountants. VA did not complete its mapping of internal controls instituted by its service providers until after year-end. In addition, as a result of its analysis, VA concluded that the scope of systems and services included in one contractor’s SSAE18 report provided insufficient audit coverage for controls relevant to performing VA’s claims processing, including the intake, providers’ claims processing, invoicing to VA, and quality assurance of its business process. As a result, VA was unable to rely on one major service organization’s controls to determine the impact on VA’s internal control over financial reporting and the effectiveness of these controls.
- *Obligations were not recorded timely* –Delays ranged from three months to nine months.

EXHIBIT A
Material Weaknesses

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 Community Care programs. For example, FBCS 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. Further, cost estimation tools used for obligations were manual and not consistently applied across all medical centers. In addition, FMS's auto-accrual function did not reflect actual liabilities at year-end.

Given the system limitations, the VHA CFO's office led efforts to analyze individual Community Care program obligations against actual expenditures over time to support the reasonableness of current obligation levels and accrual estimates. However, the analysis was provided after year-end without supporting documentation.

We also noted that 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; direct and manage policy compliance and oversight of all Community Care financial management personnel, activities, and operations.

Effect:

These conditions could cause balances for obligations, accrued expenses, and undelivered orders (UDOs), as reported in the financial statements, to be misstated.

Recommendations:

We recommend that the Executive in Charge, Veterans Health Administration:

1. Establish and implement detailed guidance and procedures to assist staff in reviewing open authorizations and obligations and automated accruals for potential adjustment. Include instructions on performing root cause analysis and performing follow-up analysis on aged authorizations and obligations – including direct follow up with medical providers when a transaction has no activity for over 90 days (for appointment and invoicing). Supplement the guidance with training at medical centers and VISNs.

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 Community Care programs.

3. Implement policies, procedures, and a reliable and accepted pricing tool to ensure:

a) FBCS authorization estimation methodology is consistently applied across all medical centers.
b) Validation of obligated amounts is performed monthly and cost estimation methodology is adjusted/revised as warranted.
c) Expired authorization estimates are promptly liquidated from both FBCS and IFCAP.
d) 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. Continue efforts to develop auditable methodologies for establishing and validating Community Care obligations and accruals. Community Care obligations by nature are generally based on estimates, and are set to auto-accrue per the system formula. The obligations as estimates may not reflect the authorized care and accruals may not fairly represent the services provided to the veterans by the year-end date. As the overall Community Care program is still evolving, the methodologies used to calculate the obligations and accrual should be adapted continually to adjust to the risks and operations of the underlying programs. Elements that require a change to the obligation and accrual methodologies should be documented and supported.

5. Expand the periodic look-back validations and analyses on obligation and accrual balances reported for all Community Care programs against subsequent activity to:
   a) Ensure accuracy of financial reporting and to maximize budgetary resources.
   b) Identify significant differences to be investigated and researched.
   c) Adjust the accrual methodology to reflect actual Community Care spending patterns.

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

7. Work with Office of Information and Technology (OI&T) to modernize the information technology (IT) infrastructure supporting key Community Care programs to:
   a) Facilitate data transparency from inception (authorization) to completion (payment and receipt of medical records) that also can be interfaced with the general ledger system.
   b) 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.
   c) Decrease manual processes where possible.

8. Work to ensure the two-way interface of financial data between the FBCS, procurement systems, and the general ledger system is part of VA's ongoing systems modernization efforts. Establish common data elements and fields to facilitate the flow and reconciliation of information between the general ledger and subsidiary systems, including Electronic Contract Management System (eCMS), FBCS, etc. to facilitate a consolidated, comprehensive reconciliation between FMS and the various subsidiary systems where the underlying transactions are initiated.

9. Work with the service provider to ensure the service provider's SSAE report will support VA's reliance on its systems and services. Continue to assess and document the results of the service provider's SSAE 18 report, including any risk to VA due to control deficiencies at the service provider, and ensure compensating controls are implemented at OCC. Ensure the OCC completes its service provider monitoring program to verify that its service organizations' controls relevant to performing VA's claims processing are working effectively.

3. Financial Reporting

Background:

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, incorrect budget mapping tables, accounting attributes (Direct vs. Reimbursable, Fed vs. non Fed, etc.) and transaction codes are not USSGL compliant. Due to FMS's 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.

Conditions:

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), 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 along with VA's Financial Service Center 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 2017, VA's financial reporting issues continued to exist or emerged 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 Veterans Health Information Systems and Technology Architecture (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. Although FMS returns transaction processing results (such as success/failure or accept/reject status) for some of these subsidiary systems, this is not considered a two-way interface.

In addition, the interface from the Long Term Solutions system (LTS) 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. However, the payment data in BDN does not feed back into LTS to show the entire history from eligibility and entitlement determinations, to actual payments processed.

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. Subsidiary systems where the financial events were initiated, were not always the systems that directly fed information into FMS, which further exacerbated the reconciliation issues.

B. Extensive Use of Journal Vouchers

Despite significant improvements, VA still recorded a large number of adjustments, called 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 86 percent of the overall MinX JVs' absolute value, created a complicated and labor-intensive financial reporting environment. The majority of JVs were due to incorrect budgetary posting, correction of trading partner data, and input of actuarial estimates after quarter-end. 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.

C. Issues with Inter-Agency Agreements and Reconciliations

VA does not have a centralized repository for all active intra- and inter-agency agreements to support and facilitate its transaction level research and reconciliation. 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 at the transactional level was performed to ensure their agreements. Intra-governmental differences by trading partner for VA was approximately $3.2 billion of which $1.4 billion is related to unresolved differences. In addition, $938 million of the $1.4 billion was attributed to intra-VA transactions as of June 30, 2017.

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 VA's trial balance submission to pass GTAS edits. The JVs recorded by management included categories such as "No Trading Partner," "IntraVA," "Unknown," etc.

D. Recording of Prior Year Budgetary Recoveries

Due to FMS system limitations, VA was unable to provide a report with transactional level details that supports its recoveries of prior year unpaid obligations (recoveries) without extensive manual efforts. VA initially reported approximately $3.5 billion as recoveries at September 30, 2017. 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 $900 million to adjust the recovery balances recorded in FMS.

In addition, certain Community Care recovery transactions were either not supported by documentary evidence or processed in a timely manner.

E. Budgetary to Proprietary Analyses Contained Material Differences

VA performs "Budgetary to Proprietary" account analysis by Treasury Fund Symbol to fix out of balance accounts. 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 2017.

F. 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, 2017. 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.

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

VA continues to not have a centralized and consolidated process to properly report, reconcile, and monitor the outstanding unapplied deposit/clearing account activities, which resulted in year-end reporting with over $2 billion of transactions in absolute value, relating to the net value of $176 million in Note 3, Fund Balance with Treasury, to the financial statements. Management was unable to provide a detailed report containing valid and outstanding transactions that still needed to be researched and applied to the proper account at year-end.

EXHIBIT A
Material Weaknesses

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:

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) complete inventory, proper accounting and monthly reconciliation of intra and interagency agreements 3) reporting for recoveries transactions, 4) budgetary to proprietary analyses, and 5) researching and clearing of abnormal balances and deposit/clearing account activities. 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 Acting Assistant Secretary for Management and Acting Chief Financial Officer:

1. With respect to FMS reconciliations with subsidiary systems:
   a) Perform an enterprise risk management (ERM) review that includes all of VA's subsidiary systems to inventory all types of VA's financial transactions and how they are initiated, interfaced, and ultimately recorded in FMS. Such an analysis can be performed in conjunction with the system modernization efforts including identifying the gaps and developing gap alternatives to address the systems that will not be part of the modernization.
   b) After such mapping is performed, management should establish a risk register for each of those systems and prioritize system modernization or institute system fix efforts. Work with the OI&T and the relevant business offices to ensure complete and consolidated reconciliations between those subsidiary systems and the general ledger system are performed on a monthly basis. Reconciliations should start with the subsidiary systems where the transactions are first initiated. This ERM assessment should be done in a consolidated and integrated manner. In addition, as VA is decentralized and the need for digital information transparency and accuracy is great, management should stay apprised of other advancing technologies that would provide VA the ability that once a transaction is initiated, it could be automatically tracked and recorded all the way through without further manual input.
   c) In the meantime, prior to system modernization, FMS cumulative reconciliation with the

subsidiary systems should be strengthened and performed to ensure complete and consolidated reconciliations between those subsidiary systems and FMS are performed on a monthly basis.

2. With respect to JVs:

Continue to implement policies and procedures:

a) Ensure that VA strengthens the JV recording process to set controls surrounding the research and review of account differences and subsequent adjustments. The process and controls should include:
   i) Standardized categories of JVs, including the type of journal entries to be recorded throughout VA. Since this was implemented recently (late FY 2016), training or other forms of communication are recommended to ensure the groupings are consistently applied across JVs in MinX.
   ii) 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.
   iii) Requirement to have an additional layer of review for significant entries to ensure their accuracy and appropriateness before posting.
b) Once the JV process has been standardized, monitoring should be performed to ensure that the policies and procedures are being implemented properly:
   i) Perform a pro forma analysis to validate major accounting entries with their posting logic and attribute settings in FMS before posting. 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, correcting posting errors, timing differences, or unusual one-time entries, etc.).
   ii) Perform an analysis over recurring, monthly MinX JVs used to adjust FMS balances to the SF-132 and the SF-133 and follow up with the budget officials as to the discrepancies noted. 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, continuing resolutions funding calculations, etc.). Provide the necessary education and training to ensure the proper recording of budgetary transactions from the onset.
   iii) Monitor and analyze JVs used in order to further reduce the volume. Update standard operating procedures and improve business processes when necessary to reduce the use of JVs. Provide and distribute the trending analysis from period to period as to the number of adjustments recorded to ensure the corrective actions are being implemented by responsible parties.
   iv) Continue reviewing and researching all JVs recorded in the FMS Station 151 default account and reclassify them to the proper funds and accounts promptly.

3. With respect to intra-governmental agreements and reconciliations:
   a) 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:
      i) Determine whether balances are recorded in FMS accurately.
      ii) Ensure that agreements in the repository reflect an active or closed status.
   b) Consider whether closed agreements need to be renewed, maintained in the repository or archived.

c) Document VA policies and procedures on the use of a centralized repository. The document should be communicated across VA. In addition, a user manual should be readily available in the repository. The repository system and the manual should include:
   i) Definition of what constitutes an inter-agency agreement versus an intra-VA reimbursable agreement, including completed sample forms of those agreements for reference.
   ii) Available electronic forms readily accessible and available for user completion and upload of the forms.
   iii) A complete listing of all related accounting treatments.
   iv) A step-by-step guide on how to upload and execute the agreements with trading partners, and a requirement to ensure those uploaded agreements are correct and current via automated edit checks.
   v) Clarification as to the required data fields versus less important but informative data fields.
   vi) Electronic means of tracking an agreement from its inception to its finalization, along with the various levels of review and approval documented in the system.
   vii) A checkbox for intra-VA reimbursable transaction included in the on-line electronic form. When the checkbox is checked off, an intra-VA transaction that includes both sides of the buyer-seller transaction should be initiated and properly recorded. An edit check function should be enabled to ensure it happens.
   viii) Automatic notification to the agreement holder (i.e., party that is executing the agreement) when the agreement is expiring in 60 days and also when it has expired.
   ix) Two way interface between the repository and the general ledger system when a transaction occurs.
   x) Automated cumulative reconciliation between the repository system and the general ledger system performed monthly.

d) Produce reports on transactions with other Federal agencies with sufficient detail to link those transactions to relevant interagency agreements. Implement a monthly reconciliation process with trading partners and amongst VA Administrations on intra-agency reimbursable agreements.

e) Fully implement the Treasury Financial Manual processes described in Volume I, Part 2, Chapter 4700, Appendix 10, *Intragovernmental Transaction Guide*, issued in July 2017, Section 2.3, for:
   i) Authoritative Source Reconciliation (subsection 2.3.1)
   ii) Material Difference Reports (subsection 2.3.2)
   iii) Root Cause/Corrective Action Plan Process (subsection 2.3.3)
   iv) Dispute Resolution Process (subsection 2.3.4)
   v) Measure IGT Activity/Scorecards (subsection 2.4)

f) Provide training to budget, program and financial management staff on the use, accounting and reconciliation of intra-VA and inter-agency reimbursable agreements to ensure their proper implementation throughout VA.

4. With respect to prior year budgetary recoveries:
   a) Implement a process to validate the transactions included in the details supporting prior year recoveries.
   b) Develop procedures to perform monthly reconciliations of the prior year recoveries detailed report to the trial balance.

5. With respect to budgetary to proprietary analysis and abnormal balances:
   a) 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.

b) 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.

6. With respect to deposit/clearing account activities:
   a) Develop a centralized process to identify and reconcile all deposit/clearing activities. The report supporting the deposit/clearing accounts should contain valid and outstanding transactions that still need to be researched and applied to the proper account. Perform analyses to identify issues/trending such as transactions not resolved in 60 days, administrations or stations with the most outstanding transactions, etc. to implement targeted corrective actions. 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.

7. Upon system modernization efforts being completed, update the OMB Circular A-123 business process 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 JVs, budgetary to proprietary analysis, abnormal balance review, and intra and inter-agency reconciliations.

We recommend that the VHA CFO and Acting VBA CFO:

8. Work with the Acting Assistant Secretary for Management and Acting 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

4. Loan Guarantee Liability

VA's Home Loan Guarantee program provides a guarantee 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 over the life of the loans and determine the cost of these guarantees on a present value basis for budgetary and for financial reporting purposes. These models ultimately produce an estimate that is reported as part of the Liability for Loan Guarantee (LLG) in the balance sheet. To accomplish its mission, VBA uses the services of two service organizations in conducting its loans operations.

VBA's Office of Resource Management (ORM), headed by VBA's acting CFO, is responsible for preparing the LLG estimate and maintaining the models. ORM considers its model to be an econometric model and does not coordinate with the Office of Enterprise Integration's Office of Predictive Analytics and Actuary. However, similar to Material Weakness No. 1, "Compensation, Pension, Burial and Education Actuarial Estimates," we observed significant management oversight issues with this liability estimate. This material weakness should be read in conjunction with Material Weakness No. 1.

EXHIBIT A
Material Weaknesses

Conditions:

A. Liability for Loan Guarantee (LLG) Estimate Has Been Consistently Misstated

ORM has consistently produced LLG estimates that have been misstated over several years for financial statement reporting purposes. Material misstatements have necessitated year-end adjustments to financial statements. These misstatements are due to structural deficiencies in ORM's model, a deficient internal control and governance environment, and inaction on the part of ORM to address model deficiencies identified by its own independent verification and validation analysis and by CLA.

We identified a minimum overstatement of approximately $1.4 billion in the LLG estimate produced by ORM for the FY 2017 financial statements to reduce the LLG estimate for home loans guarantee from $10.8 billion to $9.4 billion. The VBA model estimate was also overstated and adjusted by approximately $800 million in FY 2016.

These audit adjustments were the outcome of a combination of deficiencies identified in VBA's estimating processes and internal controls as detailed below:

1. VBA Estimating Model Structural Deficiencies:

   The VBA Housing Models (models) are the source systems for calculating the LLG accrual estimate (estimate). The estimate has been consistently misstated for several years. The estimates were consistently understated for several years following the housing crisis that started in 2007, as VBA's experience from loan defaults (i.e., claims or cash outflows) was not captured quickly enough by the model. Conversely, the model started incorporating the housing crisis data after claims had already been paid. It did not properly assess the lower risks in the new loan portfolio going forward, resulting in the model overstating the claims estimate.

   Specific limitations identified within the VBA model include:

   - The model is a cohort level single stage model versus a loan level model with multiple components to estimate the probability of default, prepayment and loss-given-default separately.
   - The model does not include underwriting characteristics such as mark-to-market loan-to-value variables to account for geographic specific housing price appreciation.
   - The model uses a moving average methodology versus predictive modeling that is able to factor in the fundamental drivers of the cash flows and cohort performance.
   - Sufficient documentation of the model's operations, source data, testing, sensitivity analysis, adjustments, changes in assumptions, and overrides was not provided.
   - The model's forecasting of zero fee refunds beyond policy year two indicates management bias in the LLG estimate as the fee refunds historically occur after policy year two.

   The limitations in the VBA models and lack of adequate internal controls, as described below, were also cited in a report issued in October 2017 by a firm hired by VBA to perform an independent verification and validation of the VBA models. Similar results were reported by another VBA hired study in 2012. CLA has communicated the overall control deficiencies identified above to VBA leadership since 2010. Not implementing corrective action timely is by itself an internal control deficiency.

These structural deficiencies have impacted VBA's ability to effectively forecast future program cash flows. Cash flows are generated from such activities as paying claims (a cash outflow) and recoveries (an inflow). The present value of the anticipated future net cash outflows represents the estimated liability that VA reports on its balance sheet.

VBA models project cash flows by year up to the maximum 30-year life of a loan. Those models have consistently shown significant differences between the model forecast and the actual program performance ranging from $244 million to $1.3 billion during the past five years, with the difference being $1.3 billion for FY 2017 and $1 billion for FY 2016, respectively.

2. Internal Control Environment and Model Governance Is Deficient

   VBA does not have a defined and documented process for engaging and involving senior leadership outside of the budget office within ORM for critical decisions and oversight over various loan guarantee subsidy modeling activities, including; model development, risk assessment, assumption development and review, and model validation. Currently, management decisions on VA model assumptions and revisions are heavily dependent on one person, the Director of VBA Credit Reform. The complexity and subjective nature of modeling require a peer review by a person experienced with the housing modeling to ensure appropriate and unbiased judgments are used in developing the estimates.

B. Service Organization SSAE 18 Reports and User Controls Mapping

VBA uses the services of two service organizations in conducting its loans operations. One service organization provides hosting and manages the technology operations relating to the Veteran Affairs' Loan Electronic Reporting Interface (VALERI). VALERI enables mortgage servicers to report loan events through their web portal user-interface within VALERI. A second service organization provides real estate owned (REO) asset disposition and related services to VA. Both service providers issue Service Organization Control (SOC) reports regarding their controls relevant to the user entities' internal control over financial reporting.

VBA, as a user entity of significant systems, does not timely review the appropriateness, adequacy or effectiveness of its service organizations' internal control as part of evaluating its internal control over financial reporting. The SOC reports of the service organizations are issued and received after the fiscal year end which does not allow VBA to timely execute its management oversight for the financial reporting period.

If VA cannot require both service organizations to provide their SOC reports within the current fiscal year to allow VA to timely assess the service organizations' internal control, VA management should document its mapping of internal controls instituted by its service organizations and its own implementation of compensating controls to avoid over-reliance on contractor processes and contractor-provided data.

Criteria:

Federal Financial Accounting and Auditing Technical Release (TR) 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.

GAO Green Book, *Standards for Internal Control in the Federal Government*, makes management responsible for the performance of processes assigned to service organizations. Management should understand the controls each service organization has designed, has implemented, and operates for the assigned operational process and how the service organization's internal control system impacts the entity's internal control system.

Cause:

ORM has refused to implement our recommendations made over many years to improve its model and has been very reluctant at times to adjust its estimates. ORM management has stated concern about introducing inconsistencies between VBA's budget estimates for the loan guarantee program and the financial statements and has represented that OMB approved the model. However, neither of these statements removes management's responsibility to prepare financial statements in accordance with generally accepted accounting principles.

Since 2008, VBA has not updated its policies and procedures outlining key aspects of its model risk management activities and how they are to be performed. 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:

The deficiencies reported above may result in significant misstatement of the LLG liability and related accounts within the financial statements, and ineffective monitoring and oversight by those parties ultimately responsible for these estimates.

Recommendations:

We recommend that the Acting Assistant Secretary for Management and Acting CFO, the Acting Assistant Secretary for Enterprise Integration, and the Acting Under Secretary for Benefits work together to:

1. 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.

2. Develop and implement a comprehensive set of policies and procedures surrounding the full life cycle of the modeling process that include model risk management, model governance, model development, use and validation. Such documentation would include the following:
   a) Definitions of the key elements of the model governance structure
   b) Governance process
   c) Model development process, standards and controls
   d) Model performance standards and tracking
   e) Model inventory management
   f) Data, assumption, and model risk assessment processes
   g) Controls over analyses and alternate scenario calculations
   h) Model documentation and user manual development practices
   i) Procedures for managing system controls and models security
   j) Procedures for capturing information on, prioritizing and planning for model updates, revisions or corrections resulting from risk management activities

3. Implement the guidance provided in Appendix A: Acceptable Sources of Documentation for Subsidy Estimates and Reestimates in the Federal Financial Accounting and Auditing Technical Release 3 (Revised) Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act.

4. Implement the 23 recommendations in the VA Budget Model Validation Report issued in FY 2017.

5. Implement the recommendations in the CLA FY 2017 independent assessment report of the VA models.

6. Request from the two service organizations their annual SOC reports on a cycle that matches VA financial statement reporting cycle. Assess and document the results of the service providers' SSAE 18 reports, including any risk to VA due to control deficiencies among the service providers, and compensating controls implemented by VBA. Complete its service provider monitoring program to ensure that its service organizations' controls relevant to performing VA's guarantee loans' related processing are working effectively.

5. CFO Organizational Structure

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 continues to weaken its compliance with the Chief Financial Officers Act of 1990 (CFO Act) and its internal control system. Fulfilling these responsibilities is inherently more difficult in a decentralized and fragmented organization where accountability follows the same decentralized structure. Breakdowns in internal control systems become more likely as needed communication and coordination across complex and layered internal organizational boundaries becomes more difficult to achieve. Based on our observations of the overall control environment, and through the results of our testing, we noted that overall accounting, financial management and financial reporting risks are not being effectively managed at the highest level of governance. This fragmented reporting structure is a contributing factor to the multiple weaknesses described below.

A. Responsibility and Accountability for VA’s Financial Management Is Divided

The Assistant Secretary for Management is VA’s statutory CFO, as required under the CFO Act. 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 the National Cemetery Administration (NCA), have their own CFOs, who oversee financial management operations and follow the chain of command within those organizations. These CFOs have reporting lines of authority to the head of their components, not to the VA CFO.

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 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 at VA components 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, continued to remain fragmented with financial personnel reporting up various chains of authority, with only one comparatively small group reporting to the VHA CFO. Overall, VHA’s financial management functions are currently managed by three categories of CFOs - the VHA CFO, the OCC CFO, and the 18 VISN CFOs through the Deputy Under Secretary for Health for Operations and Management. The VISN CFO structure includes more than 200 individuals who are VISN CFOs, medical center CFOs and program office budget officials. This structure results in ineffective design and operation of internal controls for significant business cycles across VHA. The VHA CFO’s responsibilities are limited and do not have direct authority over the activities of the other CFOs. A centralized and strategic process to oversee and effectively manage the financial management risks of VHA as a whole was not in place throughout FY 2017.

EXHIBIT A
Material Weaknesses

B. Examples of Difficulties in Financial Management Governance and Coordination

The CFO's overall monitoring efforts on key accounting and financial reporting issues, and resource management to ensure the high priority risks are attended to and properly addressed early on during the audit process, still needs significant improvement as those matters were carried from the prior year. We observed numerous instances where the lack of effective oversight and lack of overall financial management and accountability in VA's CFO organization structure contributed to material weaknesses cited in this report.

- *Compensation, Pension, Burial and Education Actuarial Estimates:* The compensation, burial, and education actuarial estimate is the largest number in VA's consolidated financial statements—over $2.9 trillion. Corrective actions recommended in our prior year report, along with management's assessment of Chapter 33 estimation uncertainty and the development of liability models for Chapter 30, 31, and 35 education programs, were implemented near or after year-end. The very late effort to develop estimation methodologies with supporting data placed the modeling estimates at risk. In addition, the acting VA and VBA CFOs, and the OEI were unable to ensure a Chief Actuary was in place to manage and take full responsibility, including performing quality control reviews, for the actuarial models. Although VBA management does not believe this finding resulted from the CFO organizational material weakness, we noted that the operation of the current CFO organizational structure as a whole was unable to effectively resolve this material weakness concerning the actuarial estimates critical to VA's financial reporting.

- *Community Care Obligations, Reconciliations and Accrued Expenses:* The obligations and accrued expenses for Community Care programs are material to VA's consolidated financial statements. Primary financial management responsibility rests with the OCC. Although the OCC has retained the authority related to Community Care programs, effective monitoring controls had not been implemented to evaluate financial management results to ensure compliance and consistent application of established controls, such as the use of similar and consistent practices in cost estimation for obligations and the management of authorizations for non-VA care. Such differences can lead to variations in estimates when compared to actual obligations. 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. Further, as Community Care funding increases, the OCC assumes more financial responsibility instead of the VHA CFO, resulting in further erosion in the VHA CFO responsibilities.

- *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 intra and inter-agency reconciliations, use of JVs, accounting for prior year recoveries, budgetary to proprietary account comparisons, and research and resolution of abnormal balances. We observed numerous instances where VA's major components had not effectively implemented or completed these procedures.

- *Loan Guarantee Liability:* VBA did not have a defined and documented process for engaging and involving senior leadership outside of its budget office for critical accounting estimate decisions and oversight over various loan guarantee subsidy modeling activities. As a result, a number of structural deficiencies in the design of VBA's variable default model and cash flow model (VBA models) that impacted VA's ability to effectively forecast future guarantee loan program cash flows persisted. Significant differences existed between the model forecasts and actual program performance.

C. Noncompliance with the CFO Act

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. Each agency CFO is to report directly to the head of the agency and is responsible for key financial activities within the department, including:

- Overseeing all financial management activities relating to the programs and business operations of the agency
- Directing, managing, and providing 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
- Developing and maintaining 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 overseeing all financial management activities at VA.

Criteria:

The CFO Act of 1990 stipulates the following:

Sec. 902. Authority and functions of agency Chief Financial Officers, states:
"a. An agency Chief Financial Officer shall—

1. report directly to the head of the agency regarding financial management matters;
2. oversee all financial management activities relating to the programs and operations of the agency;
3. develop and maintain an integrated agency accounting and financial management

system, including financial reporting and internal controls, which—

A. complies with applicable accounting principles, standards, and requirements, and internal control standards;
B. complies with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget;
C. complies with any other requirements applicable to such systems; and
D. provides for--
    i. complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management;
    ii. the development and reporting of cost information;
    iii. the integration of accounting and budgeting information; and
    iv. the systematic measurement of performance;

4. make recommendations to the head of the agency regarding the selection of the Deputy Chief Financial Officer of the agency;
5. direct, manage, and provide policy guidance and oversight of agency financial management personnel, activities, and operations, including-
    A. the preparation and annual revision of an agency plan to-- (i) implement the 5-year financial management plan prepared by the Director of the Office of Management and Budget under section 3512(a)(3) of this title; and (ii) comply with the requirements established under sections 3515 and subsections (e) and (f) of section 3521 of this title;
    B. the development of agency financial management budgets;
    C. the recruitment, selection, and training of personnel to carry out agency financial management functions;
    D. the approval and management of agency financial management systems design or enhancement projects;
    E. the implementation of agency asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control;
6. monitor the financial execution of the budget of the agency in relation to actual expenditures, and prepare and submit to the head of the agency timely performance reports."

Cause:

VA's CFO organizational structure has historically been decentralized. The decentralization of financial management functions among the VA component entities without any organizational reporting and accountability back to the VA CFO has greatly diminished the VA CFO's ability to affect financial management at the components, which could ultimately result in material errors in financial reporting going unaddressed or undetected.

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's responsibilities, there is a lack of effective and centralized 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. At a minimum, provide the VA CFO office with sufficient authority to oversee all financial management activities relating to the programs and operations of the agency. The VA CFO should have specific formal authority and active participation for:
   a) Approving job descriptions and skill requirements for those who head VA components' financial management activities and operations.
   b) Participating in the selection and recommendation of those individuals.
   c) Participating in their annual performance evaluation.

2. Implement ERM in accordance with OMB Circular A-123. As part of this implementation:
   a) Enable the VA CFO's office to centralize and consolidate its oversight and monitoring role.
   b) 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.
   c) Work to develop a transparent and accountable culture to:
      i) Openly share information regarding its financial analyses, including root causes of issues/findings, best practices and engage responsible parties to actively address financial management and reporting risks.
      ii) Work with responsible parties to implement corrective actions to timely address and mitigate the identified issues/risks.
      iii) Encourage communication and collaboration under the CFO's leadership to establish working level committees to resolve any identified accounting, financial management, and financial reporting issues.
      iv) Involve other stakeholders such as key leaders from Acquisition, Logistics and Asset Management to collaboratively address financial management issues and develop risk mitigation strategies.
      v) Provide the necessary financial management training and performance monitoring to continuously elevate the financial management capabilities and knowledge within VA.

We recommend that the Executive in Charge, Veterans Health Administration:

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 programs and operations. All VA 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 should be consistent with VA CFO's recommended above and include the following:

a) Developing and maintaining integrated accounting and financial management systems;
b) Directing, managing, and providing policy guidance and oversight of all VHA financial management businesses processes, key financial activities, and operations;
c) Approving and managing VHA financial management systems design and enhancement projects;
d) Implementing VHA asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control;
e) Monitoring the financial execution of the VHA budget in relation to actual expenditures;
f) Ensuring the proper and consistent implementation of corrective actions for key audit findings throughout VHA. Developing a financial management matrix and sharing its monitoring results with the field staff. Implementing follow-up actions to ensure corrective actions are taken in a timely manner;
g) Providing timely and necessary communication and training to field staff and program offices; and
h) Participating in the annual performance evaluation of the field staff when performance improvement is needed.

6. Information Technology Security Controls

VA relies extensively on 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 - 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 major 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 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, significantly improving the use of two-factor authentication, implementing an enhanced audit log tool, improving the overall system authorization process, 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. Further, VA has continued the implementation of an IT Governance, Risk and Compliance 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, OI&T did not accept responsibility to manage the configuration and security of these devices in

accordance with VA policy.

- Although VA continued to document and implement new baselines, weaknesses remain 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. In addition, VA's baseline security process does not address emerging security threats and vulnerabilities that could adversely impact mission critical 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 has made progress by expanding automated software monitoring and continues to work 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 and privacy 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 was not accurately reporting and concluding on the status of controls within their operating environment for the regional level System Security Plans. Specifically, VA's approach did not consider the sites in the region that did provide a response regarding the implementation of security controls. Therefore, this reporting method did not accurately depict the implementation status of controls throughout the Region. In addition, Medical and Special Purpose Systems were assigned to the Regional General Support System boundaries; however, the inventory of these devices was not reflected in the associated system security plans and the control implementation details specific to these devices were not addressed.
- VA issued Authority to Operate to several systems prior to completion of the Security

Control Assessment (SCA); contrary to VA policy. SCA's are performed to assess the operating effectiveness of operational, management, and technical controls of a system.

- System Risk Assessments did not always reflect the current operating environment, address all relevant risks, or include responses to address identified risks.
- 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. In addition, there is no centralized method for monitoring the investigation status of contractors.
- Plans of Action and Milestones (POA&Ms) were not consistently updated to incorporate all known control weaknesses, reflect changes to milestones, and documentation was inadequate to support closed actions.

Contingency Planning

- Contingency plans were not tested to ensure failover capability to alternate processing sites and to ensure that recovery efforts could be accomplished at designated locations. In addition, certain financial applications were not able to be recovered within stated Recovery Time Objectives during annual contingency and disaster recovery exercises.
- Backup tapes were not encrypted for all systems across the agency.

Criteria:

OMB Circular A-130, *Appendix I, Responsibilities for Protecting and Managing Federal Information Resources,* 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 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. 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. Further, key financial management systems use outdated technology that hinders mitigation of certain security vulnerabilities. Without remediating all significant security vulnerabilities, systems could be compromised resulting in potential harm to confidentiality, integrity, and availability of VA sensitive data.

Recommendations:

The Executive in Charge for the Office of Information and Technology should continue to analyze and prioritize remediation efforts to accomplish security and control objectives. Key tasks should include, but are not limited to:

EXHIBIT A
Material Weaknesses

1. Implement improved processes 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.

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 and protected from other networks.

5. Implement processes to consolidate the security responsibilities for local facility systems not currently managed by OI&T 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 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.

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 security control implementation status and risks are accurately reported to support a comprehensive risk management program across the organization.

19. Implement an improved process to monitor and update information system inventories and control details to ensure an accurate account of information system components including medical devices and special purpose systems.

20. Implement an improved continuous monitoring program in accordance with the National Institute of Standards and Technology Risk Management Framework. Specifically regarding evaluating the effectiveness of security controls prior to granting authorization decisions.

21. Implement improved processes for reviewing and updating key security documentation, including risk assessments on an annual basis or as needed. Such updates will ensure all required information is included and accurately reflects the current environment, new security risks, and applicable Federal standards.

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

23. 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.

24. Strengthen processes to ensure that plan of action and milestones are developed for known weaknesses and they are tracked and updated in a timely manner.

25. Implement improved processes to ensure closed plans of action and milestones are adequately supported with appropriate documentation.

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.

27. Implement improved processes to ensure the encryption of backup data prior to transferring storage media offsite.

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's overall monitoring of obligations and accrued expenses needed improvement during FY 2017, excluding the Community Care program, which is reported as a material weakness in Exhibit A. Certain control deficiencies continued to exist as the year-end adjustments to account for accrued expenses were projected to be approximately $1.6 billion.

A. Reconciliations

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. Lack of Control Surrounding the Extensive Use of 1358s

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, 2017, VA's obligations based on 1358s approximated $4.1 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. Lack of Comprehensive Look-back Analysis

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 majority of the year. Management recorded top-side journal entries in the approximate amount of $990 million to reverse over-accrued expenses for vendor pay obligations at September 30, 2017. We noted that when VA recorded these top-side entries to the accrued expenses, those amounts were reversed back to obligations without any analysis as to their continued validity.

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 four months to three years.
- *Untimely recording of contracts or modifications into the general ledger system (FMS)* – Delays ranged from approximately two months to eight months.
- *Recording of obligations prior to contract execution* – Obligations, including purchases through the National Acquisition Center (NAC), were recorded in FMS up to 1 year and 1 month prior to the execution of the contracts or 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.

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 Acting Assistant Secretary for Management and Acting Chief Financial Officer:

1. Work with OI&T 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:
   a. 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.
   b. 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.
   b) 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.
   c) Work with OALC to establish the necessary acquisition structure and provide training to 1358 preparers and approvers on the use of contracts, inter-agency agreements, and reimbursable agreements in place of 1358s.
   d) 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 VA's GTAS reporting.

5. Develop a mechanism to document the intra-VA reimbursable transactions that include the following terms and conditions to facilitate intra-VA transaction reconciliation:
   a) Goods and/or services to be provided
   b) Applicable legal authorities

c) Expected period of performance to meeting the ordering agency's needs
d) Period of availability of the funds (which should not conflict with the agency's budget restrictions, such as period of funds availability for the use of funds)
e) Beginning and termination dates of the agreement
f) Total estimated costs for which the requesting agency/administration office will obligate funds
g) That actual costs incurred by the seller agency/administration office will be reimbursed
h) The method and frequency of payment
i) Any relevant financial data elements to be included, etc.

6. 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.

7. With respect to accrued expenses:
   a) 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.
   b) 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 Executive in Charge, Veterans Health Administration, Acting Under Secretary for Benefits, and the Principal Executive Director, OALC in coordination with the Acting Assistant Secretary for Management and Acting Chief Financial Officer:

8. 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.
   a) 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.
   b) 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.

9. Continue to implement VA's Financial Policies and Procedures to ensure the following:
   a) Dollar amounts in FMS accurately reflect the status of the obligation.
   b) Timeframe for the obligation recorded in FMS is valid (i.e., both the beginning and end dates are correctly reflected in the obligation).
   c) 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.
   d) Obligations are reconciled to source documents, to include obligating documents, receiving reports, invoices and payments.

e) Aged obligations are valid and recorded correctly.

10. 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 the record (e.g., procurement files, signed contracts, etc.).

11. Provide the necessary periodic training and implement controls at the facility level to strengthen staff's knowledge and compliance with 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.

12. 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.

13. Establish an automatic notification mechanism in which the Contracting Officer's 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.

14. Monitor active interagency and reimbursable agreements where a VA party 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.

We recommend that the Executive in Charge, Veterans Health Administration, Acting Under Secretary for Benefits, and the Principal Executive Director, OALC:

15. 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.

16. Implement reconciliation controls to ensure stations timely liquidate their excess obligations upon the issuance of NAC purchase orders so that the amounts obligated in VHA's account agree to the reimbursement amount to be paid to NAC.

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, including the data processing control environment reported in Material Weakness No. 6.

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's 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's functionality limitations are further exacerbated due to the age of FMS.

As reported in previous years, complete and consolidated reconciliations between FMS and the following subsidiary systems were not performed throughout FY 2017:

- *Integrated Funds Distribution Control Point Activity, Accounting and Procurement System (IFCAP)*. IFCAP is a module within *VistA* that is used by VHA, contracting officers, and other VA personnel to initiate and authorize purchase requisitions for goods and services, as well as to accumulate vendor invoices for payment. Because the commitment accounting module was not activated during the implementation of FMS, obligations in FMS are recorded based on approved purchase requisitions or 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 $25,000 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 Health Information Systems and 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 Community Care programs. FBCS sits "on top" of VistA and is run in a decentralized manner similar to VistA. In addition, FBCS does not enable the end users to make adjustments to inpatient authorizations after the authorization is approved in FBCS. As a result, the system does not allow for upward or downward adjustments in estimates based on a patient's changing needs, causing reconciling items to permanently exist between FBCS and FMS. Further, automated and comprehensive nationwide reconciliations between authorizations initiated in FBCS and obligations recorded in FMS could not be performed due to the lack of system interface between FBCS and FMS, resulting in a wide variety of reconciliation issues.

In addition, 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.
- The Education Benefits for the various programs are processed using different applications (e.g., BDN, LTS, C-WINRS (system used to process chapter 31 benefits), FOCAS (system used for Flight on the Job Training program), TIMS (The Image Management System), etc.); some of which do not interface with FMS. Further, due to the

limited functionality of these systems, intensive manual efforts are necessary to adjudicate and process education benefits. These manual processes create additional inherent risk and leave room for error.

Furthermore, certain subsidiary systems were not integrated with each other resulting in additional manual input that produced inefficiencies and manual errors. For example, for veterans who submit applications for Education benefits through the VA Online Application System (VONAPP), the applications are scanned into TIMS and then manually input into LTS for the processing of each initial claim. The lack of information interface from VONAPP to LTS creates additional inherent risk and leaves room for manual input error.

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

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

- 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, 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 does not allow for 6 digit USSGL account reporting as required by Treasury Financial Manual.
- FMS is outdated and unable to keep up with the existing Treasury reporting requirements.
    - 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-Federa l transactions. However, mapping issues prevent the proper application of Federal and non-Federal attributes when a business event occurs. This situation created the need for VA to record significant journal vouchers.
    - 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 2017 by strengthening VA Administrations' use of the Entity Level Internal Control Assessment (ELICA) tool to assess VA wide entity level risk and to consolidate various on-going assessment efforts throughout VA to increase efficiency. The tool added consideration for Service Organization controls and charge card assessment. VA's Internal Control Program Management Office (ICPMO) also provided enhanced training efforts on completing the ELICA tool. In addition, VA aligned their program narratives to 12 business processes and prioritized them with consideration for VA's ongoing Financial Management Business Transformation (FMBT). However, according to management, efforts were invested in certain processes that will be impacted by the system modernization initiative.

EXHIBIT C
Compliance Findings

As a result of this management decision, improvement is still needed with respect to the process for preparing the Secretary's signed statements of assurance. These assurances are summarized by OMB updated 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)
- A summary of material weaknesses (FMFIA § 2), instances of non-compliance (FMFIA § 4), a summary of the assurance (unmodified, modified, or no assurance), and a summary of corrective actions to resolve the material weaknesses and instances of non-compliance.

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.
- Interim ELICA tools and assurance statements from VA's Reporting Entities' (REs') were not completed timely and not in accordance with the guidance provided by ICPMO.
- Inconsistencies existed between the control deficiencies identified in the interim ELICA tool completed by the REs and the REs' interim assurance statements.
- Material weaknesses were not properly identified by the VA Administrations along with their corrective actions.
- 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.
- VA ICPMO has not been able to provide a listing of how the REs align their programs and operations to the internal control assessment process to ensure all key VA offices are accounted for in the annual entity level assessment.
- VA's process for assessing and monitoring department-wide internal control of information and financial management systems continued to be ineffective. The previously reported material weakness in VA's IT security controls continued to exist in FY 2017.

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, 21 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, 10 of the 15 items tested were outstanding over 90 days. VBA did not charge interest or administrative costs on any of the 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.

As a result of the directive, 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 $3.5 billion in VA financing for foreclosed properties from FY 2013 through FY 2017. 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. VA completed the appropriate rulemaking to address issues that halted the vendee loan program in August 2017. However, the program was not yet fully operational as of September 30, 2017.

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 one violation of the Antideficiency Act, 31 U.S.C. 1341(a) in January 2017, and is in the process of reporting five other violations. VA is also investigating one possible violation of the Antideficiency Act.

One reported violation involves VHA's use of Medical Support and Compliance (MS&C) funds to pay for the Service-Oriented Architecture Research and Development software in the amount of $2.6 million instead of the congressionally mandated IT Systems appropriations.

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 one non-recurring maintenance project with one minor project. The other two violations in the process of being reported involve total project values exceeding the $10 million ceiling each. Congressional approval for the use of funds is required when the project value exceeds the $10 million ceiling.

6. Noncompliance with Improper Payments Elimination and Recovery Act

On May 15, 2017, the VA Office of Inspector General reported that VA did not fully comply in FY 2016 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 2016 Finding***	***Fiscal Year 2017 Status***
Material Weakness	Information Technology Security Controls	Repeat – See FY 2017 Material Weakness Finding 6
Material Weakness	Education Benefits Accrued Liability	Repeat – See FY 2017 Material Weakness Finding 1
Material Weakness	Control Environment Surrounding the Compensation, Pension, and Burial Actuarial Estimates	Partial Repeat – See FY 2017 Material Weakness Finding 1
Material Weakness	Community Care Obligations, Reconciliations, and Accrued Expenses	Repeat – See FY 2017 Material Weakness Finding 2
Material Weakness	Financial Reporting	Repeat – See FY 2017 Material Weakness Finding 3
Material Weakness	CFO Organizational Structure for VA and VHA	Repeat – See FY 2017 Material Weakness Finding 5
Significant Deficiency	Procurement, Undelivered Orders, Accrued Expenses, and Reconciliations	Repeat – See FY 2017 Significant Deficiency Finding 1
Significant Deficiency	Loan Guarantee Liability	Repeat – See FY 2017 Material Weakness Finding 4
Compliance Finding	Noncompliance with FFMIA	Repeat – See Compliance Finding 1
Compliance Finding	Noncompliance with FMFIA	Repeat – See Compliance Finding 2
Compliance Finding	Noncompliance with 38 U.S.C. 5315	Repeat – See Compliance Finding 3
Compliance Finding	Non-compliance with 38 U.S.C. 3733	Repeat – See Compliance Finding 4
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

Consolidated Financial Statements

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

DEPARTMENT OF VETERANS AFFAIRS		
CONSOLIDATED BALANCE SHEETS (dollars in millions)		
AS OF SEPTEMBER 30,	**2017**	**2016**
ASSETS (Note 2)		
INTRAGOVERNMENTAL		
Fund Balance with Treasury (Note 3)	$ 52,928	$ 50,459
Investments (Notes 5 and 19)	5,495	6,243
Accounts Receivable, Net (Note 6)	31	44
Other Assets	601	681
TOTAL INTRAGOVERNMENTAL ASSETS	**$ 59,055**	**$ 57,427**
PUBLIC		
Cash (Note 4)	$ 3	$ 4
Investments (Note 5)	140	178
Accounts Receivable, Net (Note 6)	2,607	2,796
Direct Loans and Loan Guarantees, Net (Note 7)	1,453	1,636
Inventory (Note 8)	45	50
General Property, Plant, and Equipment, Net (Note 9)	25,922	25,155
Other Assets	37	16
TOTAL PUBLIC ASSETS	**$ 30,207**	**$ 29,835**
TOTAL ASSETS	**$ 89,262**	**$ 87,262**
Heritage Assets (Note 10)		
LIABILITIES (Note 12)		
INTRAGOVERNMENTAL		
Accounts Payable	$ 281	$ 202
Debt (Note 11)	564	572
Other Liabilities (Note 15)	3,018	2,736
TOTAL INTRAGOVERNMENTAL LIABILITIES	**$ 3,863**	**$ 3,510**
PUBLIC		
Accounts Payable	$ 3,561	$ 4,789
Loan Guarantee Liability, Net (Note 7)	10,568	10,019
Federal Employee and Veterans Benefits (Note 13)	2,863,110	2,558,210
Environmental and Disposal Liabilities (Note 14)	943	989
Insurance Liabilities (Note 17)	6,936	7,713
Other Liabilities (Note 15)	5,747	5,693
TOTAL PUBLIC LIABILITIES	**$ 2,890,865**	**$ 2,587,413**
TOTAL LIABILITIES	**$ 2,894,728**	**$ 2,590,923**
Commitments and Contingencies (Note 18)		
NET POSITION		
Unexpended Appropriations – All Other Funds	$ 34,594	$ 32,920
Cumulative Results of Operations – Funds from Dedicated Collections (Note 19)	823	865
Cumulative Results of Operations – All Other Funds	$ (2,840,883)	$ (2,537,446)
TOTAL NET POSITION	**$ (2,805,466)**	**$ (2,503,661)**
TOTAL LIABILITIES AND NET POSITION	**$ 89,262**	**$ 87,262**

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

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF NET COST (dollars in millions)

FOR THE PERIODS ENDED SEPTEMBER 30,	2017	2016
NET PROGRAM COSTS BY ADMINISTRATION		
Veterans Health Administration		
Gross Cost	$ 77,917	$ 73,572
Less Earned Revenue	(4,204)	(4,326)
Net Program Cost	$ 73,713	$ 69,246
Veterans Benefits Administration		
Gross Cost		
Program Costs	$ 101,703	$ 96,222
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	75,353	106,498
Less Earned Revenue	(880)	(917)
Net Program Cost	$ 176,176	$ 201,803
National Cemetery Administration		
Gross Cost		
Program Costs	$ 354	$ 314
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	(200)	200
Net Program Cost	$ 154	$ 514
Indirect Administrative Program Costs		
Gross Cost	$ 2,154	$ 2,054
Less Earned Revenue	(469)	(523)
Net Program Cost	$ 1,685	$ 1,531
NET PROGRAM COSTS BY ADMINISTRATION BEFORE (GAIN)/LOSS FROM CHANGES IN VETERANS BENEFITS ACTUARIAL ASSUMPTIONS	**$ 251,728**	**$ 273,094**
(GAIN)/LOSS FROM CHANGES IN ACTUARIAL ASSUMPTIONS (Note 13)	229,673	377,500
NET COST OF OPERATIONS	**$ 481,401**	**$ 650,594**

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

DID YOU KNOW?

VA activated the Pharmacy Disaster Relief Plan in the wake of Hurricane Harvey. Eligible veterans with a VA ID Card needing an emergency supply of medications were able to go to any CVS or HEB pharmacy with a written prescription or active VA prescription bottle to receive a 14 day supply. Veterans in the impacted area needing assistance are also able to call the Heritage Health Solutions Veterans Help line at 1 866 265 0124 to speak to a representative.

DEPARTMENT OF VETERANS AFFAIRS

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

FOR THE PERIOD ENDED SEPTEMBER 30, 2017

	Funds from Dedicated Collections (Note 19)	All Other Funds	2017 Consolidated Total
Cumulative Results of Operations			
Beginning Balance	$ 865	$ (2,537,446)	$ (2,536,581)
Budgetary Financing Sources			
Other Adjustments	-	325	325
Appropriations Used	-	176,919	176,919
Donations and Forfeitures of Cash and Cash Equivalents	20	-	20
Transfers In/Out Without Reimbursement	(3,492)	3,736	244
Other Financing Sources (Nonexchange)			
Donations and Forfeitures of Property	23	-	23
Transfers In/Out Without Reimbursement	(10)	30	20
Imputed Financing	-	2,583	2,583
Other	-	(2,212)	(2,212)
Total Financing Sources	$ (3,459)	$ 181,381	$ 177,922
Net Cost/(Benefit) of Operations (Note 21)	(3,417)	484,818	481,401
Net Change	**$ (42)**	**$ (303,437)**	**$ (303,479)**
Cumulative Results of Operations	**$ 823**	**$ (2,840,883)**	**$ (2,840,060)**
Unexpended Appropriations			
Beginning Balance	$ -	$ 32,920	$ 32,920
Budgetary Financing Sources			
Appropriations Received	-	187,396	187,396
Appropriations Transferred In/Out	-	137	137
Other Adjustments	-	(8,940)	(8,940)
Appropriations Used	-	(176,919)	(176,919)
Total Budgetary Financing Sources	$ -	$ 1,674	$ 1,674
Total Unexpended Appropriations	**$ -**	**$ 34,594**	**$ 34,594**
Total Net Position	**$ 823**	**$ (2,806,289)**	**$ (2,805,466)**

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 PERIOD 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
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources (Note 22)		
Unobligated balance brought forward, October 1	$ 21,051	$ 10,534
Recoveries of prior year unpaid obligations	2,690	-
Other changes in unobligated balance	116	(40)
Unobligated balance from prior year budget authority, net	$ 23,857	$ 10,494
Appropriations (discretionary and mandatory)	184,275	-
Borrowing authority (discretionary and mandatory)	-	67
Spending authority from offsetting collections (discretionary and mandatory)	5,530	4,879
Total budgetary resources	**$ 213,662**	**$ 15,440**
Status of Budgetary Resources		
New obligations and upward adjustments (total)	$ 191,705	$ 4,259
Unobligated balance, end of year:		
Apportioned, unexpired account	18,977	-
Unapportioned, unexpired accounts	335	11,181
Unexpired unobligated balance, end of year	$ 19,312	$ 11,181
Expired unobligated balance, end of year	2,645	-
Unobligated Balance, end of year (total)	$ 21,957	$ 11,181
Total Budgetary Resources	**$ 213,662**	**$ 15,440**
Change in Obligated Balance		
Unpaid Obligations:		
Unpaid obligations, brought forward, October 1	$ 22,362	$ 363
New obligations and upward adjustments	191,705	4,259
Outlays (gross) (-)	(188,493)	(4,313)
Recoveries of prior year unpaid obligations (-)	(2,690)	-
Unpaid Obligations, end of year	**$ 22,884**	**$ 309**
Uncollected Payments:		
Uncollected Payments, Federal Sources, brought forward, October 1 (-)	$ (1,547)	$ -
Change in uncollected payments, Federal Sources (+ or -)	285	-
Uncollected Payments, Federal Sources, end of year (-)	**$ (1,262)**	**$ -**
Memorandum (non-add) entries:		
Obligated balance, start of year (+ or -)	$ 20,815	$ 363
Obligated balance, end of year (+ or -)	$ 21,622	$ 309

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DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budget Authority and Outlays, Net		
Budget authority, gross (discretionary and mandatory)	$ 189,805	$ 4,946
Actual offsetting collections (discretionary and mandatory) (-)	(6,955)	(4,915)
Change in uncollected pymts, Fed sources (discretionary and mandatory) (+ or -)	285	-
Recoveries of prior year paid obligations (discretionary and mandatory)	1,128	8
Budget Authority, net (total) (discretionary and mandatory)	**$ 184,263**	**$ 39**
Outlays, gross (discretionary and mandatory)	$ 188,493	$ 4,313
Actual offsetting collections (discretionary and mandatory)	(6,955)	(4,915)
Outlays, net (total) (discretionary and mandatory)	**$ 181,538**	**$ (602)**
Distributed offsetting receipts (-)	(3,785)	(1,703)
Agency Outlays, net (discretionary and mandatory)	**$ 177,753**	**$ (2,305)**

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

Outreach to returning Veterans is critical to delivering VA benefits and services.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
AS OF 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 (discretionary and mandatory)	167,471	-
Borrowing authority (discretionary and mandatory)	-	10
Spending authority from offsetting collections (discretionary and mandatory)	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 (total)	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)
AS OF 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 (total) (discretionary and mandatory)	**$ 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.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. ORGANIZATION

The mission of VA is to serve America's Veterans, their dependents, and beneficiaries with dignity and compassion, and to be their principal advocate in ensuring that they receive medical care, benefits, social support, and lasting memorials (38 U.S.C. Section 301(b) 2011). The Department is organized under the VA Secretary (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 CFS, including the Combined Statement of Budgetary Resources (SBR), report all activities of VA components. VA components include the VHA, VBA, NCA, and indirect administrative program costs. The CFS meet the requirements of the Chief Financial Officers (CFO) Act of 1990 and the Government Management Reform Act 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 GAAP for Federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the understanding that VA is a component of the U.S. Government, a sovereign entity. VA interacts with and is dependent upon the financial activities of the Federal Government as a whole. Therefore, the results of all financial decisions reflected in these CFS 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 CFS prepared on an accrual basis of accounting, and the combined SBR which reflect the appropriation and consumption of budget and spending authority, and other budgetary resources before eliminations.

The CFS include the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. In order to prepare reliable CFS, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's CFS. However, to remain consistent with the aggregate of the account-level information presented in budgetary reports, SBR is 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

VA collects revenues for both exchange and non-exchange activities. Recognition of these revenues is based upon the exchange versus non-exchange determination, and is further discussed below.

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 revenues are discussed further in Note 20, Exchange Transactions.

Non-exchange revenue is an inflow of resources to VA that is recognized when VA establishes a specifically identifiable, legally enforceable claim to cash or other assets, to the extent that collection is probable and the amount is measurable, from non-exchange transactions with other federal agencies or the public where VA does not give value directly in exchange for the inflow of resources.

VA receives non-exchange revenue either in the form of voluntary donations, or has the power to demand or compel payment in the form of a penalty. Non-exchange revenue consists primarily of imputed financing, but also includes forfeitures of property, donations, and transfers in/out without reimbursement. 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).

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, U.S.C., VHA is authorized to bill a Veteran's third-party health insurer for health care provided at VA and non-VA medical facilities. Generally, VA considers a Veteran's health care billable if the treatment is not for a service-connected disability.

Billable amounts are based on reasonable charges by locality for services provided as determined under the methodology prescribed by 38 CFR 17.101. Under this methodology, the billable amounts for services provided by VA represent the 80^{th} 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 Office of Community Care (OCC) Web site under Reasonable Charges Rules, Notices, and Federal Register Information or https://www.va.gov/COMMUNITYCARE/revenue_ops/payer_rates.asp. 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.

The Hampton National Cemetery, located in Hampton, Virginia, dates back to one of the first cemeteries, it had burials that took place as early as 1862, and is among numerous national cemeteries with origins that date to the Civil War.

Exchange revenue also 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.

F. TRANSFERRING BUDGET AUTHORITY TO OTHER AGENCIES

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

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 they 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

AR 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 the contractual nature of the balance due and VA's historical experience with collection efforts including a rolling 12-month analysis. 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.

Senior Airman Kailey Simmonds, 22nd Aircraft Maintenance Squadron assistant flying crew chief, monitors a tire pressure gauge as she fills a tire with nitrogen, July 11, 2017, at Eielson Air Force Base in Alaska. After the KC-135 Stratotanker receives fuel, crew chiefs ensure the tanker tires have the right amount of PSI to support the heavier aircraft.

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*; SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees;* and SFFAS 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees*. The Credit Reform Act provides that the present value of the estimated net cash flows to be paid by VA for subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the loan is disbursed as a result of its borrowing from Treasury. Direct loans and guaranteed loans receivable are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value.

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

When the present value of cash inflows is less than the present value of cash outflows, a subsidy cost is incurred and reported as an allowance for subsidy costs, 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 reestimated each year as of the date of the financial statements. Loan losses are reestimated by program.

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

K. PROPERTY, PLANT, AND EQUIPMENT

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 noncapitalized property, plant, and equipment (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 not meeting the capitalization criteria is expensed upon being placed in service.

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

VA hosts the annual Veterans Small Business Conference to support Veteran-Owned Businesses and to help them compete for Federal contracts.

Internal use software (IUS) 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. The useful life in regards to capitalization of the IUS is determined on a per-project basis, no less than two years, and consistent with the solution's longevity as limited by legal, regulatory, and/or contractual provisions.

L. OTHER ASSETS

Intragovernmental other assets are reported at cost, consist primarily of intragovernmental advances, and are primarily advances to the U.S. Army Corps of Engineers and the General Services Administration (GSA).

Public other assets are reported at cost and consist of public advance payments made by VHA primarily to hospitals and medical schools under house staff contracts, grantees, and beneficiaries, with the balance of the advances being made to employees on official travel.

M. ACCOUNTS PAYABLE

Accounts payable are amounts owed by VA for goods and services received, progress in contract performance, and rents due. Accounts payable also include payables to Veterans such as scheduled compensation, pension, and education benefits. Accounts payable do not include liabilities related to ongoing continuous expenses, such as employees' 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 canceled appropriations. The remaining accounts payable consist of amounts due to the public. Intragovernmental and public accounts payable are covered by budgetary resources.

N. INSURANCE LIABILITIES

Insurance liabilities for VA's life insurance programs include policy reserves, unearned premiums, insurance dividends left on credit or 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 Commissioner's 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 4.0 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 five-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.

Memorial Day fly by in Phoenix, Arizona.

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

Insurance dividends that are left on credit or deposit with VA accrue interest at a rate that varies by fund relative to the fund's investment portfolio earnings. For FY 2017 and FY 2016, 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 (CY). Dividends are declared on a CY 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 2017, 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 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. 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*.

O. 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 nonvested 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.

P. 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 comprises 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.

Q. PENSION, OTHER RETIREMENT BENEFITS, AND OTHER POSTEMPLOYMENT BENEFITS

Each employing federal agency is required to recognize its share of the cost and imputed financing of providing pension and postretirement health benefits and life insurance to its employees. Factors used in the calculation of these pension, postretirement 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 plans' requirements. CSRS and FERS are multiemployer 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.

R. 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 (COLA), 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 the average of the last 10-year quarterly spot rates with maturities consistent with the period of expected future payments. These spot rates were derived from the Treasury Nominal Coupon-Issue (TNC) Yield Curve published by the U.S. Department of the Treasury. As a result, each year for which expected future payments are projected has a separate discount rate associated with it. However, a single weighted average discount rate is also disclosed that may be used for all projected future payments that results in a present value that is not materially different than the resulting present value using multiple rates.

One of VA's Community Based Outpatient Clinics.

Estimated liabilities for Veterans' compensation and burial obligations in the financial statements are measured as of the end of the fiscal year based on June 30 beneficiary data that is adjusted for estimated changes in the number of participants covered (enrollment) during the fourth quarter. The method used to measure the liabilities provides for consistency in the underlying relationship between discount rate, COLA, and the other economic assumptions. For FY 2017, valuation techniques or their application used to measure the fair value of the actuarial liabilities were consistently applied compared to the previous year.

For eligible Veterans and their dependents, the VA provides four unique education/retraining programs.

- Post 9/11 GI Bill (Chapter 33)
- Montgomery GI Bill-Active Duty (Chapter 30)
- Dependents Education Assistance (Chapter 35)
- Vocational Rehabilitation and Employment (Chapter 31).

This is the first year that VA is reporting for Montgomery GI Bill, Dependents Education Assistance, and Vocational Rehabilitation and Employment.

The liability for future education benefits 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 with entitlement, average usage of entitlement, the program stop and restart rate, the number of Veterans and dependents receiving payments, and discount rates adjustments, impact the amount of the liability.

In FY 2017, for the Post 9/11 GI Bill, the discount rate was based on five years spot rates published by Treasury. For all other Education programs, the spot rates were based on the 10-year average historical spot rates derived from quarterly Yield Curves for Treasury *Nominal Coupon Issues*. As a result, each year for which expected future payments are projected has a separate discount rate associated with it. However, a single weighted average discount rate is also disclosed that may be used for all projected future payments that results in a present value that is not materially different than the resulting present value using multiple rates.

Estimated liabilities for the Post 9/11 GI Bill obligations in the financial statements are measured on the academic year of August 2016 to July 2017, adjusted for known material changes. Estimated liabilities for all other Education obligations in the financial statements are as of the end of the fiscal year based on June 30th beneficiary data that is adjusted for known material changes during the fourth quarter. The method used to measure the liabilities provides for consistency in the underlying relationship between discount rate and the other economic assumptions.

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 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*.

S. 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.

T. NON-FEDERAL TRUSTS

In prior fiscal years, VA has reported certain enhanced-use leases (EUL) that were entered into with non-Federal trusts. In these instances, VA was reported as 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. After careful consideration by the Office of General Counsel in FY 2017, a determination was made that VA does not have a controlling financial interest in the non-Federal trust assets under EUL. This activity has been removed from the related financial disclosures for FY 2017 reporting; however, the FY 2016 disclosures remain as VA's financial statements and note disclosures are reported comparatively. As the amounts related to these assets are not material, a restatement of the FY 2016 financial statements is unnecessary.

U. 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.

V. 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.

NOTE 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 included in FBWT, downward reestimates for the Veterans Housing Program included in Intragovernmental AR, and amounts due to Treasury for medical costs billed to Veterans included in Public AR.

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,				
		2017		2016
Intragovernmental:				
Fund Balance with Treasury	$	146	$	145
Accounts Receivable		13		8
Total Intragovernmental	$	159	$	153
Accounts Receivable		47		43
Total Non-Entity Assets		**206**		**196**
Total Entity Assets		**89,056**		**87,066**
Total Assets	**$**	**89,262**	**$**	**87,262**

NOTE 3. FUND BALANCE WITH TREASURY

Funds with 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, NSLI Fund, USGLI Fund, VSLI Fund, General Post Fund, and National Cemetery Gift Fund. The use of these funds is restricted.

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. MCCF and Lease of Land and Building (NCA Facilities Operation Fund) are special funds.

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 on a self-sustaining basis. Revolving funds record the collections and the outlays in the same Treasury account. A revolving fund is a form of permanent appropriation receiving authority to spend collections and do not generally receive appropriations.

Appropriated funds are general fund expenditure accounts established to record amounts appropriated by law for the general support of Federal Government activities and the subsequent expenditure of these funds. It includes spending from both annual and permanent appropriations. Examples include medical services, major construction, and Veterans Choice funds.

The Status of Fund Balance with Treasury section in the table below represents VA's unobligated balances, obligated balances, deposit funds, clearing accounts, unavailable general funds receipts, and unavailable receipts 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 combined SBR are supported by FBWT, as well as other budgetary resources that do not affect FBWT, primarily special funds, general receipts, and medical care funds.

Fund Balance with Treasury (dollars in millions)		
As of September 30,		
	2017	**2016**
Fund Balances		
Trust Funds	$ 77	$ 79
Revolving Funds	12,186	11,396
Appropriated Funds	40,079	38,351
Special Funds	410	463
Other Fund Types	176	170
Total Fund Balances	**$ 52,928**	**$ 50,459**
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 16,179	$ 9,551
Unavailable	14,369	19,234
Obligated Balance Not Yet Disbursed	21,932	21,178
Deposit funds, clearing accounts and unavailable general fund receipts	176	171
Unavailable Receipts Account	272	325
Fund Balance with Treasury	**$ 52,928**	**$ 50,459**

The FY 2016 balances for unobligated balance available, unavailable, and obligated balance not yet disbursed were reclassified based on a revised methodology developed in FY 2017 to appropriately align FBWT to the SBR. In addition, the unavailable receipts balance is reported separately from the deposit funds, clearing accounts, and unavailable general funds receipts line.

NOTE 4. CASH

Cash consists of Veterans Canteen Service (VCS) and Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements.

Cash (dollars in millions)		
As of September 30,		
	2017	**2016**
Cash		
Canteen Service	$ 2	$ 2
Agent Cashier Advance	1	2
Total Cash	**$ 3**	**$ 4**

NOTE 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 2032, are generally held to maturity unless needed to finance insurance claims and dividends. None of the Special bonds have been reclassified as available for sale, nor are there any impairments on these investments. 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.

Investments (dollars in millions)

As of September 30, 2017

	Cost	Amortization Method	Amortized (Premium)/ Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Federal Securities (Note 19)						
Non-Marketable: Special Bonds	$5,333	N/A	$ -	53	5,386	$ 5,386
Treasury Notes	109	Effective Interest	(1)	1	109	109
Total	**$5,442**		**$ (1)**	**54**	**5,495**	**$ 5,495**
Non-Federal Securities						
Trust Certificates (Loan Guaranty)	$ 140	N/A	$ -	-	140	$ 140
Total	**$ 140**		**$ -**	**-**	**140**	**$ 140**

As of September 30, 2016

	Cost	Amortization Method	Amortized (Premium)/ Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Federal Securities (Note 19)						
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**

NOTE 6. ACCOUNTS RECEIVABLE, NET

AR consists of intragovernmental and public AR. Intragovernmental AR 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' health care; (b) amounts due for compensation, pension, and readjustment benefit overpayments; (c) amounts due for education benefits and readjustment overpayments; and (d) other miscellaneous receivables due primarily for general fund advances and medical research.

The total contractual adjustment and allowance for loss provision as a percentage of total public AR was approximately 51 percent and 45 percent at September 30, 2017, and 2016, respectively.

During VA Research Week and on "Bring Your Children to Work Day" at VACO, Fred Downs demonstrated the new robotic arm co-designed by VA.

Accounts Receivable, Net (dollars in millions)		
As of September 30,		
	2017	**2016**
Intragovernmental Accounts Receivable	**$ 31**	**$ 44**
Public Accounts Receivable		
Medical Care	$ 3,162	$ 3,016
Contractual Adjustment and Allowance for Loss Provision	(1,568)	(1,480)
Net Medical Care	1,594	1,536
Compensation and Pension	1,511	1,469
Allowance for Loss Provision	(862)	(584)
Net Compensation and Pension	649	885
Education Benefits	494	488
Allowance for Loss Provision	(210)	(183)
Net Education Benefits	284	305
Other	102	86
Allowance for Loss Provision	(22)	(16)
Net Other	80	70
Total Public Accounts Receivable	5,269	5,059
Total Contractual Adjustment and Allowance for Loss Provision	(2,662)	(2,263)
Public Accounts Receivable, Net	**$ 2,607**	**$ 2,796**

NOTE 7. DIRECT LOANS AND LOAN GUARANTEES

The accounting for direct loans and loan guarantees made after 1991 is governed by the Credit Reform Act.

VA operates the following direct loan and loan guarantee programs:

Program Name	Program Group	Program Type
Vendee Loans	Home Loan	Direct and Guarantee
Acquired Loans	Home Loan	Direct and Guarantee
Native American Direct Loans	Home Loan	Direct
Vocational Rehabilitation and Employment	Other	Direct
Insurance	Insurance	Direct
Loan Sale Guarantees	Loan Sale Guarantees	Guarantee

LOAN PROGRAMS

HOME LOANS

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.

Vendee loans are direct loans issued to a third-party borrower for the acquisition price of foreclosed real estate. VA acquires the foreclosed property from a private sector mortgage lender upon default of a loan subject to the VA Loan Guarantee Program.

Acquired loans are VA guaranteed loans in default that VA purchases from the private sector mortgage lender. VA subsequently services the loan directly with the Veteran after VA determines the Veteran can meet debt payments.

Native American direct loans are special financing loans that enable Native Americans to purchase or construct a home on federally recognized trust land.

Under the Home Loan Guarantee 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 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.

VOCATIONAL REHABILITATION AND EMPLOYMENT LOANS

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. The loans receivable balances as of September 30, 2017, and 2016, were $747,787 and $976,423, respectively. Due to the immaterial amounts, these loans are not included in the tables throughout this note.

INSURANCE POLICY LOANS

Veterans who 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.

LOAN SALE GUARANTEES

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.

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 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.

LOANS RECEIVABLE

Loans receivable consist of direct loans and defaulted guaranteed loans receivable. The loans receivable are secured by the underlying real estate and insurance policies, with the exception of loans obligated prior to 1992.

Prior to November 2, 1987, life insurance policy loans were issued at fixed rates depending on the fund and time period. The fixed rate loans that remain 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 12.0 percent. Rate changes are tied to the 10-year constant maturity of the 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 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 amount of new direct loans disbursed as of September 30, 2017, and 2016, was $55.3 million and $60.3 million, respectively.

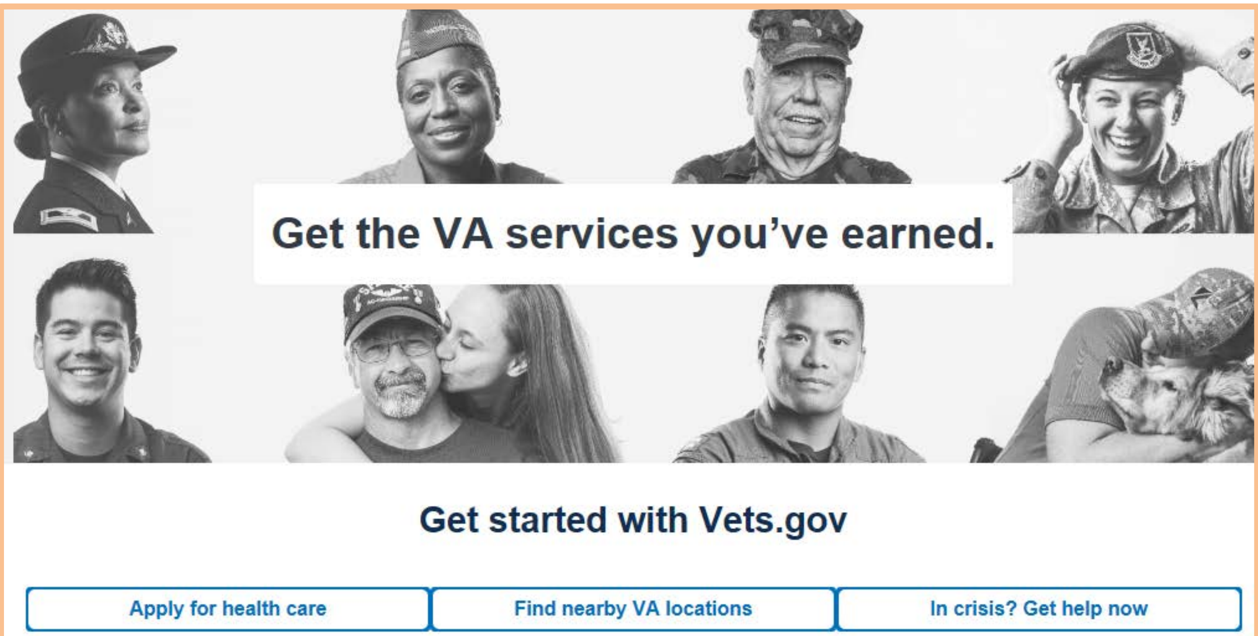
An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the loans is provided in the following table.

A group of Veterans competes in archery during the National Veterans Wheelchair Games.

Loans Receivable and Related Foreclosed Property from Direct and Guaranteed Loans (dollars in millions)

As of September 30, 2017

	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Allowance for Subsidy Cost (Present Value)	Foreclosed Property	Value of Assets Related to Loans, Net
Loans Obligated Prior to 1992 (Allowance for Loan Loss Method)						
Direct Home Loans	$ 2	-	-	-	-	$ 2
Defaulted Guaranteed Home Loans	20	-	(18)	-	1	3
Loans Obligated After 1991 (Present Value Method)						
Direct Home Loans	403	24	-	33	3	463
Defaulted Guaranteed Home Loans	4	-	-	-	727	731
Direct Insurance Policy Loans	248	6	-	-	-	254
Total Loans Receivable	**$ 677**	**30**	**(18)**	**33**	**731**	**$ 1,453**



Part of the VA vision is to provide our Veterans with a seamless, unified Veteran Experience across the entire organization and throughout the country. In support of this goal, VA created a Web site solely dedicated to helping Veterans learn about the benefits they have earned and providing a clear path for applying for them. Vets.gov provides clear instructions and steps for some of VA's most popular services and transactions, and is the single, one-stop shop for information and self-service for Veterans and those who care for them.

Loans Receivable and Related Foreclosed Property from Direct and Guaranteed Loans (dollars in millions)

As of September 30, 2016

	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Allowance for Subsidy Cost (Present Value)	Foreclosed Property	Value of Assets Related to Loans, Net
Loans Obligated Prior to 1992 (Allowance for Loan Loss Method)						
Direct Home Loans	$ 3	-	-	-	-	$ 3
Defaulted Guaranteed Home Loans	23	-	(24)	-	1	-
Loans Obligated After 1991 (Present Value Method)						
Direct Home Loans	439	22	-	24	16	501
Defaulted Guaranteed Home Loans	4	-	-	-	845	849
Direct Insurance Policy Loans	276	7	-	-	-	283
Total Loans Receivable	**$ 745**	**29**	**(24)**	**24**	**862**	**$ 1,636**

Direct home loans obligated prior to 1992 consist of Vendee and Acquired loans. Direct home loans obligated after 1991 consist of Vendee, Acquired, and Native American Housing loans. Pre-1992 defaulted guaranteed home loans consist of Veterans Housing Benefit loans. Post 1991 defaulted guaranteed home loans consist of Housing Loans for Homeless Veterans and Veterans Housing Benefit loans.

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

DID YOU KNOW?

Veteran borrowers called up to active duty may be able to request relief pursuant to the Servicemembers Civil Relief Act (SCRA). SCRA is intended to ease the economic and legal burdens on military personnel during their active service. For more information about SCRA, please visit the following Web site https://www.benefits.va.gov/homeloans/scra.asp.

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 periods ended September 30, 2017, and 2016.

As of September 30, 2017, and 2016, the number of residential properties in VA's inventory was approximately 6,285 and 7,273, respectively. For both 2017 and 2016, the average holding period from the date properties were conveyed to VA until the date properties were sold was approximately six months. The number of properties for which foreclosure proceedings are in process was approximately 40,741 and 40,811 as of September 30, 2017, and 2016, respectively.

ALLOWANCE FOR SUBSIDY FOR DIRECT LOANS (POST 1991)

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.

U.S. Marines fire the FGM-148 Javelin Missile during a live-fire range for exercise Platinum Lion at the Novo Selo Training Area in Bulgaria, December 15, 2016. The exercise brought together eight NATO Allies and partner nations for a live-fire exercise aimed to strengthen security and regional defenses in Eastern Europe. (U.S. Marine Corps photo by Sgt. Michelle Reif)

Schedule for Reconciling Subsidy Cost Allowance Balances (dollars in millions)		
As of September 30,		
	2017	**2016**
Beginning balance of the allowance	**$ (24)**	**$ (58)**
Add: Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest rate differential costs	(2)	(2)
Default costs (net of recoveries)	1	1
Fees and other collections	-	-
Other subsidy costs	-	-
Total of the above subsidy expense components	**$ (1)**	**$ (1)**
Adjustments:		
Loan Modifications	$ -	$ -
Fees Received	-	-
Foreclosed property acquired	(9)	(5)
New Loans	(1)	3
Loans written off	-	1
Subsidy allowance amortization	(6)	25
Change in reestimate approved by OMB	10	12
Total Adjustments	**$ (6)**	**$ 36**
Ending balance of the subsidy cost allowance before reestimates	**$ (31)**	**$ (23)**
Add or subtract subsidy reestimates by component		
Interest rate reestimate	$ -	$ -
Technical/default reestimate	(2)	(1)
Total of the above reestimate components	**$ (2)**	**$ (1)**
Ending balance of the subsidy cost allowance	**$ (33)**	**$ (24)**

SUBSIDY EXPENSE

Subsidy expense is defined by the Federal Credit Reform Act of 1990 as the budgetary costs of VA federal loan guarantees and direct loans, excluding all administrative costs. The budgetary costs are present values of cash flows for federal loans. VA reports subsidy expense in the financial statements annually. VA also reports revisions to subsidy expense, which are categorized as subsidy reestimates.

VA uses cash flow models to estimate subsidy expense and reestimates. The primary VA model is a limited dependent econometric model for VA home loan guarantees. The VA models transform accounting cash flow inputs with assumptions into future cash flows and subsidy estimates. The key model inputs are loan disbursements, claims, recoveries, mortgage rates, Treasury bond note yields, home price appreciation, and borrower payments.

VA updates the models with actual data and data assumptions every year. VA periodically upgrades the models and obtains independent review of the models. The updated models are used to estimate future cash flows that are transformed into subsidy expenses and reestimates. Subsidy reestimates are the difference between estimated and actual cash flows.

VA continues to grow its lending volume in recent years. The growth in lending is associated with a rise in loan claims from VA lenders. Actual loan volume and claims drive cash spending on subsidy expense and reestimates.

BUDGETARY SUBSIDY RATES BY COMPONENT (POST 1991)

The subsidy rates disclosed below pertain only to the current-year cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Direct and Guaranteed Loans Subsidy Rates	Defaults, net of recoveries	Interest	Fees	All Other	Total Subsidy Rate
Veterans Housing Direct Acquired Loans	13.91%	-12.61%	0.00%	0.62%	1.92%
Veterans Housing Direct Vendee Loans	1.51%	-25.20%	0.00%	0.11%	-23.58%
Native American Housing Loans	0.00%	-26.37%	-0.53%	8.28%	-18.62%
Housing Guaranteed Loans	1.72%	0.00%	-1.21%	0.00%	0.51%

SUBSIDY EXPENSE FOR DIRECT HOME LOANS AND LOAN GUARANTEES (POST 1991)

Direct and Guaranteed Loan Subsidy Expense Post 1991 (dollars in millions)	Interest Differential	Defaults	Fees	Interest Rate Reestimates	Technical Reestimates	Total Subsidy Expense
As of September 30, 2017						
Direct Home Loans	$ (1)	-	-	-	-	$ (1)
Guaranteed Home Loans	-	3,020	(2,128)	(40)	(1,482)	(630)
Loan Sale Guarantees	-	-	-	2	(1)	1
Total Subsidy Expense	**$ (1)**	**3,020**	**(2,128)**	**(38)**	**(1,483)**	**$ (630)**
As of September 30, 2016						
Direct Home Loans	$ (2)	1	-	-	(1)	$ (2)
Guaranteed Home Loans	-	3,059	(2,604)	(139)	(1,407)	(1,091)
Loan Sale Guarantees	-	-	-	(8)	(5)	(13)
Total Subsidy Expense	**$ (2)**	**3,060**	**(2,604)**	**(147)**	**(1,413)**	**$ (1,106)**

OUTSTANDING LOAN GUARANTEES

In the table that follows, the face value of the principal of guaranteed loans represents the unpaid balances of home loans made to eligible borrowers by financial institutions. The outstanding principal guaranteed amounts represent the portion of unpaid home loan and loan sale balances that VA has guaranteed.

Guaranteed Loans Outstanding

	Principal of Guaranteed Loans, Face Value (dollars in millions)	Amount of Outstanding Principal Guaranteed (dollars in millions)
As of September 30, 2017		
Pre-1992		
Home Loan Guarantees	$ 45	$ 19
Post-1991		
Home Loan Guarantees	596,422	151,892
Loan Sale Guarantees	-	878
Total	**$ 596,467**	**$ 152,789**
As of September 30, 2016		
Pre-1992		
Home Loan Guarantees	$ 81	$ 33
Post-1991		
Home Loan Guarantees	517,103	132,749
Loan Sale Guarantees	-	1,046
Total	**$ 517,184**	**$ 133,828**

New Guaranteed Loans Disbursed

	Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed (dollars in millions)	Number of Loans Disbursed
As of September 30, 2017			
New Guaranteed Home Loans	$ 160,078	$ 39,812	637,136
As of September 30, 2016			
New Guaranteed Home Loans	$ 151,884	$ 38,002	609,023

During the period 1992 through 2012, total loans sold amounted to $14.2 billion. There have been no new loan sale guarantees since 2012. There are no outstanding loan sale guarantees made prior to 1992.

Outstanding principal of loan sale guarantees at the start of the year for fiscal years 2017 and 2016 was $1,046 million and $1,208 million, respectively. Payments, repayments, and terminations of loan sale guarantees made during fiscal years 2017 and 2016 were $168 million and $162 million, respectively.

LOAN GUARANTEE LIABILITIES

The liability on the guaranteed loans 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.

For home loan guarantees, 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.

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.

Just hours after the deadly Las Vegas shooting, VA deployed teams of mental health professionals, counselors, social workers, and other crisis and trauma-trained experts into the community to help those in need. While VA's Vet Centers and its mobile teams usually serve combat Veterans and family members, Mobile Vet Centers also deploy to provide community support in emergency situations.

Schedule for Reconciling Guarantee Loan Liability Balance (dollars in millions)	Home Loans Post 1991	Loan Sales Post 1991	Home Loans Pre 1992	Total
As of September 30, 2017				
Beginning balance of the liability	**$ 9,650**	**123**	**246**	**$ 10,019**
Add: Subsidy expense for guaranteed loans disbursed during the reporting years by component:				
Interest rate differential costs	-	-	-	-
Default costs (net of recoveries)	3,020	-	-	3,020
Fees and other collections	(2,128)	-	-	(2,128)
Other subsidy costs	-	-	-	-
Total of the above subsidy expense components	**$ 892**	**-**	**-**	**$ 892**
Adjustments:				
Loan Guarantee Modifications	-	-	-	-
Fees received	2,128	-	-	2,128
Interest supplements paid	-	-	-	-
Foreclosed property acquired	(125)	-	(3)	(128)
Claim payments to lenders	(1,117)	(15)	-	(1,132)
Interest accumulation on the liability balance	200	7	-	207
Veteran liability debts	-	-	14	14
Amortization of liability balance	-	-	2	2
Changes in reestimate approved by OMB	78	9	-	87
Total Adjustments	**$ 1,164**	**1**	**13**	**$ 1,178**
Ending balance of the liability before reestimates	**$ 11,706**	**124**	**259**	**$ 12,089**
Add or subtract subsidy reestimates by component:				
Interest rate reestimate	(40)	2	-	(38)
Technical/default reestimate	(1,482)	(1)	-	(1,483)
Total of the above reestimate components	(1,522)	1	-	(1,521)
Ending balance of the loan guarantee liability	**$ 10,184**	**125**	**259**	**$ 10,568**

Schedule for Reconciling Guarantee Loan Liability Balance (dollars in millions)

	Home Loans Post 1991	Loan Sales Post 1991	Home Loans Pre 1992	Total
As of September 30, 2016				
Beginning balance of the liability	**$ 9,543**	**141**	**229**	**$ 9,913**
Add: Subsidy expense for guaranteed loans disbursed during the reporting years by component:				
Interest rate differential costs	-	-	-	-
Default costs (net of recoveries)	3,059	-	-	3,059
Fees and other collections	(2,604)	-	-	(2,604)
Other subsidy costs	-	-	-	-
Total of the above subsidy expense components	**$ 455**	**-**	**-**	**$ 455**
Adjustments:				
Loan Guarantee Modifications	-	-	-	-
Fees received	1,981	-	-	1,981
Interest supplements paid	-	-	-	-
Foreclosed property acquired	(310)	-	(1)	(311)
Claim payments to lenders	(764)	(18)	1	(781)
Interest accumulation on the liability balance	206	8	-	214
Veteran liability debts	-	-	14	14
Amortization of liability balance	-	-	3	3
Changes in reestimate approved by OMB	85	5	-	90
Total Adjustments	**$ 1,198**	**(5)**	**17**	**$ 1,210**
Ending balance of the liability before reestimates	**$ 11,196**	**136**	**246**	**$ 11,578**
Add or subtract subsidy reestimates by component:				
Interest rate reestimate	(139)	(8)	-	(147)
Technical/default reestimate	(1,407)	(5)	-	(1,412)
Total of the above reestimate components	(1,546)	(13)	-	(1,559)
Ending balance of the loan guarantee liability	**$ 9,650**	**123**	**246**	**$ 10,019**

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.

Loan servicers perform loan modifications under current laws without the need to modify executed subsidy estimates for existing loan guarantees from 1992 to 2017.

ADMINISTRATIVE EXPENSE

The administrative expense for direct and guaranteed loans for the fiscal periods ended September 30, 2017, and 2016, was $196 million and $163 million, respectively.

NOTE 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,		
	2017	**2016**
VCS Retail Store Stock	$ 31	$ 31
Operating, Medical, and Pharmaceutical Supplies	14	19
Total Inventory	**$ 45**	**$ 50**

NOTE 9. GENERAL PROPERTY, PLANT AND EQUIPMENT

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

Depreciation and amortization expense totaled $1.9 billion in 2017 as well as 2016. Loss on disposition of assets totaled $338 million and $227 million in 2017 and 2016, respectively.

General Property, Plant and Equipment (dollars in millions)
As of September 30, 2017

	Cost	Accumulated Depreciation/ Amortization	Net Book Value
Land and Improvements	$ 1,618	$ (549)	$ 1,069
Buildings	32,763	(17,602)	15,161
Equipment	4,099	(2,786)	1,313
Other Structures and Capital Leases	4,833	(2,666)	2,167
Internal Use Software	2,622	(1,824)	798
Construction Work in Progress	4,546	-	4,546
Internal Use Software in Development	868	-	868
Total Property, Plant, and Equipment	**$ 51,349**	**$ (25,427)**	**$ 25,922**

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**

The 75th Anniversary of Pearl Harbor on December 7, 2016.

NOTE 10. HERITAGE ASSETS

Heritage assets are properties that possess one or more of the following characteristics: historical or natural significance, cultural value, educational value, aesthetic value, or significant architectural characteristics. VA has properties at medical centers, ROs, 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 CFS for 2017 and 2016; 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 1,216 multi-use heritage assets that are included in general PP&E. These multi-use heritage assets are being utilized as administration, operation, engineering, and maintenance buildings.

VA expensed $2.0 million and $1.5 million for the periods ended September 30, 2017, and 2016, 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,

	2017 Beginning Balance	2017 Additions	2017 Withdrawals	2017 Ending Balance
Art Collections	26	2	-	28
Buildings and Structures	715	169	(148)	736
Monuments/Historic Flag Poles	1,267	3	-	1,270
Other Non-Structure Items	770	2	(9)	763
Archaeological Sites	9	1	-	10
Multi-Use buildings/Structures in PP&E	1,284	115	(183)	1,216
Total Heritage Assets in Units	**4,071**	**292**	**(340)**	**4,023**
Cemeteries, Soldier's Lots and Monument Sites	**170**	**-**	**-**	**170**

NOTE 11. DEBT

At September 30, 2017, and 2016, all debt is classified as intragovernmental debt. 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 2017 ranged from 3.00 percent to 3.15 percent and from 3.16 percent to 3.68 percent for debt issued in 2016. The interest rates on all outstanding debt issued ranged from 1.00 percent to 7.59 percent for both 2017 and 2016. Interest expense was $23 million and $26 million for 2017 and 2016, respectively.

Vocational Rehabilitation Program Direct Loan debt has a two-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 1.6 percent for 2017 and 1.00 percent for 2016. The interest rate on all outstanding debt issued was 1.6 percent for 2017 and 1.00 percent for 2016.

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 2017 or 2016. There were no redemptions or calls of debts before maturity or write-offs of debt owed to the Treasury.

Intragovernmental Debt (dollars in millions)					
As of September 30,					
	2016 Beginning Balance	**2016 Net Borrowing**	**2016 Ending Balance**	**2017 Net Borrowing**	**2017 Ending Balance**
Other Debt					
Debt to the Treasury					
Loan Guaranty Debt	$ 675	$ (109)	$ 566	$ (7)	$ 559
Direct Loans Debt*	1	-	1	-	1
Total Debt to the Treasury	**$ 676**	**$ (109)**	**$ 567**	**$ (7)**	**$ 560**
Debt to the Federal Financing Bank					
Loan Guaranty Debt	$ 5	$ -	$ 5	$ (1)	$ 4
Total Debt to the Federal Financing Bank	**$ 5**	**$ -**	**$ 5**	**$ (1)**	**$ 4**
Total Other Debt	**$ 681**	**$ (109)**	**$ 572**	**$ (8)**	**$ 564**

* Direct Loans Debt relates strictly to the Vocational Rehabilitation Program

NOTE 12. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities not covered by budgetary resources are unfunded liabilities that require Congressional action before budgetary resources can be provided. VA's unfunded liabilities are listed below and are explained in the Notes referenced in the schedule.

Liabilities Not Covered By Budgetary Resources (dollars in millions)				
As of September 30,				
		2017		**2016**
Total Intragovernmental				
Workers Compensation (FECA) and Other Employee Benefits	$	464	$	486
Future Funded Expense - Contract Dispute Act		244		249
Total Intragovernmental (Note 15)	**$**	**708**	**$**	**735**
Federal Employee and Veteran Benefits (Note 13)		2,863,110		2,558,210
Environmental and Disposal Liabilities (Note 14)		943		989
Insurance (Note 17)		1,602		1,582
Other (Note 15)		4,108		4,103
Total Liabilities Not Covered By Budgetary Resources	**$**	**2,870,471**	**$**	**2,565,619**
Total Liabilities Covered By Budgetary Resources		**24,257**		**25,304**
Total Liabilities	**$**	**2,894,728**	**$**	**2,590,923**

NOTE 13. FEDERAL EMPLOYEE AND VETERANS BENEFITS LIABILITIES

Federal employee and Veterans benefits liabilities comprise 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,				
		2017		**2016**
Workers' Compensation (FECA)	$	2,396	$	2,322
Compensation		2,805,100		2,491,400
Burial		4,900		4,900
Education Benefits		50,714		59,588
Total Federal Employee and Veterans Benefits Liabilities	**$**	**2,863,110**	**$**	**2,558,210**

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 titled, "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.

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.

Federal Employee Benefits: Imputed Expenses-Employee Benefits (dollars in millions)				
As of September 30,				
		2017		**2016**
Civil Service Retirement System	$	247	$	303
Federal Employees Health Benefits		1,483		1,682
Federal Employees Group Life Insurance		5		5
Total Imputed Expenses-Employee Benefits*	**$**	**1,735**	**$**	**1,990**

* 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.

VETERANS BENEFITS (COMPENSATION AND BURIAL)

Eligible Veterans who die or are disabled during active military service-related causes, as well as their dependents, receive compensation benefits and are provided a burial flag, headstone/marker, and grave liner for burial in a VA National Cemetery or are provided a burial flag, headstone/marker, and a plot allowance for burial in a private cemetery. These benefits are provided under Title 38, Part 2, Chapter 23 in recognition of a Veteran's military service and are recorded as a liability on the balance sheet in the period the requirements are met.

VA provides eligible Veterans and/or their dependents with pension benefits if the Veteran died or was disabled from nonservice-related causes, based on annual eligibility reviews. The actuarial present value of the future liability for pension benefits is a nonexchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2017, and 2016, was $87.6 billion and $87.2 billion, respectively.

ASSUMPTIONS USED TO CALCULATE THE VETERANS BENEFITS LIABILITY (COMPENSATION AND BURIAL)

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 are expected to 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 VBA'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, 2017, and 2016 were computed based on the average of the last 10-year quarterly spot rates. These spot rates were derived from the TNC Yield Curve published by the U.S. Department of the Treasury. The ranges of spot rates for the next 100 years were from 0.62 percent to 4.07 percent and from 1.16 percent to 4.26 percent as of September 30, 2017, and 2016, respectively. These spot rates produced a single weighted average discount rate of 3.66 percent and 3.93 percent as of September 30, 2017, and 2016, 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 ongoing 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 average of the last 10-year quarterly spot rates, COLA and presumptive service conditions resulting in benefits coverage, mortality, and future new compensation rates. The spot rates were derived from the TNC Yield Curve published by the U.S. Department of the Treasury. Prior service costs relate to new benefits due to administrative, judicial, or legislative changes.

The total number of estimated Veterans 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 changes in other factors that affect benefits.

Life expectancies of beneficiaries collecting benefits from the Compensation program were based on the Mortality Experience Study of the same population 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 rates developed by the Office of Predictive Analytics and Actuary for the 2016 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, 2017.

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 VBA 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 Compensation and Burial at September 30, 2017, of $2.8 trillion increased $313.7 billion from the September 30, 2016, liability of $2.5 trillion.

The change in liability was primarily due to a $139 billion increase due to the increased number of compensation beneficiaries, which is included in the experience category, and a $138 billion increase due to the change in the discount rate assumptions. The weighted average discount rate decreased from 3.93 percent to 3.66 percent in 2017. The COLA change decreased the liability by $13 billion. The weighted average COLA rate used for all future years at September 30, 2017, and 2016 was 2.28 percent and 2.30 percent, respectively. The other assumption changes increased the liability by $120 billion and were comprised of a $122 billion increase from the updated new compensation rate and a $2 billion decrease from the updated mortality rate trend factors. The changes in experience, which include the beneficiary and Veteran counts and benefit amount, increased the liability by $51 billion. In addition, during FY 2017 the estimated interest on the liability increased the liability by $98 billion and benefit payments decreased the liability by $80 billion.

VETERANS EDUCATION BENEFIT LIABILITY

For eligible Veterans and their dependents, the VA provides four unique education/retraining type programs:

- Post 9/11 GI Bill
- Montgomery GI Bill-Active Duty
- Vocational Rehabilitation and Employment
- Dependent Education Assistance.

In FY 2016, VA reported an estimated liability for the Post 9/11 GI Bill of $59.6 billion. This was the first time VA had reported this estimated liability and the models and assumptions used were conservative with limited experience studies or assumptions. At that time, VA had not developed models or estimates for the other three programs listed; however, it was management's assertion that the amount recorded for the Post 9/11 GI Bill was large enough to include any liability for the other three programs. In FY 2017, VA broke out each program and developed individual estimates based on actuarial standards. While not reported last year, VA did develop an estimate for FY 2016 for each of the new programs to be used for comparisons only.

The model development and estimates have been formulated by certified actuaries using VA and other data sources.

POST 9/11 GI BILL

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 include tuition and fees and a monthly housing allowance. 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 on 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 (LTS) system.

MONTGOMERY GI BILL-ACTIVE DUTY (MGIB-AD)

The MGIB-AD is an authorized program by Congress under Title 38, Chapter 30. The MGIB-AD program provides education benefits to Veterans and Servicemembers who have at least two years of active duty and have had their pay reduced by $1,200 or meet other eligibility requirements.

Eligible Servicemembers have 10 years to use their MGIB benefits, but the time limit can be fewer or more years depending on the situation. Servicemembers may receive up to 36 months of education benefits. Benefits are paid monthly based on the type of training, length of service, category, and college fund eligibility. Veterans usually have 10 years to use their MGIB benefits, but the time limit can be fewer or more years depending on the situation. VA recognizes an education benefit liability once VA has approved an original enrollment certification.

VOCATIONAL REHABILITATION AND EMPLOYMENT (VR&E)

The VR&E Program is an authorized program by Congress under Title 38, Chapter 31. VR&E helps Veterans and Active Duty Servicemembers transitioning to civilian employment with service-connected disabilities and an employment handicap prepare for, obtain, and maintain suitable careers.

The basic period of eligibility for Chapter 31 benefits is 12 years, beginning on the date of the event that occurred last from the following options:

- Separation from active military duty
- First notification of a service-connected disability rating
- The basic period of eligibility may be extended if a Vocational Rehabilitation Counselor (VRC) determines that a Veteran has a Serious Employment Handicap.

Once eligibility is established, the Veteran is scheduled to meet with a VRC for a comprehensive evaluation to determine if he/she is entitled to services. The VRC works with the Veteran to complete a determination if an employment handicap exists. An employment handicap exists if the Veteran's service-connected disability impairs his/her ability to obtain and maintain a job.

The VRC and Veteran will agree to a rehabilitation plan, which is an individualized, written plan of services, which outlines the resources and criteria that will be used to achieve employment or independent living goals. The plan is an agreement that is signed by the Veteran and the VRC and is updated as needed to assist the Veteran to achieve his/her goals. The approved plan would establish the Veteran into one of five rehabilitations “tracks”:

- Reemployment (with a former employer)
- Direct job placement services for new employment
- Self-employment
- Employment through long-term services including OJT, college, and other training
- Independent living services.

Benefits paid can include a monthly subsistence payment, tuition, books, and supplies. For those who are eligible, a Veteran could choose to be paid the Post 9/11 GI Bill housing rate instead of the basic VR&E subsistence rate. VA recognizes a VR&E benefit liability once a Rehabilitation Plan has been signed by the Veteran and VRC.

DEPENDENT EDUCATION ASSISTANCE (DEA)

The DEA Program (Chapter 35) offers education and training opportunities to eligible dependents of Veterans who are permanently and totally disabled due to a service-related condition or of Veterans who died while on active duty or as a result of a service-related condition.

To receive benefits for attending school or job training, a son or daughter must be between the ages of 18 and 26. This benefit is may not be available for active duty personnel who are in the armed forces. A child over 18 years old using DEA will not be eligible to receive Dependency Indemnity Compensation (DIC) payments from VA.

For a spouse, benefits end 10 years from the date VA determines eligibility or from the date of death of the Veteran. If VA rated the Veteran permanently and totally disabled with an effective date of three years from discharge, a spouse will remain eligible for 20 years from the effective date of the rating. For surviving spouses of Servicemembers who died on active duty, benefits end 20 years from the date of death.

A beneficiary may be entitled to receive up to 45 months of DEA benefits. Effective August 1, 2018, the number of months of entitlement will be reduced to 36 months under the Forever GI Bill.

Benefits are paid monthly directly to the Dependent. VA recognizes an education benefit liability once VA has approved an original enrollment certification.

ASSUMPTIONS USED TO CALCULATE THE VETERANS EDUCATION BENEFIT LIABILITY

ALL PROGRAMS

Several significant actuarial assumptions were used in the valuation of compensation and burial benefits to calculate the present value of the liability. The liability for future Education and Vocational Rehabilitation and Employment payments is reported on VA's balance sheet at the present value of expected future payments and is developed on an actuarial basis.

For the Post 9/11 GI Bill, in FY 2017 the discount rated was based on five years spot rate published by Treasury that ranged from 0.45 percent to 3.54 percent, which results in a single average weighted rate of 2.70 percent. A five-year rate was used for this program since Post 9/11 GI Bill benefits have only been available for the last eight years and the liability (Macaulay) duration is only 8.375 years. In FY 2016, the discount factors were based on a single-day spot rate that ranged from 0.45 percent to 1.22 percent, which results in a single average weighted rate of 0.87 percent. For all other Education programs, the weighted average discount rates at September 30, 2017, and 2016 were based on the 10-year average historical spot rates derived from quarterly Yield Curves for Treasury *Nominal Coupon Issues* published by the U.S. Treasury. 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 0.72 percent to 4.07 percent and from 1.16 percent to 4.22 percent as of September 30, 2017, and 2016, respectively. These spot rates produced a single weighted average discount rate of 1.35 percent and 1.71 percent for MGIB, 1.55 percent and 1.90 percent for VR&E, and 1.37 percent and 1.73 percent for DEA as of September 30, 2017, and 2016, respectively, that could be applied to the expected future cash flows to produce a present value that is not materially different.

The liability is impacted by interest on the liability balance, changes in experience, and changes in actuarial assumptions, 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 benefit liability balance for the prior year.

POST 9/11 GI BILL

The FY 2017 estimated liability is estimated at $42.5 billion compared to the FY 2016 amount of $59.6 billion, a decrease of $17.1 billion. There are four main changes in assumptions or experience that caused the decrease:

- In FY 2017, VA revised the model used to estimate the liability to include an assumption of Veterans who start the program but then stop and do not continue but have eligibility remaining or who restart at some later date. The addition of this assumption resulted in a decrease to the liability of $29.3 billion.
- Based on historical data, VA has determined that the average monthly cost has been increasing. This is primarily driven by increased tuition costs; these additional costs have increased the liability by $3.9 billion.
- On August 16, 2017, the President signed the Harry W. Colmery Veterans Educational Assistance Act (PL 115-48), also known as the “Forever GI Bill.” One of the provisions of this law was to eliminate the15-year limitation for using the benefit for certain eligible Veterans. This change in the law resulted in an increase to the liability of $8.2 billion.
- Changes in the FY 2017 model and methodology caused an increase in the liability by $1.9 billion.

Other assumptions used in the model were:

- As of September 30, 2017, 1,428,029 beneficiaries are currently eligible and have an enrollment certification.
- An experience study shows that the average length of benefit usage per year was 5.8 months. This average length of benefit usage was further differentiated by age group, gender, benefit type, and benefit level in the model.
- Any direct DoD contributions (kicker amount) were discounted from the payments.
- The impact from other applicable provisions of the recently enacted Harry W. Colmery Veterans Educational Assistance Act of 2017 was incorporated in the model.

MGIB

The VA estimates the liability for MGIB at the end of FY 2017 as $1.1 billion compared to the FY 2016 amount of $2.1 billion, a decrease of 1.0 billion.

There are two main changes in assumptions or experience that caused the decrease:

- VA has seen a large drop-off in the usage of MGIB mainly due to Veterans electing to use the Post 9/11 GI Bill. This decrease in the number beneficiaries resulted in a decrease of $0.7 billion. VA expects to see this same trend in future years.
- Amounts paid in FY 2017 resulted in a decrease of $0.3 billion.

The remaining changes are due to interest on the prior year liability and updating the discount rates.

Other assumptions used in the model were:

- As of September 30, 2017, an estimated 58,466 beneficiaries are currently eligible and have an enrollment certification
- This is a closed block of business with no new entries. The program has a large dropout rate partially due to transfers to the replacement program, Chapter 33, which offers higher payments. Many of those eligible for this plan are current Servicemembers who will not establish a delimiting date until separation. Considering that this is a rapidly declining program with a high dropout rate and no new enrollees, combined with the delimiting date and the eligibility data issues, it was decided to model this block of business using only the decrement rate. The high decrement rate results in a rapid run-off of business limiting the effect of not using the delimiting dates or eligibility

- Average annual payment rates are based on training time such as full time, half time, etc. The initial rates for FY 2018 are:

Training Time	Average Annual Initial Payment for 2018
Full time	$ 13,676
Three Fourths	$ 10,737
Half	$ 8,455
Three Eighths	$ 7,543
Quarter	$ 6,959

VR&E

The VA estimated the liability for VR&E at the end of FY 2017 as $5.4 billion compared to the FY 2016 amount of $4.9 billion, an increase of $0.5 billion. There are two main changes in assumptions or experience that caused the increase:

- The present value of all future changes in beneficiary counts and benefit amounts increased the liability by $1.7 billion
- Estimated actual amounts paid in FY 2017 decreased the liability by $1.4 billion.

The remaining increase is due to changes in interest and discount rates.

Other assumptions used in the model were

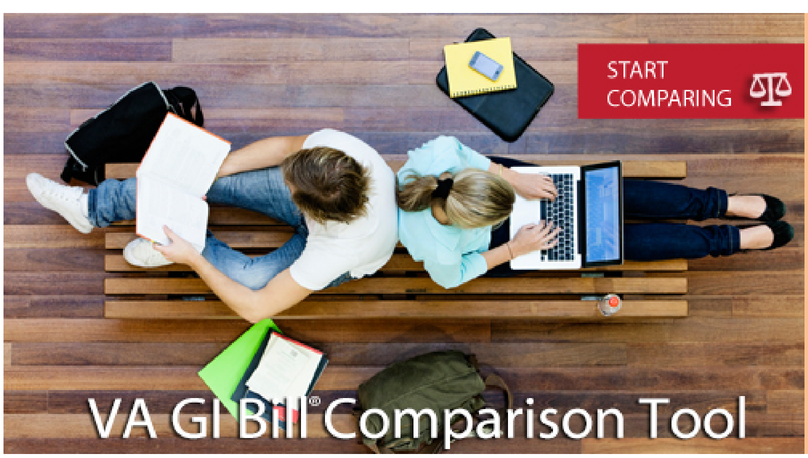
- As of September 30, 2017, an estimated 80,665 beneficiaries are currently eligible and have valid Rehabilitation Plans
- The basic period of eligibility for Chapter 31 is 12 years. However, because recipients of Chapter 31 have service-connected disabilities, exceptions are made. The model assumption for the maximum delimiting period was chosen at a level that includes 95 percent of beneficiaries in the data base. The maximum delimiting period chosen is 21.73 years
- The average eligibility used per year is 6.56 months.

DEA

The VA estimates the liability for DEA at the end of FY 2017 as $1.8 billion compared to the FY 2016 amount of $1.7 billion, an increase of $0.1 billion.

Major assumptions used in the model were:

- As of September 30, 2017, an estimated 91,259 beneficiaries are currently eligible and have an enrollment certification
- Based on VA data, the initial monthly average payment is $1,041 per unit of eligibility
- Average annual usage for children is 7.45 months and for spouses is 5.75 months.



The GI Bill comparison tool provides key information about college affordability and value so beneficiaries can choose the best education program for their needs. Visit the tool at https://www.vets.gov/gi-bill-comparison-tool

Reconciliation of Veterans Compensation, Burial, and Education Actuarial Liabilities (dollars in millions)
For the Period Ended September 30,

	Compensation	Burial	Education	TOTAL
Liability at September 30, 2015	**$ 2,014,000**	**$ 4,600**	**$ 53,091**	**$ 2,071,691**
Expense:				
Interest on the Liability Balance*	**82,200**	**200**	**196**	**82,596**
Actuarial (Gain)/Loss				
Changes in Experience (Veterans Counts, Status)*	91,900	200	18,010	110,110
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**	**$ 18,206**	**$ 570,206**
Less Amounts Paid*	**(74,100)**	**(200)**	**(11,709)**	**(86,009)**
Net Change in Actuarial Liability	**477,400**	**300**	**6,497**	**484,197**
Liability at September 30, 2016	**$ 2,491,400**	**$ 4,900**	**$ 59,588**	**$ 2,555,888**
Expense:				
Interest on the Liability Balance**	**97,900**	**200**	**677**	**98,777**
Actuarial (Gain)/Loss				
Changes in Experience (Veterans Counts, Status)**	50,700	(200)	9,447	59,947
Changes in Assumptions:				
Changes in Discount Rate Assumption	137,800	200	(38)	137,962
Changes in COLA Rate Assumption	(13,300)	-	439	(12,861)
Changes in Other Assumptions	119,800	-	(15,228)	104,572
Net (Gain)/Loss from Changes in Assumptions	244,300	200	(14,827)	229,673
Other Actuarial Changes **	-	-	8,678	8,678
Total Expense	**$ 392,900**	**$ 200**	**$ 3,975**	**$ 397,075**
Less Amounts Paid**	**(79,200)**	**(200)**	**(12,849)**	**(92,249)**
Net Change in Actuarial Liability	**313,700**	**-**	**(8,874)**	**304,826**
Liability at September 30, 2017	**$ 2,805,100**	**$ 4,900**	**$ 50,714**	**$ 2,860,714**

* The sum of these changes represents Veterans benefits actuarial cost, excluding changes in actuarial assumptions on the Statement of Net Cost for 2016.

** The sum of these changes represents Veterans benefits actuarial cost, excluding changes in actuarial assumptions on the Statement of Net Cost for 2017.

NOTE 14. ENVIRONMENTAL AND DISPOSAL LIABILITIES

VA had unfunded environmental and disposal liabilities in the amount of $943 million and $989 million as of September 30, 2017, and 2016, 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, 2017, the liabilities for friable and nonfriable asbestos removal were $250 million and $430 million, respectively.

While some facilities have applied prevailing state regulations that are more stringent than Federal guidelines, 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.

NOTE 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 and considered noncurrent.

Other Liabilities (dollars in millions)
As of September 30, 2017

		FUNDED		UNFUNDED
Intragovernmental				
Credit Reform Act Subsidy Reestimates *	$	1,883	$	-
General Fund Receipt Accounts Liability		60		-
Workers Compensation (FECA) and Other Employee Benefits		339		464
Future Funded Expense - Contract Dispute Act **		-		244
Other		28		-
Accrued Annual Leave***		24		2,244
Accrued Payables		145		-
Accrued Salaries and Benefits		1,251		-
Contingent Legal Liabilities (Note 18)		-		1,860
Deposit and Clearing Account Liability		174		-
Other		45		4
Total Other Liabilities	**$**	**3,949**	**$**	**4,816**

Other Liabilities (dollars in millions)
As of September 30, 2016

		FUNDED		UNFUNDED
Intragovernmental				
Credit Reform Act Subsidy Reestimates *	$	1,598	$	-
General Fund Receipt Accounts Liability		48		-
Workers Compensation (FECA) and Other Employee Benefits		322		486
Future Funded Expense - Contract Dispute Act **		-		249
Other		33		-
Accrued Annual Leave***		22		2,173
Accrued Payables		154		-
Accrued Salaries and Benefits		1,191		-
Contingent Legal Liabilities (Note 18)		-		1,811
Deposit and Clearing Account Liability		169		-
Amounts Due to Non-Federal Trusts		-		115
Other		54		4
Total Other Liabilities	**$**	**3,591**	**$**	**4,838**

*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.

**Future Funded Expense – Contract Dispute Act represents a liability to Treasury's Judgment Fund Branch for amounts paid by Treasury on behalf of the VA for claims related to Contract Dispute Acts (CDAs). VA is required to reimburse Treasury for claims involving CDAs.

***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.

NOTE 16. LEASES

VA has both capital and operating leases. The net capital lease liability was $168,000 and $781,000 as of September 30, 2017, and 2016, respectively. Capital leases consist primarily of information and computer technology, medical equipment, office equipment, and real property. Since capital leases entered into after 1991 are required to be fully funded by budgetary resources in the first year of the lease, the capital lease liabilities are classified as a component of other public funded liabilities in Note 15.

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, 2017

	Cost	Accumulated Amortization	Net Book Value
Real Property	$ 13.0	$ (12.5)	$ 0.5
Equipment	24.2	(20.8)	3.4
Leased Property Under Capital Lease	**$ 37.2**	**$ (33.3)**	**$ 3.9**
Amortization Expense		**$ 1.9**	

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**	

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

For the year ended September 30, 2017, VA had 1,945 real property leases in effect consisting of approximately 26 million square feet and base annual minimum rental obligations of approximately $809 million. Of the operating real property leases, VHA accounts for 85.7 percent, VBA accounts for 9.6 percent, Indirect Administrative Program offices account for 4.4 percent, and NCA accounts for 0.3 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 65 percent of the real property leases have an initial lease term of five years or less; approximately 27 percent have initial lease terms of 6 to 10 years; approximately 4.0 percent have initial lease terms of 11 to 15 years; and approximately 4.0 percent have initial lease terms of 16 years or more. Certain leases contain renewal, termination, and cancellation options.

Approximately 85 percent of VA leases are executed directly with third-party commercial property owners (third-party direct leases) with the balance of the leases executed by GSA on behalf of VA. GSA charges rental rates for space that approximates commercial rental rates for similar properties. The terms of occupancy agreements (OAs) with GSA vary according to whether the underlying assets are owned directly by the Federal Government or rented by GSA from third-party commercial property owners. VA executes cancellable and non-cancellable OAs with GSA. GSA OAs can be cancellable with varying periods of notice required (generally four to six months). For OAs executed after October 2011, periods of occupancy are generally one year. GSA OAs that are canceled 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 five years. For certain GSA OAs with occupancy terms in excess of five years or that incur capitalized building improvement or replacement costs, the base rental rate will be reassessed every five 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 CPI. Additionally, these GSA OAs and third-party direct leases require VA to reimburse increases in real estate taxes over a base year amount at least annually and, in certain cases, VA may pay the common area maintenance costs, operating costs, and real estate taxes directly.

Future commitments for real property and equipment operating leases are based on leases in effect as of September 30, 2017. 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, VA does not present information on non-cancellable equipment leases.

VA's 2017 operating lease rental costs were \$823 million for real property rentals and \$205 million for equipment rentals. The 2016 operating lease costs were \$790 million for real property rentals and \$177 million for equipment rentals.

Excluded from the following table are leases of properties that have expired as of September 30, 2017, 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 that simply preserves the terms and conditions of the lease, providing continuation of required rent payments to maintain occupancy. These commitments are excluded from the five-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 reflected in the 2017 expense in the statements of net costs. The following table represents VA's projected future non-cancellable real property operating lease commitments.

Future Payments Due for Non-cancellable Real Property Operating Leases (dollars in millions)

For the Years Ending:

	GSA OAs	Third Party Direct Leases	Total Real Property
2018	$ 226	$ 367	$ 593
2019	192	339	531
2020	172	314	486
2021	117	290	407
2022	57	258	315
2023 and Thereafter (in total)	210	2,237	2,447
Total Future Lease Payments	**$ 974**	**$ 3,805**	**$ 4,779**

VA is a lessor of certain underutilized real estate properties within the Department under its EUL program authorized by Congress. Title 38, U.S.C. Section 8161-8169, EUL 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 December 31, 2011, and was reauthorized on August 6, 2012, effective January 1, 2012 under P.L. 112-154 Section 211, limited to supportive housing, and set to expire on December 31, 2023. The previous authority under which all of the current operational leases were executed allowed VA to enter into EULs for receipt of rental income or in-kind consideration (such as cost avoidance, cost savings, and enhanced services benefitting Veterans) as all or part of the consideration for the lease to further its mission to effectively serve Veterans and was not limited to supportive housing.

The leases related to 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 67 operational leases of land and/or buildings to the public and private sector. The rental income recognized from the EUL program and the NCA leasing program was $2 million and $1 million for the years ended September 30, 2017, and 2016, respectively. The future rental income to be recognized over the next five years and thereafter from the EUL program and NCA leasing program described above approximates $65 million.

NOTE 17. LIFE INSURANCE LIABILITIES

Through VA, the Federal 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 insured Veterans 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 (Prudential) 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. Title 38, U.S.C. 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 percent to 4.0 percent. The mortality assumptions include the American Experience Table, the X-18 Table, the 1941 CSO Table, the 1958 CSO Basic Table, and the 2001 VBM Table.

Insurance Liability (Reserve) Balances (dollars in millions)

As of September 30, 2017

Program	**Insurance Death Benefits**	**Death Benefit Annuities**	**Disability Income & Waiver**	**Reserve Totals**
NSLI	$ 2,788	$ 35	$ 14	$ 2,837
USGLI	-	1	-	1
VSLI	1,184	4	6	1,194
S-DVI	679	6	782	1,467
VRI	90	-	1	91
VMLI	241	-	-	241
Subtotal	$ 4,982	$ 46	$ 803	$ 5,831
Unearned Premiums				35
Insurance Dividends Left on Credit or Deposit and Related Interest Payable				1,035
Dividend Payable to Policy holders				32
Unpaid Policy Claims				3
Insurance Liabilities Reported on the Balance Sheet				6,936
Less Liability not Covered by Budgetary Resources (Note 12)				(1,602)
Liability Covered by Budgetary Resources				**$ 5,334**

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 Credit or Deposit and Related Interest Payable				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 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 5,436,017 and 5,486,309 policy holders with a face value of $1.2 trillion for both 2017 and 2016.

The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in-force for both 2017 and 2016.

	2017 Policies	2016 Policies	2017 Face Value	2016 Face Value
	(# of policies)		(dollars in millions)	
Supervised Programs (UNAUDITED)				
SGLI Active Duty	1,406,000	1,415,000	$ 536,719	$ 541,842
SGLI Ready Reservists	729,500	742,500	237,295	243,913
SGLI Post Separation	87,000	88,000	31,736	32,231
SGLI Family - Spouse	978,000	955,000	96,246	93,998
SGLI Family - Children	1,804,000	1,855,000	18,040	18,550
TSGLI*	-	-	213,550	215,750
VGLI	431,517	430,809	73,457	71,365
Total Supervised	**5,436,017**	**5,486,309**	**$ 1,207,043**	**$ 1,217,649**
Administered Programs				
NSLI	253,731	309,658	$ 3,218	$ 3,914
VSLI	101,004	110,943	1,476	1,607
S-DVI	275,208	272,112	2,888	2,854
VRI	9,854	12,015	105	127
USGLI	124	348	- *	1
VMLI	2,632	2,654	351	345
Total Administered	**642,553**	**707,730**	**$ 8,038**	**$ 8,848**
Total Supervised and Administered Programs	**6,078,570**	**6,194,039**	**$ 1,215,081**	**$ 1,226,497**

*Less than $1 million

POLICY DIVIDENDS

The SECVA determines annually the excess funds available for dividend payment. Policy dividends for 2017 and 2016 were $70 million and $84 million, respectively.

NOTE 18. COMMITMENTS AND CONTINGENCIES

VA is a party in 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 $2,500 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 payments for 2017 and 2016 were $83.2 million and $154.4 million, respectively. Contract dispute payments for 2017 and 2016 were $8.6 million and $35.6 million, respectively. The discrimination case payments for 2017 and 2016 were $2.1 million and $1.7 million, respectively.

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 $1.9 billion and $1.8 billion for 2017 and 2016, respectively.

There were 48 contract and personnel law cases, where there was at least a reasonable possibility that a loss may occur, with financial exposure $539.2 million to $690.4 million in aggregate for 2017. Within that range, $475.5 million is considered probable and is recorded as a liability. In 2016, the range of exposure was reported as $350 million to $2.5 billion, from 54 cases, of which $276 million was probable and recorded as a liability.

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 August, 2017 and 2016. The amount recorded as a liability was $1.4 billion for 2017 and $1.5 billion for 2016.

In 2016, there was a Court of Appeals for Veterans Claims decision that resulted in a change to 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, it could potentially result in a programmatic expansion with an estimated budgetary impact ranging from $48.0 million to $100.2 million for additional health care benefits payments in 2018 and $165.7 million to $297.5 million over the next five 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 in the following table.

Judgment Fund (dollars in millions)				
For the Periods Ended September 30,				
		2017		**2016**
Fiscal Year Settlement Payments	$	859	$	201
Less Contract Dispute and "No Fear" Payments		(11)		(37)
Imputed Financing-Paid by Other Entities*		848		164
Increase (Decrease) in Liability for Claims		49		(125)
Operating Expense	**$**	**897**	**$**	**39**

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

It is the opinion of management that resolution of pending legal actions as of September 30, 2017, 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.

Any payments due that may arise relating to canceled 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 canceled on September 30, 2017, and 2016 was $1 billion and $990 million, respectively.

VA provides medical care to Veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), the SECVA makes an annual enrollment decision that identifies which Veterans, by priority, will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled Veterans, and changes in cost. While VA expects to continue to provide medical care to Veterans in future years, an estimate of this amount cannot be reasonably made. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For 2013 through 2017, the average medical care cost per year was $58 billion.

NOTE 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 Office of National Veterans Sports Programs and Special Events provides opportunities for Veterans to improve their independence, well-being, and quality of life through adaptive sport, recreation, and art therapy programs.

The source of revenue and other financing sources is a material non-Federal source that requires disclosure and program management responsibility. Treasury does not set aside assets to pay future expenditures associated with these funds. VA's funds from dedicated collections consist of trust, special, and revolving funds that remain available over time. Trust funds do not involve a fiduciary relationship with an individual or group but are designated exclusively for a specific activity, benefit, or purpose.

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

VA's funds are grouped as insurance, medical care, benefits, and burial in the condensed financial statements that follow.

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 and retired reservists and cadets attending service academies and ROTC.	Public, Veterans
Veterans Reopened Insurance Fund	36X4010	38 U.S.C. 1925	Insurance to World War II and Korean Veterans.	Public, Veterans
Service-Disabled Veterans Insurance Fund	36X4012	38 U.S.C. 1922	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
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, cumulative results of operations, net cost of operations, and changes in net positions related to funds from dedicated collections.

Balance Sheet – Funds from Dedicated Collections (dollars in millions)
As of September 30, 2017

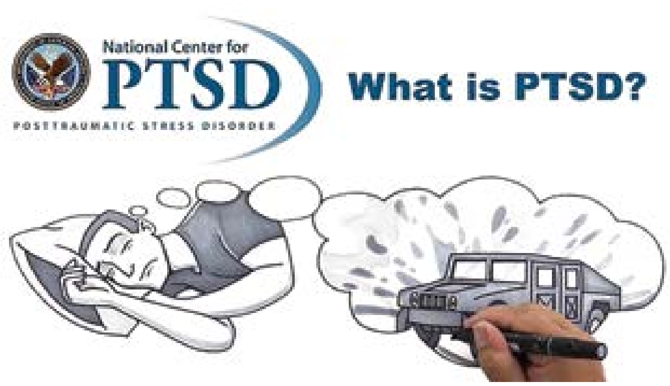
	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Assets:					
Fund Balance with Treasury	$ 45	$ 336	$ 63	$ 3	$ 447
Investments with Treasury (Note 5)	5,386	109	-	-	5,495
Other Assets	256	1,586	-	11	1,853
Total Assets	**$ 5,687**	**$ 2,031**	**$ 63**	**$ 14**	**$ 7,795**
Liabilities and Net Position:					
Payables to Beneficiaries	$ 214	$ 36	$ 1	$ -	$ 251
Other Liabilities	6,693	28	-	-	6,721
Total Liabilities	**$ 6,907**	**$ 64**	**$ 1**	**$ -**	**$ 6,972**
Cumulative Results of Operations	(1,220)	1,967	62	14	823
Total Liabilities and Net Position	**$ 5,687**	**$ 2,031**	**$ 63**	**$ 14**	**$ 7,795**

Statement of Net Cost – Funds from Dedicated Collections (dollars in millions)
For the Period Ending September 30, 2017

	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Gross Program Costs	$ 587	$ 555	$ -	$ 1	$ 1,143
Less Earned Revenues	496	4,064	-	-	4,560
Net Cost/(Benefit) of Operations	**$ 91**	**$ (3,509)**	**$ -**	**$ 1**	**$ (3,417)**

Statement of Changes in Net Position – Funds from Dedicated Collections (dollars in millions)
For the Period Ending September 30, 2017

	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Net Position Beginning of Period	**$ (1,200)**	**$ 1,988**	**$ 62**	**$ 15**	**$ 865**
Budgetary and Other Financing Sources	71	(3,530)	-	-	(3,459)
Net Cost/(Benefit) of Operations	91	(3,509)	-	1	(3,417)
Change in Net Position	**(20)**	**(21)**	**-**	**(1)**	**(42)**
Net Position End of Period	**$ (1,220)**	**$ 1,967**	**$ 62**	**$ 14**	**$ 823**



The National Center for PTSD Web site, which provides resources for Veterans, the general public, and professionals, receives over 6.9 million visitors per year. Veterans can access all of the PTSD materials, products, apps, and courses produced by the Center at: www.ptsd.va.gov.

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**
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 Period Ending 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 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 Period Ending 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**

NOTE 20. EXCHANGE TRANSACTIONS

EXCHANGE REVENUE

Exchange revenue consists primarily of medical revenue recognized when earned from other Federal agencies or the public as a result of costs incurred or services performed on their behalf; benefits revenue from reimbursement of education benefit programs from Servicemember contributions that are transferred to the general fund account with Treasury; insurance revenue from insurance policy premiums paid by policyholders; and housing revenue from interest earned on direct loans. Exchange revenue is 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 September 30, 2017, and 2016, were $2.2 billion and $2.0 billion, respectively. The loan guarantee lender participation fees collected for the years ended September 30, 2017, and 2016, were $2.3 million for both years.

NCA leases lodges at seven 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 12 cemeteries with private sector entities for which it receives rental payments and one with a not-for-profit group at no cost. Two permits are licensed to the Federal Aviation Administration and Department of Interior at no cost. Two easements are leased to commercial entities that are required to pay annual fees for access to the land. Total rental revenues earned under the contracts above were $207 thousand and $90 thousand for September 30, 2017, and 2016, respectively.

VA's MCCF, "Conforming Amendments," changed the language of specific sections of Title 38 U.S.C. Chapter 17 to substitute "reasonable charges" for "reasonable cost." The VHA OCC, 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 health care services, non-Federal workers' compensation, and 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 38 CFR 17.101, 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 interagency per diems are calculated annually to produce rates used to bill for medical care or services provided by VA:

(a) Furnished 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 (OF) 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 CFS, 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 sharing agreements for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA’s General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements; additionally, VHA and DoD are currently working to develop a national billing methodology and reimbursement process.

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 OCC, Revenue Operations PRO Rates and Charges. Interagency billing rates are determined from cost and workload data in the VHA OF Cost Reports.

On March 21, 1917, Loretta Perfectus Walsh became America's first official enlisted woman when she joined the Navy. Women Veterans gathered at the Women in Military Service for America Memorial for this centennial anniversary to honor the service of more than 2.5 million women Veterans who have served our country.

NOTE 21. NET PROGRAM COSTS BY ADMINISTRATION

Schedule of Net Program Costs by Administration (dollars in millions)

For the Period Ended September 30, 2017

	Veterans Health Administration	Veterans Benefits Administration	National Cemetery Administration	Indirect Administrative Program Costs	Total
Program Costs					
Intragovernmental Costs	$ 10,912	$ 839	$ 53	$ 457	$ 12,261
Less Earned Revenues	(77)	(471)	-	(226)	(774)
Net Intragovernmental Program Costs	**$ 10,835**	**$ 368**	**$ 53**	**$ 231**	**$ 11,487**
Public Costs	$ 67,005	$ 100,864	$ 301	$ 1,697	$ 169,867
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	-	75,353	(200)	-	75,153
Less Earned Revenues	(4,127)	(409)	-	(243)	(4,779)
Net Public Program Costs	**$ 62,878**	**$ 175,808**	**$ 101**	**$ 1,454**	**$ 240,241**
Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	$ 73,713	$ 176,176	$ 154	$ 1,685	$ 251,728
Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13)	-	229,473	200	-	229,673
Net Cost of Operations	**$ 73,713**	**$ 405,649**	**$ 354**	**$ 1,685**	**$ 481,401**

Schedule of Net Program Costs by Administration (dollars in millions)

For the Period Ended September 30, 2016

	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 Cost, 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**

NOTE 22. DISCLOSURES RELATED TO THE STATEMENTS OF BUDGETARY RESOURCES

BUDGETARY ACCOUNTING

Budgetary resources, which include new budget authority, unobligated balances, direct spending authority, and obligation limitations, are forms of authority given to VA allowing it to incur obligations. Budget authority is provided by federal law to enter into financial obligations that will result in immediate or future outlays involving Federal Government funds. Budget authority may be classified by the period of availability (annual, 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 Treasury's 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 five additional fiscal years. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled.

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 five 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 canceled.

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 “Appropriations Received” under “Budgetary Financing Sources” 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 No. 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)			
As of September 30,			
	2017	**2016**	**Change**
Category A, Direct	$ 90,849	$ 89,671	$ 1,178
Category B, Direct	100,023	90,910	9,113
Category A, Reimbursable	506	1,114	(608)
Category B, Reimbursable	4,586	3,595	991
Total Obligations Incurred	**$ 195,964**	**$ 185,290**	**$ 10,674**

ADJUSTMENTS TO BUDGETARY RESOURCES AND PRIOR YEAR RECOVERIES

Adjustments to Unobligated and Obligated Balances (dollars in millions)		
As of September 30,	**2017**	**2016**
Total Prior Year Recoveries	**$ 2,690**	**$ 2,663**
Total Rescissions	**$ 7,476**	**$ 1,750**

BORROWING AUTHORITY

The Loan Guaranty Program had borrowing authority of $82 million and $62 million for 2017 and 2016, respectively. The interest rates on the borrowing authority ranged from 1.00 percent to 4.83 percent for 2017 and 2016. Principal repayment is expected over a 30-year period from the date of issuance of debt. Direct loans under the Vocational Rehabilitation Program had borrowing authority of $2.5 million and $3.0 million for 2017 and 2016, respectively. The interest rate on the borrowing authority was 1.61 percent and 1.00 percent for 2017 and 2016, respectively. Principal repayment is expected over a two-year period from the date of issuance of debt. The Loan Guaranty Program borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to housing trusts.

The Vocational Rehabilitation Program loans generally had a duration of one year, and repayment was made from offsetting collections.

PERMANENT INDEFINITE APPROPRIATIONS

VA has three permanent and indefinite appropriations to cover unexpected housing losses. The Veterans Housing Benefit Program Account covers all estimated subsidy costs arising from post 1991 loan obligations for Veterans Housing Benefits. The fund's objective is to encourage and facilitate the extension of favorable credit terms by private lenders to eligible Veterans and their families for the purchase, construction, or improvement of homes they occupy. The Native American Veteran Housing Loan Program Account was established to cover all subsidy costs arising from direct loan obligations related to a Veteran's purchase, construction, or renovation of a dwelling on trust land. The Veterans Housing Benefit Program Liquidating Account is a Loan Guarantee Revolving Fund that contains all of VA's pre-credit reform direct and guaranteed loans. It holds fund balances received from reimbursements from financing accounts for loan modifications and rentals of foreclosed properties not yet transferred to VA. This account is responsible for the property management expenses prior to the sales of foreclosed properties.

EXPLANATIONS OF DIFFERENCES BETWEEN THE SBR AND THE BUDGET OF THE U.S. GOVERNMENT

The table below documents the material differences between the 2016 SBR and the actual amounts reported in the 2018 Budget of the U.S. Government. The 2019 Budget of the United States with the actual 2017 SBR amounts will not be available until February 2018. Once published, the 2017 actual data will be available on the OMB Web site at http://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, 2016

	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Actual Balances per the 2018 Budget of the US Government	**$ 212,277**	**$ 185,289**	**$ 509**	**$ 176,432**
Reconciling Items: *				
Expired Funds	4,409	(50)	-	(175)
Medical Care Collections Fund health care Veterans co-payments excluded from the US Budget but in the SBR	-	-	(3,537)	-
Special Funds not in the US Budget but in the SBR	189	49	(91)	34
Offsetting Differences between the US Budget and the SBR	-	-	(1,009)	-
Miscellaneous Differences	-	2	(3)	-
Per the 2016 Statement of Budgetary Resources	**$ 216,875**	**$ 185,290**	**$ (4,131)**	**$ 176,291**

*The material reconciling items are expired unobligated balances; health care co-payments, special and trust funds; and distributed offsetting receipts. These items are reported in the SBR and the SF 133, *Report on Budget Execution and Budgetary Resources*, but are not in the Budget of the U.S. 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 2017 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 2017 Appropriation Act (P.L. 114-223). 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

Undelivered Orders (dollars in millions)		
As of September 30,	2017	2016
Total Undelivered Orders	**$ 17,054**	**$ 15,488**

CONTRIBUTED CAPITAL

During 2017, VA received donations totaling $42.9 million; $42.2 million to the General Post Fund, $0.5 million to the National Cemetery Gift Fund, and $0.2 million to the Supply Fund.

LEGAL ARRANGEMENTS AFFECTING THE USE OF UNOBLIGATED BALANCES

Legal Arrangements Affecting the Use of Unobligated Balances (dollars in millions)		
As of September 30,	2017	2016
Unapportioned Amounts Unavailable for Future Apportionments	$ 11,516	$ 15,831
Expired Authority	$ 2,645	$ 3,217
Total Unobligated Balances	**$ 14,161**	**$ 19,048**

Unobligated balances of amounts available for apportionment are restricted by public law. Unobligated balances with expired authority remains available for five additional fiscal years for recording and adjusting previously recorded obligations properly charged or to record unrecorded obligations for the period of availability, but cannot be used to fund new obligations. VA's unapportioned balances for 2017 and 2016, respectively, are disclosed in the table above.

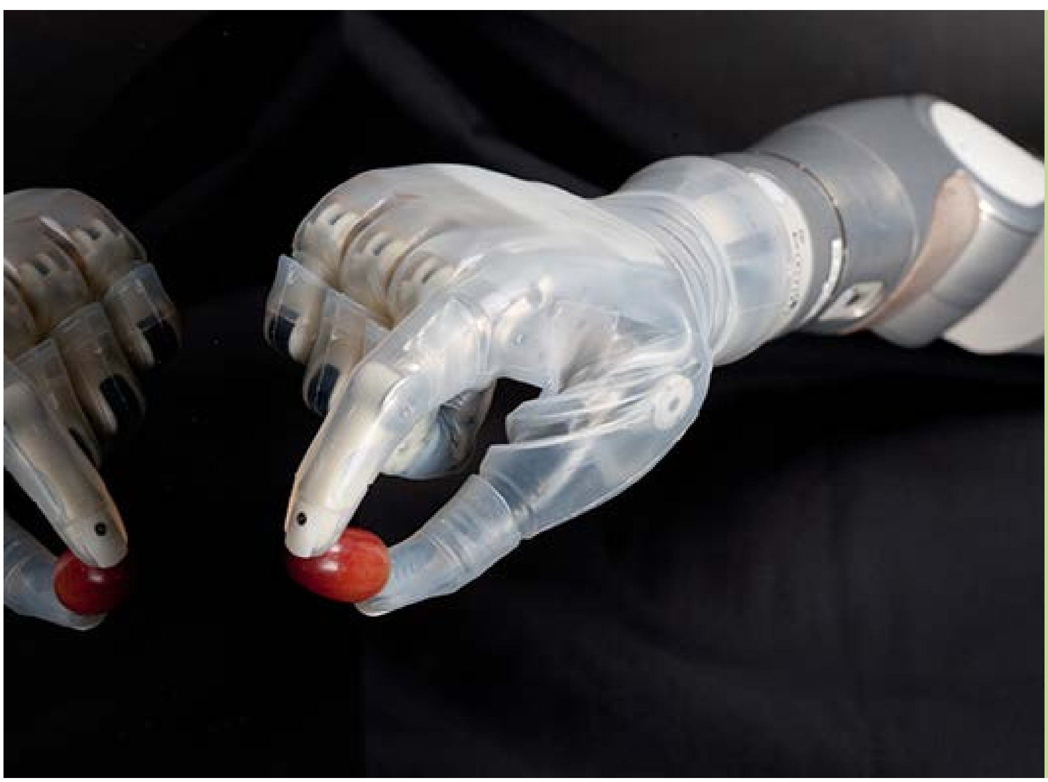
NOTE 23. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

VA presents its Consolidated Statement of Net Cost using the accrual basis of accounting. This differs from the obligation based measurement of total resources supplied, both budgetary and from other sources, on the combined SBR. 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 nonbudgetary resources available to VA with its net cost of operations.

The schedule below begins by detailing the resources used to finance activities. This section reconciles the total obligations incurred from the SBR to the total resources used to finance activities by adjusting for items that have an effect on total resources available that do not use budgetary resources. These adjustments account for resources available to VA that are obtained from sources other than Congressional appropriations.

The next section of the schedule further reconciles the items that do not have an effect on the stated year's net cost of operations, but consumed resources in the stated year. These include items to fund expenses from prior or future periods.

Finally, there are items of net cost that do not have a current year budgetary impact. Primarily, these include costs associated with the changes in actuarial estimates. As these will be funded by budgetary resources in future periods they do not have an impact on the SBR of the current and prior years.



The DEKA arm features six preprogrammed grips that allow users to do a variety of everyday tasks, from handling small, delicate objects to using tools. The DEKA system is a huge leap forward in technology from existing prosthetic arms and hands. Still today, most upper-limb amputees use a hook or split-hook prosthesis that offers only limited function, or an artificial hand that looks natural on the outside but provides no finger movement or grasp. The DEKA arm offers a variety of firsts: It has multiple powered joints and degrees of freedom and can carry out several movements at the same time. It uses an array of sensors and switches and has wireless control. The wrist and fingers adjust into six different grips, enabling users to perform a range of everyday functions: picking up a grape or a glass, holding a tube of toothpaste, turning a key in a lock, using a power tool.

Reconciliation of Net Costs of Operations to Budget (dollars in millions)		
For the Period Ended September 30,	**2017**	**2016**
Resources Used to Finance Activities		
Obligations Incurred	$ 195,964	$ 185,290
Less Offsetting Collections, Receipts and Adjustments	(18,018)	(16,962)
Obligations Net of Offsetting Collections and Adjustments	177,946	168,328
Donations of Property	23	89
Transfers-out	20	25
Imputed Financing	2,583	2,161
Other Financing Sources	(2,212)	(1,811)
Total Resources Used to Finance Activities	**$ 178,360**	**$ 168,792**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	$ (1,910)	$ (2,094)
Resources that Finance the Acquisition of Assets	(7,266)	(6,140)
Resources that Fund Expenses Recognized in Prior Periods	838	(1,894)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	5,074	4,915
Total Resources that Do Not Fund Net Cost of Operations	(3,264)	(5,213)
Total Resources Used to Finance the Net Cost of Operations	**$ 175,096**	**$ 163,579**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	$ 71	$ 102
Increase in Environmental and Disposal Liability	(46)	130
Increase (Decrease) to Judgement Fund Future Funded Expense	192	(194)
Reestimates of Credit Subsidy Expense	(3,227)	(1,033)
Increase in Exchange Revenue Receivable from the Public	(168)	(639)
Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities*	304,786	484,252
Depreciation and Amortization	1,944	1,890
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	630	(39)
Loss on Disposition of Assets	338	227
Undistributed Offsetting Receipts	-	(6)
Other	1,785	2,325
Total Costs That Do Not Require Resources in the Current Period	**306,305**	**487,015**
Net Cost (Benefit) of Operations*	**$ 481,401**	**$ 650,594**

*Portions of the FY 2016 balance in Other were realigned to the increase (decrease) in Veterans benefits and other noncurrent liabilities line during a reconciliation update after interim reporting.

SECTION II: REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED)

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 Periods Ended September 30,					
	2017	**2016**	**2015**	**2014**	**2013**
State Extended Care Facilities	$ 90	$ 140	$ 105	$ 92	$ 180
State Veterans Cemeteries	52	49	47	52	36
Total Grant Program Costs	**$ 142**	**$ 189**	**$ 152**	**$ 144**	**$ 216**

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day health care for Veterans and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, and day health care for Veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last five fiscal years, the State Home Construction Grant Program has awarded grants in excess of $500 million. VA also provides per diem payment for the care of eligible Veterans in state homes.

Since the cemetery program was established in 1980, it has helped establish, expand, improve, operate, and maintain 108 Veterans cemeteries in 47 states and territories including Tribal trust lands, Northern Mariana Islands, and Guam, which provided more than 38,239 burials in 2017. VA awarded grants totaling more than $743 million. State or Tribal organizations provide the land and agree to operate and maintain the Veterans cemeteries in accordance with National Cemetery Administration Standards and Measures.

HUMAN CAPITAL

Investment in human capital comprises expenses for education and training programs for eligible Servicemembers, Veterans, and family members and is 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 VR&E Program provides evaluation services, counseling, and training necessary to assist Veterans in becoming employable and maintaining employment to the extent possible. The program is open to Veterans who have a 10 percent or greater service-connected disability rating and are found to have a serious employment handicap. The Veterans education program provides educational assistance to eligible Servicemembers and Veterans and eligible family members.

Veterans and Dependents Education (dollars in millions)
For the Periods Ended September 30,

	2017	2016
Program Expenses		
Education and Training-Dependents of Veterans	$ 537	$ 526
Vocational Rehabilitation and Education Assistance	13,960	14,503
Administrative Program Costs	536	533
Total Program Expenses	**$ 15,033**	**$ 15,562**
Program Outputs (Participants)		
Dependent Education	99,265	95,477
Veterans Rehabilitation	117,742	107,491
Veterans Education	898,633	931,097

Veterans and Dependents Education (dollars in millions)
For the Periods Ended September 30,

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

Veterans and Dependents Education (dollars in millions)		
For the Periods Ended September 30,		
		2013
Program Expenses		
Education and Training-Dependents of Veterans	$	487
Vocational Rehabilitation and Education Assistance		12,693
Administrative Program Costs		372
Total Program Expenses	**$**	**13,552**
Program Outputs (Participants)		
Dependent Education		89,618
Veterans Rehabilitation		89,708
Veterans Education		971,597

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 health care system. Building on the long-standing partnerships between VA and the Nation's academic institutions, VA plays a leadership role in defining the education of future health care professionals to meet the changing needs of the Nation's health care delivery system.

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

VA employees use technology products offered by the Office of Information and Technology.

SECTION II: REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED)

PROGRAM OUTCOMES

Health Professionals Education					
For the Periods Ended September 30,					
	2017	**2016**	**2015**	**2014**	**2013**
Program Expenses (dollars in millions)					
Physician Residents and Fellows	$ 746	$ 715	$ 689	$ 748	$ 692
Associated Health Residents and Students	162	171	168	157	164
Instructional and Administrative Support	892	903	851	905	856
Total Program Expenses	**$ 1,800**	**$ 1,789**	**$ 1,708**	**$ 1,810**	**$ 1,712**
Program Outputs in units					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	43,100	43,400	41,534	40,420	38,106
Medical Students	24,683	24,283	22,931	21,541	20,218
Nursing Students	27,519	28,389	27,275	29,067	25,948
Associated Health Residents and Students	26,292	27,121	28,663	27,771	33,228
Total Program Outcomes	**121,594**	**123,193**	**120,403**	**118,799**	**117,500**

RESEARCH AND DEVELOPMENT

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 Period Ended September 30, 2017				
	Basic	**Applied**	**Development**	**Total**
Medical Research Service	$ 274.1	$ -	$ -	$ 274.1
Rehabilitative Research and Development	-	76.3	13.5	89.8
Health Services Research and Development	-	90.3	-	90.3
Cooperative Studies Research Service	-	228.1	-	228.1
Medical Research Support	226.6	326.2	11.1	563.9
Total Program Expenses	**$ 500.7**	**$ 720.9**	**$ 24.6**	**$ 1,246.2**

SECTION II: REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED)

Program Expense (dollars in millions) For the Period 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 Period 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 Period 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 Period 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**

In addition, estimates are that VHA researchers received grants of $595 million from the National Institutes of Health and other Federal and non-VA sources in 2017. 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.

SECTION II: REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED)

PROGRAM OUTCOMES

For 2017, VA's R&D general goal related to stewardship was to ensure that Pre-clinical Research and Clinical Research Programs (excluding Cooperative Studies Program [CSP]) met the needs of the Veteran population and contributed to the Nation's knowledge about disease and disability. Target levels were established for the (1) percent of funded research projects relevant to VA's health care mission in designated research areas and (2) number of research and development projects. Strategies were developed in order to ensure that performance targets would be achieved.

Research and Development Measures-Actual
For the Periods Ended September 30,

	2017	2016	2015	2014	2013
Percent of Funded Research Projects Relevant to VA's Health Care Mission	100%	100%	100%	100%	100%
Number of Research and Development Projects	2,150	2,205	2,224	2,184	2,241

VA's Pre-clinical Research and Clinical Research Programs' (excluding CSP) goal is to be premier research organizations, leading the 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.

DID YOU KNOW?

VA's Loan Guaranty Service (LGY) is updating its Regional Loan Center phone operations to better serve our Veteran customers and program participants. Effective on August 14, 2017, Regional Loan Centers no longer maintain individual toll free numbers.

LGY's new national toll-free number will be (877) 827-3702, with hours of operation from 8:00 a.m. to 6:00 p.m., EST.

As part of the update, the phone menu is changing to simplify options and improve the user experience.

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.

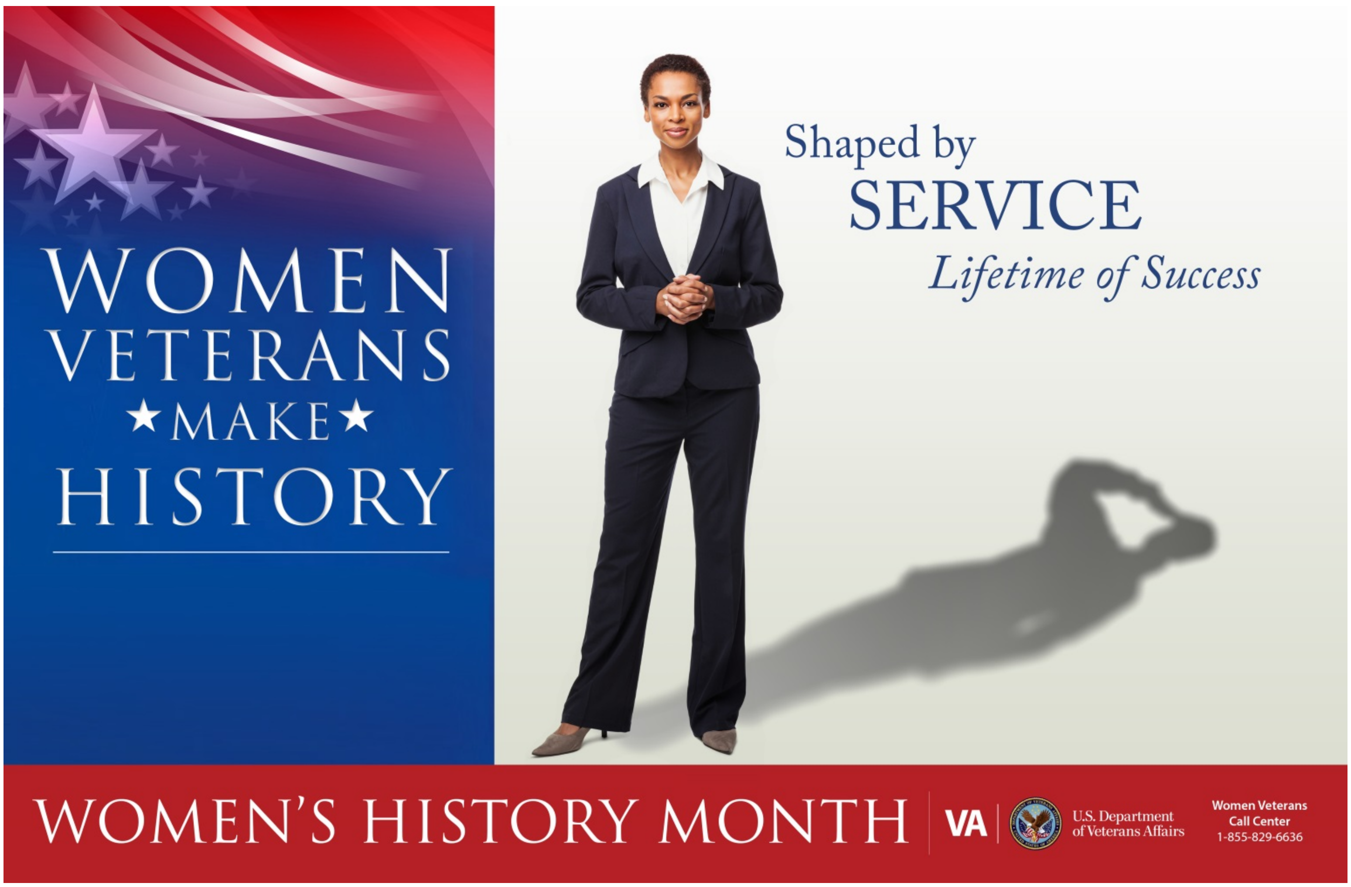
Management determines the level of service and condition that is acceptable to carry out VA's mission, which may vary by VA components, including VHA, VBA, NCA, and Indirect Administrative Program Costs. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained, 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; the surveys are used 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 three-year cycle, assessing all components. Building components assessed include architectural structures and mechanical, plumbing, and electrical systems. Also included for assessment are capitalized, fully depreciated, and noncapitalized 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) and “F” (critical) is given an estimated correction cost and recorded in Deferred Maintenance and Repairs, except where deficiencies will be replaced by capital expenditures. See notes 1, 9, and 10 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 significantly increase cost estimates when sites are reevaluated.

Schedule Of Deferred Maintenance And Repairs (dollars in millions)
As of September 30, 2017

	Ending Balance	Beginning Balance
General PP&E	$ 10,047	$ 9,671
Heritage Assets	977	996
Total Deferred Maintenance and Repairs	**$ 11,024**	**$ 10,667**



Schedule of Budgetary Activity (dollars in millions)
As of September 30, 2017

	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	$ 7,015	$ 6,503	$ 130	$ 882	$ 1,041	$ 6,214
0160 Medical Care	52,712	49,081	2,023	7,926	6,964	48,020
0162 Medical Facilities	5,902	5,684	326	2,995	2,945	5,408
0167 Medical Facilities	5,116	4,594	304	2,108	2,096	4,302
0172 Veterans Choice Fund	7,306	5,574	702	1,744	1,784	4,832
All Other	14,284	11,175	783	2,627	4,224	8,795
Total	**$ 92,335**	**$ 82,611**	**$ 4,268**	**$ 18,282**	**$ 19,054**	**$ 77,571**
Veterans Benefits Administration						
0102 Compensation, Pension, & Burial Benefits	$ 89,446	$ 85,615	$ 521	$ 142	$ 163	$ 85,073
0137 Readjustment Benefits	19,833	13,752	578	182	130	13,226
4127 Direct Loan Financing	121	34	72	-	-	(38)
4129 Guaranteed Loan Financing	15,155	4,192	4,822	361	307	(576)
8132 National Service Life Insurance Fund	810	810	51	854	761	852
0151 General Operating Expenses	4,091	3,981	1,070	501	780	2,632
All Other	4,066	2,476	1,096	462	449	1,393
Total	**$ 133,522**	**$ 110,860**	**$ 8,210**	**$ 2,502**	**$ 2,590**	**$ 102,562**

(continues on next page)

Schedule of Budgetary Activity (dollars in millions)

As of September 30, 2017

	Total Budgetary Resources	Obligations Incurred	Spending Authority from Offsetting Collections and	Obligated Balance net, Oct. 1	Obligated Balance net, Sept. 30	Total Outlays
National Cemetery Administration						
Total	**$ 364**	**$ 344**	**$ 12**	**$ 151**	**$ 159**	**$ 324**
Indirect Administrative Program Cost						
0142 General Administration	$ 720	$ 644	$ 332	$ 202	$ 113	$ 401
1122 Board of Veterans Appeals	152	131	2	10	10	129
4537 Supply Fund	1,660	1,164	1,432	(59)	(169)	(158)
All Other	1,249	1,110	919	90	174	107
Total	**$ 3,781**	**- 3,049**	**$ 2,685**	**$ 243**	**$ 128**	**$ 479**
Total of all Administrations	**$ 230,002**	**$ 196,864**	**$ 15,175**	**$ 21,178**	**$ 21,931**	**$ 180,936**

On Tuesday, November 7, 2017, Secretary Shulkin joined community and corporate partners in honoring Veterans and active duty Servicemembers at the New York Stock Exchange.

Report Distribution

VA Distribution

Office of the Secretary
Veterans Benefits Administration
Veterans Health Administration
National Cemetery Administration
Assistant Secretaries
Office of General Counsel
Office of Acquisition, Logistics, and Construction
Board of Veterans' Appeals

Non-VA Distribution

House Committee on Veterans' Affairs
House Appropriations Subcommittee on Military Construction, Veterans Affairs, and Related Agencies
House Committee on Oversight and Government Reform
Senate Committee on Veterans' Affairs
Senate Appropriations Subcommittee on Military Construction, Veterans Affairs, and Related Agencies
Senate Committee on Homeland Security and Governmental Affairs
National Veterans Service Organizations
Government Accountability Office
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This report is available on our website at www.va.gov/oig.