Department of Veterans Affairs 1997 Financial Presentation

FINANCIAL CONTENTS

Consolidated Financial Statements

Statement of Financial Position
As of September 30, 1997 and 1996
(dollars in millions)

Assets	1997	1996
Fund Balances in Treasury	$ 14,083	$ 13,143
Investments (Note 7)	14,644	14,548
Receivables (Note 8)	5,317	4,463
Merchandise and Supply Inventories	64	68
Advances and Prepayments (Note 8)	266	308
Property, Plant and Equipment, Net (Note 9)	11,655	11,140
Total Assets	46,029	43,670
Liabilities		
Funded Liabilities		
Accounts Payable and Accrued Liabilities	4,044	4,596
Liabilities for Loan Guarantees (Note 5)	4,196	3,514
Deferred Revenues and Other Liabilities	234	282
Dividends on Credit or Deposit	1,258	1,174
Insurance Policy Reserves (Note 6)	12,966	12,933
Dividends Payable	805	858
Resources Payable to Treasury	1,046	1,249
Intragovernmental-Debt from Borrowing Authority	3,707	1,783
Total Funded Liabilities	28,256	26,389
Unfunded Liabilities		
Accrued Leave	868	856
Insurance Policy Reserves (Note 6)	469	556
Liability for Federal Employees Compensation Act	1,742	1,699
Liability for Veterans' Compensation and Burial Benefits (Note 4)	468,353	442,324
Total Unfunded Liabilities	471,432	445,435
Total Liabilities	499,688	471,824
Net Position		
Fund Balances		
Unexpended Appropriations	4,458	4,333
Invested Capital	11,719	11,209
Cumulative Results of Operations	1,345	1,462
Equity in Overpayment Receivables and Other	251	277
Total Fund Balances	17,773	17,281
Less Future Funding Requirements	471,432	445,435
Net Position (Deficit)	(453,659)	(428,154)
Total Liabilities and Net Position	$ 46,029	$ 43,670

The accompanying notes are an integral part of these statements.

Consolidated Financial Statements

Statement of Operations and Changes in Net Position (Deficit)
Fiscal Years Ending September 30, 1997 and 1996
(dollars in millions)

	FY 1997	FY 1996
Revenues and Financing Sources		
Appropriations Expended	**$ 40,269**	$ 37,592
Revenues from Sales of Goods and Services	**2,189**	2,352
Interest and Penalties	**1,746**	1,836
Imputed Financing-Expenses Paid by Other Entities	**826**	817
Vendee Loan Reimbursements	**437**	808
Other Revenues and Administrative Expense Financing	**92**	78
Receipts Transferred to Treasury or Other Agencies	**(38)**	(34)
Total Revenues and Financing Sources	**45,521**	43,449
Expenses		
Program or Operating Expenses	**40,923**	38,373
Cost of Goods Sold	**182**	153
Depreciation and Amortization	**899**	743
Bad Debts and Write-offs	**585**	894
Interest on Treasury Borrowing	**418**	478
Interest on Dividends Credit or Deposit	**100**	99
Dividends to Policyholders	**826**	884
Other Expenses and Benefit Administrative Costs	**1,025**	996
Total Expenses	**44,958**	42,620
Excess (Shortage) of Revenues and Financing Services over Total Expenses before Extraordinary Items	**563**	829
Extraordinary Items and Other Adjustments	**(26,029)**	(189,607)
Excess (Shortage) of Revenues and Financing Sources over Total Expenses	**(25,466)**	(188,778)
Net Position, Beginning Balance	**(428,154)**	(207,236)
Plus (Minus) Non Operating Changes	**(39)**	(32,140)
Net Position (Deficit) Ending Balance	**$(453,659)**	$(428,154)

The accompanying notes are an integral part of these statements.

Consolidated Financial Statements

Statement of Cash Flows
Fiscal Years ending September 30, 1997 and 1996
(dollars in millions)

	1997	1996
Cash Provided by Operating Activities		
Sale of Goods and Services	$ 1,177	$ 1,248
Interest and Penalties	1,772	1,779
Benefit Programs	196	209
Insurance and Guarantee Programs	1,615	2,289
Other Operating Cash Provided	77	22
Total Cash Provided	4,837	5,547
Cash Used by Operating Activities		
Personal Services and Benefits	(11,645)	(11,442)
Travel and Transportation	(244)	(233)
Rent, Communications and Utilities	(771)	(725)
Printing and Reproduction	(17)	(21)
Other Contractual Services	(2,345)	(2,298)
Supplies and Materials	(2,951)	(2,665)
Insurance Claims and Indemnities	(21,174)	(19,170)
Grants, Subsidies and Contributions	(2,016)	(2,525)
Interest and Dividends	(1,137)	(1,154)
Total Cash Used	(42,300)	(40,233)
Net Cash Provided (Used) by Operating Activities	(37,463)	(34,686)
Cash Provided (Used) by Investing Activities		
Sales of Foreclosed Property	397	589
Purchase of Property, Plant and Equipment	(2,934)	(2,135)
Sale of Securities	2,658	2,834
Purchase of Securities	(1,676)	(1,691)
Collection of Long-Term Loans Receivable	474	515
Creation of Long-Term Loans Receivable	(2,211)	(2,164)
Net Cash Provided (Used) Investing Activities	(3,292)	(2,052)
Net Cash Provided (Used) by Financing Activities		
Appropriations (Current Warrant)	40,235	38,149
Withdrawals	(708)	(982)
Transfer of Cash from Others	67	732
Net Appropriations	39,594	37,899
Borrowing from the Treasury	1,926	1,903
Repayments on Loans from the Treasury	(6)	(1,703)
DoD Servicemen's Group Life Insurance Collections	474	467
DoD GI Bill Treasury Collections	185	148
Servicemen's Group Life Insurance Transfers to Prudential	(478)	(474)
Net Cash Provided (Used) by Financing Activities	41,695	38,240
Net Cash Provided (Used) by Operating, Investing and Financing Activities	940	1,502
Beginning Fund Balances with Treasury	13,143	11,641
Ending Fund Balances with Treasury	14,083	13,143
Reconciliation of Excess (Shortage) of Revenues and Financing Sources over Total Expenses Before Extraordinary Items	563	829
Adjustments to Reconcile Excess (Shortage) of Revenues and Financing Sources Over Total Expenses to Net Cash Provided by Operating Activities		
Appropriated Capital Used	(40,269)	(37,592)
Decrease (Increase) in Accounts Receivable	(717)	(254)
Decrease (Increase) in Loans Receivable	10	(323)
Decrease (Increase) in Other Assets	124	(131)
Increase (Decrease) in Accounts Payable	137	2,530
Increase (Decrease) in Other Liabilities	1,597	(658)
Depreciation and Amortization	899	744
Other Unfunded Expenses	167	760
Subsidy Reestimates and Other Adjustments	26	(591)
Total Adjustments	(38,026)	(35,515)
Net Cash Provided (Used) by Operating Activities	$(37,463)	$(34,686)

The accompanying notes are an integral part of these statements.

Consolidated Financial Statement

Statement of Budgetary Resources and Actual Expenses
For the Fiscal Years Ending September 30, 1997 and 1996
(dollars in millions)

	1997	1996
Total Resources	**$70,219**	$67,852
Obligations		
Direct	**46,947**	45,214
Reimbursed	**6,460**	7,800
Actual Expenses	**44,958**	42,620
Budget Reconciliation		
Total Expenses	**44,958**	42,620
Capital Acquisitions	**2,939**	2,693
Loans Disbursed	**2,087**	1,631
Other Expended Budget Authority	1,657	1,018
Depreciation and Amortization	**(899)**	(743)
Unfunded Annual Leave Expense	**(12)**	(73)
Bad Debt and Other Unfunded Expenses	**(1,460)**	110
Accrued Expenditures	**49,270**	47,256
Less Reimbursements	**(6,460)**	(7,800)
Accrued Expenditures, Direct	**$42,810**	$39,456

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

(Tabular dollars in millions)

Significant Accounting Policies

Note 1 Entity and Basis of Consolidation

The Department of Veterans Affairs (VA) used 65 funds: 22 general, 24 revolving, 8 trust, 5 deposit, 5 clearing accounts and 1 special fund in its ongoing mission to care for, support, and recognize America's veterans. They are distributed among five lines of business: Medical & Construction (18), Veterans Benefits (10), Housing Credit Assistance (13), Life Insurance (7), and Administration & Cemeteries (17) Some trust and revolving fund activities for insurance and housing credit assistance programs are augmented by budget appropriations.

The consolidated financial statements comprise all funds for which VA is responsible on the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. They have been prepared from the accounting records of VA in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 94-01 and VA's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared by VA pursuant to OMB directives, that are used to monitor and control VA's use of budgetary resources. All significant intra-agency balances and transactions have been eliminated in consolidation.

The VA life insurance programs follow the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 120, "Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts."

The life insurance program's reserves are based on mortality tables and interest assumptions prescribed by Federal statutes and are designed to be sufficient to provide for guaranteed policy benefits.

These footnotes to the financial statements present data by line of business which varies from the format specified in OMB Bulletin 94-01, "Form and Content of Agency Financial Statements", but contain basically the same disclosure level.

Recognition of Financing Sources

The current congressional budgetary process under which VA operates does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of budgetary resources (outlays) as paid. For financial reporting purposes under accrual accounting, operating expenses are recognized currently, while expenditures for capital and other long-term assets are capitalized and not recognized as expenses until actually used. Financing sources for these expenses, which derive from both current and prior year appropriations and operations, are also recognized this way. The consolidated statement of budget and actual expenses presents a reconciliation of operating expenses on an accrual basis with budgetary expenditures.

For certain accrued expenses (e.g., annual leave earned but not taken, future period veterans compensation and pension benefits, and insurance premiums for disabled veterans funded by appropriations), current or prior year appropriations aren't available to fund them; but, these expenses are usually financed (funds appropriated) the year payment is made. Amounts due from future financing sources are therefore recognized in operations each year for the year's accrued expenses. These cumulative accruals are disclosed in the Consolidated Statement of Financial Position as a reduction of total net position. These statements represent a U.S. Government Department - a sovereign entity. The unfunded liabilities reported in them, which depend on federal financing, can't be liquidated without the enactment of an appropriation law. Statement users must realize that payment of liabilities other than contracts can be abrogated by the sovereign entity.

Operating Revenue and Other Financing Sources Recognition

Interest income, which is earned primarily from the investments of VA's life insurance program, is recognized on the accrual basis. Insurance premiums are recognized as revenue when due. Loan origination fees are recognized as revenues at the time of the guaranty.

VA life insurance programs receive the majority of the funding needed to support the programs from premiums paid by policyholders and interest earned on U.S. Government securities. Appropriated funds are required to meet the operating deficits of the Service Disabled Veterans Insurance (SDVI) and Veterans Insurance and Indemnity (VI&I) programs. Appropriations are recognized as revenues at the time they are received to fund the operating deficits and claims. Other revenues are recognized when earned.

Cash with Department of the Treasury and On Hand

VA does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the Department of the Treasury. The balance in the Treasury represents the right to draw on the Treasury for allowable expenditures. Cash advanced to imprest fund cashiers totaled $5.5 million at September 30, 1997, and $5.8 million at September 30, 1996.

Commitments

VA has obligations remaining at the end of each year for goods and services ordered but not yet received (undelivered orders). Aggregate undelivered orders amounted to $2.7 billion at September 30, 1997, and $2.3 billion at September 30, 1996. Of these amounts $646 million in FY 1997 and $800 million in FY 1996 were related to construction projects of both long and short-term duration. The remainder were mainly comprised of obligations for medical supplies and equipment that were incurred by VA in normal mission fulfillment.

Obligations Related to Canceled Appropriations

The amount of unobligated and obligated authority relating to appropriations canceled on September 30, 1997, was $68.6 million and on September 30, 1996, was $78.3 million. Any payments that may arise relating to canceled appropriations will be paid out of the current year appropriations in accordance with the provisions of the Expired Fund Control Act of 1990.

Property and Equipment

The majority of the reported property represents facilities and equipment used to provide medical care to veterans. Property and equipment, including transfers from other Federal agencies, are valued at cost. Expenditures for major additions, replacements, and alterations are capitalized. Routine maintenance is recognized as an expense when incurred. Costs of construction are capitalized as Construction in Progress until completed and then transferred to the appropriate property account.

Buildings are depreciated using the straight line method over estimated useful lives ranging from 25 to 40 years. Equipment is depreciated using the straight line method over useful lives, and for most equipment, ranges from 5 to 20 years.

Insurance Program Loans Receivable

Policyholders with permanent plan coverage may borrow up to 94 percent of the cash value of their policies. Loans are accounted for as receivables after funds have been disbursed. Policyholder loans are not subject to the Federal Credit Reform Act.

Insurance Interest Payable

Insurance interest payable is interest earned on dividends left on deposit and paid annually to insurance policyholders on their policy anniversary dates.

Investments in U.S. Government Securities

Investments in U.S. Government Securities are reported at cost and redeemable at any time for their original cost.

Accrued Compensation and Pension Benefits

Compensation and pension benefits are accrued when veterans have satisfied VA's eligibility criteria. This accrual pertains only to benefits due and payable in a particular fiscal year.

Unfunded Expenses

Unfunded expenses include accrued program expenses customarily financed by appropriations. The cumulative amount for which appropriations have not been enacted is classified as an unfunded liability.

Future Liability for Veterans Compensation and Burial Benefits

These unfunded liabilities represent the future liability for veterans' disability compensation and burial benefits as required by SFFAS No. 5. The actuarial liability for veterans' benefits is discussed in Note 4.

Losses on Guaranteed Loans

Upon foreclosure of a guaranteed loan, VA may be required to pay the maximum claim, acquire the property, or acquire the property and pay less than the maximum claim pursuant to criteria established in 38 U.S.C. 3732. Thus, when VA acquires the property, the cost is comprised of the claimed amount paid the lender less net proceeds from the sale of the property. VA incurs an additional cost for direct home (vendee) loans, issued upon the sale of foreclosed properties, that subsequently default.

Estimated losses on anticipated defaults of guaranteed loans are recorded as expenses when the loans are guaranteed. A liability provision is simultaneously established representing the estimated cost of defaults for those guaranteed loans indicating probable future default. A portion of this provision is subsequently reclassified as a reduction to: (1) direct home loans receivable when such loans are issued (see Note 8); (2) foreclosed property held for sale when property is acquired, recording such property at its net realizable value and; (3) investments in subordinate securities reflecting the estimated loss of principal for the securities due to their subservient position. The remainder of the provision for loan losses is classified as a liability for future loan losses.

Annual, Sick, and Other Types of Leave

Annual leave is accrued when earned and the accrual is reduced when leave is used. At least once a year, the balance in the accrued annual leave account is adjusted to reflect current pay rates of cumulative annual leave earned but not taken. The amount of unfunded annual leave accrued at September 30, 1997, was $868 million and $856 million for September 30, 1996. A corresponding amount has been established in the future funding requirements for each year. Sick and other types of leave are expensed as taken.

Policy Dividends

The Secretary of Veterans Affairs determines annually the excess funds available for dividend payment. Dividends payable are based on an actuarial analysis of the individual programs at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. Policyholders can elect: (1) cash payment, (2) prepay premiums, (3) repay loans, (4) purchase paid-up insurance, or (5) deposit in an interest-bearing account. A provision for dividends is charged to operations and an insurance dividend payable is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs. Dividends Payable shown in the Statement of Financial Position represents dividends expected to be paid during the subsequent fiscal year. It also includes an estimate of the amount of dividends due and unpaid at fiscal year end. Dividends shown in the Statement of Cash Flows represent the amount of dividends paid in the last twelve months. During FY 1997 total dividends paid for all insurance programs was $879 million and $915 million in 1996.

Insurance Program Liabilities

Most insurance liabilities are actuarially determined reserves representing the present value of future benefits less the present value of future premiums. Insurance reserve liabilities are based on mortality tables and interest assumptions prescribed by Federal statutes and are designed to be sufficient to provide for guaranteed policy benefits. Such liabilities are determined as the present value of future benefits less the present value of future revenues. These liabilities are recorded for: (1) unpaid claims in process, (2) experience-based estimates of claims incurred but not reported, and (3) incurred death and permanent disability installment claims. These liabilities are included in Accounts Payable.

Liabilities for the SDVI and VI&I programs for which an appropriation has not been enacted are classified as unfunded liabilities.

Dividends Left on Deposit

Dividends are held on credit or deposit, with interest. The liability for dividends left on deposit was $1.3 billion at September 30, 1997, and $1.2 billion at September 30, 1996.

Trust Fund Balances

Trust fund balances consist of the Post-Vietnam Educational Assistance Trust Fund, National Service Life Insurance (NSLI) Fund, United States Government Life Insurance (USGLI) Fund, Veterans Special Life Insurance (VSLI) Fund, General Post Fund, National Cemetery Gift Fund, Transitional Housing Loan Program Account and the Transitional Housing Loan Financing Account. These funds are accounted for separately and their use is restricted.

Workers Compensation

Legal actions brought by VA employees for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the Department of Labor (DOL). DOL bills each Agency annually as its claims are paid; however, payment on these bills is deferred two years to allow for funding through the budget process. Using actuarial estimates provided by DOL, VA recorded FECA liabilities for balances billed to VA and for estimates of the present value. The discount rates used range from 5.4% - 6.2% for September 30, 1997, and 5.1% - 6.2% for September 30, 1996, of the long-term payments related to cases on hand at the end of the fiscal year. The amount of unfunded FECA liability accrued was $1.7 billion at September 30, 1997, and September 30, 1996. A "mirror" amount has been established in the future funding requirements of each year.

Statement of Budget and Actual Expenses

This statement presents key amounts taken from the Report on Budget Execution (SF-133) as submitted to OMB, specifically Total Resources available to fund Direct and Reimbursed Obligations, and Accrued Expenditures. Total Resources equals new budget authority, available unobligated balances, and reimbursements. Accrued Expenditures are charges against appropriations and other financial resources. The reconciliation of "Total Expenses" shows adjustments from the accrual-based Statement of Operations to the obligations-based Accrued Expenditures.

Note 2 Intragovermental Financial Activities

Department of Treasury Funding

VA's financial activities interact with and are dependent upon those of the Federal Government as a whole. Therefore, VA's financial statements do not reflect the results of all financial decisions and activities applicable to VA as if VA were a stand-alone entity.

VA's consolidated financial statements are not intended to report the Department's proportionate share of the Federal deficit or public borrowing including interest thereon. Financing for budget appropriations reported on VA's statement of operations could be derived from tax revenues, public borrowing, or both. The ultimate source of this financing, whether it be tax revenues or public borrowing, has not been specifically allocated to VA.

Financing for major and minor construction projects was obtained through budget appropriations. To the extent that this financing was derived from public borrowing, no interest has been capitalized because such borrowings are recorded in total by the Department of the Treasury and are not allocated to individual Departments and agencies.

Veterans Life Insurance Activities

The accompanying financial statements reflect the financial decisions and activities directly related to the Life Insurance programs of the Veterans Benefits Administration, Department of Veterans Affairs. Day-to-day operations of the programs are impacted by both VA and other Federal agencies. Specifically, the SDVI, VI&I and Veterans Mortgage Life Insurance (VMLI) programs receive appropriations to meet their operating deficits. The National Service Life Insurance (NSLI) and United States Government Life Insurance (USGLI) programs receive appropriations to fund claims traceable to the extra hazards of military service. The NSLI, USGLI, SDVI, Veterans Special Life Insurance (VSLI) and Veterans

Reopened Insurance (VRI) programs receive appropriations to fund the cost of overpayments waived.

The Servicemen's Group Life Insurance (SGLI) and Veterans Group Life Insurance (VGLI) programs are administered by VA through a group policy with the Prudential Life Insurance Company of America. Premiums are set by mutual agreement of VA and Prudential. SGLI premiums for Active Duty service personnel, ready Reservists, and Reservists with part-time coverage are deducted from their pay and remitted by each uniformed service to VA, which in turn remits them to Prudential. Veterans insured under VGLI send their premiums directly to Prudential.

VA also monitors Prudential reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. Amounts withdrawn are held in the SGLI revolving fund and are invested in U.S. Treasury Department securities. VA can use the SGLI revolving fund assets to stabilize and to augment participant premiums.

VAcash balances are maintained by the Treasury Department, and Life Insurance programs' receipts and disbursements are processed by the Federal Reserve System and Treasury. As required by Title 38, the Life Insurance programs invest in U.S. Treasury Securities.

The facilities occupied by the Life Insurance program offices in Philadelphia, St. Paul, and at VA Central Office are owned and maintained by the General Services Administration.

Employee Retirement Systems and Benefits

During FY 1997, nearly 97 thousand VA employees continued to participate in the contributory Civil Service Retirement System (CSRS) to which VA makes matching contributions. However, VA does not report CSRS assets, accumulated plan benefits, or unfunded liabilities applicable to its employees. This data in total is reported by the Office of Personnel Management.

On January 1, 1987, the new Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Employees hired after December 31, 1983, are automatically covered by FERS, while employees hired prior to January 1, 1984, may elect to either join FERS or remain in CSRS. One of the primary differences between FERS and CSRS is that FERS offers a savings plan to which VA will automatically contribute one percent of base pay as well as match employee contributions up to an additional four percent of basic pay. During FY 1997, over 164 thousand VA employees participated in FERS.

Employees participating in FERS are covered under the Federal Insurance Contributions Act (FICA) for which VA contributes a matching amount to the Social Security Administration. VA's total contributions for CSRS and FERS participants, including contributions to the Social Security Administration, during FY 1997 and 1996 are shown below:

VA Funded Contributions	**FY 1997**	FY 1996
Civil Service Retirement System	**$ 255**	$ 270
Federal Employees Retirement System	**742**	719
Federal Insurance Contributions Act	**449**	443
Total Contributions	**$1,446**	$1,432

While VA has no liability for future payments to employees under these programs, the

Federal Government is liable for future payments to employees through the various agencies administering the programs.

VA does not fund post-retirement benefits such as the Federal Employees Health Benefit (FEHB) Program and the Federal Employees Group Life Insurance (FEGLI) Program. VA also is not required to fully fund the CSRS pension liability. However, VA is required to recognize an expense and impute a financing source for the future cost of these benefits and pensions while its employees are still working. This expense was $771 million for FY 1997 and $769 million for FY 1996 as shown below:

Recognized Expense and Imputed Financing	FY 1997	FY 1996
Civil Service Retirement System	**$349**	$385
Federal Employees' Heath Benefits	**421**	383
Federal Employees' Government Life Insurance	**1**	1
Total Expense	**$771**	$769

Medical Care Cost Recovery Program

Beginning in fiscal year 1992, a separate fund was activated at the Treasury Department to track the cost recovery of medical care furnished to insured veterans who have no service connected disabilities. The fund provided a method for recording collection of funds owed to VA while also showing the costs for recovery of those funds. Under the Medical Care Cost Recovery program VA was authorized to retain enough of the recovered monies to fund expenses incurred in the collection activities nationwide. Collections in excess of program costs were transferred to the Treasury's general fund in the early part of each succeeding fiscal year. The MCCR collections transferred to Treasury amounted to $365,334,669 and $421,162,309 for FY 1997 (through June 30, 1997) and FY 1996, respectively. The transfers to Treasury's general fund were accomplished in December 1997, and December 1996, respectively.

Medical Care Collection Fund

In FY 1998, the MCCR program will be replaced by the Medical Care Collection Fund (MCCF). MCCF collections will be transferred to the VA Medical Care appropriation and remain available until expended. These funds are authorized for any purpose that the Medical Care appropriation can be used. The authority to transfer these collections was effective as of July 1, 1997. Collections for the final quarter of FY 1997 of $139,520,655 were transferred through MCCF to the Medical Care appropriation in November 1997.

If in FY 1998 the Secretary determines that the total amount to be recovered will be less than the amount contained in the Congressional Budget Office baseline estimate ($604 million), the Treasury will deposit the amount of the shortfall in excess of $25 million into MCCF.

Judgment Fund

Certain legal matters to which VA may be a named party are administered and, in some instances, litigated and paid by other Federal agencies. These primarily relate to allegations of medical malpractice, but also include other tort claims and contract disputes. Generally, amounts (more than $2,500 for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award pertaining to these litigations are funded from a special appropriation called the Judgment Fund, which is maintained on deposit with the Department of the Treasury. Of the amounts paid from the Judgment Fund, malpractice cases claimed 78% and 85% in FY 1997 and FY 1996, respectively. Contract dispute payments require reimbursement to the Judgment Fund by VA.

In accordance with OMB's "Interpretation No. 2"of Federal Financial Accounting Standards, VA has included a liability for pending legal claims that will probably be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is required or not. This liability was $23 million for FY 1997 and $14 million for FY 1996. VA is also required to record an operating expense and imputed financing source for Judgment Fund pending claims and settlements. Judgment Fund accounting is shown below:

Judgment Fund	FY 1997	FY 1996
Fiscal Year Settlement Payments	**$64.1**	$50.5
Contract Dispute Payments	**(9.9)**	(2.1)
Imputed Financing-Paid by other Entities	**54.2**	48.4
Increase (Decrease) in Liability for Claims	**8.9**	14.0
Total Operating Expense	**$63.1**	$62.4

Note 3 Restatement, Reclassifications and Changes in Accounting Practices

Restatements of FY 1996 Financial Statements

Veterans Benefit Programs

The FY 1996 Statement of Financial Position reported an unfunded liability for future compensation, pension and burial claims of $232 billion. As described below under "Changes in Accounting Practices & Estimates", the FY 1996 financial statements have been restated as if SFFAS No. 5 had been adopted in the prior year. The effects of this change in accounting principle on the financial statements were to: (A) decrease the "Liability for Veterans Compensation and Burial Benefits", "Total Unfunded Liabilities", and "Future Funding Requirements" by $29.4 billion, and; (B) to increase "Total Net Position", "Extraordinary Items and other Adjustments" and "Excess (Shortage) of Revenues and Financing Sources over Total Expenses" by the same amount. Also, the FY 1996 beginning Net Position increased by $31 billion which is the amount equivalent to the FY 1995 Unfunded Pension Liability, and "Non-Operating Changes" decreased by the same amount.

Additionally, during FY 1997 changes were made to the assumptions used in the actuarial model that projects the liability for future compensation, burial and pension claims. The signifcant changes are described below under "Changes in Accounting Practices & Estimates". A complete description of the assumptions used by the model is provided in Note 4. The liability that was previously reported for FY 1996 has been re-calculated using the revised assumptions. The effects of this change were to: (A) increase the "Liability for Veterans Compensation and Burial Benefits", "Total Unfunded Liabilities", and "Future Funding Requirements" by $232 billion, and; (B) to increase the deficit/(shortage) reported as "Total Net Position", "Extraordinary Items and other Adjustments" and "Excess (Shortage) of Revenues and Financing Sources over Total Expenses" by the same amount.

Since the revised estimate has a significant effect on the overall presentation of the FY 1996 financial statements, they have been restated for comparison purposes. The net effect of the two changes described above were: (A) to increase the "Liability for Veterans Compensation and Burial Benefits", "Total

Unfunded Liabilities", and "Future Funding Requirements" by $202.4 billion, and; (B) to decrease "Total Net Position", "Extraordinary Items and other Adjustments" and "Excess (Shortage) of Revenues and Financing Sources over Total Expenses" by the same amount. (see Changes in Accounting Practices & Estimates)

Housing Credit Assistance Program

The FY 1996 "Statement of Financial Position" and "Statement of Operations and Changes in Net Position" were restated to include the FY 96 subsidy reestimates (see Changes in Accounting Practices & Estimates). Accordingly, "Receivables" increased by $239 million, "Accounts Payable" increased by $946 million, "Liabilities for Loan Guarantees" decreased by $707 million, and Program Expenses decreased by $637 million. In addition, the Statement of Operations was restated to reduce Revenues by $708 million and reclassify that amount as an offset to Program Expenses. The $708 million represented restored funds due to subsidy reestimates which should be netted into subsidy expense per OMB Circular A-11.

Judgment Fund Accounting

For comparison purposes the consolidated financial statements have been restated to show the effect of incorporating the requirements of OMB's "Interpretation No.2" of the Statements of Federal Financial Accounting Standards (see Changes in Accounting Practices & Estimates). This adjustment increases "Deferred Revenue and Other Liabilities" and decreases "Cumulative results of operations" by $14 million. It increases "Program or Operating Expenses" by $62 million and "Imputed Financing" by $48 million which results in a $14 million decrease in net position. This also decreases the amount of "Excess revenues over financing sources".

Reclassifications

Housing Credit Assistance Program

The presentation of Pre-1992 loan guarantee and direct loan Liquidating Funds was modified to reflect the requirements of credit reform accounting. This involved reclassifying the $1.2 billion previously reported as "Cumulative Results of Operations" to a new line item entitled "Resources Payable to Treasury". Also, the $293 million previously reported as "Reserve for Future Losses on Guaranteed Loans" was reclassified to "Resources Payable to Treasury".

General Post Fund

This fund is a trust fund but has been shown as an appropriated fund on the financial statements. Therefore, the Statement of Financial Position for FY 1996 has been restated to reclassify $39 million from "Unexpended Appropriations" to "Cumulative Results of Operations". Also, the Statement of Operations and Changes in Net Position has been restated to reclassify $24 million from "Appropriated Capital Used" to the "Other Revenues and Administrative Expense Financing".

Post-Vietnam Era Veterans Educations Assistance Fund

This fund is a trust fund but has been shown as an appropriated fund on the financial statements. Therefore, the Statement of Financial Position for FY 1996 has been restated to reclassify $189 million from "Unexpended Appropriations" to the "Cumulative Results of Operations".

Changes in Accounting Practices & Estimates

Veterans Benefit Programs

SFFAS No. 5 "Accounting for Liabilities of the Federal Government" prescribes that liabilities based on non-reciprocal transfers of funds be disclosed as a contingent liability rather than being recorded on the face of the financial statements. FASAB has opined that VA's Pension payments are non-reciprocal transfers. Accordingly, this portion of the actuarial liability is disclosed in Note 4. Previously, pension, compensation and burial components of the actuarial liability were shown on the face of the financial statements. Consequently, for purposes of comparability the FY 1996 financial statements were restated to reflect this change in accounting practice.

The assumptions used in projecting the future liability for future compensation, burial and pension claims have been revised. The most significant changes in the assumptions were: (1) the old methodology only reflected the liability associated with those currently receiving benefits and ignored future retroactive benefits and changes in benefits levels for reasons other than costs of living adjustments; and (2) that the population of beneficiaries was expanded to include an estimate of potential claims by survivors of existing veterans. For more details on the assumptuions used in determining the actuarial liability see Note 4.

Housing Credit Assistance Program

OMB Circular A-11 requires credit agencies to review their initial subsidy estimates and make (upward or downward) adjustments as appropriate. Since the time the FY 1996 statements were prepared additional information about the subsidy estimates has become available that had a material effect on amounts previously reported. Accordingly, these amounts were restated to reflect the revised estimates (see Restatements).

Judgment Fund Accounting

OMB's "Interpretation No. 2" of the Statements of Federal Financial Accounting Standards suggests that a Federal entity's management must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity should recognize an expense and liability for the full amount of the expected loss. Accordingly the expense and liability that would have existed at end of FY 1996 has been estimated and incorporated into the financial statements. Previously a liability and expense were not reported. OMB's "Interpretation No. 2" also states that after a claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "Other Financing Source" amount representing the amount to be paid by the Judgment Fund would be recognized.

Veterans Life Insurance

The valuation basis for the reserves held to provide for premium waivers was revised for the participating VA life insurance programs for FY 1997. This was done in order to comply with Financial Accounting Standards Board (FASB) Statement No. 60, "Accounting and Reporting by Insurance Enterprises". FASB 60 requires that realistic assumptions, subject to a provision for adverse deviation, be used in determining the liability for future benefits. As a result, the valuation interest rate for each of these reserves was increased to five percent.

Note 4 Veterans Benefits Programs

Veterans or their dependents receive compensation benefits if the veteran was disabled or died from military service-connected causes. War veterans or their dependents receive pension benefits, based on annual eligibility reviews, if the veteran was disabled or died from non service-connected causes. Certain pension benefits are subject to specific income limitations.

Veterans and service members who die on active duty and their dependents are eligible for burial in one of VA's 115 national cemeteries. An eligible veteran must have been discharged or separated from active duty under conditions other than dishonorable and have completed the required period of service. Additionally, the VA provides a burial and plot allowance for burial in private cemeteries, burial flags, headstones and markers, and graveliners to the family of eligible service persons. These benefits are not subject to income limitations and are provided in exchange for a veteran's military service.

VA has a future liability for benefits expected to be paid in future fiscal years to veterans and, if applicable, their survivors who have met or are expected to meet defined eligibility criteria. The future liability of the compensation, pension and burial programs (C&P) is not currently funded, nor is there any intent to do so. Rather, payments for benefits that become due in a particular year are financed from that year's appropriation, in effect, on a pay-as-you-go basis. Payments of the future liability as it becomes due rely on congressional authorization of future tax revenues or other methods, such as public borrowing, for their financing.

Compensation and Burial Projections

The future liability for compensation and burial benefits is recorded as an unfunded liability on the Statement of Financial Position in accordance with SFFAS No. 5. The change in the actuarial present value of the future liability for compensation and burial benefits from September 30, 1996, to September 30, 1997, (in millions) is as follows:

Future Liability-Compensation and Burial Benefits

	FY 1997	FY 1996	Increase
Compensation	**$465,715**	$439,811	$25,904
Burial	**2,638**	2,513	125
Total	**$468,353**	$442,324	$26,029

The net increase in the actuarial present value of the future liability for compensation and burial benefits from 1996 to 1997 is recognized in the Statement of Operations and Changes in Net Position (Deficit) on the "Extraordinary items and Other Adjustments" line.

Pension Projection

The actuarial present value of the future liability for Pension benefits is disclosed herein but not recorded on the Statement of Financial Position in accordance with SFFAS No. 5. The pension program is a needs based program in which the beneficiaries are subject to income limitation eligibility screening. Many pension payments are made to survivors of deceased veterans. Accordingly, it has been determined that the Pension program payments are non-exchange transactions or nonreciprocal payments since the payments are not based on goods or services received. The accounting for this liability is similar to accounting for social insurance programs (e.g. Food Stamps.)

The projected liability for pension benefits as determined by VA at September 30, 1997, and

September 30, 1996, (in millions) is as follows:

Projected Liability for Pension Benefits

	FY 1997	FY 1996	Increase
Pensions	**$73,414**	$68,719	$4,695

Actuarial Assumptions

As mentioned in note 3, changes were made to the actuarial assumptions used in determining the estimate of future compensation, pension and burial claims. The significant increase in the estimate of the liability resulting from utilizing the new methodology is that the current methodology incorporates 1) all veterans and survivors collecting benefits under the programs as of the valuation date, as well as for (2) all existing veterans not currently collecting such benefit payments but who will in the future and (3) all future survivors of existing veterans, not restricted to those collecting benefits on the valuation date. The old methodology ignored these factors. Also, the new methodology recognizes a liability for all future survivors of existing veterans, not restricted to those collecting benefits on the valuation date as was done previously. Additionally, a lower interest rate has the effect of increasing the present value of the projected liability. In the latter part FY 1997 there was a decrease in interest rates of FY 1997.

The significant actuarial assumptions used in the September 30, 1997, and 1996, valuations of compensation, pension and burial benefits were:

A. To calculate the present value of the liability, future cash flows were discounted in perpetuity. A liability was recognized for existing veterans and future survivors of existing veterans, including retroactive benefit adjustments and changes in benefit levels. Discount rates were based on rates on securities issued by the Treasury on September 30, 1997, ranging from 5.47% to 6.47%, and on October 1, 1996, ranging from 5.71% to 7.05%. Cash flows were assumed to occur at the midpoint of the fiscal year.

B. All calculations were done by program. The calculation for pension benefits was performed separately for each law: Old Law, Sec. 306, and P.L. 95-588. Burial liabilities were calculated on an overall basis.

C. Dollars by category, and by age, were used in the liability for C&P benefits. Therefore, ratios, trends in caseloads, and mortality tables, were used to allocate dollars in these areas.

D. Life expectancy of veterans is based upon studies by VA actuaries in relation to the Service Disabled Veterans Insurance (SDVI) Fund adjusted to 1991 and supplemented by adjusted 1991 U.S. Life mortality for males in early years. The life expectancies for elderly males were determined using the 1994 Uninsured Pensioners mortality table. These rates were brought forward to the present by applying mortality improvements at a rate of 1% per annum. The SDVI study contains mortality information for ages 41 through 75 inclusive.

E. Cost of living adjustments (COLAs) were applied to determine the average benefits per veteran, for each future time period. COLAs of 2.1% and 3.1% were assumed for fiscal years 1997 and 1998, respectively. For fiscal years after 1998, COLAs were determined from the Congressional Budget Office's inflation rate projection and range from 2.5% to 3.1% over the 30-year period. COLAs were applied to all compensation benefits and only to P.L. 95-588 pension benefits.

F. Expected benefit payments have been explicitly modeled for the next seventy-two years. This period is roughly the same as that used by the Office of the Actuary of the Social Security Administration (seventy-five years).

The actuarially determined liability for future compensation and burial claims does not include an estimate for payments expected to result from claims under the recently enacted Spina Bifida and Minimum Income Widow programs. These programs were not established until after FY 1997. In addition, the liability does not include an amount for tobacco-related claims since the VA has proposed legislation that if enacted, will disallow benefits for the majority of these cases (See Note 10).

Vocational Rehabilitation Revolving Fund

The Federal Credit Reform Act of 1990, included the Vocational Rehabilitation Revolving Fund in Credit Reform. This fund provides cash advances based on entitled future benefits (non interest bearing loans) to veterans for purchasing educational equipment and supplies while attending an approved training program. The advances are recovered through benefit deductions over a period of four to six months.

As of the end of FY 1997, $2,308,985, had been advanced and $1,465,485 or 64% had been collected. The number of loans issued were 4,856, an average of $475.50, for each loan. As of the end of FY 1996, $1,722,537 had been advanced. The number of loans issued were 3,888, an average of $443, for each loan. As of the end of FY 1997, for loans issued during FY 1996, $1,714,176 or 99.5% had been collected. This fund has historically been financially sound because most of the advances are recovered directly from C&P benefits.

Education Loan Fund

As a result of the Federal Credit Reform Act of 1990 the main function of this fund is to record collections of loans issued prior to 1991. The Education Loan Fund disbursed loans to veterans attending an approved educational program. There have been no loans disbursed from FY 1990 to FY 1997.

Administrative Expenses

The total cost to administer all benefit programs of the VA was $670 million and $653 million in FY 1997 and FY 1996 respectively. The majority of the cost represents an allocation from the General Operating Expenses(GOE) appropriation for the Veterans Benefits Administration. The cost components are summarized in the following table for fiscal years 1997 and 1996.

Benefit Programs-Administrative Expenses

	FY 1997	FY 1996
Direct Costs	**$353**	$341
Indirect Costs		
Program Costs	**281**	274
Accrued Annual Leave	**(1)**	2
Federal Employees Compensation Act	**2**	2
Other Retirement Benefits	**35**	34
Total Indirect Costs Allocated	**317**	312
Total Administrative Costs	**$670**	$653
Reimbursements to General Operating Expense (GOE)		
Compensation and Pension	**$(14)**	(16)
Other	**(1)**	(1)
Total Paid	**$(15)**	(17)
Net Cost aborbed by GOE	**$655**	$636

Note 5 Housing Credit Assistance Program - Cost of Guaranteed Loan Defaults

Activities under VA's Housing Credit Assistance Program primarily involve the partial guaranty of residential mortgage loans issued to eligible veterans by private lenders.

In addition, VA originates direct loans to veterans, sells foreclosed property on credit terms (vendee loans) and monitors foreclosure settlements for ultimate claims reimbursement to VA.

Residential loans guaranteed by VA are originated by private lenders and are not recorded in the financial statements of VA. As of September 30, 1997, the face value of outstanding guaranteed loans was approximately $198 billion, of which $69.4 billion was guaranteed by VA. The guaranty, in effect, transfers some or all of the risk of default from the lender to VA. At the time of default, VA has the option to either pay the guarantee amount or pay a reduced amount and acquire the property from the lender. In FY 1997, VA held foreclosed properties for an estimated average of 14 months. There were 16,091 properties for which foreclosure proceedings were in process as of September 30, 1997.

Vendee and Direct Loans

The total amount of vendee loans and direct loans established during fiscal years 1997 and 1996 are:

Vendee and Direct Loans

	FY 1997	FY 1996
Vendee Loans	**$1,280**	$1,337
Direct Loans	**2**	6
Total Vendee and Direct Loans	**$1,282**	$1,343

Credit Program Loans Receivable

Credit program loans receivable represents the net value of assets related to pre-1992 and post-1991 direct loans and acquired defaulted guaranteed loans. Those assets are comprised of loans receivable, interest receivable and related foreclosed property. They are offset by an allowance for estimated uncollectible loans and interest or an allowance for subsidy cost. The components of direct loans obligations and loan guarantee commitments made prior to 1992 and after 1991 are as follows:

Direct Loans

	FY 1997	FY 1996
Pre-1992		
Loans Receivable, Gross	**$ 395**	$ 433
Interest Receivable	**22**	7
Allowance for Loan Losses	**(52)**	(25)
Foreclosed Property	**139**	81
Value of Assets Related to Direct Loans	**504**	496
Post-1991		
Loans Receivable, Gross	**971**	737
Interest Receivable		
Foreclosed Property	**9**	58
Allowance for Subsidy Cost (PV)	**(325)**	(54)
Value of Assets Related to Direct Loans	**655**	849
Total Direct Loans, Net	**$1,159**	$1,345

Guaranteed Loans

	FY 1997	FY 1996
Pre-1992		
Loans Receivable, Gross	**$ 516**	$1,208
Interest Receivable		
Allowance for Loan Losses	**(501)**	(1,159)
Foreclosed Property	**150**	284
Guaranteed Loans Receivable	**165**	333
Post-1991		
Loans Receivable, Gross	**102**	61
Interest Receivable		
Foreclosed Property	**718**	415
Allowance for Subsidy Cost (PV)		
Value of Assets Related to Guaranteed Loans	**820**	476
Total Guaranteed Loans, Net	**985**	809
Total Credit Program Loans Receivable, Net	**$2,144**	$2,154

Liability for Loan Guarantee Programs

The liability for FY 1997 loan guarantees represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee. The following is the liability for the pre-1992 and post-1991 loan guarantees:

Post-1991 Loan Guarantees

	FY 1997	FY 1996
Loan Guaranty	**$ 1**	$ 1
Guaranty and Indemnity	**4,195**	3,513
Total Liability	**$4,196**	$3,514

Subsidy Expense

Pursuant to the Credit Reform Act, all direct loans established and guaranteed loans closed after September 30, 1991, will be subsidized. The subsidy expenses for FY 1997 direct loans were based on a direct loan level of $1.3 billion. The subsidy expenses for FY 1997 guaranteed loans were based on guarantees with a face value of about $24 billion. The subsidy expense for direct loans and loan guarantees is as follows:

FY 1997 Subsidy Expense

	Direct Loans	Loan Guarantees
Interest Differential/Supplemental	$(33)	$
Defaults*	61	1,423
Fees	(2)	(1,198)
Reestimates (Prior Years)	365	137
Total Subsidy Expense	$391	$ 362

* Includes estimated losses on loan sales and defaults.

Provision for Losses

One element of the cost of the mortgage loan benefit that VA provides to veterans is the present value of the cost VA will bear as loans already guaranteed default in the future. This cost is reflected in the financial statements as a resource payable to Treasury and as an offset to the value of certain related assets.

The provision for losses on guaranteed loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The provision calculation is also based on the use of the average interest rate of the U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding guaranteed loans will default over a twelve-year period. The discount rate used in the calculation was 6.9 percent for FY 1997 and 7.0 percent for FY 1996. The components of the provision are as follows:

Provisions for Losses

	FY 1997	FY 1996
Offset s Against Loans Receivable	**$ 34**	$ 18
Offsets Against Foreclosed Property held for Sale	**21**	15
Offset against Investments	**39**	37
Reserve for Future Losses on Guaranteed Loans	**115**	293
Total	**$209**	$363

Impact of Provision on Future Appropriations

The projected cost of guaranteed loan defaults (for loans closed prior to September 30, 1991) will not necessarily reflect VA's future appropriation requests over the next 12 years, because those requests will also include anticipated inflows and outflows of resources for non operating use such as for transfers, purchase and sale of properties, and issuance and repayment of loans, and sale of loans.

To the extent that revolving fund revenues are not sufficient to fund future costs, financing will have to be obtained from future appropriations, or other congressionally approved sources.

Loan Sales

The Department of Veterans Affairs continues to have vendee loan sales to meet the budget commitments of the Loan Guaranty Program. VA completed three sales during both fiscal years 1997 and 1996 totaling approximately $1 billion and $1.3 billion respectively of vendee loans to Vendee Mortgage Trust. The components of the vendee sales are summarized in the table as follows:

Loan Sales

	FY 1997	FY 1996
Loans Receivable Sold	**$ 980**	$1,263
Proceeds from Sale*	**1,019**	1,234
Loss (Gain) on Receivables Sold	**$ (39)**	$ 29

* Information presented does not reflect the transaction expenses incurred to sell the loans.

Offset For Losses on Investments

As of September 30, 1997, an allowance was recorded to reflect an estimated loss of principal as a result of the subordinated position in American Housing Trust I-V certificates. The estimated allowance computation was based upon historical loan defaults. The net investment balances are as follows:

American Housing Trust I-V

	FY 1997	FY 1996
Investment in subordinated certificates of securities at time sale	**$424**	$424
Cumulative reductions	**(67)**	(134)
Allocation of Loss Provision	**(39)**	(37)
Net Investment	**$318**	$253

These subordinated certificates have been pledged as collateral to support recourse loans made under American Housing Trust VI through XI and the "Vinnie Mac" program. Although the VA no longer has legal title to these subordinated securities, the Department has a contingent interest in any residual income that these certificates earn. The income earned on these certificates covers the amount of the realized losses for American Housing Trust VI through XI and the "Vinnie Mac" program and any residual income reverts to VA.

Contingent Liability

As the VA continues to sell vendee loans, the Department has an increasingly large potential liability related to sales amounts which it has guaranteed. VA's actual liability is expected to be much less than the sales amount. Historically, the loss rate on portfolio loans has been between 3-4 percent.

Guarantee Commitments

As of September 30, 1997, VA had outstanding commitments to guarantee loans which will originate in FY 1998. The number of commitments could not be determined, as VA has granted authority to various lenders to originate VA loans that meet established criteria without prior VA approval. Nearly 90 percent of VA's guaranteed loans originate under this authority.

Administrative Expense

The total cost to administer the housing programs of VA was $155 million and $154 million in FY 1997 and FY 1996, respectively. The cost represents an allocation from the General Operating Expenses (GOE) appropriation for the Veterans Benefits Administration and is summarized in the following table.

Housing Credit Administrative Expenses

	FY 1997	FY 1996
Allocated from GOE		
Total Direct Costs	**$ 81.6**	$80.6
Indirect Program Costs	**64.9**	64.6
Accrued Annual Leave	**(.2)**	.6
Federal Employees Compensation Act	**.5**	.4
Other Retirement Benefits	**8.0**	7.9
Total Indirect Allocation	**73.2**	73.5
Total Administrative Costs	**$154.8**	$154.1
Reimbursed to GOE		
Direct Loan Program	**.1**	.5
Native American Program	**.2**	.2
Loan Guaranty Program	**33.8**	52.1
Guaranty and Indemnity Program	**105.2**	65.2
Total Paid	**$139.3**	$118.0
Net Cost Absorbed by GOE	**$ 15.5**	$36.1

Note 6 Insurance Programs

VA directly administers six life insurance programs for veterans:

1. United States Government Life Insurance, established in 1919 to handle new issues and the conversion of World War I War Risk Term Insurance;

2. National Service Life Insurance, established in 1940 to meet the needs of World War II service personnel;

3. Veterans Special Life Insurance, established in 1951 for Korean veterans who did not have service-connected disabilities;

4. Service-Disabled Veterans Insurance, established in 1951 for veterans with service-connected disabilities;

5. Veterans Reopened Insurance, a one-year reopening in 1965 of National Service Life Insurance for certain disabled World War II and Korean veterans;

6. Veterans Mortgage Life Insurance, established in 1971 to provide insurance to veterans who have received Specially-Adapted Housing grants.

VA also supervises the administration of the Servicemembers' Group Life Insurance (SGLI) program and a subprogram of SGLI, the Veterans' Group Life Insurance (VGLI) program. SGLI is directly administered by the Prudential Insurance Company of America. This coverage is provided to active members of the Military Services, cadets attending service academies, and active members of the Armed Forces Reserves, National Guard and Reserve Officers Training Corp.

Policy Loans

Policyholders in the life insurance programs with permanent plan coverage may borrow up to 94 percent of the cash value of their policies. In the past, all policy loans carried fixed interest rates. However, policy loans issued after November 2, 1987, have a variable interest rate with a minimum of 5% and a maximum of 12%, depending on U.S. Treasury security rates. The interest rate during fiscal years 1997 and 1996 was 6%. Policy loans do not have a fixed repayment schedule as long as the policy loan does not exceed the reserve value of the policy. The policyholder may repay the loan at their discretion. On an annual basis, any unpaid interest becomes part of the loan principal and bears interest in the same manner.

Insurance Reserves	FY1997	FY1996
National Service Life Insurance	**$10,973**	$10,943
United States Government Life Insurance	**73**	80
Veterans Special Life Insurance	**1,387**	1,374
Service-Disabled Veterans Insurance	**434**	517
Veterans Reopened Insurance	**471**	476
Veterans Insurance and Indemnities	**97**	99
Subtotal	**$13,435**	$13,489
Less Unfunded Reserves*	**(469)**	(556)
Total Reserves	**$12,966**	$12,933

*SDVI and VI&I reserves include future policy benefits which are classified at Unfunded Liabilities in the accompanying statement of financial position. Actuarial reserve liabilities for VA Life insurance programs are based on mortality and interest assumptions at time of issue. These assumptions vary by fund, type of policy and type of benefits. The interest assumptions range include the American Experience Table, the 1941 CSO Table, the 1958 CSO Basic Table and 1980 Basic Table.

Insurance Administrative Expenses

	FY 1997	FY 1996
Total Direct Costs	**$22.7**	$22.0
Indirect Program Costs	**14.9**	20.0
Accrued Annual Leave		.2
Federal Employees Compensation Act	**.1**	.1
Other Retirement Benefits	**2.2**	2.7
Total Administrative Costs	**$39.9**	$45.0
Reimbursed to General Operating Expense		
Less		
Veterans Reopened Insurance	**$1.1**	$1.1
Servicemen's Group Life Insurance	**0.5**	0.5
U.S.. Government Life Insurance	**0.1**	0.1
Veterans Special Life Insurance	**4.3**	4.0
National Service Life Insurance	**29.2**	27.9
Total Paid	**$35.2**	$33.6
Net Cost Absorbed by GOE	**$ 4.7**	$11.4

Administrative expenses of $33.6 million in FY 1997 and $32 million in FY 1996 were paid out of the excess earnings of the National Service Life Insurance Program, Veterans Special Life Insurance Program, and United States Government Life Insurance Program. Congressional action in FY 1996 limited the payment of administrative expenses out of the excess earnings of NSLI, VSLI and USGLI funds to $32 million.

Insurance In-Force

Supervised Programs	Number of Policies FY 1997	Number of Policies FY 1996	Face Amount FY 1997	Face Amount FY 1996
Servicemember's Group Life Insurance				
Active Duty	**1,495,000**	1,558,000	**$287,784**	305,576
Ready Reservists	**852,500**	884,500	**155,989**	165,488
Post Separation	**161,000**	180,000	**30,371**	34,576
Veterans Government Life Insurance	**369,659**	354,766	**30,955**	28,963
Retired Reservists		14,297		1,045
Sub-Total Supervised Programs	**2,878,159**	$2,991,563	**505,099**	535,648
Administered Programs				
National Service Life Insurance	**2,013,221**	2,120,347	**18,826**	19,365
Veterans Special Life Insurance	**248,997**	256,330	**2,785**	2,825
Service Disabled Veterans Insurance	**159,941**	163,053	**1,473**	1,492
Veterans Reopened Insurance	**92,582**	97,502	**727**	750
United States Government Life Insurance	**21,343**	23,130	**71**	77
Veterans Insurance and Indemnity	**1,370**	1,514	**7**	8
Veterans Mortgage Life Insurance	**3,747**	3,878	**203**	207
Total Administered Programs	**2,541,201**	2,665,754	**24,092**	24,724
Grand Total	**5,419,360**	5,657,317	**$529,191**	$560,372

Note 7 Investments

Insurance program investments, which comprise most of VA's investments, are in non-marketable U.S. Treasury special bonds and certificates. Interest rates for Treasury special securities are based on average market yields for Treasury issues. The special bonds, which mature during various years through the year 2012, are generally held to maturity unless needed to finance insurance claims and dividends. The certificates are short-term in nature and are either redeemed or replaced at maturity, depending upon the cash needs of the insurance programs.

Other VA program investments are in securities issued by the Department of the Treasury with the exception of the Housing Credit Assistance Program investments which are in trust certificates that were issued by the American Housing Trust, a private entity not associated in any way with the Government.

Investments

	Interest Range	FY 1997	FY 1996
Special Bonds (Insurance)	6.125-13.75%	**$14,249**	14,215
Treasury Notes (General Post Funds)*	5.0-9.25%	**37**	40
Treasury Bills (Canteen)	4.81-5.26%	**38**	40
Treasury Bills (Escrow Fund)	4.89-5.07%	**2**	0
Trust Certificates (Housing Credit)**		**318**	253
Total Investments		**$14,644**	14,548

*The investment in Treasury Notes includes unamortized premiums of $127,749 and $293, 962 as of September 30, 1997 and September 30, 1996 respectively.

**The Trust investments constitute the only VA investments in certificates not issued by the Untied States Treasury Department.

Note 8 Receivables, Advances and Prepayments

Accounts Receivable

Public accounts receivable mainly comprise amounts due from individuals for Compensation and Pension overpayments, and funds due from third party insurers (through MCCR) for veterans health care. MCCR receivables totaled $709.5 million and $727.1 million at September 30, 1997, and September 30, 1996, respectively, without regard to a loss allowance or loss from contractual adjustments.

Although VA actively participates in Federal Debt Collection programs like the IRS Income

Accounts and Loan Receivable	FY 1997	Medical & Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration & Cemeteries
Accounts Receivable						
Public	**$1,741**	850	625	209	28	29
Federal	**1,489**	32	26	1,085	293	53
Loss Allowance	**(696)**	(63)	(462)	(154)		(17)
Contractual Adjustment Allowance	**(317)**	(317)				
Net Accounts Receivable	**$2,217**	502	189	1,140	321	65
Loans Receivable						
Current	**$ 844**		2	842		
Long Term	**2,119**			1,165	954	
Foreclosed Property	**1,015**			1,015		
Loss Allowance	**(553)**			(553)		
Loss Subsidy	**(325)**			(325)		
Net Loan Receivables	**$3,100**		2	2,144	954	
Total Accounts and Loans Receivables	**$5,317**	502	191	3,284	1,275	65

Accounts and Loan Receivable	FY 1996	Medical & Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration & Cemeteries
Accounts Receivable						
Public	$1,771	857	641	181	29	63
Federal	566	35	1	174	305	51
Loss Allowance	(633)	(37)	(445)	(151)		
Contractual Adjustment Allowance	(345)	(345)				
Net Accounts Receivable	$1,359	510	197	204	334	114
Loans Receivable						
Current	$1,631		4	1,627		
Long Term	1,766			818	948	
Foreclosed Property	839			839		
Loss Allowance	(1,186)		(2)	(1184)		
Loss Subsidy	54			54		
Net Loan Receivables	$3,104		2	2,154	948	
Total Accounts and Loans Receivables	$4,463	510	199	2,358	1,282	114

Tax Refund Offset, Federal Salary Offset, Litigation, Referral to Credit Reporting Agencies, and Referral to Private Collection Agencies, there are still a number of accounts which will successfully circumvent all available collection efforts.

Based on prior experience, allowance for losses and contractual adjustments on medical care and third party insurer's public receivables are established at 45%. The allowance for losses from veterans for Compensation and Pension debt overpayments is 74%.

Federal accounts receivable are principally upward subsidy reestimates and interest payments due on VA investments from the Department of the Treasury and from sharing agreements with the Department of Defense; these receivables for FY 1997 total $1.5 billion.

Loans Receivable

Current loans receivable are amounts due mainly from defaults under VA's Housing Credit Assistance Program, including Home Loan Guaranty and Direct Loan, amounting to $.9 billion and $1.6 billion at September 30, 1997, and September 30, 1996, without regard to a Loss Allowance. Loans in Default amounted to $.6 billion and $1.3 billion at September 30, 1997, and September 30, 1996. Non-judicial foreclosure debt of $730 million was written off during September 1997. Allowances for loss on defaulted loans receivable were $.5 billion and $1.2 billion at September 30, 1997, and September 30, 1996. The remaining loss allowance relates to active home loans and is derived from the Provision for Losses computation (See Note 5). Defaulted Housing debts reported for individuals include a loss allowance of 97%.

Foreclosed Property valued at $1 billion is included in the gross loans receivable of $3 billion shown on the table "Accounts and Loans Receivable", as is nonfederal interest receivable of $3.9 million for September 30, 1997.

Non-current loans receivable represent amounts due from loans and liens against life insurance policies issued by VA, and amounts owed to VA's Housing Credit Assistance Program beyond one year. Insurance policy loans do not have a fixed repayment schedule. Home loans have a firm repayment schedule over the life of the individual loan - (generally 30 years); however, it is VA practice to sell these loans rather than hold them to maturity. (See Note 5 - VA loan sales). Home loans authorized and awaiting closure were $355.3 million and $446.7 million at September 30, 1997 and September 30, 1996.

Advances and Prepayments

Non-Federal advances are usually payments to VA construction contractors, grantees, beneficiaries, and employees on official travel. Federal advances are mostly to GSA for supplies and equipment. Advances are always considered current.

Advances and Prepayments

	FY 1997	FY 1996
Public	**$ 66**	$ 65
Federal Government	**200**	243
Total	**$266**	$308

Note 9 Property and Equipment

Fixed Assets

Current year depreciation totaled $898.7 million in FY 1997 and $743 million in FY 1996. The following tables provide property and equipment data as of September 30, 1997 and September 30, 1996:

Property and Equipment	Cost FY 1997	Cost FY 1996	Accumulated Depreciation FY 1997	Accumulated Depreciation FY 1996	Net Book Value FY 1997	Net Book Value FY 1996
Land	$ 154	$ 153			$ 154	$ 153
Buildings	12,109	11,365	4,576	4,219	7,533	7,146
Equipment	4,382	4,086	2,346	2,138	2,036	1,948
Other	1,482	1,355	772	704	710	651
Construction in Progress	1,222	1,242			1,222	1,242
Total	$19,349	$18,201	$7,694	$7,061	$11,655	$11,140

Leases	Accumulated Depreciation FY 1997	Accumulated Depreciation FY 1996
Medical Leases-Private Sector	***$186.9***	$173.0
Leases Assisgned-GSA	**120.6**	117.6
Other Direct Leases-Public	**66.3**	55.4
Total Cost	**$373.8**	$346.0

Note 10 Contingencies

VA is a party in various administrative proceedings, legal actions, and tort claims brought by or against it, which ultimately results in settlements or decisions adverse to the Federal Government. These actions, claims, and cases arise from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice.

Contract Dispute Act cases are the only claims decided against the Government that have been disbursed out of the Judgment Fund which require reimbursement to this special appropriation located at the Department of the Treasury. Contract Dispute Act cases that were pending as of September 30, 1997, may ultimately result in payment out of VA appropriations totaling approximately two million dollars if these cases are decided against the Government.

A national grievance was filed by AFGE (National Federation of Federal Employees & American Federation of Government Employees v. Department of Veterans Affairs) alleging that VA mis-classified certain employees as exempt who were non-exempt and therefore entitled to overtime pay. There was also an OWCP case (Workers Compensation) filed. Potential liability for these two grievances may exceed one million dollars.

Medicare “carve-out” overpayment amounts collected by MCCR have to be refunded. Various Medigap insurers have pending claims against VA for overpayments to VA for Medicare-eligible insureds under “carve-out” policies. In November 1997 VA General Counsel held that Treasury appropriation 20X1807 is the proper account to charge for refunds of erroneous prior year MCCR overpayments collected or recovered before June 30, 1997. It is the opinion of VA’s Office of General Counsel that the ultimate resolution of the legal action challenging VA’s medical care collection authority still pending as of September 30, 1997 (U.S. v. USAA), will not materially affect VA’s operations or financial position.

VA's General Counsel has determined that under current law, service connection of a disability or death may be established if injury or disease resulted from tobacco use in the active military service. VA already has received and begun to adjudicate tobacco related disability and death claims. OMB requested that VBA's FY 1999 budget submission include an estimated cost of providing compensation for disabilities attributable to tobacco usage.

The FY 1999 budget proposes legislation to disallow benefits for those disabilities acquired after military service and based on nicotine dependence beginning in the military. This proposal would amend Title 38 to prohibit service connection of disabilities acquired after service and based solely on it being attributable, in whole or in part, to use of tobacco products during service. It would not preclude establishing service connection based on a finding that a disease or injury became manifest or was aggravated during active service, or become manifest to the requisite degree of disability during any applicable statutory presumptive period. The savings from this proposal in FY 1999 are estimated to be $741 million, with a projection of approximately $17 billion in savings over five years.

See Note 4 for discussion of the fact that tobacco related disabilities and deaths were not included in the Actuarial computation of unfunded liability for Veterans Compensation and Burial Benefits.

Management is not aware of any other unasserted claims and assessments.

In accordance with OMB "Interpretation No. 2 "of Federal Financial Accounting Standards, VA is required to include a liability on its financial statements for all pending cases that will probably be paid out of the Judgment Fund whether or not reimbursement is made by VA (See Note 2).

It is the opinion of VA's management and Office of General Counsel, that the ultimate resolution of legal actions still pending as of September 30, 1997, will not materially affect VA's operations or financial position especially when consideration is given to the availability of the Judgment Fund appropriation to pay some court settled legal cases.

OFFICE OF INSPECTOR GENERAL'S REPORT ON THE DEPARTMENT OF VETERANS AFFAIRS CONSOLIDATED FINANCIAL STATEMENTS

To The Secretary Department Of Veterans Affairs

This report presents our opinion on the Consolidated Financial Statements of the Department of Veterans Affairs (VA). This report also presents our determinations from our review of the Department's internal control structure and our review of compliance with certain laws and regulations.

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying consolidated Statement of Financial Position of the Department of Veterans Affairs as of September 30, 1997 and 1996, and the related consolidated Statements of Operations and Changes in Net Position; Cash Flows; and Budgetary Resources and Actual Expenses for the fiscal years then ended. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion based on our audit.

As described in Notes 3 and 4 of the financial statements, VA changed its methodology for estimating and recording the unfunded liability for veterans' benefits, and restated the amounts shown for Fiscal Year (FY) 1996 for comparability, in order to adopt accounting principles in Statement of Federal Financial Accounting Standard Number 5, Accounting for Liabilities of the Federal Government, that was effective for FY 1997.

Scope

Except as discussed in the following paragraphs, we conducted our audit in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States; and the Office of Management and Budget's (OMB) *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. Moreover, in accordance with these standards we reviewed VA's internal control structure and its compliance with laws and regulations.

Qualifications

We were unable to satisfy ourselves as to the recorded balances for receivables, liabilities for loan guarantees, and resources payable to Treasury as of September 30, 1997, and related Statement of Operations and Changes in Net Position; Statement of Cash Flows; and, Statement of Budgetary Resources and Actual Expenses because of the inadequacy of accounting records. Nor were we able to satisfy ourselves as to the balances by other auditing procedures. The inaccurate balances resulted from VA accounting procedures not being consistently followed and/or internal controls not operating effectively. The effect of the resulting errors on the reported balances cannot reasonably be determined.

Opinion

In our opinion, except for the qualifications discussed above, the accompanying Consolidated Financial Statements present fairly, in all material respects, the financial position of the Department as of September 30, 1997 and 1996, and the related items in the Statement of Operations and Changes in Net Position; Statement of Cash Flows; and Statement of Budgetary Resources and Actual Expenses in conformity with generally accepted accounting principles and OMB guidance.

Consistency of Other Information

Our audit was conducted for the purpose of expressing an opinion on VA's Consolidated Financial Statements taken as a whole. VA's draft Accountability Report includes an overview of VA and supplemental financial and management information containing a wide range of data, most of which are not directly related to the Consolidated Financial Statements. We reviewed the draft Accountability Report to assess whether the information and the manner of its presentation is materially inconsistent with the information, and the manner of its presentation, appearing in the Consolidated Financial Statements. The information presented in the draft Accountability Report and the supplemental financial and management information has not been subjected to the auditing procedures applied in the audit of the VA's Consolidated Financial Statements and accordingly, we express no opinion on this information.

Other Matters

VA has submitted required progress reports to OMB on the status of work required to address Year 2000 computer issues, and has reported that it believes it is on schedule to achieve Year 2000 compliance regarding its financial systems. In addition, VA has reported Year 2000 computer compliance as an Internal High Priority issue in its Federal Managers' Financial Integrity Act (FMFIA) reporting. If VA, or other private sector and government entities with which VA does business, are unable to resolve Year 2000 issues on a timely basis, it could result in a material financial risk.

REPORT ON INTERNAL CONTROL STRUCTURE

In planning and performing our audit of VA's Consolidated Financial Statements for the fiscal year ended September 30, 1997, we considered VA's internal control structure in order to determine our auditing procedures necessary for expressing our opinion on the financial statements and not to provide assurance on the overall internal control structure.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the effectiveness of the design, and operation of policies and procedures may deteriorate.

Management's Responsibility For Establishing And Maintaining Internal Control Structure

VA's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, management makes estimates and judgments assessing the expected benefits and related costs of internal control structure policies and procedures. The objective of an internal control structure is to provide management with reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition, (2) transactions are executed in accordance with management's authorization, and (3) transactions are recorded properly to permit the preparation of the financial statements in accordance with generally accepted accounting principles and OMB guidance.

Classification Of VA's Major Programs And Functions

For purposes of this report, we classified the significant internal control structure policies and procedures for the five major VA programs and functions into the following categories:

- Medical and Construction (revenue; expenditures; real property, plant, and equipment; and payroll).
- Housing Credit Assistance (loan origination and approval; loan servicing; default servicing and property acquisition; property management and sales; vendee loan sales; accumulation and reporting of credit reform and other financial data).
- Veterans Benefits (veteran benefit disbursements; cash; liability for unfunded future benefits).
- Life Insurance (insurance reserves; cash and investments; premium and loan collections; benefit, dividend, and loan disbursements).
- Administration And Cemeteries (revenue; expenditures; real property, plant, and equipment; and payroll).

For the internal control structure categories listed above, we obtained an understanding of the design of relevant systems, policies, and procedures; determined whether they have been placed in operation; and assessed control risk.

Definition Of Reportable Conditions

We noted certain matters involving the internal control structure and its operation that we consider reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB's audit requirements. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Conclusion

We concluded that five matters involving the internal control structure and its operation were weaknesses that could materially affect the VA's Consolidated Financial Statements. We believe the issues in these five areas should be considered for inclusion as material weaknesses in the Department's Federal Managers' Financial Integrity Act reporting.

1. Information System Security Controls - Information system security has significant weaknesses, which leave VA assets and financial data vulnerable to error or fraud. Elements of VA's information security management program, access and monitoring controls, as well as physical security needed improvement.

These improvements were necessary to ensure effective internal controls, conformance with government-wide standards, and to reduce vulnerability and risk to a minimum.

2. Housing Credit Assistance Program Financial Reporting - The amounts reported for HCA programs required considerable and material adjustments from the amounts reported by the HCA program financial systems. Internal controls did not ensure that adjustments were clearly documented, therefore the adjustments could not be verified. Accordingly, we were unable to attest to the accuracy of material HCA account balances and the financial statement disclosure notes.

3. Housing Credit Assistance Program Direct Loan Portfolio - Because of inadequate controls, incomplete records, and the poor quality of the direct loan portfolio records, we were not able to conclude that the receivable account balances were complete or fairly stated.

4. Guaranteed Sales of Vendee Loans - A number of errors were identified in recording transactions related to those sales. First, proceeds of loan sales were not accurately recorded in the accounting records. Second, some aspects of the transactions were not recorded until after the close of FY 1997. Third, the liability for the guarantee was erroneously included in the liability computation for direct loans instead of in the computation for guaranteed loans, as is required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees. Fourth, payments for defaults covered by the guarantee were paid out of funds not recorded in VA's accounting records. Fifth, earnings on reserves related to these sales were not turned over to Treasury as required.

5. Medical Facility Receivables - Internal controls were not sufficient to ensure that the amounts of open receivables and the valuation of the collectibility of these receivables were fairly stated.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Compliance with laws and regulations applicable to VA is the responsibility of VA's management. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatement, we performed tests of VA's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Our review consisted of tests of VA's compliance with provisions of the following laws and regulations that could have a material effect on VA's Consolidated Financial Statements, and the related combining information, if not complied with:

- Veterans' Benefits [Title 38 United States Code (U.S.C.)] and other laws and regulations relating to veterans benefits, services, and funding.
- The Budget and Accounting Procedures Act of 1950, as amended.
- The Chief Financial Officers Act of 1990.
- The Cash Management Improvement Act of 1990 and amendments.
- The Federal Credit Reform Act of 1990.
- The Anti-Deficiency Act.

- The Debt Collection Improvement Act of 1996.
- The Prompt Pay Act.
- The Federal Employees Compensation Act.
- Public Law 96-466 and Title 38 U.S.C. Section 5315, "Interest and Administrative Costs."
- Federal Managers' Financial Integrity Act (FMFIA) of 1982.
- Public Law 101-510, "National Defense Authorization Act of 1991."
- Public Law 104-208, "Federal Financial Management Improvement Act (FFMIA) of 1996."

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by FMFIA and compared the Department's most recent FMFIA reporting with the evaluation we conducted of VA's internal control system.

Conclusion

The results of our tests for FY 1997 indicate that, for the items tested, VA complied with those provisions of laws and regulations which could have a material effect on the financial statements, except for noncompliance with FFMIA financial management system requirements concerning Housing Credit Assistance program financial information and FFMIA requirements concerning information system security. With respect to transactions not tested, nothing came to our attention that caused us to believe that VA had not complied, in all material respects, with these provisions.

However, we did identify a continuing noncompliance with the law concerning requirements for charging interest and administrative costs on compensation and pension accounts receivable that, while not material to the financial statements, warrants disclosure. We have reported each year since our report of the Audit of VA's Consolidated Financial Statements for FY 1992, that VA was not in compliance with Public Law 96-466 (the Veterans Rehabilitation And Education Amendments of 1980) and Title 38 U.S.C. Section 5315. Public Law 96-466 and Title 38 prescribe that interest and administrative costs shall be charged on any amount owed to the United States for an indebtedness resulting from a person's participation in a benefits program administered by the Secretary, other than a loan, loan guaranty, or loan-insurance program. VA does not charge interest and administrative costs on compensation and pension accounts receivable balances. The balance for compensation and pension accounts receivable totaled about $561 million at the end of FY 1997, and more than 60 percent ($337 million) were over 2 years old. The total interest and administrative costs applicable to FY 1997 was over $25 million. Therefore, from FY 1992 through FY 1997 VA has not taken collection action on over $175 million in interest and administrative costs due the Department. VA should comply, or work with Congress to change Public Law 96-466 if it believes the law is not appropriate.

Michael G. Sullivan

MICHAEL G. SULLIVAN
Assistant Inspector General
for Auditing

April 30, 1998

REPORTABLE CONDITIONS

1. Information System Security Controls

VA assets and financial data were vulnerable to error or fraud because of significant weaknesses in computer controls. Elements of VA's information security management program, access and monitoring controls, as well as physical security needed improvement. These improvements were necessary to ensure effective internal controls, conformance with government-wide standards, and to reduce vulnerability and risk to a minimum.

Information Security Management

A comprehensive, entity-wide security program is essential for achieving adequate information system security and control in a large, geographically dispersed, computerized organization like VA. This is particularly important today when information systems and controls change rapidly and constantly. Improvements were needed in VA's security management program to ensure that policies at individual data processing centers were comprehensive and address all minimum information system security requirements. In addition, improvements should ensure that individuals assigned to monitor information security practices had the knowledge and time to provide effective oversight, and that provisions for service continuity in the event of unexpected disruptions are adequate and are fully tested.

- ◆Existing information security policies at data processing centers often addressed only the mainframe computers, excluding networks and communication systems. Further, these policies often lacked descriptions of specific minimum controls within the mainframes.

- ◆Oversight by VA Central Office officials of the effectiveness of information security management by VA administrations needed to ensure that each administration implemented effective information security practices. With the exception of the Veterans Health Administration (VHA), managers within VA's administrations had yet to establish oversight functions to monitor and assess the effectiveness of Information Security Officers (ISOs) at facilities.

- ◆ISOs assigned to monitor information security practices at VA data processing centers and medical facilities often lacked the knowledge and time to provide effective oversight.

- ◆While VA facilities typically had disaster recovery plans, these plans frequently provided neither detailed directions instructing employees how to contend with significant risks nor up-to-date equipment inventories, phone numbers, and addresses. We found that contingency plans as well as software and data backups were not always stored away from the facility.

Access Controls And Monitoring

Information system controls used to limit and monitor access to computer resources including data files, application programs, operating system software and utilities, and equipment needed improvement.

- ◆Each facility tested needed to improve its controls and restrictions for safeguarding operating system and application software.

- ◆At each facility where we tested user account management, more active management was needed to improve individual accountability and reduce the number of user accounts.

- Password configurations at most facilities did not adequately provide individual accountability.

Physical Access Controls

We also observed significant improvements were made to limit physical access and ensure environmental stability. Some improvements were needed throughout VA. For example, at each of the facilities tested we found that large numbers of employees had access to the computer room who had no need for such access. Other weaknesses were noted at some sites but were not pervasive. For example, exterior doors to one facitlity could not be locked, cameras could be better placed, guards needed to conduct rounds, and alarms needed to be connected. At another facility, computer room doors were consistently left open, defeating temparture and humidity controls.

Conclusion

Improvements in VA information system security controls would significantly decrease VA's vulnerability to unauthorized access, to incomplete or erroneously processed data, to undetected errors, and to disaster. Facility officials took or began taking steps to implement improved safeguards during our review. For example, at one facility, the system manager immediately removed powerful privileges from users whose use of these privileges allowed them to perform functions either incompatible with or unnecessary to perform their jobs. However, for a large computerized organization like VA, achieving an adequate level of systems control is highly dependent upon maintaining consistently effective safeguards throughout the organization. A coordinated, comprehensive, entity-wide security program is particularly important for organizations such as VA with a large number of geographically dispersed facilities connected by communication systems.

Recommendation No. 1

We recommend that VA enhance information systems security by:

a. Modifying current policies and procedures to more explicitly establish comprehensive standards and criteria for minimum information system security safeguards.

b. Strengthening the oversight and monitoring of information security activities.

c. Strengthening information systems controls that limit and monitor access to operating system and application software as well as data.

d. Ensuring that a comprehensive contingency program incorporates regular backups and continuous recovery testing and improvement.

e. Strengthening safeguards that restrict physical access to computers and reduce environmental vulnerabilities.

2. Housing Credit Assistance Program Financial Reporting

We were unable to attest to the accuracy of material HCA account balances and the financial statement disclosure notes, because internal controls over HCA financial reporting were not sufficient to ensure that amounts were fairly stated. The control weaknesses affected loan receivable, liability for loan guarantee, and resources payable to Treasury lines on the Statement of Financial Position and related items in other financial statements.

Financial Automated Data Processing (ADP) Systems

Because the HCAADP systems pre-date credit reform and Federal financial accounting standards requirements, a considerable amount of out of system processing of data is required in order to prepare the HCA program financial statements.

The HCA ADP systems do not include a financial reporting module to produce the financial statement information in VA's Consolidated Financial Statements. Instead, HCA relies on manual data entry into a PC-based spreadsheet.

In addition, the HCA automated general ledger system (GLS) permits partial transaction processing. If errors were identified during processing, the system may reject the debits, but continue to process the credits. As a result, many VA stations' HCAgeneral ledgers were out of balance at year end and a large number of account adjustments had to be made to balance the general ledger. The reasons for the adjustments were not adequately documented. Therefore, we could not determine why adjustments were made and whether dollar amounts were adequately supported.

Spreadsheet Tools Used

The spreadsheets used to prepare the HCA financial statement data were very large and extremely complex which made it difficult to prevent or identify errors. The design of these spreadsheets did not adequately document the composition of account balances and adjusting entries.

Some financial transactions and adjustments were not recorded in the HCA general ledger. Instead, the transactions were included in the financial statements by making the adjustments only in the spreadsheets. By not recording these adjustments in the HCA general ledger, there is a significant risk that adjustments will not be properly recognized in computations of related accounts/transactions, and will not be properly included in future accounting periods.

Additionally, some financial statement data were drawn from sources outside the general ledger or only partially from the general ledger. The financial statement information should come from the general ledger; otherwise, the internal control and checks and balances intended by having a "dual entry" accounting system are eliminated and the financial statements are vulnerable to error.

HCA Financial Statement Information

VBAis unable to prepare timely HCAfinancial statement information as a result of accounting system weaknesses. The control and design weaknesses over the HCA financial reporting process caused voluminous changes and corrections to be made by HCA accounting staff to the draft financial statements. While initial draft statements were provided for audit in December 1997, the staff was still making changes in April 1998.

Conclusion

VA first identified the need for HCA systems modernization in its 1986 FMFIA report. Additionally, VA added the credit reform accounting area as an FMFIA material weakness in 1995. We previously included the HCA program financial reporting weakness as a reportable condition in our FY 1996 VA Consolidated Financial Statement audit report. VA management needs to replace the current program systems to ensure the HCA program will be able to produce reliable and timely financial statement information.

Recommendation No. 2

We recommend that VA improve the HCAprogram by replacing the current program oriented multiple systems with a financial accounting system that interfaces with VA's accounting system and meets Federal financial accounting requirements.

3. Housing Credit Assistance Program Direct Loan Portfolio

We were unable to attest to the accuracy of the amounts reported for the receivable account balance due to a material weakness in internal controls over the HCA program direct loans portfolio. Because of incomplete records and the poor quality of the direct loan portfolio records, we were not able to conclude that the receivable account balance was complete or fairly stated.

During FY 1997, VA contracted with a management group to service its loan portfolio. However, the Veterans Benefits Administration (VBA) Loan Guaranty program officials did not adequately plan the conversion, nor did they provide for VBAFinance management participation in the conversion process. Consequently, control over the conversion of the direct loan portfolio from VA's own Portfolio Loan System (PLS) accounting system, to the contractor's system was not adequate.

VA converted only the established loans on PLS to the contractor's system for servicing. Because PLS ceased operationally upon transfer, the management of the non-converted loan receivables was transferred and became the responsibility of individual VA regional offices. VA did not have an appropriate system to process the loans not converted to the contractor. VA did not perform adequate reconciliations of the direct loan portfolio during or after the conversion. As a result of having inadequate records, there were:

- Numerous errors in direct loan and associated escrow account balances, and payment of taxes and insurance,
- Significant delays in establishing new loans in the accounting records, and processing borrowers' loan payments, and
- Inconclusive general ledger account balances.

The lack of an appropriate system to account for loans not accepted by the contractor also affected the reliability of:

- Foreclosure and termination costs,
- Loan activity recorded for refunded or repurchased loans,
- Tax data needed for loan closing statements for borrowers, and
- Loan data used for subsidy estimation and budget execution reporting.

Since contracting with a management group to service its loan portfolio, VBA has been working closely with the contractor to resolve these various accounting and program issues.

Recommendation No. 3

We recommend that VBA management complete actions underway to assure that all direct portfolio loan records are complete and accurate.

4. Accounts Related To Guaranteed Sales Of Vendee Loans

A number of errors were identified in recording transactions related to those sales. First, proceeds of loan sales were not accurately recorded in the accounting records. Second, some aspects of the transactions were not recorded until after the close of FY 1997. Third, the liability for the guarantee was not computed in accordance with the Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees. Fourth, payments for defaults covered by the guarantee were paid out of funds not recorded in VA's accounting records. Fifth, earnings on reserves related to these sales were not turned over Treasury as required.

As a result of erroneous recording of transactions, VA's accounts related to vendee loan sales contain significant errors. Because VA does not segregate the costs associated with the guarantee of principle and interest on vendee loans sold, as required under the Statement of Federal Financial Accounting Standards Number 2, the true cost associated with sales of vendee loans (about $1.1 billion per year) originally authorized by Public Law 102-291, cannot be measured.

VA identified loan sales program management as a material weakness in its 1996 FMFIA report. Correction of this material weakness is pending. In addition, VBA plans to meet with OMB in May 1998 to revise VA's credit reform models to include liability (guaranty) resulting from the vendee loan sales.

Recommendation No. 4

We recommend that VBA management complete actions underway to develop and implement changes to account correctly for the vendee loan sales.

5. Medical Facility Receivables

We were unable to attest to the accuracy of the net receivable account balances related to medical facilities at the end of FY 1997, because internal controls were not sufficient to ensure that the amounts of open receivables and the valuation of the collectibility of these receivables were fairly stated.

The total amount of receivables in the general ledger was significantly different than the amount of open receivables in subsidiary Veterans Integrated Systems Technology Architecture (VISTA) system files at medical facilities. Our analysis of FY 1997 year end amounts showed differences totaling about $49 million. Analysis of the year end amounts identified a number of factors causing differences such as:

- Individual receivables that had been deleted from the Financial Management System (FMS) general ledger at a number of stations were still in the VISTA subsidiary file.

- One facility inappropriately set up a dummy account in the VISTA subsidiary file to track General Post Fund receipts. This caused an imbalance with the FMS general ledger.

- When a pilot program involving several facilities operating as independent health systems ended in 1995, about $7 million of medical receivables at one facility were recorded in the FMS general ledger, but did not get recorded in the VISTA system subsidiary file.

- Interest and administrative charges added to receivables in the VISTA system subsidiary file were not recorded in the FMS general ledger.

While VA policy exists requiring facilities to reconcile general ledger and subsidiary accounts each month, it is very difficult to do because the VISTA system did not automatically reconcile the individual receivable amounts to the related FMS general ledger amounts. The individual records supporting medical facility receivables are maintained in the VISTA system at each medical facility. Transactions processed to record, reduce and adjust individual receivable records in VISTA are summarized monthly in VISTA and transmitted through an automated interface to update the FMS general ledger. This makes reconciliations difficult. An automated reconciliation would be more efficient, would improve internal control, and is needed to be compliant with Joint Financial Management Improvement Program Core financial system requirements.

Additionally, uncertainty in the reported net receivable amounts for medical facilities occurred because of errors in estimating the collectibility of the receivables. VA facilities had implemented procedures for estimating the collectibility of receivables and VHA staff was monitoring the related accounts. However, data used in the calculation had errors that made the estimates questionable and all factors affecting collectibility were not considered. First, significant amounts of receivables were incorrectly classified. This caused uncertainty in the calculations because the collection experience is different for each type of receivable. For example, at two stations $1.2 million of receivables classified as “MISCN” (and considered collectible) were actually Tort receivables that had much lower expectation of recovery. Second, the previously discussed differences between the subsidiary receivable file and the general ledger may have affected the estimate calculation at individual facilities because the calculation is based on the detail in the subsidiary file.

Recommendation No. 5

We recommend that the Department:

a. Change the automated feed from the VISTA system subsidiary file to the FMS general ledger to provide for automated reconciliation of the total of all individual open receivables in the VISTA system subsidiary file to the FMS general ledger.

b. Completely reconcile the medical facility subsidiary and general ledger receivable accounts to correct errors in the existing files.

c. Ensure that medical facilities take into consideration when estimating the collectibility of receivables the differing collection rates for the different categories of receivables and any other factors that may cause the trend of collection rates to change.

DETAILS ON COMPLIANCE WITH LAWS AND REGULATIONS

1. Public Law 104-208, Federal Financial Management Improvement Act (FFMIA) of 1996.

VAreported in its Management Representation Letter to the Office of Inspector General that Loan Guaranty Program systems, which provide the data used in preparing the Housing Credit Assistance component of VA’s Consolidated Financial Statements, were not in compliance with FFMIAFederal financial management system requirements. We discussed material weaknesses concerning the Housing Credit Assistance Program financial management systems in the Report on Internal Control Structure on pages 98 to 101. VA further reported that financial systems for two education programs and the Canteen Service were not compliant. These three systems did not materially affect VA's Consolidated Financial Statements.

In addition, VA was not compliant with the FFMIA requirement that security over financial information be provided in accordance with OMB Circular A-130. We discussed the material weakness in VA's information system security controls in the Report on Internal Control Structure starting on page 97.

2. Public Law 96-466 And Title 38 U.S.C. Section 5315, Interest And Administrative Costs.

We have reported each year since our report of the Audit of VA's Consolidated Financial Statements for FY 1992, that VA was not in compliance with Public Law 96-466 (the Veterans Rehabilitation And Education Amendments of 1980) and Title 38 U.S.C. Section 5315. Public Law 96-466 and Title 38 prescribe that interest and administrative costs shall be charged on any amount owed to the United States for an indebtedness resulting from a person's participation in a benefits program administered by the Secretary other than a loan, loan guaranty, or loan-insurance program. VA does not charge interest and administrative costs on compensation and pension accounts receivable balances. The balance for compensation and pension accounts receivable totaled about $561 million at the end of FY 1997, and more than 60 percent ($337 million) were over 2 years old. The total interest and administrative costs applicable to FY 1997 were over $25 million. Therefore, from FY 1992 through FY 1997 VA has not taken collection action on over $175 million in interest and administrative costs due the Department.

In a July 1992 decision, the former VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. We disagreed with the Deputy Secretary's decision. Congress passed the law with the intent of charging interest and penalties on benefit debts similar to charges levied on other debts owed the Federal government. Rather than continuing the nonconformance, VA should comply, or work with Congress to change Public Law 96-466 if it believes the law is not appropriate. During FY 1998, VA sent documentation to OMB supporting their request for relief from charging interest and administrative costs. On April 10, 1998, OMB returned the request to VA asking for additional information.

3. Title 38 U.S.C., Section 312, Provisions Concerning Minimum Staffing Levels.

VA is not in compliance with Title 38 U.S.C., Section 312, provisions which state that the President shall include in the budget transmitted to Congress for each fiscal year pursuant to Section 1105 of Title 31 an estimate of the amount for the Office of Inspector General that is sufficient to provide for a number of full-time positions in that office that is not less than the number of full-time positions in that office on March 15, 1989, plus 40. Funding for 417 full-time positions would be required to achieve compliance. We encourage the Secretary to work with OMB and Congress to provide the funding needed to enable compliance.

Combining Statement of Financial Position
As of September 30, 1997
(dollars in millions)

	Total	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Cemeteries
Assets						
Intergovernmental						
Fund Balances with Treasury	**$14,083**	5,947	2,011	5,726	28	371
Investments	**14,326**	75			14,249	2
Accounts Receivable, Net	**830**	31	26	719		53
Interest Receivable	**659**	1		365	293	
Advances and Prepayments	**200**	125				75
Governmental						
Investments	**318**			318		
Accounts Receivable, Net	**701**	470	163	55		12
Policy Loans Receivable	**954**				954	
Credit Program Receivables, Net	**2,145**		1	2,144		
Interest Receivable	**28**				28	
Advances and Prepayments	**66**	43		22		1
Merchandise and Supply Inventories	**64**	29				35
Property and Equipment, Net	**11,655**	11,638				17
Total Assets	**$46,029**	18,359	2,201	9,349	15,553	567
Liabilities Covered by Budgetary Resources						
Intragovernmental Liabilities						
Accounts Payable and Accrued Liabilities	**444**	154	12	248		30
Debt from Borrowing Authority	**3,707**		1	3,706		
Resources Payable to Treasury	**1,046**			1,046		
Governmental Liabilities						
Accounts Payable and Accrued Liabilities	**3,600**	1,419	1,616	138	196	231
Liabilities for Loan Guarantees	**4,196**			4,196		
Deferred Revenues and Other Liabilities	**234**	24	1	12	135	62
Dividends on Credit or Deposit	**1,258**	1			1,256	
Insurance Policy Reserves	**12,966**				12,966	
Dividends Payable	**805**				805	
Total Liabilities Covered by Budgetary Resources	**28,256**	1,598	1,630	9,346	15,359	323
Not Covered by Budgetary Resources						
Intragovernmental						
Federal Employee Compensation Act	**1,742**	1,658				84
Governmental						
Annual Leave	**868**	805				63
Insurance Policy Reserves	**469**				469	
Veterans' Compensation and Burial Benefits	**468,353**		468,353			
Total Liabilities Not Covered by Budgetary Resources	**471,432**	2,463	468,353		469	147
Total Liabilities	**$499,688**	4,061	469,983	9,346	15,827	470
Net Position Fund Balances						
Unexpended Appropriations	**4,458**	4,111	261	3		83
Invested Capital	**11,719**	11,668				52
Cumulative Results of Operations	**1,345**	895	147		194	109
Equity in Overpayment Receivables and Other	**251**	88	163			
Total Fund Balances	**17,773**	16,761	571	3	194	243
Future Funding Requirements	**(471,432)**	(2,463)	(468,353)		(469)	(147)
Total Net Position (Deficit)	**(453,659)**	14,298	(467,782)	3	(275)	97
Total Liabilities and Net Position (Deficit)	**$ 46,029**	18,359	2,201	9,349	15,553	567

Note: Detail may not add due to rounding.

Combining Statement of Operations and Changes in Net Position (Deficit)
For the Fiscal Year Ending September 30, 1997
(dollars in millions)

	Total	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Cemeteries
Revenues and Financing Sources						
Appropriated Capital Used	**$40,269**	17,780	20,702	796	39	952
Revenues from Sales of Goods and Services:						
To the Public	**1,607**	769			815	23
Intragovernmental	**582**	91	192			300
Interest and Penalties, Non-Federal	**183**			133	50	
Interest, Federal	**1,563**	4		355	1,203	
Imputed Financing-Expenses Paid by Other Entities	**826**	765				60
Vendee Loan Reimbursements	**437**			437		
Other Revenues and Administrative Expense Financing	**92**	38	672	15	5	(638)
Less: Receipts Transferred to Treasury or Other Agencies	**(38)**	(32)				(6)
Total Revenues and Financing Sources	**$45,521**	$19,415	$21,566	1,736	2,112	692
Expenses						
Program or Operating Expenses	**$40,923**	16,714	20,912	995	1,087	1,216
Cost of Goods Sold						
To the Public	**121**	121				
Intragovernmental	**61**					61
Depreciation and Amortization	**899**	895				3
Bad Debts and Write-offs	**585**	165	135	285		1
Interest on Dividends on Credit or Deposit	**100**				100	
Interest on Treasury Borrowing	**418**			418		
Dividends to Policyholders	**826**				826	
Other Expenses and Benefit Administrative Costs	**1,025**	774	670	155	40	(614)
Total Expenses	**$44,958**	18,669	21,717	1,853	2,053	666
Excess (Shortage) of Revenues and Financing Sources over Total Expenses Before Extraordinary Items	**563**	746	(151)	(117)	59	25
Extraordinary Items and Other Adjustments	**(26,029)**		(26,029)			
Excess (Shortage) of Revenues and Financing Sources over Total Expenses	**(25,466)**	746	(26,180)	(117)	59	25
Net Position (Deficit), Beginning Balance	**(428,154)**	13,776	(441,901)	199	(333)	104
Plus (Minus) Non-Operating Changes	**(39)**	(224)	299	(79)		(32)
Net Position (Deficit), Ending Balance	**$(453,659)**	14,298	(467,782)	3	(275)	97

Note: Detail may not add due to rounding.

Combining Statement of Cash Flows
For the Fiscal Year Ending September 30, 1997
(dollars in millions)

	Total	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Cemeteries
Cash Provided by Operating Activities						
Sales of Goods and Services	**$1,177**	872				306
Interest and Penalties	**1,772**	5		503	1,265	
Benefit Programs	**196**		196			
Insurance and Guarantee Programs	**1,615**			812	803	
Other Operating Cash Provided	**77**	27	17			33
Total Cash Provided	**4,837**	903	213	1,314	2,067	339
Cash Used by Operating Activities						
Personal Services and Benefits	**(11,645)**	(10,640)	(1)	(139)		(865)
Travel and Transportation	**(244)**	(226)				(18)
Rent, Communications and Utilities	**(771)**	(566)				(205)
Printing and Reproduction	**(17)**	(11)				(6)
Other Contractual Services	**(2,345)**	(2,288)				(58)
Supplies and Materials	**(2,951)**	(2,846)				(104)
Insurance, Claims and Indemnities	**(21,174)**		(19,405)	(591)	(1,179)	
Grants, Subsidies and Contributions	**(2,016)**	(43)	(1,550)	(417)		(6)
Interest and Dividends	**(1,137)**			(258)	(879)	
Total Cash Used	**(42,300)**	(16,620)	(20,955)	(1,406)	(2,058)	(1,261)
Net Cash Provided (Used) by Operating Activities	**$ (37,463)**	(15,717)	(20,742)	(91)	10	(922)
Investing Activities						
Sale of Foreclosed Property	**397**			397		
Purchase of Property, Plant and Equipment	**(2,934)**	(1,411)		(1,514)		(9)
Sale of Securities	**2,658**	3		1,013	1,642	
Purchase of Securities	**(1,676)**				(1,676)	
Collection of Long-Term Loans Receivable	**474**			307	168	
Creation of Long-term Loans Receivable	**(2,211)**			(2,038)	(173)	
Net Cash Provided (Used) by Investing Activities	**$(3,292)**	(1,407)		(1,836)	(40)	(9)
Financing Activities						
Appropriations (Current Warrants)	**40,235**	17,822	20,977	461	39	936
Withdrawals	**(708)**	(472)	(13)	(212)		(11)
Transfer of Cash to and from Others	**67**		(185)	252		
Net Appropriations	**39,594**	17,351	20,778	501	39	925
Borrowing from the Treasury	**1,926**		4	1,922		
Repayments on Loans from the Treasury	**(6)**		(6)			
DoD Servicemen's Group Life Insurance Collections	**474**				474	
DoD GI Bill Treasury Collections	**185**		185			
Servicemen's Group Life Insurance Transfers to Prudential	**(478)**				(478)	
Net Cash Provided (Used) by Financing Activities	**$41,695**	17,351	20,962	2,423	34	925
Net Cash Provided (Used) by Operating, Investing and Financing Activities	**940**	226	220	496	4	(6)
Beginning Fund Balances with Treasury	**13,143**	5,721	1,790	5,229	24	378
Ending Fund Balance with Treasury	**$14,083**	5,947	2,010	5,726	28	371
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	**563**	746	(151)	(117)	59	25
Adjustments to Reconcile Excess (Shortage) of Revenues and Financing Sources Over Total Expenses to Net Cash Provided by Operating Activities						
Appropriated Capital Used	**(40,269)**	(17,780)	(20,702)	(796)	(39)	(952)
Decrease (Increase) in Accounts Receivable	**(717)**	133	33	(935)	12	39
Decrease (Increase) in Loans Receivable	**10**		1	9		
Decrease (Increase) in Other Assets	**124**	104		(22)		42
Increase (Decrease) in Accounts Payable	**137**	67	91	60	1	(81)
Increase (Decrease) in Other Liabilities	**1,597**		(24)	1,644	(23)	1
Depreciation and Amortization	**899**	895				3
Other Unfunded Expenses	**167**	164				4
Subsidy Reestimates and Other Adjustments	**26**	(46)	11	65		(2)
Total Adjustments	**(38,026)**	(16,463)	(20,591)	26	(49)	(948)
Net Cash Provided (Used) By Operating Activities	**$(37,463)**	$(15,717)	(20,742)	(91)	10	(922)

Note: Detail may not add due to rounding.

Combining Statement of Budgetary Resources and Actual Expenses
For the Fiscal Year Ending September 30, 1997
(dollars in millions)

Program	Resources	Direct	Reimbursed	Actual Expenses
Medical and Construction	$20,473	$18,087	$ 380	$18,669
Veterans Benefits	21,403	21,025	194	21,717
Housing Credit Assistance	11,385	5,458	4,093	1,853
Life Insurance	15,552	1,340	1,440	2,053
Administration and Cemeteries	1,406	1,037	353	666
Totals	$70,219	$46,947	$6,460	$44,958

Budget Reconciliation	
Total Expenses	$44,958
Capital Acquisitions	2,939
Loans Disbursed	2,087
Other Expended Budget Authority	1,657
Depreciation and Amortization	(899)
Unfunded Annual Leave Expense	(12)
Bad Debt and Other Unfunded Expenses	(1,460)
Accrued Expenditures	49,270
Reimbursements	(6,460)
Accrued Expenditures, Direct	$42,810

Note: Detail may not add due to rounding.