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 controls and our review of compliance with certain laws and regulations.

Opinion on Financial Statements

We have audited the accompanying Consolidated Balance Sheet of the Department of Veterans Affairs as of September 30, 1998, and the related Consolidated Statements of Net Cost, and Changes in Net Position; and the Combined Statements of Budgetary Resources, and Financing for the fiscal year then ended. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion based on our audit.

Scope

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards, the **Government Auditing Standards** issued by the Comptroller General of the United States; and the Office of Management and Budget's (OMB) Bulletin No. 98-08, **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 intragovernmental accounts receivable loans receivable and related foreclosed property, liabilities for loan guarantees, and resources payable to Treasury as of September 30, 1998, and related items on the Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing 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, 1998, and the related items in the Consolidated Statements of Net Cost, and Changes in Net Position; and the Combined Statements of Budgetary Resources, and Financing in conformity with Federal accounting standards and OMB guidance as described in Note 1 of VA's financial statements.

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 included 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. 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. 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. Based on our limited work, we found no material inconsistencies with the financial statements.

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 Controls

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) Bulletin No. 98-08, **Audit Requirements for Federal Financial Statements**. In planning and performing our audit of VA's Consolidated Financial Statements as of and for the fiscal year ended September 30, 1998, we considered VA's internal control structure in order to determine our auditing procedures necessary for expressing our opinion on the financial statements. In evaluating the reliability of financial information we obtained an understanding of the design of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of VA's internal controls. However, our evaluation was not made to provide assurance on the overall internal control structure. Consequently, we do not provide an opinion on internal controls.

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.

In addition, with respect to internal controls related to performance measures reported in the Department's draft Accountability Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures and accordingly, we do not provide an opinion on such controls.

With respect to Required Supplementary Stewardship Information (RSSI), we performed a review to determine the reasonableness of data presented. Our procedures were not designed to provide assurance on internal control over RSSI and accordingly, we do not provide an opinion on such controls.

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 (i) assets are safeguarded against loss from unauthorized use or disposition, (ii) transactions are executed in accordance with management's authorization, and (iii) transactions are recorded properly to permit the preparation of the financial statements in accordance with Federal financial accounting standards and OMB guidance.

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 and reported performance measurement information.

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 two matters involving the internal control structure and its operation were weaknesses that could materially affect VA's Consolidated Financial Statements: information systems security and Housing Credit Assistance (HCA) program accounting. The Department reported these items as material weaknesses in the their Federal Managers' Financial Integrity Act (FMFIA) report for FY 1998. We concluded that a third issue regarding medical facility accounts receivable was a reportable condition. These internal control weaknesses expose VA to significant risks and vulnerabilities.

1. Information Systems Security. VA's program and financial data continue to be vulnerable to error or fraud because of Department-wide weaknesses in VA's information system security program, access and monitoring controls, and physical security controls. We reported this condition in our FY 1997 Consolidated Financial Statement (CFS) audit report and the Department reported it as a material weakness in its FMFIA report for FY 1998.

2. Housing Credit Assistance Program Accounting. The amounts reported for HCA programs continue to require considerable and material adjustments from the amounts reported in the HCA financial systems. We reported serious weaknesses in HCA program (i.e., loan guaranty) accounting in our FY 1997 CFS audit report. The Department reported loan guaranty financial modernization, loan service and claims, and loan sale program management as a material weakness in its FMFIA report for FY 1998. VBA staff corrected a number of weaknesses in the financial reporting process during FY 1998, and has significant corrective actions in process concerning direct loan portfolio and loan sales accounting issues. The Department reported that they expect to complete corrective actions during FY 1999. Financial reporting will continued to be a high risk area vulnerable to error until HCA program financial systems comply with financial systems requirements.

3. Medical Facility Accounts Receivable. We concluded that the balances remain susceptible to significant errors because staff at some facilities had not reconciled subsidiary records to the general ledger control accounts. These reconciliations are a generally accepted accounting practice required in order to identify errors and ensure that the records are complete. The audit identified a number of significant errors that could have been identified by completed reconciliations. We reported this condition in our FY 1997 CFS audit report. While the Department has made significant progress in correcting the weaknesses noted, further action is necessary. Additionally, we observed weaknesses in accounts receivable follow-up and review practices and, a separate review identified cases of improper billing that resulted in VA refunding some collections to one insurance carrier.

The Department reported the information systems security and the Housing Credit Assistance program accounting issues as material weaknesses in the Department's FY 1998 FMFIA reporting. The

Department should consider reporting medical facility accounts receivable as an Internal High Priority item. In addition, to assist Department managers in improving operations and financial reporting, we are issuing management letters addressing internal control weaknesses in information systems security, housing credit assistance accounting, and medical accounts receivable; as well as management letters addressing property accounting, payroll and timekeeping, veterans benefits accounting, life insurance accounting, expenditures and payables, Treasury reporting, and cost accounting issues.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

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) Bulletin No. 98-08, **Audit Requirements for Federal Financial Statements**. 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.

Under Public Law 104-208, "Federal Financial Management Improvement Act (FFMIA) of 1996," we are required to report whether the agency's financial management systems substantially comply with the Federal financial management system requirements, Federal accounting standards, and United States Standard General Ledger (U.S. SGL) at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA in OMB Bulletin No. 98-08.

Our review determined that VA noncompliance with provisions of the FFMIA and the Credit Reform Act, as it relates to guarantees on HCA loans sold, could have a material effect on VA's Consolidated Financial Statements and the related combining information. Additionally, VA was noncompliant with the following two laws and regulations that, while not material to the consolidated financial statements, warrant disclosure:

- Public Law 96-466 and Title 38 U.S.C. § 5315, "Interest and Administrative Costs."
- Title 31 U.S.C. § 3302(b), "Miscellaneous Receipts."

As part of our audit, we also 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 1998 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 certain provisions of the FFMIA and of the Federal Credit Reform Act of 1990. Regarding FFMIA: (i) VA's HCA program was noncompliant with Federal accounting standards for guaranteed loan sales, with financial information systems requirements, and with the FFMIA requirement that the U.S. SGL be maintained at the transaction level; (ii) with the exception of the Austin Automation Center, the Department was noncompliant VA-wide with FFMIA information system security requirements; and (iii) VA was noncompliant with respect to requirements that systems be able to accumulate and report the costs of their activities on a regular basis. Regarding the Federal Credit Reform Act of 1990, VA was noncompliant with requirements that VA estimate a future liability for guarantees on loans sold and that they include it in its annual budget requests to the Congress, and it was noncompliant with a provision that income arising from pre-1992 credit activities must be used only to offset expenses arising from those same activities. VA was using some of the funds for post-1991 activities. 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 those provisions.

Department officials informed us they expect all VA financial systems to be U. S. SGL compliant by FY 1999. The Department also has a number of actions in process, and that they plan to complete by May 1999, to correct the HCA program accounting issues. With respect to the cost accounting system requirements, the Department was able to develop and allocate costs on a reasonable basis in preparing the Statement of Net Cost. However, full implementation of activity level cost accounting systems was in process but not completed during FY 1998. The Veterans Benefits Administration tested a cost accounting system during FY 1998 and implemented the system October 1, 1998. The National Cemetery Administration (NCA) is testing a system during FY 1999 and the Veterans Health Administration designated and approved its managerial cost accounting system in November 1998. Department officials informed us they expect all systems to be fully compliant by FY 2000.

In addition, we identified noncompliance with two laws that, while not material to the financial statements, warrant 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 the requirements 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. Since FY 1992, VA has not taken collection action on over $132.6 million in interest and administrative costs due the Department. This year we also report noncompliance with the requirement of law that agents of the Government receiving money for the Government from any source shall deposit the money in the general fund of the Treasury as soon as practical. A VA contract for the HCA program inappropriately allowed the contractor to open and maintain an account and to transfer receipts once a month, instead of daily as required. Receipts average approximately $18 million per month. VA should comply with the laws for charging interest and administrative costs on benefit program indebtedness and for depositing money with the Treasury as soon as possible.

This report is intended for the information of the management of VA, OMB, and Congress. However, this report is a matter of public record and its distribution is not limited.

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for Auditing
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REPORTABLE CONDITIONS

1. Information System Security Controls

VA's program and financial data continue to be vulnerable to error or fraud because of Department-wide weaknesses in VA's information system security program, access and monitoring controls, and physical security controls. We reported this condition in our FY 1997 audit report and the Department reported it as a material weakness in its FMFIA Report for FY 1998.

A number of corrective actions were completed during FY 1998, particularly at the Austin Automation Center where significant progress was made toward improving the overall general controls environment and in correcting most newly identified security exposures. Additionally, the establishment of the Office of the Assistant Secretary for Information and Technology should better focus top management attention on ADP security. However, corrective actions to improve other ADP control issues throughout the Department were incomplete or had not been addressed at the time of our audit.

We consider each of the recommendations made as a result of the FY 1997 audit unresolved and report the status of those recommendations. We also make an additional recommendation for VA to provide technical training about the systems for which computer and network operators as well as administrators are responsible. This training should acquaint these staffs with the security risks associated with specific technologies combined with the technical measures and practices that reduce those risks.

Information Security Policies

Responsible program managers were in the process of revising and adding new information security policies to more explicitly establish comprehensive standards and criteria for minimum information system security safeguards. However, these revised security policies often only reiterated general statements from higher organization elements rather than providing the detail necessary to implement effective controls. Policies were sometimes contrary to general practices, and did not fully address restrictions to user access.

Applicable policies at each VA organization level reviewed did not define the knowledge needed by Information Security Officers (ISOs) to be effective. Instead, current and revised policies essentially restated the requirement by OMB that personnel assigned responsibility for information security should be knowledgeable.

General practices as well as VA directives required information security duties to be assigned to personnel who do not have management or operational responsibility. However, local facility policies and practice often specifically assigned responsibility to personnel who did have operational responsibilities.

Policies did not fully address user access restrictions throughout the information system. For example, at one facility, neither the application security plan, nor the Local Area Network (LAN) policy had been coordinated to address access restrictions. As a result, unauthorized individuals had full system access and authorized users had excessive privileges giving both groups inappropriate access to computer resources, including data files and applications programs.

Oversight, Monitoring, and Reviews

Improvements were in progress to strengthen the oversight functions that assess the effectiveness of the next lower organization level and that monitor computer activities. For example, managers at the Southwest Health Care Network (VISN 18) conducted reviews at associated facilities and the Austin Automation Center (AAC) established a solid foundation for its computer security planning and management program by creating a centralized computer security group, developing a comprehensive policy, and promoting security awareness. However, oversight and monitoring activities at most VA organizations still needed significant improvement. The AAC had not yet fully implemented a framework for assessing risks or monitoring and evaluating the effectiveness of computer controls on a routine basis. The majority of ISOs at other VA organizations reviewed still lacked sufficient knowledge and time for effective oversight and monitoring. In addition, reviews of user accounts and systems vulnerabilities needed to be better coordinated and more comprehensive.

Oversight needed to be merged into an integrated operation. VA Central Office staff had not incorporated into their integrated action plan results from either VHA's penetration study or the annual wide-area-network review. These studies identified significant risks to and actions needed by VA to reduce those risks.

The monitoring programs at facilities often needed to be more effective. Although AAC staff began reviewing violations to sensitive resources, a program had not yet been fully implemented to evaluate successful access to such resources for unusual or suspicious activity. At other facilities, activities on the communications networks were seldom monitored; servers were often poorly configured including logging that was not activated and insufficient space for log files. Data within those security logs that were activated were often not reviewed or analyzed.

Administration-level staff needed to coordinate reviews of user accounts by ISOs. For example, Veterans Benefits Administration's (VBA's) Benefits Delivery Center (BDC) ISO recently began to verify that accounts were still needed for remote users who had either not logged on since January 1, 1998, or who had never logged on. One VBA regional office included 167 remote users of the BDC system. None of these users had logged on since January 1, 1998, 87 had never logged on, and 6 had not logged on since 1996. The regional office Director initially responded that the "Office carefully reviewed" the listing of users. This first response directed the BDC ISO to delete one user, to change one surname, and to correct the spellings of six names. The second response to the ISO's follow-up provided only that the Office had "not had the opportunity to train all our employees on the system." This was in conflict with VA policy that required that all users be trained before being given privileges. Yet, the BDC ISO did not have the authority to suspend or delete users. The ISOs at Hines reported similar problems in their attempt to reduce user accounts for remote operations.

Additional comprehensive reviews were needed to ensure the different access provided to employees was necessary and appropriate. These reviews needed to compare access between different applications and through operating systems. Conducting this type of review, we identified 397 individuals with unneeded and inappropriate access at one facility and found evidence that indicated a similar weakness existed throughout VBA.

Access to Operating Systems, Applications, and Data

Improvements needed to improve controls and implement restrictions for safeguarding operating systems, applications, and data were made at selected organizations. Management at the AAC made significant progress during the year and responded quickly to correct most new security exposures identified during the audit. However, significant weaknesses remained at other facilities. Often, computer operations and security functions were improperly mingled, compounding the weaknesses by allowing computer operators to alter programs as well as data and to remove evidence of their activities.

Tests of Virtual Memory Storage (VMS) access at medical facilities demonstrated that powerful operating privileges assigned to VMS users were often unnecessary and unmonitored.

In addition, users who were not authorized to perform data entry functions, including computer and telecommunication specialists, secretaries, and students, had access through the operating system giving them the capability to read, write, and delete information.

Contingency Program

Managers at selected VA facilities were improving their respective contingency programs by revising contingency plans and planning to begin continuous recovery testing and improvement programs. However, these programs were mostly in the planning process. In addition, backups were often still stored in or near the building where data was processed.

Physical Access Controls

Improvements to physical access controls continue to be needed, for the most part, at selected facilities rather than throughout VA. The one general exception was that significant numbers of employees often had unnecessary access to the computer room.

Conclusion

Computer operation and security staffs needed to be more knowledgeable about the security concerns related to the specific technologies for which they were responsible. Configuration weaknesses existed that were well known within the security community and often easy and inexpensive to correct.

Operating system vulnerabilities that allowed access to applications and data included operating systems without security patches installed, running outdated services and utilities, poor password selection including accounts having systems-level access without passwords, and the use of insecure trust relationships.

Recommendation No. 1

We reaffirm recommendations a through e below made in our FY 1997 audit report, and provide new recommendation f, that VA enhance information system security by:

a. Modifying current policies and procedures to provide more explicit direction to the organizational level being addressed to establish comprehensive standards and criteria for minimum information system security safeguards.

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

c. Strengthening information system 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.

f. Providing computer operations and security staffs training about the specific technologies they are responsible for.

2. Housing Credit Assistance Program Accounting

The VA HCA program accounting systems do not efficiently and reliably accumulate the financial information needed to comply with Federal financial accounting requirements. In each of our last two VA CFS audits we reported serious internal control weaknesses over HCA financial reporting. The Department has recognized these weaknesses and has reported loan guaranty financial modernization, loan service and claims, and loan sale program management as material weaknesses in its FMFIA report for FY 1998. Staff corrected a number of weaknesses in the financial reporting process during FY 1998. Additionally, they have corrective actions in process. However, complete correction will not occur until at least May 1999. Accordingly, we limited our audit scope and testing on the FY 1998 CFS audit and continued to qualify the auditor's opinion concerning loan guaranty accounts in our audit report. Loan Guaranty account items will continue to be a high risk area vulnerable to error until HCA program financial systems comply with financial system requirements.

Background

VA first identified a need for improving HCA systems in 1986 in its FMFIA report. The credit reform accounting area was added as material weaknesses in 1995 and a new material weakness in loan sales program management was added in 1996. These weaknesses have financial system implications.

In our FY 1996 CFS audit report we reported that the HCA accounting process is not efficiently and reliably accumulating the financial information needed to comply with Federal financial accounting requirements. The lack of an integrated financial accounting system, coupled with the complexities of accounting requirements under credit reform, resulted in a financial statement preparation process that was labor intensive, cumbersome, and error prone. The increasing complexity of credit reform accounting and significance of credit reform dollar amounts on VA's financial statements was increasing the risk and magnitude of financial reporting errors each successive year.

We concluded in our FY 1996 CFS audit report that to ensure the HCA program will be able to continue to produce reliable financial statement information, VA management needed to:

- Actively seek the funding necessary to replace the current multiple program-oriented systems with an integrated financial accounting system that interfaces with VA's current FMS system and meets Federal financial accounting requirements.

- Provide training to staff responsible for preparing the HCA financial statement information.

In our FY 1997 CFS audit report we further reported weaknesses in internal controls over HCA financial reporting and identified a number of specific weaknesses in the process used to compile the financial statements, in internal controls over the HCA program direct loans portfolio, and in the accounting for guaranteed sales of direct vendee loans. We recommended that VA:

- Improve the HCA program 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.

- Complete actions underway to assure that all direct portfolio loan records are complete and accurate.

- Complete actions underway to develop and implement changes to account correctly for vendee loan sales.

Corrective Action In Process

A VBA contract study completed in April 1998 concluded it would cost as much as $36 million for the Loan Guaranty operational, financial, and accounting systems to be made compliant to the OMB and Joint Financial Management Improvement Program core system requirements for both finance and credit reform, and to be compliant with the FFMIA Standard General Ledger (SGL) requirements. The contract study recommended alternatives. The alternatives included considering that the Loan Guaranty (LGY) General Ledger System be deactivated and LGY accounting be done in VA's core Financial Management System (FMS), or that all LGY systems be reengineered for financial and credit reform compliance. They also recommended that at least four additional full-time employees be provided for the LGY accounting effort.

Because of the high resource requirement identified, the Department developed and is reviewing long term options for reengineering the LGY systems. VA also identified short term solutions with the objective of focusing on those issues that must be corrected to support the amounts and disclosures made and provide a reasonable assurance that their financial information is free of material misstatements.

Significant progress has been made on the short term items, much of this since the end of FY 1998. However, material correction is not scheduled to occur until at least May 1999. VBA staff made a number of improvements in documentation supporting the Loan Guaranty financial statements and significant progress was made toward improving the accuracy of the HCA program direct loan portfolio accounting. Regarding the accounting and internal control weaknesses concerning the guaranteed sales of vendee loans, a contractor developed estimates that were used in the VA FY 1998 CFS and is developing detail information and an accounting application to track individual loans in sales back to FY 1992. The target date estimated for completing this contractor work is May 1999.

Conclusion

We limited our audit scope and testing on the FY 1998 CFS and continue to qualify our opinion concerning loan guaranty accounts in management's financial statements because many of the corrective actions are still in process. Loan

Guaranty account items will continue to be a high risk area vulnerable to error until corrective actions are complete and HCA program financial systems comply with financial system requirements.

Recommendation No. 2

We reaffirm recommendations a through c made in our FY 1997 audit report, and add new recommendation d, to:

a. Replace the current multiple program-oriented systems with an integrated financial accounting system that interfaces with VA's current FMS system and meets Federal financial accounting requirements.

b. Complete actions underway to assure that all direct portfolio loan records are complete and accurate.

c. Complete actions underway to develop and implement changes to account correctly for vendee loan sales.

d. Provide training to staff responsible for preparing the HCA financial statement information.

3. Medical Facility Accounts Receivables

We conclude medical accounts receivable balances remain susceptible to significant errors because some medical facilities did not reconcile accounts receivable subsidiary records to the general ledger control accounts. Reconciliations are generally accepted accounting practices that are required in order to identify errors and ensure that the records are complete. As a result, subsequent audit tests and analysis identified a number of significant accounting errors and we also observed weaknesses in accounts receivable follow-up and review practices. A separate review also identified cases of improper billing that resulted in VA refunding some collections to one insurance carrier.

We qualified our audit opinion on VA's FY 1997 CFS because accounts receivable balances in the VA general ledger were significantly different from the amount of open receivables in subsidiary Veterans Integrated Systems Technology Architecture (VISTA) system files at medical facilities. In addition, significant errors were made in estimating the collectibility of the accounts receivable. We recommended that the Department:

- 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.
- Completely reconcile the medical facility subsidiary and general ledger accounts receivable to correct errors in the existing files.
- Make changes to improve the collectibility estimates of receivables.

During FY 1998 VHA Medical Care Cost Recovery staff made software changes and issued guidance that substantially corrected the errors in estimating the collectibility of receivables. However, our audit testing at 16 facilities during the 4th quarter FY 1998 and 1st quarter FY 1999 showed that 5 facilities had not performed any FY 1998 accounts receivable reconciliations at the time of our visits. VA policy requires facilities to reconcile general ledger and subsidiary accounts each month.

We tested the accuracy and completeness of the medical facility accounts receivable balances by (i) comparing an extract of the individual open accounts receivable in the VISTA subsidiary file to the VA general ledger amounts for each station, and (ii) verifying a national statistical sample of open accounts receivable at September 30, 1998.

The comparison of the VISTA subsidiary file and general ledger amounts initially identified plus and minus differences that totaled $63.6 million for medical facilities. Using the VISTA subsidiary file extract, we performed further analysis to identify the causes of the differences of those medical facilities comprising $45.6 million of the differences. Staff at the medical facilities were able to identify the cause of most of the differences. Some examples of the causes were:

■ About $5.3 million were errors in the FMS general ledger, which resulted in a net understatement of $2.7 million.

■ About $20.4 million of the difference was attributed to recent medical facility integration where the FMS amount for the legacy facility was combined to the host facility, but the subsidiary records had not been combined, resulting in a plus difference at one facility and an offsetting minus difference at the other facility.

■ Another $13.5 million in differences were errors in the VISTA subsidiary records or the data extract, but the FMS general ledger account was correct. Examples included: several transactions recorded into FMS that did not get recorded in the VISTA subsidiary records; at one facility the data collector used in the extract did not pick up all accounts; and, in two other cases OPAC (Online Payment and Collection) collections totaling $1,892,767 paid by another Federal government agency and recorded in VA's FMS before September 30, but were not recorded in VISTA until late October.

Our separate review of 569 medical accounts receivable identified additional errors in recorded receivable balances that we estimate overstated recorded receivable balances in the general ledger by about $65 million. Examples included:

■ The bill number was inadvertently input into FMS rather than the actual bill amount.

■ The medical facility over billed a university for too many hours of professional services.

■ The veteran's eligibility status changed which made the co-payment bill invalid.

■ The VA Regional Counsel had determined that the bill should be closed, but the medical facility was unaware of the Regional Counsel's decision.

Complete reconciliation of the VISTA subsidiary accounts receivable records to the FMS general ledger accounts is essential to ensure that accounts receivable balances are complete and accurate. The reconciliations are difficult to do because the VISTA system does not automatically total the individual receivable amounts and reconcile the totals to the related FMS general ledger amounts. Staff had to do the reconciliations manually and they frequently did not have readily available the detail information needed to identify discrepancies. This made reconciliations difficult and time consuming.

Automated reconciliation would be more efficient and improve internal controls. During the audit VHA Medical Care Cost Recovery staff requested ADP programming support to make software changes so that the data extracted and provided for use in our audit analysis is refined to facilitate comparison with the general ledger amounts; and, also that the data be provided to each medical facility to use in reconciling the VISTA subsidiary records and the general ledger accounts.

Many of the errors found in the sample were neither detected nor corrected because the medical facilities did not adequately follow-up or review long outstanding bills. In some cases, long outstanding bills had previously been forwarded to the VA Regional Counsel, or were in dispute, but in other cases the bills had not been referred to others. Adequate and timely follow-up is needed to assure that the recorded receivable amounts are accurate, valid, and current.

A separate review was requested by the Under Secretary for Health for us to identify improper medical insurance billing practices by a VA medical center to an insurance carrier. The review identified the following types of improper billings:

■ Medical services not documented in the medical records.

■ Services incorrectly coded.

■ Services involving "upcoded" bills to indicate a higher level of service than actually provided.

■ Services not covered by insurance.

The improper billings for medical services could occur at other medical facilities. In response to the OIG briefing and recommendations, VHA management took immediate action and developed a detailed strategy to correct and prevent inappropriate billing by VHA facilities. If not curtailed, improper billings could adversely affect future collections.

Recommendation No. 3

We recommend that VA:

a. Provide the necessary ADP programming support to (i) enable automated reconciliation of the VISTA system subsidiary accounts receivable file to the FMS general ledger control accounts and (ii) as an interim measure, to make software changes so that the data extracted and provided the OIG for use in audit analysis is refined to facilitate comparison with the general ledger amounts and also that the data be provided each medical facility to use in reconciling the VISTA subsidiary records and the general ledger accounts.

b. Ensure that medical facility staff completely reconcile the subsidiary and general ledger receivable accounts, resolve any reconciliation differences, and make appropriate adjustments.

c. Ensure that medical facilities perform periodic reviews of outstanding receivable amounts to verify that receivable amounts are accurate and that the receivable is still valid.

DETAILS ON COMPLIANCE WITH LAWS AND REGULATIONS

1. Public Law 104-208, Federal Financial Management Improvement Act (FFMIA) Of 1996 and Federal Credit Reform Act of 1990

The results of our tests for FY 1998 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 certain FFMIA requirements and specific provisions of the Federal Credit Reform Act of 1990.

Concerning FFMIA: (i) VA's HCA program was noncompliant with Federal accounting standards for guaranteed loan sales, with financial information systems requirements, and with the FFMIA requirement that the U.S. SGL be maintained at the transaction level; (ii) with the exception of the AAC, the Department was noncompliant VA-wide with FFMIA information system security requirements; and, (iii) VA was noncompliant with respect to requirements that systems be able to accumulate and report the costs of their activities on a regular basis. VA reported in its Management Representation Letter to the OIG that Loan Guaranty program systems, which provide the data used in Housing Credit Assistance items in VA's CFS, were not in compliance with the FFMIA requirement that the U.S. SGL be maintained at the transaction level. We discussed material weaknesses concerning the Housing Credit Assistance program financial management systems in the Report on Internal Control Structure. VA also further reported that financial systems for Canteen Service; and VBA Readjustment Benefit, Vocational Rehabilitation, and Education Funds were not compliant. These systems and applications did not materially affect VA's CFS. Department officials informed us they expect all systems to be fully compliant by FY 2000.

In addition, VA was not compliant with the FFMIA requirements that security over financial information be provided in accordance with OMB Circular A-130, and requirements relating to cost accounting standards. We discussed the material weakness in VA's information system security controls in the Report on Internal Control Structure.

The Department was in conformance with the Statement of Financial Accounting Standard No. 4, **Managerial Cost Accounting Concepts and Standards for the Federal Government** provisions that require that federal reporting entities be able to accumulate and report costs either through the use of cost accounting systems or through the use of cost finding techniques. However, cost accounting systems were not in place during FY 1998 to accumulate activity level cost data. The Department was able to develop and allocate costs to the responsibility segments (the ten programs defined in the Statement of Net Cost) on a reasonable basis in preparing the statement. VBA and NCA selected Activity Based Cost (ABC) systems for providing their cost accounting information.

VBA has performed extensive field testing of ABC during FY 1998, and implemented the system on October 1, 1998. NCA has purchased software that it is pilot testing at selected sites and anticipates full implementation by the end of FY 2000. On November 12, 1998, VHA designated and approved the Decision Support System as its managerial cost accounting system.

Regarding the Federal Credit Reform Act of 1990, the Department was not fully compliant with the section 661c(a) and (f) requirements that VA estimate a future liability for guarantees on loans sold and that they include it in its annual budget requests to the Congress, and it was not compliant with the §661f(b) provision that stipulates that income arising from pre-1992 credit activities must be used only to offset expenses arising from those same activities. VA was using some of the funds for post-1991 activities.

2. Public Law 96-466 And Title 38 U.S.C. § 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. § 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 1998. More than 61 percent ($342 million) were over 2 years old. The total interest and administrative costs applicable to FY 1998 were over $32 million. Since 1992, VA has not taken collection action on over $132.6 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 that the law is not appropriate. During FY 1998, VA sent documentation to OMB supporting its request for relief from charging interest and administrative costs. On April 10, 1998, OMB returned the request to VA asking for additional information. According to VA officials, a decision has not yet been rendered.

3. Title 31 U.S.C. § 3302(b), "Miscellaneous Receipts"

We also report noncompliance with the requirement of Title 31 U.S.C. § 3302(b), "Miscellaneous Receipts" that agents of the Government receiving money for the Government from any source shall deposit the money in the general fund of the Treasury as soon as practical. A VA contract for the HCA inappropriately allowed the contractor to open and maintain a bank account, and to transfer receipts once a month, instead of daily, as required. Receipts average approximately $18 million per month. VA should comply with the law.