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Report to the Congress

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FINANCIAL AUDIT

Veterans Administration's Financial Statements for Fiscal Years 1988 and 1987

GAO

United States
General Accounting Office
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Comptroller General
of the United States

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To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our audit of the consolidated financial statements of the Veterans Administration (VA) (which became, in March 1989, the Department of Veterans Affairs) for the fiscal years ended September 30, 1988 and 1987. Our opinion on VA's consolidated financial statements is qualified because we were not able to satisfy ourselves that VA's property and equipment accounts were presented fairly. The opinion is also qualified because life insurance reserves were not presented in accordance with generally accepted accounting principles.

In addition, our opinion addresses the financial condition of VA's life insurance and housing credit assistance programs which are designed to be financed primarily from self-generated revenues. The financial condition of the life insurance program is satisfactory. However, the housing credit program is experiencing financial problems that may require assistance beyond that identified in VA's current appropriation request.

The report contains separate reports on VA's system of internal accounting controls and on its compliance with laws and regulations. Our report on internal accounting controls discusses several material weaknesses reported by VA in its fiscal year 1988 Federal Managers' Financial Integrity Act report and two identified by our financial audit which we reported previously and which VA has not completely corrected. We have also identified other significant weaknesses which are not material to the financial statements and will report them separately to the Secretary of Veterans Affairs. Our report, Financial Management: Other Opportunities for Improving VA's Internal Accounting Controls and Procedures (GAO/AFMD-89-35, August 1989), discusses weaknesses identified during our fiscal year 1987 audit and VA's actions to correct them. Our report on compliance with laws and regulations discloses that VA complied with the provisions of laws and regulations for the transactions we tested which could have materially affected its financial statements.

The accompanying consolidated financial statements reflect statutorily calculated life insurance reserves rather than reserves calculated in accordance with generally accepted accounting principles (GAAP). (See note 6.) These reserves, which cover the principal insurance plans which VA administers and supervises, were established based on federal statutes which prescribe conservative investment yields and mortality assumptions. Under GAAP, more realistic interest earnings projections and actual mortality experiences are used to calculate such reserves. The insurance reserves reflected in the statements, which were calculated using statutorily set interest rates ranging from 2.3 percent to 4.5 percent and mortality tables dated as far back as 1941, amounted to $11.8 billion and $11.6 billion for fiscal years 1988 and 1987, respectively. Insurance reserves under GAAP, calculated using interest rates ranging from 7 percent to 8.5 percent and mortality assumptions based on actual program experience, amount to approximately $8.9 billion and $8.6 billion for fiscal years 1988 and 1987, respectively. Thus, under GAAP, the insurance reserves reflected on the consolidated statement of financial position would have been about $3 billion less for each fiscal year. This difference is called "Participating Policyholders' Interest in Accumulated Participating Earnings" and, under GAAP, would be classified on the consolidated statement of financial position as a liability. Operating expenses for fiscal year 1988 would have been greater under GAAP, but not in a material amount.

In our opinion, except for the effect of adjustments, if any, that might have been necessary had we been able to perform the necessary auditing procedures to substantiate the asset and related expense accounts, as discussed in paragraph three above, and, except for the effect of the financial statement presentation of life insurance reserves using statutory assumptions rather than the more realistic assumptions under generally accepted accounting principles, as discussed in paragraph four above, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Veterans Administration as of September 30, 1988 and 1987, the results of its operations, and the changes in its financial position and reconciliation to budget for the fiscal years then ended, in conformity with generally accepted accounting principles.

VA's Financial Condition

VA has five major categories of programs for accomplishing its legislative mission. Three of the categories are financed principally through appropriations while two—the life insurance and housing credit assistance programs—are designed to be financed primarily by revenues generated

1988—which has resulted in increased cash outlays for property acquisitions, thereby severely straining the loan guaranty fund's normal operating financial resources.

The loan guaranty fund will need approximately $3.5 billion from future years' financing sources to pay unfunded losses incurred by the program through fiscal year 1988. While a portion of these future financing needs will come from the fund's normal operations, VA estimates that for at least the next several years the fund will require additional resources from appropriations. For example, VA estimates that the fund will need (1) about $788 million in direct appropriations in fiscal year 1989 and (2) about $100 million in transfers from the direct loan fund plus about $453 million in additional direct appropriations in fiscal year 1990. However, as in fiscal year 1988 when a $526 million supplemental appropriation had to be obtained to meet the total cash needs of the loan guaranty fund, the amount of appropriations needed to defray the costs of the housing credit program may increase significantly from VA's initial estimates. We are concerned that VA may require direct appropriation assistance from the Congress which is significantly greater than that currently identified in VA's 1989 appropriation request and budget proposals for the next few years.

Reasons Additional Appropriation Estimates May Be Low

Various factors may affect the level of direct, annual appropriations needed by the loan guaranty fund. Actual financial results may deviate from VA's estimates if, for example, any of the following situations occur:

- The number of properties that VA has to acquire and the claims it has to pay due to foreclosures on VA-guaranteed loans is greater than anticipated because envisioned economic improvements do not occur or VA foreclosure estimates are inaccurate. VA expects the foreclosure trend to reverse itself, but other mortgage industry sources expect the trend to continue at its current level.
- The sales of loans on acquired properties are made on a without-recourse contract basis versus a with-recourse basis since without-recourse loan sales provide less cash at the time of sale.
- A significant lapse occurs in VA's authority to collect a 1-percent funding fee on guaranteed and direct loans.

In addition, unlike the situation in previous years, resources available for transfer from the direct loan fund are limited.

(1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over agency assets. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, a lapse in the degree of adherence to the procedures, or a deterioration in the effectiveness of the design and operation of policies and procedures.

VA annually evaluates its system of internal accounting and administrative controls and issues a report to the President, in accordance with FMFIA. In its December 1988 FMFIA report covering fiscal year 1988, VA reported that its internal control system, taken as a whole, complied with the requirement to provide reasonable assurance that internal control objectives were achieved. However, VA also reported that several material weaknesses existed. These weaknesses involved items such as automated data processing (ADP) security and reconciliation of control accounts to source documents.

The 1988 FMFIA report also contained VA's annual assessment of its financial management system's compliance with accounting principles, standards, and related requirements for federal agencies. VA has six major accounting systems. In those systems, the assessment identified 12 areas which materially failed to conform with accounting principles and standards. One of these areas was scheduled for correction in 1989, one in 1990, six in 1992, and the remaining four in 1996. However, only two of VA's six major accounting systems, when taken as a whole, did not comply with accounting principles and standards. These two systems are scheduled for corrective action by 1990. By the end of 1992, VA plans for its accounting system structure to consist of a single, agency-wide financial management system supported by three program systems—compensation, pension, and education; loan guaranty; and insurance.

We considered VA's FMFIA reports, as well as the IG's reports on financial matters and internal accounting controls, in determining the nature, timing, and extent of our audit tests of VA's internal controls. As previously changed to permit an increase in the dollar threshold at which an expenditure would require capitalization. Our fiscal year 1988 audit work disclosed that VA made improvements in the other two areas. During fiscal year 1988, VA initiated a special review to identify all completed projects in work-in-process and to transfer the cost of the projects to the completed facilities' general ledger balances as of September 30, 1988. As a result, VA capitalized about $900 million in nonexpendable property, buildings, and improvements. With respect to the last area, the VA Controller issued revised depreciation instructions to assist VA field units in the implementation of VA's capitalization and depreciation policies in these areas. However, the results of our fiscal year 1988 tests of procedures show that further improvements are needed in these areas.

VA field station accountants are still not properly recording transfers from work-in-process and VA's Supply Service is not calculating depreciation in accordance with generally accepted accounting principles or with VA guidance. Examples of discrepancies include the following:

- Of the 74 property transfers from work-in-process that we tested (which included 40 transfers made as part of the VA's special review described above), 54 were recorded to property records after the quarter in which they were placed in use. Twenty-seven of the 54 were recorded more than a year after being placed in use. Since the VA depreciates property quarterly, depreciation accounts are misstated when a project is not capitalized in the quarter it is placed into service.
- The cost of each general improvement to property is depreciated over the improvement's expected life span (often 40 years) instead of the remaining useful life of the property.

ADP Controls Need Strengthening

In our fiscal year 1987 internal control report, we reported that our review of VA's automated data processing (ADP) internal controls disclosed weaknesses in VA's software maintenance and data integrity controls at all three data processing centers (DPC)—Austin, Texas; Hines, Illinois; and Philadelphia, Pennsylvania. We also identified ADP problems within the compensation and pension system and inadequate compensating controls, such as reconciliations between systems or between control and subsidiary accounts. Taken collectively, these weaknesses significantly increased the risk of data errors or incorrect processing, which, in turn, could have affected both account balances and financial reports.

Recommendation

We recommend that the Secretary of Veterans Affairs direct the VA Controller to determine an appropriate method for achieving consistent implementation of the federal capitalization and depreciation accounting principles and policies. One possible approach would be to provide assistance and training on this matter to field station accountants during VA's normal field station reviews.

Other Opportunities for Improvement

During the course of our audit, we identified other matters involving the internal control structure and its operation which do not affect the fair presentation of the consolidated financial statements. These matters nonetheless warrant management's attention and will be reported separately to VA. During the course of our audit, we also followed up on VA's actions to correct internal accounting control weaknesses identified during our fiscal year 1987 audit. We recently issued a report, Financial Management: Other Opportunities for Improving VA's Internal Accounting Controls and Procedures (GAO/AFMD-89-35, August 11, 1989), which discusses VA's corrective action plans for the weaknesses disclosed during the 1987 audit.

Except for the problems relating to property, which caused us to qualify our opinion, the weaknesses in the control procedures did not affect our opinion on VA's consolidated financial statements.

Agency Comments

Although we did not obtain formal agency comments on this report, we did provide appropriate VA officials with a draft of the report and have incorporated their comments where appropriate. VA officials generally agreed with our findings and have initiated corrective action on our recommendation. In June 1989, VA's Office of Facilities and Office of Budget and Finance began a joint project to refine VA's capitalization and depreciation policies. This project involves a review of a sample of field station property records and discussions with field station personnel concerning proper implementation of capitalization and depreciation policies.

The results of our tests for fiscal year 1988 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. 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 same provisions.

Our fiscal year 1987 report on compliance with laws and regulations included comments on VA's noncompliance with two legal requirements. Our fiscal year 1988 audit tests disclosed that VA has improved its compliance, or plans to take action to permit its compliance, with the two legal requirements. These cases were

- failure to fully comply with the Prompt Payment Act and applicable regulations and
- violations of the Veterans' Rehabilitation and Education Act Amendments of 1980.

The following segments of this report discuss the status of VA's efforts to comply with these legal requirements.

Prompt Payment Act

The Prompt Payment Act (31 U.S.C. 3902) provides governmentwide payment standards for determining when federal agencies should pay commercial vendors. If payments are not made within the specified time period, interest penalties must be paid to the vendors.

As disclosed by VA in its Federal Managers' Financial Integrity Act report dated December 28, 1988, and as shown by our fiscal year 1988 audit tests, VA's compliance with the Prompt Payment Act requirements for paying vendors within the specified time period has improved. This is demonstrated by the decline in the annual interest penalties paid by VA to its vendors. Unpaid penalties declined from $431,282 in fiscal year 1987 to $361,081 in fiscal year 1988. Furthermore, with the modifications made to VA's automated money management system in fiscal year 1988, VA projects an additional decline in unpaid interest penalties in fiscal year 1989.

Financial Statements

Consolidated Statement of Financial Position

SEPTEMBER 30, 1988 AND 1987

(Dollars in Thousands)

	1988	(Restated) 1987
ASSETS:		
Fund Balance with U.S. Treasury	$ 5,377,895	$ 5,997,027
Imprest Funds	8,989	9,616
Advances, Accounts, and Loans Receivable, net (note 8)	3,096,796	3,211,966
Investments (note 7)	12,651,054	12,242,563
Foreclosed Property Held for Sale	818,833	864,104
Land, Buildings, and Equipment Net of Accumulated Depreciation (note 9)	7,729,963	6,839,263
Other Assets	157,640	151,615
Future Financing Sources (note 1)	$ 5,812,540	$ 4,616,267
TOTAL ASSETS	$ 35,653,710	$ 33,932,421
LIABILITIES, TRUST FUND BALANCES, AND EQUITY:		
Accounts Payable, Principally to the Public	1,099,294	$ 1,111,935
Accrued Compensation and Pension Benefits	724,086	1,280,054
Accrued Payroll and Payroll Related Liabilities	1,102,511	1,011,568
Dividends on Credit or Deposit (note 6)	785,238	706,018
Insurance Dividends Payable (note 6)	997,184	956,347
Other Liabilities	423,719	459,879
Liability for Federal Employees Compensation Act (note 1)	1,024,309	944,886
Liability for Losses on Guaranteed Loans (note 5)	3,663,488	2,718,898
Insurance Statutory Reserves (note 6)	11,838,984	11,612,555
Borrowings from Treasury	1,730,078	1,730,078
TOTAL LIABILITIES	23,388,891	22,532,218
TRUST FUND BALANCES	850,297	889,639
EQUITY OF THE U.S. GOVERNMENT:		
Unrealized Appropriations:		
Invested Capital	8,111,422	7,018,461
Deferred Appropriations	275,763	316,365
Unobligated Balances	1,210,724	1,369,786
Undelivered Orders	1,816,613	1,805,952
TOTAL EQUITY OF THE U. S. GOVERNMENT	11,414,522	10,510,564
TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY	$35,653,710	$ 33,932,421

The accompanying notes are an integral part of these statements.
Note 11 includes financial information by major program area.

Consolidated Statement of Changes in Financial Position and Reconciliation to Budget

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1988 AND 1987
(Dollars in Thousands)

	1988	(Restated) 1987
NET USE OF RESOURCES:		
Operating Expenses	$ 30,807,934	$ 30,001,897
Items Requiring (Providing) Funds:		
Increase in Future Liability Provisions	(1,250,442)	(1,301,221)
Depreciation	(412,099)	(363,477)
Decrease in Accounts Receivable	(91,778)	(420,471)
Decrease (Increase) in Accounts Payable and Accruals	186,200	(274,715)
Revenues Accounted for as Offsetting Collections	(2,142,762)	(2,263,283)
Funds Used By Operations	27,097,053	25,378,730
Non-Operating Uses:		
Dividends (note 6)	952,507	927,500
Acquisitions of Land, Buildings, and Equipment	1,090,664	969,993
Purchase of Foreclosed Property Held for Sale	1,630,545	1,380,338
Issuance and Repurchase of Loans and Liens	1,174,472	1,327,375
Other, Net	(23,441)	(98,328)
Financing Activities:		
Sale of Foreclosed Property Held for Sale	(1,661,608)	(1,482,928)
Sale of Loans, with Recourse	(296,683)	(849,196)
Loan/Lien Repayments/Optional Income Settlements	(353,607)	(372,900)
Revenues Collected for Treasury	(338,924)	(228,546)
NET USE OF BUDGETARY RESOURCES (OUTLAYS)	29,270,978	26,952,038
SOURCES OF BUDGETARY RESOURCES PROVIDED		
Current Year Appropriation, Adjusted	28,363,176	26,605,398
Contract Authority and Reappropriation	(121,192)	
Proceeds of Loan Sales With Recourse	389,259	
Interest on Government Securities	998,165	964,383
Net Transfers, Reimbursements, and Other	(382,838)	(165,973)
Funds Returned to Treasury	(183,882)	(170,226)
TOTAL RESOURCES PROVIDED	29,062,688	27,233,582
INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS	(208,290)	281,544
Funds Exchanged for U.S. Government Securities	(411,469)	(433,094)
NET DECREASE IN U.S. TREASURY AND IMPREST FUNDS	(619,759)	(151,550)
U.S. TREASURY AND IMPREST FUNDS:		
Beginning of Year	6,006,643	6,158,193
End of Year	$ 5,386,884	$ 6,006,643

The accompanying notes are an integral part of this statement.
Note 11 includes financial information by major program area.

Operating Revenue And Other Financing Sources Recognition

Interest income, which is earned primarily from the investments of the insurance program, is recognized on the accrual basis. Insurance premiums are recognized as revenue when due. Loan origination fees, which are charged to veterans at a rate of 1 percent of the loan principal, are recognized as revenues at the time of the guaranty.

Funds With U.S. Treasury

VA does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The balance in the U.S. Treasury represents the right to draw on the U.S. Treasury for allowable expenditures.

Commitments

VA has obligations remaining at the end of each year for goods and services which have been ordered but not yet received (undelivered orders). Aggregate undelivered orders amounted to $1,816,613,000 and $1,805,952,000 at September 30, 1988 and 1987, respectively. Of these amounts, $1,011,475,000 in 1988 and $960,440,000 in 1987 related to construction projects of both long- and short-term duration. The remainder is principally comprised of obligations for medical supplies and equipment which were incurred by VA in the normal course of fulfilling its mission.

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, based upon the American Hospital Association's estimate of useful lives of hospital assets. Equipment is depreciated using the straight line method over useful lives, which, for most equipment, range from 5 to 20 years.

Dividends Payable

Dividends from the VA's insurance programs are recorded as a liability when declared by the Administrator of Veterans Affairs. Dividends are normally declared when fund balances are in excess of statutorily required insurance claim reserves.

Trust Fund Balances

Trust fund balances are comprised of the Post-Vietnam Educational Assistance Trust Fund, Insurance Trust funds, and the General Post Fund. These funds are accounted for separately and can be used only for specified purposes. They are not available to fund general purpose governmental activities and thus are excluded from VA's equity accounts.

Invested Capital

Invested Capital includes VA's investment in plant, property, and equipment.

Deferred Appropriations

Deferred appropriations include certain accounts receivable for which outlay authority is not available until collection.

Workers Compensation

Legal actions brought by employees of the VA 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 so they may be funded through the budget process. Using actuarial estimates provided by the Department of Labor, VA has recorded FECA liabilities for balances billed to VA by DOL and for an estimate of the present value of the long-term payments related to cases on hand at the end of the fiscal year.

NOTE 2: INTRAGOVERNMENTAL FINANCIAL ACTIVITIES

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

VA's total contributions for CSRS and FERS participants, including contributions to Social Security, during fiscal year 1988 and fiscal year 1987 were as follows:

	1988	1987
CSRS	$274,869,684	$306,844,931
FERS	227,139,124	132,990,446
FICA	120,831,572	104,309,122
Total VA Contributions	$622,840,380	$544,144,499

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.

- 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 (over $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 that is maintained on deposit with the Department of Treasury. Since VA, is not required to reimburse the Judgment Fund for payments made on its behalf, except for contract dispute payments, the amount of payments from the Fund for VA are not reflected in VA's statements. Amounts paid from the Judgment Fund on behalf of VA were $35 million and $30 million in fiscal years 1988 and 1987, respectively. Amounts reimbursed the Judgment Fund by VA for contract dispute payments were not material.

NOTE 3: RESTATEMENT OF FISCAL YEAR 1987 STATEMENTS

The fiscal year 1987 consolidated statement of financial position and consolidated statement of operations and changes in financial position and reconciliation to budget have been restated to revise VA's liability for workers' compensation benefits, based on an actuarial evaluation of the long-term liability for FECA. In total, this change has increased the asset future financing sources and the liability for Federal Employees Compensation Act by $521,159,000.

NOTE 4: FUTURE LIABILITY FOR COMPENSATION AND PENSION

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 if the veteran was disabled or died from nonservice-connected causes or is age 65 or older. Certain pension benefits are subject to specific income limitations.

NOTE 5: HOUSING CREDIT ASSISTANCE PROGRAM - COST OF GUARANTEED LOAN DEFAULTS

Activities under the VA housing credit assistance program primarily involve the partial guaranty of residential mortgage loans issued to eligible veterans by private lenders. In addition, the VA originates direct loans to veterans, sells foreclosed property on credit terms (vendee loans), and monitors foreclosure settlements for ultimate claims reimbursement to the VA.

Residential loans guaranteed by the VA are originated by private lenders and are not recorded in the financial statements of the VA. The face amount of such loans outstanding as of September 30, 1988 and 1987, was $150 billion and $146 billion respectively, and the guaranteed amount of outstanding loans at September 30, 1988 and 1987 was approximately $60 billion on each date. The guaranty, in effect, transfers some or all of the risk of default from the lender to the VA. At the time of default, the VA has the option to either pay the guarantee amount or pay a reduced amount and acquire the property from the lender. VA assumes this risk to provide a benefit to the veteran who obtains a mortgage with interest rates which are usually lower than conventional mortgage rates and without a normally required downpayment.

Vendee and Direct Loans

The total amount of vendee loans and loans of the direct loan program as of September 30, 1988 and 1987, was (dollars in thousands):

	1988	1987
Vendee loans	$1,056,100	$1,158,681
Direct loans	77,372	98,100
	$1,133,472	$1,256,781

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 liability for losses on guaranteed loans and as an offset to the value of certain related assets. The unfunded portion of this liability is also reported in the consolidated statement of financial position as an amount due from future financing sources.

Recourse loan sales

During 1988, the VA sold approximately $379 million of loans with recourse marketing agreements for $365 million. Under the terms of the agreements, the VA will repurchase the loans sold if default occurs. Any losses from defaults of repurchased loans are borne by the VA. The VA has estimated the potential loss based upon historical data and has recorded this amount as a component of the provision for loan losses at September 30, 1988.

Non-recourse loan sales

During fiscal 1988, the VA conducted two non-recourse loan sales. The components of the sales are summarized as follows (in thousands):

	American Housing Trust I	American Housing Trust II	Total
Loans receivable sold	$308,937	$234,346	$543,283
Proceeds from Sale:			
Cash*	185,557	134,284	319,841
Investment in subordinated certificates of securities	105,059	91,391	196,450
	290,616	225,675	516,291
Loss on loans receivable sold	$ 18,321	$ 8,671	$ 26,992

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

American Housing Trust I

On June 29, 1988, the VA completed its first sale of non-recourse loans to the American Housing Trust I (AHT I). Under the terms of the sale, the VA sold approximately $309 million of its vendee loans to AHT I, who in turn, sold the loans as mortgage pass-through certificates. The mortgage pass-through certificates consisted of seven senior classes of certificates which were offered to the public and subordinate certificates which were assigned to the VA as partial proceeds from the sale of the loans. The face value of the subordinate certificates at the time of sale was approximately $105 million. Interest and principal payments on the senior certificates are guaranteed by American Loan Guarantee Association. Under the securities structure, principal and interest payments to the VA are subordinate to the senior certificate holders.

	Year Ended September 30	
	1988	1987
	(In thousands)	
Foreclosed property held for sale	$962,914	$965,720
Allocation of loss provision	144,081	101,616
Net	$818,833	$864,104

Guarantee Commitments

At September 30, 1988, the VA had outstanding commitments to guarantee loans, which will originate in fiscal year 1989. The number of commitments could not be determined, as the VA has granted authority to various lenders to originate VA loans meeting established criteria without prior VA approval.

Participation Certificates

During fiscal year 1988, the final series of Federal Asset Financing Trust (FAFT) Participation Certificates (PCs) matured. A final principal payment of $146 million was made to the sinking fund administered by the Government National Mortgage Association (GNMA), in order to end VA's involvement in the Participation Sales Act of 1966 (P. L. 89-429). This payment had been included in Other Liabilities in the September 30, 1987 Consolidated Statement of Financial Position.

Over the life of FAFT, VA transferred interest payments to GNMA for coverage of the periodic interest payments on the PCs. GNMA invested excess funds not needed to meet current interest payments on behalf of the VA. The balance associated with this investment at September 30, 1987, was $155 million. When the final series matured in August 1988, VA received $165 million from GNMA as their share of interest income to the investment.

Subsequent Event - Supplemental Appropriation Request

Presently, the high level of foreclosures resulting in increased cash outlays in property acquisition and claim costs has severely strained the revolving fund resources. VA requested a supplemental appropriation for an increase of $130 million for the loan guaranty revolving fund which will bring the total fiscal year 1989 appropriation to $788 million. A continuing high rate of foreclosures on VA-guaranteed mortgages may require additional supplemental appropriations in future years.

The statutory insurance reserve balance as of September 30, 1988, consists of reserves for:

Program	Death Benefits	Death Benefit Annuities	Disability Income and Waiver of Premium	Other	1988 Statutory Reserve Total
	(dollars in thousands)				
NSLI	$8,311,932	$432,333	$ 836,172	$190,874	$ 9,771,311
USGLI	144,998	28,697	2,234	1,090	177,019
VSLI	904,089	3,484	119,481	3,362	1,030,416
SDVI	266,395	2,294	148,269		416,958
VRI	414,978	1,289	27,013		443,280
TOTAL	$10,042,392	$468,097	$1,133,169	$195,326	$11,838,984

The statutory insurance reserve balance as of September 30, 1987, consists of reserves for:

Program	Death Benefits	Death Benefit Annuities	Disability Income and Waiver of Premium	Other	1987 Statutory Reserve Total
	(dollars in thousands)				
NSLI	$8,082,269	$465,070	$ 880,877	$162,394	$ 9,590,610
USGLI	162,411	32,149	2,496	1,220	198,276
VSLI	848,576	3,445	120,334	1,325	973,680
SDVI	257,854	2,299	148,462		408,615
VRI	411,939	1,251	28,184		441,374
TOTAL	$9,763,049	$504,214	$1,180,353	$164,939	$11,612,555

These statutorily computed reserves for death benefits differ from those computed under generally accepted accounting principles (GAAP) for Federal agencies (title 2). Under GAAP, reserves are computed based on recent mortality experience and on interest assumptions that are expected to hold true for at least the next 10 years. As a result, the classified "insurance reserves" under GAAP are lower than "insurance reserves" computed using statutory assumptions. The difference in statutory and GAAP basic insurance reserves represents future benefits (dividends) that inure to program participants based on statutory requirements and practices.

Statutory reserves are based on interest rates ranging from 2.3 percent to 4.5 percent. GAAP reserves are based on interest rate assumptions ranging from 7 percent to 8.5 percent. Actual average investment yield for insurance program securities was 9.67 percent as of September 30, 1988, and 9.58 percent as of September 30, 1987.

Statutory mortality assumptions include the American Experience Table, the 1941 CSO Table and the 1958 CSO Basic Table. GAAP mortality assumptions are based on actual mortality experience of the insurance programs, with a provision for adverse deviation.

Certain premium items are also accounted for differently under Statutory and GAAP principles. Statutorily, a liability is set up for unearned premiums and advance premiums. Under GAAP, the liability for these items is reduced. A comparison is provided below:

Unearned Premium Reserve and Advance Premium
(dollars in thousands)

	9/30/88		9/30/87	
Program	Statutory	GAAP	Statutory	GAAP
NSLI	$106,344	$43,358	$105,487	$48,111
USGLI	21	21	23	23
VSLI	23,930	10,051	23,341	11,347
SDVI	1,364	1,364	1,447	1,447
VRI	3,558	2,831	3,487	2,638
Total	$135,217	$57,625	$133,785	$63,566

Under statutory principles, an asset is set up for uncollected premiums. Under GAAP, this asset is reduced. A comparison is provided below:

Uncollected Premiums
(dollars in thousands)

	9/30/88		9/30/87	
Program	Statutory	GAAP	Statutory	GAAP
NSLI	$2,176	$ 903	$2,292	$ 933
VSLI	466	196	447	202
SDVI	90	90	91	91
VRI	46	36	47	35
Total	$2,778	$1,225	$2,877	$1,261

VA Supervised Insurance Programs

VA also supervises the administration of the Servicemen's Group Life Insurance Program (SGLI). SGLI is supervised by the VA, but directly administered by the Prudential Life Insurance Company of America which provides group life insurance coverage and pays all claims and expenses associated with the program. This coverage is provided to active members of the Military Services, to cadets attending service academies, and to active members of the Armed Forces Reserves, National Guard, and ROTC.

VA's responsibilities are to establish premium rates and to act as the transfer agent for premiums paid by payroll deductions and for extra hazard costs paid by the service organizations involved. The VA also determines the adequacy of SGLI insurance reserves, and, if excess reserves exist, VA can both lower premium rates and withdraw excess funds. To date, VA has withdrawn approximately $94 million from these reserves. These funds, together with investment interest earned, are held in a trust fund which on September 30, 1988, had a balance of $148.1 million. On September 30, 1987, this balance was $144.9 million. This balance is used as a premium stabilization fund to augment premium payments remitted by the insureds.

SGLI Insurance In Force	1988	1987
Number of Policies	3,509,029	3,540,376
Amount (in millions)	$174,537.1	$176,065.8

In addition to SGLI, VA administers a similar program, Veterans Group Life Insurance, which provides life insurance to discharged veterans.

Other VA Administered Insurance Program

Effective September 1, 1988, VA commenced direct administration versus supervision of the Veterans' Mortgage Life Insurance program (VMLI). Under this program, disabled veterans can obtain insurance coverage of up to $40,000 of the outstanding balance of their home mortgage. Coverage ceases at age 70. Premiums, based on standard mortality tables, are deducted from the veteran's monthly compensation payment. Administrative expenses and the additional cost of insuring these medically impaired lives are borne by the Government through appropriations.

VMLI Insurance in Force	1988	1987
Number of Policies	5,416	5,539
Amount (in millions)	$185.5	$182.7

Other VA programs with investments are Housing Credit and Medical. Medical program investments are in securities issued by the U.S. Department of Treasury. Housing Credit program investments are, as of September 30, 1987, in GNMA participation certificates, which were issued by the Government National Mortgage Association, a subdivision of the U.S. Department of Housing and Urban Development. Housing Credit program investments are, as of September 30, 1988, in Trust Certificates which were issued by the American Housing Trust, a private entity not associated in any way with the U.S. Government.

NOTE 8: RECEIVABLES

Non-Federal accounts receivable principally represent amounts due from individuals for Home Loan Guaranty and Direct Loan defaults and Compensation and Pension overpayments. Federal accounts receivable are mostly accrued interest payments due from the U.S. Treasury Department on VA investments. Non-Federal advance payments are principally advances to VA construction contractors, grant recipients, beneficiaries, and VA employees engaged in official travel. Federal advance payments are mostly to the General Services Administration for the procurement of supplies and equipment. Current loans receivable are principally amounts due under VA's Housing Credit Assistance Program. Non-Current loans receivable represent amounts due from loans against VA-issued life insurance policies and also amounts owed VA's Housing Credit Assistance Program beyond the next 12 months.

The receivables as of September 30, 1988, consist of:

	Current	Non-Current	Total
Accounts:			
Individuals/Corporations	$2,913,957	$ 132	$2,914,089
Federal Government	368,401	461	368,862
Less: Allowances for Loss	2,463,120		2,463,120
Accounts Receivable, net	819,238	593	819,831
Advances:			
Individuals/Corporations	53,432		53,432
Federal Government	133,660		133,660
Total Advances	187,092		187,092
Loans			
Individuals	616,558	1,644,686	2,261,244
Less: Allowances for Loss	46,727	124 644	171,371
Loans, Net	569,831	1,520,042	2,089,873
Net Receivables	$1,576,161	$1,520,635	$3,096,796

Property and equipment consisted of the following as of September 30, 1988:

	Cost	Accumulated Depreciation	Net Book Value
	(dollars in thousands)		
Land	$ 91,955	$	$ 91,955
Buildings	6,201,962	1,888,078	4,313,884
Equipment	3,059,155	1,543,620	1,515,535
Other	802,186	313,077	489,109
Construction in Progress	1,319,480		1,319,480
TOTAL	$11,474,738	$3,744,775	$7,729,963

Property and equipment consisted of the following as of September 30, 1987:

	Cost	Accumulated Depreciation	Net Book Value
	(dollars in thousands)		
Land	$ 85,123	$	$ 85,123
Buildings	5,215,825	1,746,422	3,469,403
Equipment	2,786,842	1,649,730	1,137,112
Other	732,127	291,568	440,559
Construction in progress	1,707,066		1,707,066
TOTAL	$10,526,983	$3,687,720	$6,839,263

VA leases facilities, primarily office space and medical facilities, from GSA. These leases are cancelable without penalty. In addition, VA has operating leases with the public for office, data processing, and other equipment. Fiscal year 1988 and fiscal year 1987 rent expense for these leases amount to approximately $90 million and $76 million, respectively, from GSA, and $65 million and $60 million, respectively, from the public.

NOTE 10: CONTINGENCIES

As previously stated in Note 2, VA is a party in various administrative proceedings, legal actions, and tort claims brought by or against it, primarily relating to allegations of medical malpractice. However, also as stated in Note 2, such legal settlements of tort claims awards in excess of $2,500 and contract disputes are paid from a Governmentwide Judgment Fund appropriation maintained by the Department of the Treasury, with an agency having to reimburse the Fund for only contract dispute payments.

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF ASSETS, LIABILITIES, AND EQUITY BY MAJOR PROGRAM
SEPTEMBER 30, 1988
(Dollars in Thousands)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
ASSETS:						
Fund Balance with U.S. Treasury	$ 3,515,888	$ 1,213,776	$ 318,747	$ 18,328	$ 311,156	$ 5,377,895
Imprest Funds	8,989					8,989
Advances, Accounts, and Loans Receivable, Net	325,132	286,020	1,015,793	1,360,603	109,248	3,096,796
Investments	55,257		150,682	12,445,115		12,651,054
Foreclosed Property Held for Sale			818,833			818,833
Land, Buildings, and Equipment Net of Accumulated Depreciation	7,727,083				2,880	7,729,963
Other Assets	23,102				134,538	157,640
Future Financing Sources	1,751,577	87,259	3,450,553	376,717	146,434	5,812,540
TOTAL ASSETS	$13,407,028	$ 1,587,055	$5,754,608	$14,200,763	$ 704,256	$35,653,710
LIABILITIES, TRUST FUND BALANCES, AND EQUITY:						
LIABILITIES:						
Accounts Payable, Principally to the Public	$ 622,831	$ 44	$ 103,351	$ 172,447	$ 200,621	$ 1,099,294
Accrued Compensation and Pension Benefits		724,086				724,086
Accrued Payroll and Payroll Related Liabilities	1,010,436				92,075	1,102,511
Dividends on Credit or Deposit				785,238		785,238
Insurance Dividends Payable				997,184		997,184
Other Liabilities	190,492		34,005	151,546	47,676	423,719
Liability for Federal Employees Compensation Act	932,121				92,188	1,024,309
Liability for Losses on Guaranteed Loans			3,663,488			3,663,488
Insurance Statutory Reserves				11,838,984		11,838,984
Borrowings from Treasury			1,730,078			1,730,078
TOTAL LIABILITIES	2,755,880	724,130	5,530,922	13,945,399	432,560	23,388,891
TRUST FUND BALANCES	24,108	570,825		255,364		850,297
EQUITY OF THE U.S. GOVERNMENT:						
Unrealized Appropriations:						
Invested Capital	7,941,342				170,080	8,111,422
Deferred Appropriations		275,763				275,763
Unobligated Balances	987,041		223,683			1,210,724
Undelivered Orders	1,698,657	16,337	3		101,616	1,816,613
TOTAL EQUITY OF THE U.S. GOVERNMENT	10,627,040	292,100	223,686		271,696	11,414,522
TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY	$13,407,028	$1,587,055	$5,754,608	$14,200,763	$ 704,256	$35,653,710

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF EXPENSES, DIVIDENDS, REVENUE,
AND FINANCING SOURCES BY MAJOR PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988
(Dollars in Thousands)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
OPERATING EXPENSES AND DIVIDENDS:						
Expenses By Category:						
Personnel Compensation and Fringe Benefits	$ 6,903,251				$ 612,030	$ 7,515,281
Veterans' Benefits		$ 15,939,277				15,939,277
Claims and Indemnities	124		$2,031,537	$1,159,763	368	3,191,792
Depreciation	411,798				301	412,099
Supplies and Materials	1,639,354				16,548	1,655,902
Contractual Services	1,420,037				80,101	1,500,138
Rent, Communications, and Utilities	393,764				138,505	532,269
Other	39,087				22,089	61,176
Total Operating Expenses	10,807,415	15,939,277	2,031,537	1,159,763	869,942	30,807,934
Insurance Provisions:						
Dividends to Policyholders				934,485		934,485
SGLI Reserve				3,416		3,416
Total Dividends				937,901		937,901
	$10,807,415	$ 15,939,277	$2,031,537	$2,097,664	$ 869,942	$31,745,835
OPERATING REVENUE AND FINANCING SOURCES:						
Operating Revenues:						
Premium Income				873,912		873,912
Interest Income			168,143	1,229,557		1,397,700
Loan Origination Fees			135,118			135,118
Reimbursements and Other	314,643	108,133	(66,181)	(25,439)	111,408	442,564
Total Operating Revenue	314,643	108,133	237,080	2,078,030	111,408	2,849,294
Financing by Source:						
Appropriations and Financing Sources Realized	10,211,450	15,509,385	940,194	14,058	750,435	27,425,522
Funds to be Provided by Future Financing Sources	281,322	47,012	854,263	5,576	8,099	1,196,272
Transfers, Reimbursements, and Other		274,747				274,747
Total Financing Sources	10,492,772	15,831,144	1,794,457	19,634	758,534	28,896,541
	$10,807,415	$ 15,939,277	$2,031,537	$2,097,664	$ 869,942	$31,745,835

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF SOURCES AND USES OF
RESOURCES AND RECONCILIATION TO BUDGET BY MAJOR PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988
(Dollars in Thousands)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
NET USE OF RESOURCES:						
Operations:						
Operating Expenses	$10,807,415	$ 15,939,277	$ 2,031,537	$ 1,159,763	$ 869,942	$ 30,807,934
Items Requiring (Providing) Funds:						
Increase in Future Liability Provisions	(72,274)		(944,590)	(226,429)	(7,149)	(1,250,442)
Depreciation	(411,798)				(301)	(412,099)
Increase (Decrease) in Accounts Receivable	5,643	(23,671)	(109,869)	(1,505)	37,624	(91,778)
Decrease (Increase) in Accounts Payable and Accruals	(133,513)	555,950	(136,871)	(86,080)	(13,286)	186,200
Revenues Accounted for as Offsetting Collections	(314,643)	(382,880)	(237,080)	(1,096,751)	(111,408)	(2,142,762)
Resources Used (Provided) by Operations	9,880,830	16,088,676	603,127	(251,002)	775,422	27,097,053
Non-Operating Uses:						
Dividends				952,507		952,507
Acquisitions of Land, Buildings, and Equipment	1,078,337				12,327	1,090,664
Purchase of Foreclosed Property Held for Sale			1,630,545			1,630,545
Issuance and Repurchase of Loans and Liens		(13,492)	1,080,064	107,900		1,174,472
Other, Net	(844)		(36,562)		13,965	(23,441)
Financing Activities:						
Sale of Foreclosed Property Held for Sale			(1,661,608)			(1,661,608)
Sale of Loans, without Recourse, net			(296,683)			(296,683)
Loan/Lien Repayments/Opt Income Settlements			(179,845)	(173,762)		(353,607)
Revenues Collected for Treasury	(118,751)	(220,173)				(338,924)
NET USE OF BUDGETARY RESOURCES (OUTLAYS)	10,839,572	15,855,011	1,139,038	635,643	801,714	29,270,978
SOURCES OF BUDGETARY RESOURCES PROVIDED						
Intra-agency Transfers	21,730	(200,000)	178,270			0
Current Year Appropriation, Adjusted	10,932,746	15,724,930	916,400	14,290	774,810	28,363,176
Contract Authority and Reappropriation	(24,849)	(84,343)			(12,000)	(121,192)
Proceeds of Loan Sales With Recourse			389,259			389,259
Interest on Government Securities				998,165		998,165
Net Transfers, Reimbursements, and Other	11,704	(220,173)	(146,046)		(28,323)	(382,838)
Funds Returned to Treasury	(177,323)	(932)			(5,627)	(183,882)
TOTAL RESOURCES PROVIDED	10,764,008	15,219,482	1,337,883	1,012,455	728,860	29,062,688
INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS	(75,564)	(635,529)	198,845	376,812	(72,854)	(208,290)
Funds Exchanged for U.S. Government Securities	(33,177)			(378,292)		(411,469)
NET INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS	(108,741)	(635,529)	198,845	(1,480)	(72,854)	(619,759)
U.S. TREASURY AND IMPREST FUNDS:						
Beginning of Year	3,633,618	1,849,305	119,902	19,808	384,010	6,006,643
End of Year	$ 3,524,877	$ 1,213,776	$ 318,747	$ 18,328	$ 311,156	$ 5,386,884

NOTE 11: (CONTINUED) **VETERANS ADMINISTRATION**

BUDGETED AND ACTUAL OUTLAYS BY FUNCTION AND PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988
(Dollars in Thousands)

	Budgeted Outlays President's Budget	Budgeted Outlays Enacted Bill	Actual Outlays
HOSPITAL AND MEDICAL CARE:			
Medical Care	$ 9,847,794	$10,083,229	$10,045,310
Medical and Prosthetic Research	207,076	208,703	197,330
Medical Administration	43,981	43,463	40,463
Construction	616,263	571,313	649,456
Proposed Legislation			
All Other	(199,781)	(57,165)	(92,987)
Total Hospital and Medical Care	10,515,333	10,849,543	10,839,572
BENEFITS:			
Income Security for Veterans:			
Compensation	10,369,000	10,357,900	11,251,859
Pensions	3,839,500	3,835,800	3,934,821
Burial and Other Benefits	141,687	141,688	141,674
Proposed Legislation	235,450		
Reinstated Entitlement for Survivors		8,034	(755)
Subtotal Income Security	14,585,637	14,343,422	15,327,599
Education, Training, and Rehabilitation:			
Readjustment Benefits (G.I. Bill)	646,000	654,100	700,006
Post-Vietnam Era Education	17,740	58,800	28,558
Veterans Job Training	5,498	31,737	25,252
All Other	(228,298)	(217,920)	(226,404)
Proposed Legislation	202,134		
Subtotal Education, Training, and Rehabilitation	643,074	526,717	527,412
Total Benefits	15,228,711	14,870,139	15,855,011
HOUSING CREDIT ASSISTANCE:			
Loan Guaranty	253,500	568,100	1,218,842
Proposed Legislation	(389,823)		
Direct Loans	(29,600)	(67,000)	(79,804)
Total Housing Credit Assistance	(165,923)	501,100	1,139,038
INSURANCE PROGRAMS	658,298	599,297	635,643
Proposed Legislation	4,250		
Total Insurance Programs	662,548	599,297	635,643
ADMINISTRATION			
Other Benefits and Services	804,696	803,088	801,714
Total Administration	804,696	803,088	801,714
TOTAL VETERAN ADMINISTRATION	$27,045,365	$27,623,167	$29,270,978

Where actual outlays exceeded outlays budgeted in the enacted bill, funds were obtained from available unobligated balances. This does not constitute a violation of the Anti-Deficiency Act (31 U.S.C. 1341).

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NOTE 11: (CONTINUED) VETERANS ADMINISTRATION

BUDGETED AND ACTUAL OUTLAYS BY FUNCTION AND PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1987
(Dollars in Thousands)

	Budgeted Outlays		
	President's Budget	Enacted Bill	Actual Outlays
HOSPITAL AND MEDICAL CARE:			
Medical Care	$ 8,960,952	$ 9,500,505	$ 9,499,750
Medical and Prosthetic Research	187,332	212,729	195,123
Medical Administration	43,952	43,417	40,265
Construction	687,028	607,851	537,156
Proposed Legislation	(185,173)		
All Other	40,934	(19,347)	10,889
Total Hospital and Medical Care	9,735,025	10,345,155	10,283,183
BENEFITS:			
Income Security for Veterans:			
Compensation	10,415,000	10,418,900	10,502,353
Pensions	3,825,000	3,830,500	3,793,200
Burial and Other Benefits	134,392	135,908	130,730
Proposed Legislation	243,800		
Reinstated Entitlement for Survivors		5,398	(2,845)
Subtotal Income Security	14,618,192	14,390,706	14,423,438
Education, Training, and Rehabilitation:			
Readjustment Benefits (G.I. Bill)	754,897	756,297	776,401
Post-Vietnam Era Education	(75,700)	(7,750)	50,501
Veterans Job Training	5,384	41,737	38,005
All Other	(192,448)	(212,238)	(205,425)
Proposed Legislation	25,573		
Subtotal Education, Training, and Rehabilitation	517,706	578,046	659,482
Total Benefits	15,135,898	14,968,752	15,082,920
HOUSING CREDIT ASSISTANCE:			
Loan Guaranty	148,900	277,800	382,059
Proposed Legislation	(131,800)		
Direct Loans	(43,453)	(36,900)	(33,064)
Total Housing Credit Assistance	(26,353)	240,900	348,995
INSURANCE PROGRAMS	747,832	612,744	538,869
ADMINISTRATION			
Other Benefits and Services	759,317	757,684	698,071
Proposed Legislation	952		
Total Administration	760,269	757,684	698,071
TOTAL VETERAN ADMINISTRATION	$26,352,671	$26,925,235	$26,952,038

Where actual outlays exceeded outlays budgeted in the enacted bill, funds were obtained from available unobligated balances. This does not constitute a violation of the Anti-Deficiency Act (31 U.S.C. 1341).

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF SOURCES AND USES OF
RESOURCES AND RECONCILIATION TO BUDGET BY MAJOR PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1987
(Dollars in Thousands Restated)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
NET USE OF RESOURCES:						
Operations:						
Operating Expenses	$10,278,849	$ 15,630,956	$ 2,131,936	$ 1,140,184	$ 819,972	$ 30,001,897
Items Requiring (Providing) Funds:						
Increase in Future Liability Provisions	(79,712)		(983,646)	(229,979)	(7,884)	(1,301,221)
Depreciation	(362,617)				(860)	(363,477)
Increase (Decrease) in Accounts Receivable	(37,217)	10,675	(384,818)	(4,842)	(4,269)	(420,471)
Increase in Accounts Payable and Accruals	(64,610)	(41,608)	(38,274)	(93,155)	(37,068)	(274,715)
Revenues Accounted for as Offsetting Collections	(277,221)	(319,559)	(487,376)	(1,094,351)	(84,776)	(2,263,283)
Resources Used (Provided) by Operations	9,457,472	15,280,464	237,822	(282,143)	685,115	25,378,730
Non-Operating Uses:						
Dividends				927,500		927,500
Acquisitions of Land, Buildings, and Equipment	954,782				15,211	969,993
Purchase of Foreclosed Property Held for Sale			1,380,338			1,380,338
Issuance and Repurchase of Loans and Liens		(2,002)	1,224,720	104,657		1,327,375
Other, Net	(807)				(2,255)	(3,062)
Financing Activities:						
Sale of Foreclosed Property Held for Sale			(1,482,928)			(1,482,928)
Sale of Loans, with Recourse			(849,196)			(849,196)
Loan/Lien Repayments/Opt Income Settlements			(161,761)	(211,139)		(372,900)
Disposals of Equipment and Other	(95,260)			(6)		(95,266)
Revenues Collected for Treasury	(33,004)	(195,542)				(228,546)
NET USE OF BUDGETARY RESOURCES (OUTLAYS)	10,283,183	15,082,920	348,995	538,869	698,071	26,952,038
SOURCES OF BUDGETARY RESOURCES PROVIDED						
Intra-agency Transfers						
Current Year Appropriation	10,514,378	15,215,750	100,000	4,770	770,500	26,605,398
Interest on Government Securities				964,383		964,383
Net Transfers, Reimbursements, and Other	21,931	(200,706)		(3,488)	16,290	(165,973)
Funds Returned to Treasury	(160,069)	(661)			(9,496)	(170,226)
TOTAL RESOURCES PROVIDED	10,376,240	15,014,383	100,000	965,665	777,294	27,233,582
INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS	93,057	(68,537)	(248,995)	426,796	79,223	281,544
Funds Exchanged for U.S. Government Securities	(1,289)			(431,805)		(433,094)
NET INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS	91,768	(68,537)	(248,995)	(5,009)	79,223	(151,550)
U.S. TREASURY AND IMPREST FUNDS:						
Beginning of Year	3,541,850	1,917,842	368,897	24,817	304,787	6,158,193
End of Year	$ 3,633,618	$ 1,849,305	$ 119,902	$ 19,808	$ 384,010	$ 6,006,643

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF EXPENSES, DIVIDENDS, REVENUE,
AND FINANCING SOURCES BY MAJOR PROGRAM
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1987
(Dollars in Thousands Restated)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
OPERATING EXPENSES AND DIVIDENDS:						
Expenses By Category:						
Personnel Compensation and Fringe Benefits	$ 6,447,310				$565,397	$ 7,012,709
Veterans' Benefits		$ 15,630,956				15,630,956
Claims and Indemnities	176		$2,131,936	$1,140,184		3,272,296
Depreciation	362,617				860	363,477
Supplies and Materials	1,602,432				20,520	1,622,952
Contractual Services	1,256,107				64,542	1,320,649
Rent, Communications, and Utilities	389,585				126,682	516,267
Other	220,622				41,969	262,591
Total Operating Expenses	10,278,849	15,630,956	2,131,936	1,140,184	819,972	30,001,897
Insurance Provisions:						
Dividends to Policyholders				928,845		928,845
SGLI Reserve				9,027		9,027
Total Dividends				937,872		937,872
	$10,278,849	$ 15,630,956	$2,131,936	$2,078,056	$ 819,972	$30,939,769
OPERATING REVENUE AND FINANCING SOURCES:						
Operating Revenues:						
Premium Income				877,756		877,756
Interest Income			191,425	1,192,317		1,383,742
Loan Origination Fees			340,972			340,972
Reimbursements and Other	277,211	86,453	(45,021)	(8,404)	84,776	395,015
Total Operating Revenue	277,211	86,453	487,376	2,061,669	84,776	2,997,485
Financing by Source:						
Appropriations and Financing Sources Realized	9,881,636	15,271,150	674,593	5,848	726,918	26,560,145
Funds to be Provided by Future Financing Sources	120,002	40,247	969,967	10,539	8,278	1,149,033
Transfers, Reimbursements, and Other		233,106				233,106
Total Financing Sources	10,001,638	15,544,503	1,644,560	16,387	735,196	27,942,284
	$10,278,849	$ 15,630,956	$2,131,936	$2,078,056	$ 819,972	$30,939,769

NOTE 11: (CONTINUED)

VETERANS ADMINISTRATION

SCHEDULE OF ASSETS, LIABILITIES, AND EQUITY BY MAJOR PROGRAM
SEPTEMBER 30, 1987
(Dollars in Thousands Restated)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Administration and Other	Consolidated
ASSETS:						
Fund Balance with U.S. Treasury	$ 3,624,002	$ 1,849,305	$ 119,902	$ 19,808	$ 384,010	$ 5,997,027
Imprest Funds	9,616					9,616
Advances, Accounts, and Loans Receivable, Net	243,527	322,909	1,172,506	1,408,271	64,753	3,211,966
Investments	20,994		154,746	12,066,823		12,242,563
Foreclosed Property Held for Sale			864,104			864,104
Land, Buildings, and Equipment Net of Accumulated Depreciation	6,836,854				2,409	6,839,263
Other Assets	31,043				120,572	151,615
Future Financing Sources	1,470,255	40,247	2,596,289	371,141	138,335	4,616,267
TOTAL ASSETS	$12,236,291	$ 2,212,461	$4,907,547	$13,866,043	$ 710,079	$33,932,421
LIABILITIES, TRUST FUND BALANCES, AND EQUITY:						
LIABILITIES:						
Accounts Payable, Principally to the Public	$ 608,569	$ 1	$ 135,555	$ 172,126	$ 195,684	$ 1,111,935
Accrued Compensation and Pension Benefits		1,280,054				1,280,054
Accrued Payroll and Payroll Related Liabilities	924,743				86,825	1,011,568
Dividends on Credit or Deposit				706,018		706,018
Insurance Dividends Payable				956,347		956,347
Other Liabilities	71,779		171,856	148,855	67,389	459,879
Liability for Federal Employees Compensation Act	859,847				85,039	944,886
Liability for Losses on Guaranteed Loans			2,718,898			2,718,898
Insurance Statutory Reserves				11,612,555		11,612,555
Borrowings from Treasury			1,730,078			1,730,078
TOTAL LIABILITIES	2,464,938	1,280,055	4,756,387	13,595,901	434,937	22,532,218
TRUST FUND BALANCES	20,503	598,994		270,142		889,639
EQUITY OF THE U.S. GOVERNMENT:						
Unrealized Appropriations:						
Invested Capital	6,865,853				152,608	7,018,461
Deferred Appropriations		316,365				316,365
Unobligated Balances	1,205,316		151,157		13,313	1,369,786
Undelivered Orders	1,679,681	17,047	3		109,221	1,805,952
TOTAL EQUITY OF THE U.S. GOVERNMENT	9,750,850	333,412	151,160		275,142	10,510,564
TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY	$12,236,291	$2,212,461	$4,907,547	$13,866,043	$ 710,079	$33,932,421

The VA is involved in several legal actions relating to debts established against veterans whose VA-guaranteed loans were foreclosed judicially. Based on recent conflicting judgments, the VA is unable to estimate the final outcome of the lawsuits.

There is currently pending in the claims court an action alleging VA's failure to comply with the Prompt Payment Act in its property acquisition process. As there is no case law on this issue, the outcome of the litigation cannot be determined at this time.

In the opinion of VA's management and General Counsel, the ultimate resolution of legal actions still pending at September 30, 1988, 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 court settled legal cases.

NOTE 11: SUPPLEMENTAL INFORMATION

The following schedules provide further detail, by major program area, of assets, liabilities and U.S. Government equity, of revenue, financing sources and expenses, of sources and uses of funds by major program area and of budgeted and actual outlays.

- o The medical program area includes financial data for the medical care program, including the VA's 172 medical facilities, medical research and administration, and construction. The construction program was included since most of its activities relate to medical facilities.

- o The veterans' benefits area includes the compensation, pension, and education programs, as well as the burial and miscellaneous assistance and veterans' job training programs.

- o Housing credit assistance includes both VA's loan guaranty and direct loan programs.

- o The administration area includes costs of managing the Agency as a whole and the National Cemetery System. Also included are costs of managing the Supply Fund and automated data processing systems.

Personnel compensation and fringe benefits for employees involved in veterans benefits, housing credit assistance, and life insurance have not been allocated to these major program areas and are included in the administration area.

The receivables as of September 30, 1987, consist of:

	Current	Non-Current	Total
Accounts:			
Individuals/Corporations	$2,363,256	$ 19	$2,363,275
Federal Government	350,139	480	350,619
Less: Allowances for Loss	1,982,060		1,982,060
Accounts Receivable, net	731,335	499	731,834
Advances:			
Individuals/Corporations	44,933		44,933
Federal Government	110,519		110,519
Total Advances	155,452		155,452
Loans			
Individuals	602,118	1,857,405	2,459,523
Less: Allowances for Loss	33,011	101,832	134,843
Loans, Net	569,107	1,755,573	2,324,680
Net Receivables	$1,455,894	$1,756,072	$3,211,966

NOTE 9: 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, based upon the American Hospital Association's estimate of useful lives of hospital assets. Equipment is depreciated using the straight line method over useful lives, which, for most equipment, range from 5 to 20 years. Current year depreciation amounted to $412,100,000 in FY 1988 and $363,477,000 in FY 1987.

Insurance Administrative Expenses

Except for the SGLI and VRI programs, administrative costs are not charged to VA life insurance programs. Administrative costs charged the SGLI program were $306,000 and $334,000 in 1988 and 1987 respectively. Administrative costs charged the VRI program were $1,304,000 in 1988 and $1,316,000 in 1987. Administrative costs for the other insurance programs borne by VA appropriations were $26,234,000 in 1988 and $26,515,000 in 1987.

NOTE 7: INVESTMENTS

Insurance program investments, which comprise most of VA's investments, are in non-marketable U.S. Treasury special bonds and certificates and, to a lesser degree, in Government National Mortgage Association participation certificates in fiscal year 1987. Interest rates for Treasury special securities are based on average market yields for similar Treasury issues. The special bonds, which mature during various years through 2003, 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 program. At September 30, 1988, investment securities consist of:

Security	Interest Range	Insurance Programs	Other Programs	Total
		(dollars in thousands)		
Special Bonds	5.875-13.75%	$12,304,372		$12,304,372
Certificates	8.75-10%	140,743		140,743
Bonds	7.875-8.5%		$ 2,251	2,251
Notes	7.375-14.625%		21,006	21,006
Treasury Bills	6.7-7.5%		32,000	32,000
Other	Various		150,682	150,682
		$12,445,115	$205,939	$12,651,054

At September 30, 1987, investment securities consist of:

Security	Interest Range	Insurance Programs	Other Programs	Total
		(dollars in thousands)		
Special Bonds	5.875-13.75%	$11,737,185		$11,737,185
Certificates	8.375-10.375%	194,638		194,638
GNMA Certificates	6.2-6.45%	135,000		135,000
Bonds	7.875-8.5%		$ 2,251	2,251
Notes	10-14.625%		18,743	18,743
Other	Various		154,746	154,746
		$12,066,823	$175,740	$12,242,563

Policy Dividends

The VA Administrator annually determines the excess funds available for dividend payment. Dividends to be paid are based on an actuarial analysis of the individual programs as of the end of the preceding calendar year. Dividends are declared on a calendar year basis and are paid on policy anniversary dates. Policyholders may receive them in cash, use them to pay premiums in advance, repay loans, purchase paid-up insurance, or place them in an interest-bearing account.

Dividends payable shown in the Schedule of Assets, Liabilities, and Equity represents the amount of dividends potentially payable in the next 12 months. Dividends shown in the Schedule of Sources and Uses of Resources and Reconciliation to Budget represents the amount of dividends paid in the last 12 months. Dividends to policyholders shown in the Schedule of Expenses, Dividends, Revenue, and Financing Sources represents the amount of dividends paid in the preceding 12 months and the change in the trust fund balances.

Dividends paid during fiscal years 1988 and 1987 were as follows:

	Dividends Paid	
	1988	1987
Program	(In Thousands)	
NSLI	$823,485	$804,878
USGLI	12,132	13,554
VSLI	83,769	76,033
VRI	33,121	33,035
TOTAL	$952,507	$927,500

The payment of termination dividends in the VRI program began in 1985, in order to ensure that terminating insureds receive an equitable share of surplus. Termination dividends amounted to approximately $250,000 in 1988 and $300,000 in 1987.

Insurance Cash Surrender Value

All whole life policies build cash surrender values equal to policy reserves plus any dividends held on account. Policyholders may borrow up to 94 percent of the cash surrender value or use it to purchase reduced paid-up insurance.

Accordingly, it is called Participating Policyholders' Interest in Accumulated Participating Earnings (Participating Policyholders' Interest) and, if the reserves were presented on the financial statements on the GAAP basis, this difference would appear as a separate line item in the liability section of the Consolidated Statement of Financial Position. However, although the amount represents payables to participating policyholders, it cannot be fully disbursed on a current basis without seriously affecting the statutory solvency requirements of the insurance programs. The Schedule of Expenses, Dividends, Revenues, and Financing Sources would be affected if the statutory reserves were replaced by GAAP reserves. The effect would be to increase operating expenses by $103 million in 1988.

The GAAP insurance reserve balances and Participating Policyholders' Interest as of September 30, 1988, are shown below:

Program	Death Benefits	Death Benefit Annuities	Disability Income and Waiver of Premium	Other	1988 GAAP Reserve Total	Participating Policyholders Interest
			(dollars in thousands)			
NSLI	$5,915,734	$432,333	$ 836,172	$190,874	$7,375,113	$2,504,541
USGLI	103,629	28,697	2,234	1,090	135,650	46,896
VSLI	534,224	3,484	119,481	3,362	660,551	416,462
SDVI	266,395	2,294	148,269		416,958	
VRI	273,744	1,289	27,013		302,046	160,660
TOTAL	$7,093,726	$468,097	$1,133,169	$195,326	$8,890,318	$3,128,559

The GAAP insurance reserve balances and Participating Policyholders' Interest as of September 30, 1987, are shown below:

Program	Death Benefits	Death Benefit Annuities	Disability Income and Waiver of Premium	Other	1987 GAAP Reserve Total	Participating Policyholders Interest
			(dollars in thousands)			
NSLI	$5,601,202	$465,070	$ 880,877	$162,394	$7,109,543	$ 2,594,514
USGLI	100,086	32,149	2,496	1,220	135,951	67,785
VSLI	480,804	3,445	120,334	1,325	605,908	417,715
SDVI	257,854	2,299	148,462		408,615	
VRI	271,386	1,251	28,184		300,821	162,184
TOTAL	$6,711,332	$504,214	$1,180,353	$164,939	$8,560,838	$3,242,198

NOTE 6: INSURANCE PROGRAMS

The Veterans Administration administers the following life insurance programs which provide permanent (whole life) and term coverage: National Service Life Insurance (NSLI); United States Government Life Insurance (USGLI); Veterans Special Life Insurance (VSLI); Veterans Reopened Insurance (VRI); and Service-Disabled Veterans Insurance (SDVI). Data on insurance in force for each of these programs is as follows:

Insurance in Force
As of September 30, 1988 and 1987

Program	Number of Policies (Thousands)		Amount of Insurance (Millions)		Principal Veterans Group Covered
	1988	1987	1988	1987	
NSLI	2,824	2,913	$21,317	$21,647	WW II
USGLI	48	53	178	199	WW I
VSLI	327	341	2,989	3,075	Korea
VRI	127	130	869	891	WW II/Korea
SDVI	176	180	1,599	1,632	WWII/Korea/Vietnam
Total	3,502	3,617	$26,952	$27,444	

Insurance Reserves

The insurance reserves as reflected in the financial statements were determined based on assumptions prescribed by Federal statutes. Thus, the reserves are based on statutory standards and are called statutory insurance reserves. The reserves consist of the actuarial computation of the present value of amounts that will be necessary to pay guaranteed policy and participating policyholders' benefits in the future as policyholders or their beneficiaries make benefit claims or dividends are declared. The two most important factors used to compute these reserves are assumed investment yields and mortality rates, both of which are prescribed by Federal statutes. The statutory standards were designed to insure the solvency and equity of the insurance program for the policyholders.

American Housing Trust II

On September 23, 1988, the VA completed its second sale of non-recourse loans. Under the terms of the sale, approximately $234 million of loans receivable were sold to the American Housing Trust II (AHT II). AHT II then sold the loans as mortgage pass-through certificates. The mortgage pass-through certificates consisted of two senior classes of certificates which were offered to the public and subordinate certificates which were assigned to the VA as partial proceeds from the sale of the loans.

The face value of the subordinate certificates at the time of sale was approximately $91 million. Interest and principal payments on the senior certificates are guaranteed by American Loan Guarantee Association. Under the securities structure, principal and interest payments to the VA are subordinate to the senior certificate holders.

Offset for losses on investments

At September 30, 1988, an allowance has been recorded to reflect the estimated loss of principal as a result of the subordinate position. The estimated allowance computation was based upon historical loan defaults. At September 30, 1988, the net investment balances are as follows:

	American Housing Trust I	American Housing Trust II (In thousands)	Total
Investment in subordinated certificates of securities	$105,059	$91,391	$196,450
Allocation of loss provision	18,788	27,036	45,824
Net Investment	$ 86,271	$64,356	$150,627

At September 30, 1988, the investments are carried at cost, adjusted for the estimated foreclosures, as the fair market value cannot be determined.

Foreclosed property held for sale

The VA acquires property from homeowners who default on guaranteed or vendee loans. An allowance for losses has been recorded based on historical loss data, as follows:

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 U.S. interest-bearing debt as a discount rate and the assumption that VA's outstanding guaranteed loans will default over a nine-year period as follows (dollars in thousands):

1989	$ 987,042
1990	959,279
1991	720,593
1992	486,115
1993	365,313
1994-97	491,128
	$4,009,470

The discount rate used in the computation was 8.8% for 1988 and 8.7% for 1987.

The components of the provisions are as follows:

	Year ended September 30 (In thousands)	
	1988	1987
Offsets against loans receivable	$ 156,077	$ 133,088
Offsets against foreclosed property held for sale	144,081	101,616
Offset against investments	45,824	-
Liability for losses on guaranteed loans	3,663,488	2,718,898
	$4,009,470	$2,953,602

Impact of Provision on Future Appropriations

The projected cost of guaranteed loan defaults will not necessarily reflect VA's future appropriation requests over the next nine years, since those requests will also include anticipated inflows and the outflows of resources for non-operating uses such as for transfers, purchases and sales of property, and issuances and repayments of loans, sale of loans, and the receipt of the 1% funding fee.

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

The compensation and pension benefits for fiscal years 1988 and 1987 were:

Fiscal Year	Compensation	Pension
1988	$10,864,549,000	$3,825,700,000
1987	$10,513,080,000	$3,792,945,000

The 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 and pension programs is not currently funded, nor is there any intent to do so. Rather, payments for benefits that become due in a particular fiscal 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.

The future liability for compensation and pension benefits represents the present value, using an 8.8 percent discount rate, of projected annual benefit payments. Projected benefit payments were based on assumed cost-of-living increases ranging from 2.6 percent to 4.0 percent for 1989 - 1993 and 2.1 percent to 4.0 percent thereafter. In addition, the mortality and accession rates used were based on trends in the current veteran population.

This calculation was not based on an independent actuarial study, and thus there is a risk that the assumptions and methods underlying it may not be reflective of actual economic and demographic trends affecting veterans.

The present value of the estimated future liability for compensation and pension benefits payable for the next five fiscal years and thereafter is as follows (dollars in thousands):

1989	$ 13,976,946
1990	12,825,548
1991	11,759,406
1992	10,776,884
1993	9,863,119
Thereafter	80,686,716
TOTAL	$139,888,619

No liability for compensation and pension benefits has been included in the accompanying consolidated statement of financial position.

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

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

- Since the U.S. Treasury Department does not charge agencies interest on borrowings from the Treasury, VA does not recognize interest costs related to foreclosed property in its financial records. In fiscal year 1988, VA held foreclosed properties an average of 6.9 months. Based on this estimate and the average interest rate for the public debt (8.8 percent), the holding costs associated with the foreclosed property held for sale were approximately $65 million in fiscal year 1988.

- VA's Housing Credit Assistance program has a liability to the U.S. Treasury of $1.7 billion. These funds were originally provided to support the direct loan fund, but were subsequently transferred to the loan guaranty fund and have since been fully used. The liability which is owed by the Direct Loan Fund bears no interest or specific payment date, and VA's ability to pay it is contingent upon receiving other financing.

- During fiscal year 1988, many of the VA's employees still participated in the contributory Civil Service Retirement System (CSRS), to which VA makes matching contributions. The VA does not, however, report CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees since this data is only reported in total 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 thereto elected 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 1 percent of pay and then match employee contributions up to an additional 4 percent of basic pay.

  Employees participating in FERS are also covered under the Federal Insurance Contributions Act (FICA) for which VA contributes an employer's matching amount to the Social Security Administration.

Accrued Compensation and Pension Benefits

Compensation and pension benefits are accrued when veterans have satisfied the VA's eligibility criteria. This accrual only pertains to benefits due and payable in a particular fiscal year. See note 4 for a description of the VA's future liability under its compensation and pension program.

Losses on Guaranteed Loans

Upon foreclosure of a guaranteed loan, the 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 Section 1816 of Title 38, United States Code. Thus, when the VA acquires the property, the cost is comprised of the claimed amount paid the lender less net proceeds from the sale of the property. The 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. Simultaneously a liability provision is established, representing the estimated cost of defaults for those guaranteed loans which experience indicates will default in the future. A portion of this provision is subsequently reclassified as a reduction: (1) to direct home loans receivable when such loans are issued (see Note 8); (2) of foreclosed property held for sale when property is acquired, in order to record such property at its net realizable value; and (3) to investments in subordinate securities to reflect the estimated loss of principal for the securities due to their subservient position. This 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 as it is earned, and the accrual is reduced as leave is taken. At least once per year, the balance in the accrued annual leave account is adjusted to reflect current pay rates of cumulative annual leave earned, but not taken. Sick and other types of leave are expensed as taken.

Insurance Program Liabilities

Insurance program liabilities are recorded for unpaid claims in process, for an experience-based estimate of claims incurred but not reported, and for incurred death and permanent disability installment claims. These liabilities are included in accounts payable.

Notes to Financial Statements

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

Entity and Basis of Consolidation

In fulfilling its mission to provide veterans with care, support, and recognition, the Veterans Administration maintains 15 general funds, 11 revolving funds, 5 trust funds, 5 deposit funds, and 5 clearing accounts. The financial activities of these funds have been classified into the following functional areas: Medical and Construction; Veterans Benefits (compensation, pension, education, and other benefits); Housing Credit Assistance; Life Insurance; and Administration. Some of the trust and revolving fund activities for the insurance and housing credit assistance programs are augmented by budget appropriations.

The consolidated financial statements account for all funds for which the VA is responsible and are presented on the accrual basis of accounting as required by the GAO Policy and Procedures Manual for Guidance of Federal Agencies (Title 2). All significant intra-agency balances and transactions have been eliminated in consolidation.

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, however, operating expenses are recognized currently while expenditures for capital and other long-term assets are capitalized and are not recognized as expenses until they are consumed in the VA's operations. Financing sources for these expenses, which derive both from current and prior year appropriations and operations, are recognized on this same basis. The consolidated statement of changes in financial position and reconciliation to budget 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, insurance premiums for disabled veterans funded by appropriations, and losses on guaranteed loans), current or prior year appropriations are not available to fund the expenses. However, such expenses are customarily financed (funds appropriated, or for a portion of the loan losses, revenues received) in the year payment is required. An amount due from future financing sources is therefore recognized in operations each year for the year's accrued amount of such expenses. The cumulative amount of these accruals is reflected on the consolidated statement of financial position as an asset, future financing sources. The total amount of the future financing sources account is also reflected in the liability section of this statement as part of various liability accounts.

Consolidated Statement of Operations

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1988 AND 1987

(Dollars in Thousands)

	1988	(Restated) 1987
OPERATING EXPENSES AND DIVIDENDS:		
Expenses by Category:		
Personnel Compensation and Fringe Benefits	$ 7,515,281	$ 7,012,709
Veterans Benefits	15,939,277	15,630,956
Claims and Indemnities	3,191,792	3,272,296
Depreciation	412,099	363,477
Supplies and Materials	1,655,902	1,622,952
Contractual Services	1,500,138	1,320,649
Rent, Communications, and Utilities	532,269	516,267
Other	61,176	262,591
Total Operating Expenses	30,807,934	30,001,897
Provisions for Dividends to Policyholders	934,485	928,845
Provisions for Servicemen's Group Life Insurance Reserve	3,416	9,027
	$31,745,835	$30,939,769
OPERATING REVENUE AND FINANCING SOURCES:		
Operating Revenues:		
Premium Income	$ 873,912	$ 877,756
Interest Income	1,397,700	1,383,742
Loan Origination fees	135,118	340,972
Reimbursements and Other	442,564	395,015
Total Operating Revenue	2,849,294	2,997,485
Financing by Source:		
Appropriations and Financing Sources Realized	27,425,522	26,560,145
Funds to be Provided by Future Financing Sources	1,196,272	1,149,033
Transfers, Reimbursements, and Other	274,747	233,106
Total Financing Sources	28,896,541	27,942,284
	$31,745,835	$30,939,769

The accompanying notes are an integral part of this statement.
Note 11 includes financial information by major program area.

Veterans' Rehabilitation and Education Amendments of 1980

The Veterans' Rehabilitation and Education Amendments of 1980 (Public Law 94-466, now codified as 38 U.S.C. 3115) specify interest and administrative costs to be charged to VA's delinquent debtors. The law requires that interest on delinquent debt be accrued based on the Department of the Treasury's rate, which, as of September 30, 1988 and 1987, was 6 percent and 7 percent, respectively. We reported that, for fiscal years 1986 and 1987, VA did not fully comply with this provision because it did not assess interest and administrative costs on certain compensation and pension benefit overpayments for which VA is seeking reimbursement. Also, we reported that VA only charged interest at 4 percent annually on its loan guaranty accounts receivable rather than the current interest rate required by the 1980 amendments to the act.

VA is examining various methods for resolving the issue of charging interest on the compensation and pension benefit overpayments. However, at the completion of our fiscal year 1988 audit, VA did not believe it was possible to establish a date when the method ultimately chosen could be implemented. To increase the interest rate charged on loan guaranty accounts receivable, VA will have to revise certain computer software. Because of the complicated nature of the logic involved in this reprogramming effort, VA does not believe that reprogramming can be accomplished before late 1990 or early 1991.

Report on Compliance With Laws and Regulations

We have audited the consolidated financial statements of the Veterans Administration (VA) (which, in March 1989, became the Department of Veterans Affairs) for the fiscal years ended September 30, 1988 and 1987, and have issued our opinion thereon. This report pertains only to our consideration of VA's compliance with laws and regulations for the year ended September 30, 1988. Our report on compliance with laws and regulations for the year ended September 30, 1987, is presented in GAO/AFMD-89-23, dated November 30, 1988.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of VA is responsible for compliance with laws and regulations applicable to VA. As part of obtaining reasonable assurance as to whether the consolidated financial statements were free of material misstatement, we selected and tested transactions and records to determine the organization's compliance with provisions of the following laws and regulations which could have a material effect on VA's financial statements if not complied with:

- Federal Employees Compensation Act (5 U.S.C. 5332) and specific authority for special VA employee rates (38 U.S.C. 4107);
- Anti-Deficiency Act (31 U.S.C. 1341, 1342, and 1511-1519);
- legislation concerning recording obligations and balances available for obligation (31 U.S.C. 1501 and 1502) and related regulations;
- Debt Collection Act of 1982 (31 U.S.C. 3302, 3711, and 3717), related regulations, and specific legislation related to collecting amounts owed to VA (38 U.S.C. 3114 and 3115);
- Prompt Payment Act (31 U.S.C. 3901-3906) and related regulations;
- legislation concerning veterans compensation for service-connected disability or death (38 U.S.C. 310, 314, 315, 331, and 335), pensions either for nonservice-connected disability or death or for service (38 U.S.C. 502, 503, 506, 521, and 541), and regulations concerning evidence required to establish eligibility for benefits;
- legislation concerning veterans insurance (38 U.S.C. Chap. 19) and educational assistance (38 U.S.C. Chaps. 32, 34-36); and
- regulations concerning veterans' guaranteed home mortgage loans.

Because of the purpose for which our tests of compliance were made, the laws and regulations tested did not cover all the requirements that VA has to comply with.

VA concurred with each of the recommendations in our fiscal year 1987 report and initiated corrective action, especially at the Austin DPC. However, most of the problems will, by their nature, require several years to correct. Our fiscal year 1988 audit work disclosed that the majority of the identified ADP control and system problems still exist. VA identified virtually the same ADP control and system problems in its fiscal year 1988 FMFIA report, dated December 28, 1988, either in the section of the report dealing with internal control systems or the section covering compliance of accounting systems with generally accepted accounting principles and standards.

Our fiscal year 1988 audit tests also disclosed that VA is continuing to experience problems in institutionalizing adequate compensating accounting controls for the ADP weaknesses. The reconciliation of control accounts to support documents and/or subsidiary accounts is a major control procedure for ensuring the accuracy and integrity of accounting data processed by financial management systems. Yet, nearly all of VA's functional areas either fail to perform or do not consistently perform such procedures. This area is also identified as a material weakness in VA's 1988 FMFIA report. Under the FMFIA process, VA plans to revise several automated systems to eliminate paper documents; it also plans to improve document control and the timeliness of transaction recording. This should reduce the manual workload normally required to perform reconciliations.

Conclusions

The VA Controller has initiated appropriate policy changes related to the depreciation of assets. However, VA has not been successful in obtaining proper and consistent implementation of these policies at each of its field stations where the assets are located and accounted for. Accordingly, inaccuracies, inconsistencies, and the lack of adherence to policies still exist in the asset and depreciation accounts with respect to

- the expensing of items purchased with operating funds that meet VA's capitalization policy and
- the failure to calculate depreciation in accordance with generally accepted accounting principles and VA's policy.

VA has initiated corrective action to strengthen ADP controls. However, most of the problems will, by their nature, require several years to correct. The FMFIA process is an appropriate mechanism for VA to ensure that corrective action is subsequently completed on the ADP control weaknesses and the applicable compensating control procedures.

stated, we relied on the IG's tests of control procedures for fiscal year 1988 tests of internal controls in the medical care area.

Our consideration of the system of internal accounting controls, made for the limited purpose described in the first paragraph, would not necessarily disclose all material weaknesses in a system of internal controls. Accordingly, we do not express an opinion on VA's system of internal accounting controls, taken as a whole, or on the categories of controls identified above.

As a result of our fiscal year 1988 audit tests, nothing came to our attention which indicated there were any additional internal accounting control weaknesses that have not been previously reported in VA's FMFIA reports or our fiscal year 1987 internal control report (GAO/AFMD-89-23, dated November 30, 1988). Although VA has made improvements in the areas reported, our tests disclosed that further improvements are needed with respect to the two conditions which we noted in our fiscal year 1987 internal control report. These conditions involve VA's property and related depreciation accounts and controls over data processing activities.

Property Accounting Needs Improvement

As our fiscal year 1987 internal control report stated, inconsistent adherence to management policies on the capitalization and depreciation of buildings has led to inaccurate property account balances. We reported that this problem was due in part to VA's manual real property accounting system. This manual system does not provide for either the consistent capitalization of improvements to buildings and other structures or a centralized review of recorded amounts. During our fiscal year 1987 audit, we had noted the following problems:

- Items purchased with operating funds that were expensed should have been capitalized according to federal accounting principles and VA's policy.
- Project costs were improperly transferred (capitalized) from work-in-process to completed facilities.
- Depreciation was not calculated in accordance with generally accepted accounting principles and VA's policy.

VA advised us during our fiscal year 1988 audit that it anticipated being able to improve the first area when federal accounting principles are

Report on Internal Accounting Controls

We have examined the consolidated financial statements of the Veterans Administration (VA) (which, in March 1989, became the Department of Veterans Affairs) for the years ended September 30, 1988 and 1987, and have issued our opinion thereon. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended September 30, 1988. Our report on the study and evaluation of internal accounting controls for the year ended September 30, 1987, is presented in GAO/AFMD-89-23, dated November 30, 1988.

As part of our examination, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on VA's financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- financial reporting;
- medical care and construction;
- compensation, pension, and education benefits;
- housing credit assistance;
- life insurance; and
- administration and other, including all payroll.

We tested internal controls in all of the categories listed above except medical care. For that category, VA's Inspector General (IG) assisted us by conducting internal control testing. However, neither we nor the IG tested the internal accounting controls over all functions within the categories. Furthermore, we did not evaluate accounting controls in certain miscellaneous funds, such as the General Post Fund. For all the areas where controls were not evaluated, it was more efficient to expand the scope of our substantive audit tests. Substantive audit tests can also serve to identify weaknesses in internal control policies and procedures.

The management of VA is responsible for establishing and maintaining a system of internal controls, including accounting controls, in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act (FMFIA) of 1982. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of a system of internal controls are to provide management with reasonable, but not absolute, assurance that

VA's experience with loan sales has demonstrated that loans sold with recourse provide a greater amount of initial cash than those sold without recourse. For example, although either type of sale was considered to have approximately the same long-term financial benefit to VA, VA's financial advisors for the two without-recourse loan sales in fiscal year 1988 (see note 5) estimated that VA would have increased its initial cash proceeds by about $200 million had the sales been made with recourse agreements. Thus, using recourse contracts for selling loans could have given the loan guaranty fund a substantial amount of additional cash receipts in fiscal year 1988. This would have resulted in the fund's requiring $200 million less in appropriated funds for that year. Public Law 100-136 precludes VA from making without-recourse sales after September 30, 1989, unless VA receives an amount equal to the unpaid balance of the loan. Since this restriction will, in effect, make loans sold without recourse unmarketable, VA's fiscal year 1990 budget estimate is predicated on the sale of loans with recourse agreements. However, VA is proposing legislation which would grant the Secretary flexibility to sell loans with or without recourse.

VA assesses a 1-percent funding fee on guaranteed and direct loans under the loan guaranty fund. Although this fee is not intended to fully cover expected losses, it is a significant financing source for the loan guaranty fund. VA's authority to charge this fee expires on September 30, 1989. If the authority is not extended or if it lapses for a period of time, as it did in fiscal year 1988, the loan guaranty fund will lose financing, which will have to be replaced by appropriations. When VA's authorization to collect the 1-percent funding fee lapsed for 6 weeks in fiscal year 1988, VA suffered an estimated $30 million revenue loss to the loan guaranty fund.

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Comptroller General
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April 14, 1989

from operations. The financial condition of VA's life insurance program is satisfactory, but the housing credit program is experiencing financial problems.

Weakened Housing Credit Program

The entire home mortgage industry has experienced increased home loan foreclosures during the 1980s. This has also been VA's experience with the two revolving funds which make up its housing credit program. The direct loan fund was established to provide direct mortgage loans to veterans in rural areas where private financing was not generally available. The fund's authorization to issue direct loans was suspended during fiscal year 1981 except for loans to severely disabled veterans for specially adapted housing. The loan guaranty fund guarantees a portion of private sector loans made to eligible veterans and makes direct (vendee) loans for properties acquired because of foreclosures. Virtually all of VA's new housing credit assistance relates to the loan guaranty fund.

The direct loan fund has sufficient assets and anticipated collections (principal and interest payments) to cover normal operations for the next few years. However, the fund does not have sufficient resources to repay a $1.7 billion liability to the Department of the Treasury for resources transferred to the loan guaranty fund. The liability does not bear an interest charge and has no required repayment date. However, either VA will ultimately have to obtain an appropriation to pay the liability or legislation will be required authorizing Treasury to release the direct loan fund from the liability.

From its inception in 1962 through the 1970s, the loan guaranty fund's annual financial requirements were met primarily through its operational resources. Supplemental financing of about $1 billion, which was obtained through transfers from the direct loan fund, was required during this period. However, the loan guaranty fund's requirement for both transfers and annual appropriations to help defray program costs has increased significantly since 1980. From fiscal year 1980 through fiscal year 1988, the fund required about $1.4 billion in transfers from the direct loan fund and other VA appropriations and $1.6 billion in appropriations—$900 million in fiscal year 1988 alone.

The primary cause of the loan guaranty fund's increased need for funding beyond that generated through normal operations was the weakened financial condition of certain sectors of the economy, particularly energy and agriculture. VA has experienced a high level of home loan foreclosures—44,693 in fiscal year 1987 and 48,963 in fiscal year

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

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To the Secretary
Department of Veterans Affairs

We have audited the accompanying consolidated statement of financial position of the Veterans Administration (VA) (which became, in March 1989, the Department of Veterans Affairs) as of September 30, 1988 and 1987, and the related consolidated statements of operations and changes in financial position and reconciliation to budget for the fiscal years then ended. These consolidated financial statements are the responsibility of VA's management. Our responsibility is to express an opinion on these statements based on our audits. In addition to this report on our audit of VA's fiscal year 1988 and 1987 consolidated financial statements, we are also reporting on our consideration of VA's system of internal accounting controls and compliance with laws and regulations.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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.

As we stated in our report on VA's fiscal year 1987 consolidated financial statements (GAO/AFMD-89-23), our opinion was qualified because documents supporting the original cost of land, buildings, and equipment, many of which were acquired by VA over periods dating back to its establishment in 1930, were not readily obtainable. Furthermore, although the accounting records for equipment were maintained in an automated system, the manually kept records for land and buildings were not always subject to uniform accounting controls and contained many errors in recorded values. Our audit of the fiscal year 1988 financial statements disclosed that, although VA has made significant improvements in this area, especially in transferring project costs from work-in-process to completed facilities, the accounting records for land and buildings were still kept manually and contained errors in recorded values. Accordingly, we determined that it was not practical for us to perform, nor did we perform, sufficient alternative audit procedures to remove our qualification relating to the presentation of land, buildings, and equipment.

Contents

Abbreviations

ADP	automatic data processing
DPC	data processing center
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
GAAP	generally accepted accounting principles
VA	Veterans Administration

We are sending copies of this report to the Chairman, Senate Committee on Veterans' Affairs; the Chairman, House Committee on Veterans' Affairs; the Director, Office of Management and Budget; the Secretary, Department of the Treasury; and the Secretary, Department of Veterans Affairs.

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