Financial Highlights

Pursuant to the requirements of 31 U.S.C. 3515 (b), VA's financial statements report the financial position and results of operations of the Department. Deloitte & Touche, LLP, performed the audit of the statements under the direction of the Office of Inspector General. While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget (OMB), they are, in addition to the financial reports, used to monitor and control budgetary resources that are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides the authority to do so.

VA received an unqualified opinion on the financial statements for 2002 and 2001 from Deloitte & Touche, LLP, continuing a noteworthy achievement first attained in 1999. As a result of their audit work, however, Deloitte & Touche, LLP, identified and reported 2 material weaknesses and 3 reportable conditions in VA's system of internal controls and compliance with laws and regulations. VA corrected three material weaknesses identified by the auditors in the 2001 audit and continues to implement corrective actions to close the remaining material weaknesses. However, correction of these material weaknesses will take several years, given the level of resources required to implement required actions.

VA implemented a change in accounting principles, raising the fixed asset capitalization threshold from $25,000 to $100,000 for real and personal property. This change reduced the number of capitalized property items in VA's system by 39,000 items. This reduction improves VA's property, plant and equipment (PP&E) accounting by enhancing the asset reconciliation--a cost savings. This initiative will also improve VA's ability to meet the accelerated reporting dates mandated by OMB and enhance the accuracy of the PP&E value presented in the consolidated financial statements--a key issue in maintaining a clean audit opinion. This change is discussed in Note 22 in the Notes to the Consolidated Financial Statements.

VA programs operated at a net cost of $210.3 billion in 2002 compared with $187.3 billion in 2001. The calculation of the actuarial liability for future years' veterans' compensation and burial benefits, which increased by $157.3 billion during 2002 and by $139.4 billion in 2001, heavily impacts each year's cost. The most significant sources of change associated with the compensation and pension (C&P) programs during 2002 and 2001 were the overall decrease in interest rates during these two periods and the number of new compensation awards made for diabetes in 2001. Excluding the change in this actuarial liability from the net cost would result in an adjusted net cost for VA's programs of $53.0 billion and $47.9 billion for 2002 and 2001, respectively. The majority of this increase applies to two programs -- compensation, $2.1 billion, and medical care, $1.8 billion.

An examination of assets and liabilities reported on VA's balance sheets reveals four lines with changes greater than $1 billion. The largest increase is in the Federal Employee and Veterans Benefit Liabilities, which is related to the increase in the actuarial liability for future compensation and burial benefit payments. It should be noted that the future cash flows to liquidate the Federal Employee and Veterans Benefits Liability are not supported by any identifiable assets, as they are anticipated to be funded from the future general revenues of the U.S. Government. The change in the compensation and burial benefit liability is the most significant component of the change

in Cumulative Results of Operations. The third significant change relates to an increase in borrowing from the Treasury in the Direct Loan Housing Program. Additional borrowing was required to cover program interest cost.

VA continues to increase the amount of collections from patients and third-party insurers. Collections deposited to the Medical Care Collections Fund (MCCF) were $1.2 billion in 2002 and $0.8 billion in 2001. MCCF collections have increased by $0.4 billion over the past 2 fiscal years. In addition, the newly created Health Services Improvement Fund (HSIF), which receives designated pharmacy co-pay, generated an additional $0.2 billion in new collections. Further, as VA begins an overall review of open medical claims, medical receivables reported for patient and third-party insurers show a slight decline this year. We expect this trend to continue next year as medical centers review and close claims with little likelihood of additional collection activity.

The Department continued its aggressive use of the governmentwide commercial purchase card program. Purchase card disbursements for 2002 were over $1.5 billion, covering over 2.7 million transactions and earning VA credit card rebates from Citibank totaling over $15.9 million. This is an 18 percent increase over the rebates earned in 2000 ($13.5 million).

In the area of debt management, VA has established an excellent record for referral of eligible delinquent debt to the Department of Treasury's Offset (TOP) and Cross-Servicing (CS) Programs. Since VA began participation in TOP, we have referred $348 million, of which $119 million was referred in FY 2002. Currently, $283 million remains at TOP, which is 97 percent of the debt eligible for referral for offset. Since VA began participation in the CS program, we have referred $393 million, of which $87 million was referred in FY 2002. Currently, $183 million remains at CS, which is 93 percent of the debt eligible for referral to CS.

Under 38 U.S.C. 8161, et seq., VA may enter into long-term (up to 75 years) outleases of VA property in return for fair consideration including goods, services, or space beneficial to VA's mission. In some cases, the lessee provides "in-kind" consideration through a third party including an independent trust. Once established, the independent trust assumes obligations to provide in-kind consideration to the Department. VA is not party to the trust agreement and does not "own" or control the trust, and has no beneficial, residual, or other interest in the trust estate other than the assets that are specifically deposited into the enhanced-use leasing account for the purpose of providing in-kind consideration to VA. This arrangement has proven to be very beneficial to the Department in the several enhanced-use leases now in place. Consequently, as the Department uses the enhanced-use leasing program to address its capital and resource requirements, VA anticipates that most of its in-kind benefits will be received through these types of third-party providers.