

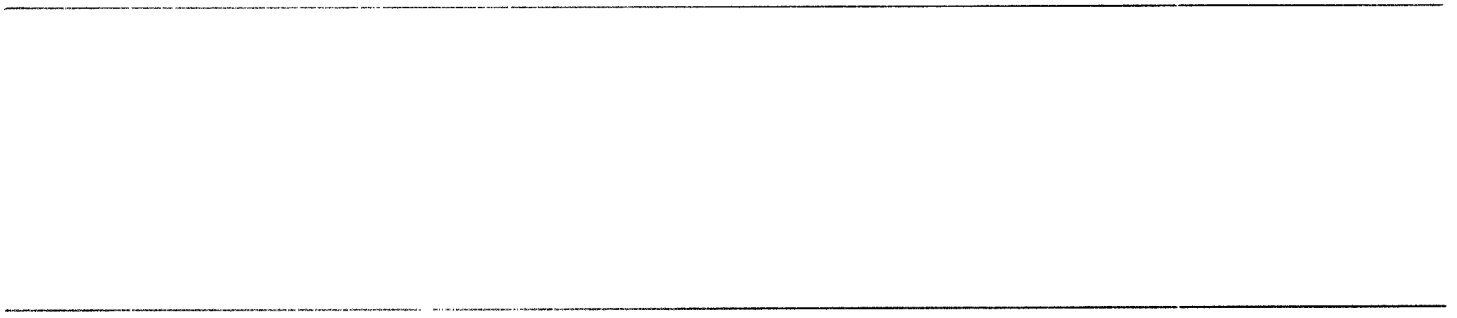
November 1990

# FINANCIAL AUDIT

## Department of Veterans Affairs Financial Statements for Fiscal Years 1989 and 1988



142659



**Comptroller General  
of the United States**

B-226801

November 14, 1990

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

This report presents the results of our financial audit of the Department of Veterans Affairs (VA) for the fiscal years ended September 30, 1989 and 1988. Our audit results are summarized in this letter and described in greater detail in our opinion on VA's consolidated financial statements and in our reports on VA's internal control structure and its compliance with laws and regulations. (See appendixes I through III.) VA's financial statements are presented as appendix IV.

In addition to the audit reports normally required by generally accepted government auditing standards, we present later in this letter a discussion and analysis of VA's financial operations. We have also included a statement analyzing VA's appropriation activity and a summary of VA's self-assessment of internal controls under the Federal Managers' Financial Integrity Act (FMFIA). (See appendixes V and VI.) We believe that a financial statement which analyzes appropriation activity is a desirable addition to the standard set of financial statements. It provides a fuller reporting of the relationship between accrual-based statements and the status of appropriations used. We also believe that a summary of an agency's FMFIA report should be part of the agency's annual report and eventually be included within the scope of the independent auditor's work and report.

We believe these additions will provide the Congress and the President greater insight into and understanding of an agency's financial affairs. Taken together, this information represents the kind of financial disclosure that should be made in an annual report by the head of an executive agency, department, or government corporation to the Congress and the President. In this report, we prepared the financial information to provide an illustration of how such information could be similarly presented in other agencies' reports. The only difference would be that, similar to the financial statements presented in this report, the preparation of the additional financial information would be the responsibility of agency management and the independent auditor would attest to its fair presentation.

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**Results in Brief**

In our opinion, except for property and equipment, VA's consolidated financial statements for fiscal years 1989 and 1988 are fairly stated in

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accordance with generally accepted accounting principles (GAAP). The property and equipment amounts shown in the financial statements are not accurate primarily because of missing or undocumented values of the assets and the inconsistent adherence to capitalization and depreciation policies by VA's field personnel. The weaknesses in VA's control over its property and equipment accounts are discussed in our report on internal control structure, which is included in appendix II.

VA's financial statements report certain accrued expenses aggregating nearly \$5 billion at September 30, 1989, that will have to be funded principally from future appropriations. These expenses (employee annual leave earned but not taken, life insurance premiums for disabled veterans that are funded by appropriations, and losses on guaranteed housing credit loans) are customarily financed through appropriated funds in the year payment is required. In addition, VA disclosed in the notes to its financial statements that the present value of the currently authorized compensation and pension benefits to veterans, which will also have to be funded by future appropriations, amounted to about \$135 billion at September 30, 1989.

Our discussion and analysis of VA's financial operations, which was based on the audited financial statements and statistical data, budget reports, and other VA program data over the 4-year period ending with fiscal year 1989, shows the following:

- VA's net operating costs decreased slightly from fiscal year 1988 to fiscal year 1989, when they were \$27.9 billion, whereas they increased by \$1.6 billion over the 4 fiscal years from 1986 to 1989. However, such costs, when measured in 1986 constant dollars, decreased by \$1.6 billion, or 6.1 percent, during the 4-year period.
- Costs related to VA's health care program grew at a moderate 6.3 percent annually between fiscal years 1986 and 1989, but this increase is in the context of a continuing decline in the number of veterans served and the occupancy rates in acute care hospitals. Hospital acute care costs, measured on a per patient day basis, have increased 9.2 percent annually. Health care costs can be expected to continue rising at or above this level. However, VA is studying the possible realignment, or change of mission, for its medical facilities, which may influence future funding levels.
- Veterans benefit costs, which are comprised primarily of compensation and pension benefits, stayed basically constant during fiscal years 1986 through 1989, ranging from about \$15.3 billion to \$15.9 billion a year. However, such benefits could increase significantly in the future due to

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recent court rulings declaring certain citizens of the Philippines eligible for full U.S. veterans benefits and requiring benefit payments to those Filipino recipients to be paid at the same rates that other recipients are paid.

- About \$2.5 billion of the nearly \$5 billion in accrued expenses at September 30, 1989, that will have to be paid during future years, principally with appropriations, represents accrued losses on outstanding guaranteed loans under VA's housing credit assistance program.
- VA's life insurance program is secure with \$12.2 billion in reserve. These reserves consist of (1) amounts determined under GAAP needed to pay the actuarially determined guaranteed life insurance policy benefits, exclusive of future premium and investment income (\$9.1 billion), and (2) additional amounts VA must hold in reserve to comply with the statutes which establish VA's reserve requirements (\$3.1 billion). This latter amount, under current VA practices, will eventually be distributed to policy holders through dividends or policy enhancements. The Congress can anticipate, though, the need to continue funding, through appropriations, certain unallocated administrative expenses relating to the VA life insurance program and certain premium subsidies and policy claims under several insurance plans. The total of such appropriations amounted to about \$41 million in fiscal year 1989.
- VA has serious problems collecting its receivables and therefore provided a reserve for doubtful accounts of \$3.2 billion as of September 30, 1989.

VA's self assessment of its accounting systems under FMFIA<sup>1</sup> has identified eight areas where its major accounting systems fail to conform with accounting principles and standards for government agencies. These areas include, for example, weaknesses in the controls over property and equipment accounts, security controls at automatic data processing (ADP) centers, and the inability to adequately control funds and effectively detect duplicate payments for the loan guaranty program. As a result of our audit tests, we are not aware of any information which would contradict the matters included in VA's FMFIA reports, and our summary of these reports is included in appendix VI.

In our report on VA's internal control structure, we are recommending that the Secretary of Veterans Affairs direct the Chief Veterans Benefits Director and various responsible assistant secretaries to take certain actions to correct weaknesses we reported concerning property and

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<sup>1</sup>Under the Federal Managers' Financial Integrity Act of 1982 [31 U.S.C. 3512(b) and (c)] agencies must evaluate and report on their agency internal control and accounting systems to the President and the Congress each year.

equipment accounts, ADP security controls, and the recovery of erroneous veterans benefit payments.

## Discussion and Analysis of VA's Financial Position and Operations

This discussion and analysis presents information on VA's operating costs and major assets for fiscal years 1986 through 1989. It is a narrative presentation of the results of an analytical review of financial data for each of VA's programs. Important aspects of VA's financial operations are discussed and relevant trends are pointed out. For some programs, financial data are related to other measures of performance. In addition, we have included information, where appropriate, to make the Congress aware of critical areas, such as VA's debt collection activities or whether a program may need significant future funding.

## Highlights of VA's Financial Operations

VA's net operating cost<sup>2</sup> for fiscal year 1989 was \$27.9 billion, which represents approximately 2.5 percent of the U.S. government's net operating cost for that year. Table 1 shows VA's total cost of operations during the 4 years beginning with fiscal year 1986, a period during which it served a declining veterans population.

**Table 1: Net Cost of Operating VA's Programs for Fiscal Years 1986 Through 1989**

Program	Net operating cost for fiscal year			
	1986	1987	1988	1989
Health care	\$9.5	\$10.0	\$10.5	\$11.4
Benefits	15.4	15.3	15.5	15.9
Housing credit assistance	0.7	1.6	1.8	(0.2)
Life insurance <sup>a</sup>	0.0	0.0	0.0	0.0
Administration	0.7	0.7	0.8	0.8
<b>Total net operating costs</b>	<b>\$26.3</b>	<b>\$27.6</b>	<b>\$28.6</b>	<b>\$27.9</b>

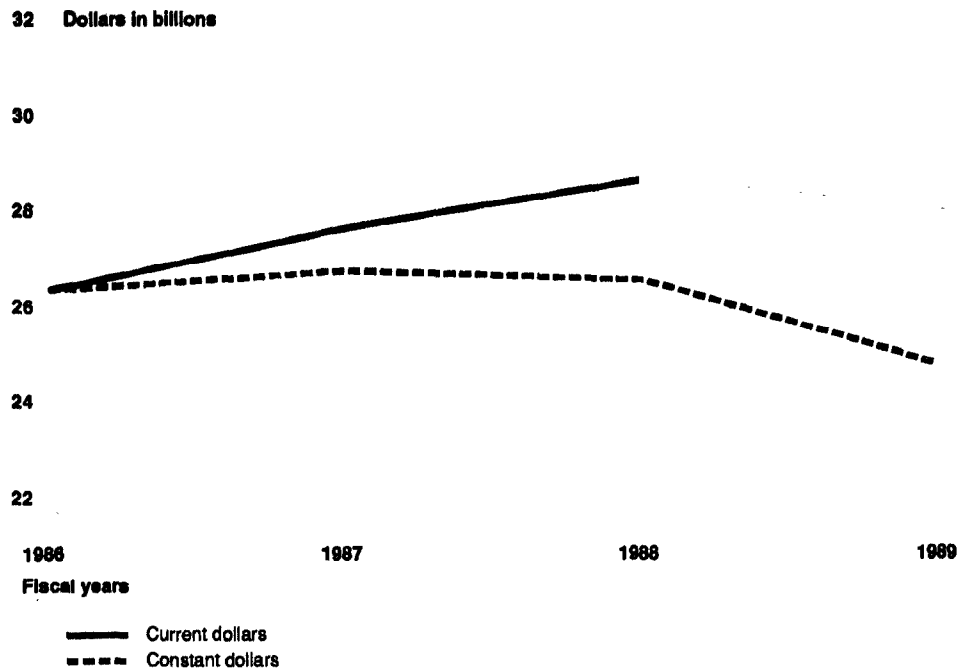
<sup>a</sup>While VA's life insurance program operated at slightly greater or less than break-even throughout the 4 years, these operating results are shown as zero due to rounding.

Although VA's net operating cost decreased slightly between fiscal year 1988 and 1989, it grew at an average annual rate of 2 percent over the 4-year period from fiscal year 1986 through fiscal year 1989. However, during this period, VA's net cost of operations, when calculated in 1986

<sup>2</sup>As used in this report, unless otherwise stated, the term "net operating cost" for health, benefits, and other nonbusiness-type operations is defined as the sum of expenses and benefit payments minus reimbursements and revenues, and before appropriations. For business-type programs, such as the housing credit and life insurance programs, "net operating cost" represents the net loss of the program, also before appropriations.

constant dollars, decreased 6.1 percent, or \$1.6 billion overall. Figure 1 depicts VA's net operating costs in both current and constant dollars for the 4-year period.

**Figure 1: VA's Net Operating Costs in Current and Constant Dollars for Fiscal Years 1986 Through 1989**



Note: Constant dollars were computed by deflating current dollar levels using the consumer price as the deflator.

VA's total assets at the end of fiscal year 1989 were valued at \$35.2 billion—down \$501 million from the previous year. Aside from cash with the U.S. Treasury of \$4.9 billion, receivables of \$3 billion, and future financing sources of \$4.8 billion, VA's major assets were comprised of two major categories. The first category is investments derived primarily from VA's life insurance program. These investments, which amounted to \$13.2 billion at September 30, 1989, are mainly in special non-marketable U.S. Treasury bonds. The second category is property and equipment, which is used primarily to provide medical care to veterans. Although the amount is not considered accurate, based on our audit, the value of property and equipment at the end of fiscal year 1989, as reported by VA, was almost \$8.4 billion.

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## VA's Health Care Costs Growing at Nominal Rate But Could Change

The health care program operated by VA is the nation's largest health care system and includes 172 hospitals, 235 outpatient clinics, 122 nursing homes, and 29 domiciliary care units. All of the hospitals and domiciliary care units and most of the outpatient clinics are organized into 172 medical centers. In addition, VA health care is acquired under contractual and grant arrangements with private and state medical providers. VA's health care program employs over 226,000 full- and part-time health care workers, which is more than 90 percent of VA's total employees.

The cost of operating this health care program increased \$1.9 billion, or 6.3 percent annually, from fiscal years 1986 to 1989, reaching \$11.4 billion. The majority (62 percent) of VA's health care costs are for personnel services and benefits of its approximately 226,000 health care workers—a complement of employees that has remained at about the same level in recent years. Lesser amounts finance the cost of supplies, materials, and contractual services (27 percent) and rent, communications, utilities, depreciation, and other expenses (11 percent).

In recent years, VA has provided fewer episodes of inpatient care in its hospitals while nursing care and other services have increased slightly. Between fiscal years 1986 and 1989, the inpatient occupancy rate of hospitals, as reported by VA, declined from 73.4 percent to 68.8 percent and the average daily census of hospital inpatients declined from 56,940 to 49,040. Meanwhile, the average daily census of nursing home patients increased from 10,482 in fiscal year 1986 to 11,468 in fiscal year 1989. In addition, the daily patient census for domiciliary care units increased from 5,767 to 6,315 during the 4-year period.

Although VA reduced its hospital staffing levels of "full-time equivalent employees" about 9 percent in response to the reduced demand during that period, VA's total staffing of health care workers remained about the same with more workers used for other health care services. Recent appropriations for medical care have specified minimum funding levels for personnel compensation and benefits object classifications. For example, the supplemental appropriations act for fiscal year 1989 (Public Law 101-45) required that not less than \$6.8 billion shall be available for those classifications, and the conference report (H. R. Rep. 101-89) on a related bill directed VA to proceed towards a medical care, full-time equivalent employee staffing level of 194,700. Accordingly, VA's flexibility to reduce the total number of health care workers may be limited.



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VA spent about \$1.2 billion in fiscal year 1989 to acquire land, buildings, and equipment, most of which was related to providing veterans health care. In addition, VA spent about \$460 million in fiscal year 1989 to maintain its medical facilities. VA hospital construction projects were mostly aimed at replacing, relocating, or modernizing facilities. VA's long-range plans relating to medical facilities call for spending about \$9.8 billion to repair or replace aging facilities.

The declining occupancy rate raises questions about the continuing need for the present size of the aging VA hospital system—many of whose facilities were constructed more than 40 years ago and are deteriorating.

Whether the need for hospital facilities and staffing will continue to be the same as in the past or whether reductions can be made are major considerations in structuring the future alignment of VA's medical facilities. Significant potential may exist for consolidation of hospital facilities and closure of older, less efficient units.

In this regard, in April 1990, VA established a Commission on the Future Structure of Veterans Health Care. The Commission has been charged with reviewing the missions and programs of every VA medical facility to ascertain whether programmatic improvements or enhancements can be realized through facility realignments or major mission changes. Unfortunately, the results of the Commission's work are not expected until late 1991.

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### **Veterans Benefits Costs Have Remained Constant But Face an Uncertain Future**

Various entitlement programs provide veterans with a number of benefits. Compensation is paid to veterans with disabilities resulting from or coincident with military service and to survivors of service-connected deaths. Pensions are paid to low-income, wartime veterans who are 65 years old or older or who have become permanently and totally disabled, as well as to qualified survivors of deceased wartime veterans. Other veterans benefits cover education, rehabilitation, and burial services.

The cost of operating veterans benefits programs increased an average of 1.1 percent annually for fiscal years 1986 through 1989. For fiscal year 1989, the cost of operating these programs was \$15.9 billion, compared with \$15.6 billion the previous year.

About 96 percent of fiscal year 1989's net operating costs for these programs, or \$15.2 billion, related to disability compensation and pension

benefits. The remaining 4 percent related to other veterans benefit costs, such as education, vocational training and rehabilitation, burial, and clothing allowances.

Two factors could affect the growth (or reduction) of VA's compensation and pension program costs. These factors are the number of veterans who receive benefits and the amounts these veterans receive. Together, these factors have acted to maintain compensation and pension costs at a generally consistent level during the past 4 fiscal years.

The number of recipients decreased an average of 2.1 percent each year from fiscal year 1986 to 1989, whereas the average amount paid per recipient increased about 4 percent annually during that period. The increase in the amount paid to recipients is attributable to cost-of-living adjustments and legislative changes in the amounts paid to recipients.

The effect of these factors is likely to result in VA's annual compensation and pension program costs, at least for the next several years, remaining at levels comparable to those of the last 4 fiscal years unless the benefit amounts are significantly changed through legislation or other action. For example, one area of uncertainty that could significantly affect the amount of annual VA benefit payments involves certain recent court rulings. These recent rulings<sup>3</sup> may increase compensation and pension payments by as much as \$1.6 billion annually, which represents 10 percent of benefit payments for fiscal year 1989. If not reversed by a higher court, these rulings would (1) make members of the Philippine Commonwealth Army and recognized guerrilla forces eligible for full U.S. veterans benefits as a result of their U.S. service during World War II, rather than the partial benefits previously provided, and (2) require benefit payments to those Filipino recipients to be paid at the same rates that other recipients are paid, rather than the previous one-half rate paid to those Filipinos.

The present value of the authorized compensation and pension benefits to veterans as of September 30, 1989, which will be payable over future years, is not recorded in VA's financial statements. Federal accounting principles governing the recording of such liabilities are undergoing reexamination by the General Accounting Office (GAO). The present interpretation of this matter by GAO is that disclosure of the estimated

<sup>3</sup>Quiban v. United States Veterans Administration, 713 F. Supp. 436 (D.D.C.), reconsideration denied, 724 F. Supp. 993 (D.D.C. 1989) and Quizon v. United States Veterans Administration, 713 F. Supp. 449 (D.D.C. 1989).

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value of such future benefit payments, or entitlements, is required but need not be recorded in the financial statements. Accordingly, VA has not recorded the liability for such future payments in its financial statements. However, VA disclosed the estimated present value of these benefits, not counting the potential effect of the court rulings relating to Filipino benefit recipients, in the notes to its financial statements. The amount disclosed was \$135.2 billion as of September 30, 1989.

The estimated liability for these future payments is not currently funded. Rather, payments for benefits that become due in a particular fiscal year are financed from that year's appropriation. Therefore, future tax revenues or other resources, such as public borrowings, will have to be made available to finance payments of the future liability as it becomes due.

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### **Housing Credit Assistance for Veterans Will Require Substantial Future Appropriations**

VA's housing credit program provides for the partial guaranty of home mortgage loans that eligible veterans or qualified survivors of veterans borrow from private lenders. At the end of fiscal year 1989, VA reported more than 3.9 million guaranteed home loans outstanding, with a total face amount of \$152 billion, of which VA had guaranteed about \$60 billion. VA has also extended direct loans to home-buying veterans in certain rural areas where the veterans cannot find commercial lenders. As of September 30, 1989, VA was holding direct loans with a face value of \$1.2 billion, including "vendee" loans, which are direct loans on properties that VA acquired through foreclosure and then resold.

VA's housing credit assistance program can incur expenses or losses in several ways: (1) payments made either to fully satisfy vendor claims or to acquire foreclosed property, (2) expenses paid to maintain and sell acquired property, and (3) losses incurred when foreclosed properties are sold. In addition, losses can be experienced if VA sells its vendee loans for less than the face value of the loans and if it pays for defaults on any of these loans which may have been sold with recourse. Revenues received from such sources as loan origination fees and interest income from direct loans currently reduce housing program losses.

The cumulative net operating losses of VA's housing credit assistance program for fiscal years 1986 through 1989 amounted to \$3.9 billion. Table 2 summarizes the housing program's net income or loss for these years.

**Table 2: VA's Housing Credit Assistance Program's Net Income or Loss for Fiscal Years 1986 Through 1989**

Dollars in millions					
Revenue/expense category	Fiscal year				4-year total
	1986	1987	1988	1989	
<b>Revenues</b>					
Fees	\$258	\$341	\$135	\$141	\$875
Interest income	184	191	168	165	708
Reimbursements	( 1)	( 45)	( 66)	7	( 105)
<b>Total Revenues</b>	<b>441</b>	<b>487</b>	<b>237</b>	<b>313</b>	<b>1,478</b>
<b>Operating Expenses<sup>a</sup></b>	<b>1,094</b>	<b>2,132</b>	<b>2,032</b>	<b>110</b>	<b>5,368</b>
<b>Net Operating Income (Loss)</b>	<b>(\$653)</b>	<b>(\$1,645)</b>	<b>(\$1,795)</b>	<b>\$203</b>	<b>(\$3,890)</b>

<sup>a</sup>Fluctuations in the amount of operating expenses were caused by changes in the total provision for losses, which is determined through a statistical methodology based on historical default experience and economic forecasting. The provision for losses increases in those years where adverse conditions occur, such as increasing default rates and adverse statistical and economic indicators, and decreases when the conditions improve. In addition, a decrease occurred in the provision for losses during fiscal year 1989 due to a change, which the auditors approved, in the statistical methodology used to estimate the losses on guaranteed loans.

As of September 30, 1989, \$2.7 billion of the 4-year cumulative net loss of the housing credit assistance program represented estimated accrued loan losses that are payable in the future. VA's financial statements show this net loss as a liability for losses on guaranteed loans.<sup>4</sup> About \$2.5 billion of this liability will result in a demand on future financing sources.

Appropriations will be required to finance most of this demand. This is consistent with the \$2.3 billion in appropriations and transfers the Congress approved during fiscal years 1986 through 1989 to finance claims and operating expenses for the housing credit assistance program that were in excess of finances generated by the program.

However, because of recent legislative changes in the program, the demand for appropriations or other financing for VA's Loan Guarantee Fund, which is part of the housing credit assistance program, may be even greater in the future. The Veterans Home Loan Indemnity and Restructuring Act of 1989 (Public Law 101-237, Title III) required that, starting in 1990, most new guaranteed or insured loan origination fees

<sup>4</sup>Before fiscal year 1986, VA reported the housing credit program on a budgetary basis, whereby loan losses were recorded as payment was required. Beginning in fiscal year 1986, VA changed to an accrual basis of accounting for loan losses and established a reserve for the estimated cost that it would bear as loans already guaranteed default in the future.

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be deposited in a new fund—the Guarantee and Indemnity Fund. The Loan Guarantee Fund will not, therefore, have a significant amount of loan origination fees as a source of financing. These fees amounted to \$875 million during the 4 fiscal years from 1986 to 1989.

Future requirements for appropriations may, however, be eased somewhat if the downward trend in the number of direct and guaranteed loans and in loan defaults experienced in fiscal year 1989 continues. Between fiscal years 1988 and 1989, the number of guaranteed loans outstanding decreased from 4 million to 3.9 million, and the number of guaranteed loans in default dropped from 139,400 to 130,276. The percentage of loans in default during this 4-year period has ranged from 3.2 percent to 3.5 percent.

In addition, the amount of appropriations required for the housing credit program is affected by the number and types of loan sales. 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. VA's financial advisors for the two without-recourse loan sales in fiscal year 1988 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.

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## Veterans' Life Insurance Program Is Secure

VA administers five plans to provide life insurance to veterans of different war eras, including World Wars I and II, and the Korean Conflict. VA also supervises three life insurance plans, operated by commercial insurance companies, which provide coverage to active military personnel and veterans. Of the five life insurance plans that VA administers, only Service-Disabled Veterans Insurance remains open for new policy issues. The other four are no longer writing new policies.

VA's life insurance program receives revenue primarily from life insurance premiums received from policyholders and interest earned on investments. Costs are incurred for this program when it pays claims and dividends to policyholders. In addition, the life insurance program has administrative expenses, but the majority of these costs are paid with VA's appropriated funds and are not allocated to the life insurance program.

Over the 4 fiscal years from 1986 to 1989, the life insurance program, as intended by the Congress, has operated at a near break-even level. That is, revenues generated by the program were generally sufficient to pay benefit payments and dividends to policyholders.

In this regard, the life insurance program's fiscal year 1989 expenses were \$2 million less than receipts—excluding certain unallocated, administrative expenses. During the preceding 3 fiscal years, the life insurance program's expenses were greater than receipts ranging from \$16 million to \$20 million. These differences were largely attributable to the Service-Disabled Veterans Insurance plan, which is intended to receive appropriated funds to finance the portion of policyholders' premiums applicable to the service-connected disability of the veteran. The veteran, or policyholder, pays the standard premium rate for the life insurance coverage. Two other government insurance plans, the National Service Life Insurance and the United States Government Life Insurance plans, also receive limited appropriations for payment of claims traceable to the extra hazards of military service. Table 3 summarizes the results of operating VA's life insurance program during the period from fiscal year 1986 to 1989.

**Table 3: Operating Results of VA's Life Insurance Program for Fiscal Years 1986 Through 1989**

Dollars in millions				
Revenue/expense category	Fiscal year			
	1986	1987	1988	1989
<b>Revenues</b>				
Premiums	\$848	\$878	\$874	\$871
Interest income	1,166	1,192	1,230	1,274
Reimbursements	( 3)	( 8)	79	43
<b>Total Revenues</b>	<b>2,011</b>	<b>2,062</b>	<b>2,182</b>	<b>2,188</b>
<b>Expenses and Losses</b>				
Loss reserve provision	191	230	313	222
Claim payments	931	919	933	959
<b>Total Expenses and Losses</b>	<b>1,122</b>	<b>1,149</b>	<b>1,246</b>	<b>1,181</b>
<b>Net Gain Over Expenses</b>	<b>\$889</b>	<b>\$913</b>	<b>\$936</b>	<b>\$1,007</b>
<b>Policy Dividends</b>	<b>\$907</b>	<b>\$929</b>	<b>\$956</b>	<b>\$1,005</b>

VA's life insurance program is in a secure position. Revenues of about \$2 billion have stayed reasonably constant between fiscal years 1986

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and 1989—rising about \$200 million during that period. Life insurance program investments, which generated 58 percent of the program's revenue in fiscal year 1989, are principally in special U.S. bonds and experienced an average return of about 9.7 percent in fiscal years 1988 and 1989. However, life insurance premiums, which constituted 40 percent of revenues in fiscal year 1989, are declining as the program has matured. Most veteran policyholders are paying premiums at the capped maximum rate or are no longer required to pay premiums.

In addition, costs related to claim payments and dividends remained steady. For fiscal year 1989, claim payments were about \$959 million, which were slightly higher than claim payments made during the preceding 3 fiscal years. Except for fiscal year 1986, the amounts paid as dividends to policyholders were slightly higher than the amounts paid to life insurance claimants.

VA has provided adequate reserves for future life insurance policy benefits and participating policyholders' interest.<sup>5</sup> These reserves were \$9.1 billion and \$3.1 billion, respectively, at September 30, 1989. The reserves plus VA's life insurance program revenues are expected to be sufficient to pay future claims and dividends. Thus, VA can expect to maintain its life insurance activities without additional financial assistance from appropriations.

The Congress can anticipate, though, the need to continue funding, through appropriations, the VA life insurance program's unallocated administrative expenses, which were \$27.2 million in fiscal year 1989, and the premium subsidies and certain claims under several government life insurance plans, which were about \$13.5 million in fiscal year 1989.

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### VA's General Administrative Costs Have Not Grown Significantly

VA's general administrative costs were \$800 million in fiscal year 1989—about the same amount as was incurred in fiscal year 1988. In addition, about \$1.5 million of general administrative costs is allocated annually to VA's life insurance program to cover certain insurance plans. The remaining general administrative costs are not allocated to the life insurance or other VA programs.

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<sup>5</sup>As discussed in our opinion on VA's financial statements (appendix I), VA's current practices will eventually cause the reserve for participating policyholders interest to be distributed to policyholders in the form of dividends or policy enhancements.

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The unallocated general administrative costs represent 2.9 percent of VA's total operating costs and increased by \$100 million between fiscal years 1986 and 1989. These unallocated costs are composed of the following types of expenses: salaries and employee benefits (70 percent); rents, utilities, and communications (17 percent); and other expenses (13 percent).

The Congress can anticipate the continuing need to finance VA's general administrative activities through appropriations. However, these costs have not grown significantly in recent years and are expected to remain at comparable levels in the near future.

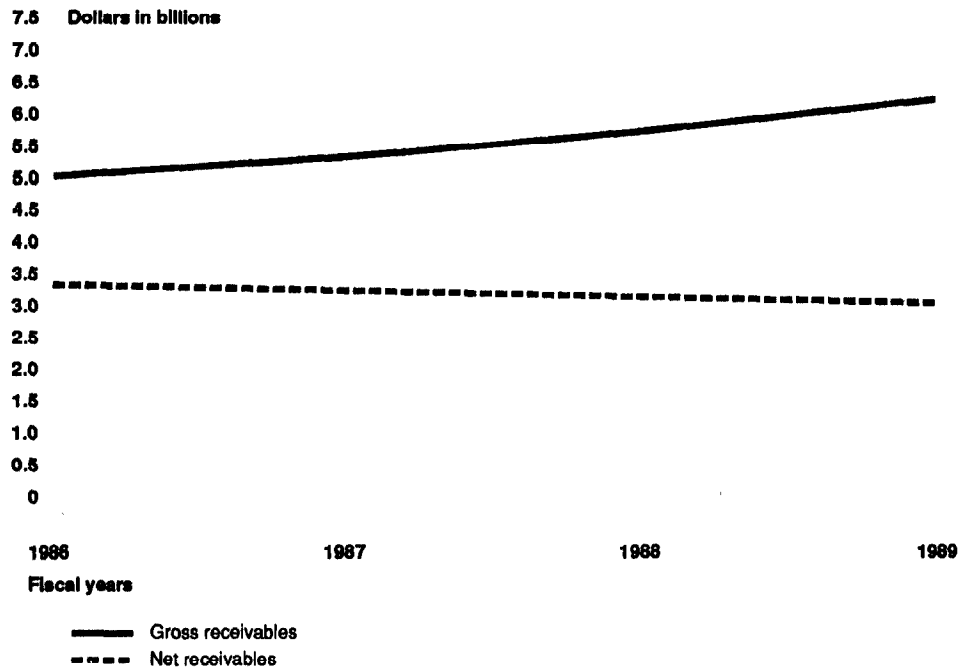
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### **VA Has Serious Credit Management Problems**

At the end of fiscal year 1989, VA had \$6.2 billion in amounts due the government from advances and accounts and loans receivable. These assets increased \$1.2 billion from fiscal year 1986 to 1989. VA's allowance for doubtful accounts related to its receivables is considerable, amounting to \$3.2 billion at September 30, 1989. This represents 52 percent of aggregated accounts and loans receivable at that time—a substantial increase from 34 percent in fiscal year 1986. Figure 2 compares VA's total receivables with receivables it expects to collect after considering its allowance for doubtful accounts for fiscal years 1986 through 1989.



**Figure 2: VA's Gross and Net Receivables for Fiscal Years 1986 Through 1989**



Note: In this figure, net receivables equal gross receivables less the provision for doubtful accounts. Therefore, the area between the two lines represents the provision for doubtful accounts.

Figure 2 reflects VA's serious credit management problems. In this connection, total bad debt losses for uncollectible accounts and loans aggregated \$3.1 billion for fiscal years 1986 through 1989. Further evidence of VA's credit management problems is indicated by the large percentages of some types of receivables for which VA has established doubtful account reserves. For instance, as of September 30, 1989, about \$775 million was receivable from individuals for amounts due primarily on education loan defaults and compensation and pension benefit overpayments; from third-party insurers for health care; and from veterans for hospital services copayment billings. VA's reserve for doubtful accounts on these assets was 37 percent. As of September 30, 1989, about \$3.6 billion of the \$4.7 billion in loan receivables was for loans due under the housing credit assistance program. VA's reserve for doubtful accounts on the housing credit loans was 73 percent.

We have reported on VA's serious credit management problems many times in the past. Most recently, we reported in April 1990<sup>6</sup> that much remains to be done to ensure that a comprehensive governmentwide credit management program as set forth by the Office of Management and Budget in Circular A-129 is fully implemented. The report included recommendations to the Secretary of Veterans Affairs for improving VA's credit management.

In that report, we also recommended to the Congress that the Debt Collection Act of 1982 be amended to require agencies, including VA, to use certain credit management techniques. In addition, we recommended that the Congress require agencies to provide it annually with audited financial information on their receivables and delinquencies for its use in making budgetary decisions to supply new funds. As demonstrated in this discussion and analysis and the appendixes to this report, it is important for the Congress to have reliable information on receivables and delinquencies to assess how well agencies, such as VA, are doing in collecting amounts owed to the government and the extent to which these government assets can be collected.

## Scope and Methodology

The above discussion and analysis is based primarily on accounting data included in VA's audited consolidated financial statements for fiscal years 1986 through 1989. However, certain analyses required the use of statistical and financial data, such as daily hospital occupancy rates, from other sources. We obtained these data from VA's various budget reports and program systems, which were not subject to our audit and independent verification. Thus, we are not expressing any views on the accuracy of these other statistical and financial data.

Our analysis is focused on the following financial attributes:

- the overall cost of VA's operations and the operating cost of each major program and
- financing sources and their effect on VA's financial position.

We also considered the efficiency of VA's asset utilization and the liquidity and solvency of VA's business-type programs.

<sup>6</sup>Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, April 16, 1990).

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As previously stated, the information in this report reflects the kind of financial disclosure we believe should be made in an annual report to the President and the Congress by the head of each executive agency and government corporation. Such information reflects accountability for government programs and resources and can be useful for oversight and decisionmaking when assessing department programs and determining public policy. With improved financial reporting as an objective, we plan to continue working with agencies, such as VA, and the Office of Management and Budget to have the issuance of annual audited financial statements permanently adopted as a requirement for all agencies of the federal government.

We are sending copies of this report to the Chairmen of interested congressional committees and subcommittees, the Director of the Office of Management and Budget, the Secretary of Veterans Affairs, and the heads of other federal agencies. Copies will be made available to others upon request.



Charles A. Bowsher  
Comptroller General  
of the United States

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**Abbreviations**

ADP	automated data processing
CARD	centralized accounts receivable division
DABS	Disbursing, Accounting and Budgeting System
DPC	data processing center
EFT	electronic funds transfer
FMFIA	Federal Managers' Financial Integrity Act
GAAP	generally accepted accounting principles
GAO	General Accounting Office
IG	inspector general
OMB	Office of Management and Budget
VA	Department of Veterans Affairs
SSA	Social Security Administration



# Opinion Letter

**GAO**

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

Comptroller General  
of the United States

B-226801

To the Secretary  
Department of Veterans Affairs

We have audited the accompanying consolidated statements of financial position of the Department of Veterans Affairs (VA) as of September 30, 1989 and 1988, 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 financial statements based on our audits.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. Also, in accordance with those standards and as an integral part of our audits, we, with assistance from VA's Inspector General, reviewed VA's internal control structure and its compliance with laws and regulations, and we are reporting separately on the results of these reviews. Our audits included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

COSTS OF LAND, BUILDINGS, AND EQUIPMENT

Our opinion on VA's consolidated financial statements remains qualified as to the amounts reported for land, buildings, equipment, and related expense accounts. This qualification could be removed if VA were to establish the missing or undocumented values by appraisal or some other reasonable basis and install and maintain adequate property



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accounting records that provide accountability. The 172 medical centers and related facilities which provide medical care to veterans comprise the majority of VA's reported property. We believe that the failure to establish proper accountability is a material internal control weakness which requires correction to ensure adequate financial management of VA's assets, a proper recording of the cost of operating the medical centers, and the preparation of satisfactory consolidated financial statements.

CHANGES IN LIFE INSURANCE  
PROGRAM REPORTING

Our opinion, dated April 14, 1989, on VA's fiscal year 1988 and 1987 consolidated financial statements, was also qualified because the statements presented life insurance policy reserves which were calculated in accordance with statutorily-required assumptions rather than generally accepted accounting principles (GAAP), which would have more fairly presented the amount of reserves needed to pay future insurance policy benefits. As described in note 6, in fiscal year 1989, VA adopted the policy of presenting these reserves in its financial statements in accordance with GAAP and restated its 1988 consolidated financial statements to make the change retroactive to that year. Accordingly, this qualification was removed from our opinion on the 1988 consolidated financial statements as presented herein.

VA changed to GAAP reporting of its life insurance reserves because these principles are the preferred practice in the insurance industry for the public reporting of life insurance transactions and the resulting reserves and liabilities. As a result of this change, VA's reserve for insurance policy benefits, which is now presented in accordance with GAAP, has been reduced by \$2.9 billion. The reduction of this reserve and related changes create a new reserve of approximately \$3.1 billion which, consistent with GAAP, is called "Participating Policyholders' Interest in Accumulated Participating Earnings." However, this \$3.1 billion reserve is not immediately payable by VA under existing statutes. Although VA has adopted the policy of reporting the reserves that are realistically required to pay future insurance policy benefits, it is still required by the applicable statutes to hold the \$3.1 billion in reserve.

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VA no longer issues new life insurance policies under the programs associated with the \$3.1 billion. VA presently pays dividends to its policyholders, and provides insurance policy enhancements such as "paid-up" and "reduction-in" policy premiums, which are based upon the amount of its total accumulated premiums and earnings in excess of its statutory reserves. As the number of policies decreases, the reserves required under either GAAP or VA's statutes will gradually decrease to zero. Accordingly, under current VA practices, the \$3.1 billion reserve will eventually be distributed to policyholders in the form of dividends or policy enhancements.

OPINION ON VA'S CONSOLIDATED  
FINANCIAL STATEMENTS

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, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Department of Veterans Affairs as of September 30, 1989 and 1988, 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.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental schedules to the consolidated financial statements are presented for purposes of additional analysis. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, except for the same qualification mentioned above, are fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

VA'S HOUSING CREDIT PROGRAM

In our fiscal year 1988 and 1987 report on VA's consolidated financial statements (GAO/AFMD-89-69), we expressed concern that, for the loan guaranty fund component of its housing credit program, VA might require increased assistance from the Congress over the next several years if certain

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conditions worsened. The conditions did not worsen in 1989. The principal condition, home loan foreclosures, improved in fiscal year 1989, with home loan foreclosures decreasing from about 49,000 in fiscal year 1988, to about 43,000 in 1989. This was the first year that VA experienced a lessening of home loan foreclosures since 1980. Accordingly, only about \$780 million in appropriations was needed to supplement the financing of the loan guaranty fund's operations during fiscal year 1989, versus the approximately \$900 million requested in VA's budget.

VA anticipates that this improvement will continue but that it will still need annual appropriations to operate the fund for several years. For example, VA estimates that it will need about \$558.5 million in appropriations for the loan guaranty fund during fiscal year 1990. VA's fiscal year 1991 budget submission includes a request for \$512.2 million for the fund.

Establishment of an Additional Fund--  
the Guaranty and Indemnity Fund

On December 18, 1989, the Veterans Home Loan Indemnity and Restructuring Act of 1989 (Public Law 101-237, Title III) established an additional revolving fund called the Guaranty and Indemnity Fund, which is available to operate VA's programs for guaranteed or insured loans closed on or after January 1, 1990. Among other things, this legislation changed the veteran's loan origination fee on each loan guaranteed, insured, or made by VA from 1 percent to a percentage that varies from zero to 1.25 percent, depending on the veteran's status and amount of downpayment made on a loan. These fees are to be credited to the Fund. The Act also added the requirement for the federal government to credit the Fund with certain amounts for each loan guaranteed, insured, or made through the Fund. A bill introduced in the Congress (S. 2100) would make technical corrections to the amounts the federal government must credit to the Fund.

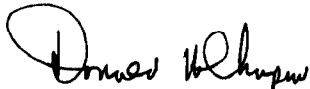
Both VA and the Congressional Budget Office (CBO) estimate that the fees and credits required by the legislation will not be sufficient to finance the operations of the Fund for the long term. This cash insufficiency will not be apparent for a number of years because outlays for losses will not be required until that time. VA estimates that the Fund will require direct appropriations beginning in fiscal year 1995, while CBO estimates that such appropriations will not be required until fiscal year 1999.

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CERTAIN EXPENSES AND  
BENEFIT COMMITMENTS REQUIRE  
CONGRESSIONAL APPROPRIATIONS

VA's consolidated financial statements reflect accrued expenses aggregating approximately \$5 billion at September 30, 1989, that will be funded principally from future appropriations. About one-half of this amount represents losses incurred under the housing credit program referred to in the preceding section of this report. In addition, the present value of commitments for compensation and pension benefits to veterans which will also have to be funded from appropriations in future years aggregated approximately \$135 billion at September 30, 1989.

Payment of these expenses and benefits requires congressional appropriations of future tax revenues or other sources, such as public borrowing. The accounting for these items is explained in notes 1 and 4.



Charles A. Bowsher *for*  
Comptroller General  
of the United States

April 20, 1990

# Report on Internal Control Structure

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We have audited the consolidated financial statements of the Department of Veterans Affairs as of and for the year ended September 30, 1989, and have issued our report thereon dated April 20, 1990. We conducted our audit in accordance with generally accepted government auditing standards. As required by these auditing standards and as part of our audit, we obtained an understanding of and assessed VA's internal control structure to the extent we considered necessary in planning and performing our audit. Our consideration of the internal control structure was made to determine our auditing procedures for the purpose of expressing an opinion on VA's consolidated financial statements and not to provide assurances about the adequacy of the overall internal control structure. The consideration of an internal control structure for financial auditing planning purposes by itself is not sufficient for expressing an overall opinion about the design and operation of an entity's internal control structure as a whole or of any specific elements, but such a consideration may disclose weaknesses in specific aspects of the control structure.

The purpose of this report is to describe VA's internal control structure that we considered and to communicate the results of our consideration and tests of the policies and procedures comprising the structure. This report pertains only to our consideration of VA's internal control structure for the year ended September 30, 1989. Our report on VA's internal accounting controls for the year ended September 30, 1988, is presented in GAO/AFMD-89-69, dated September 15, 1989.

The management of VA is responsible for establishing and maintaining a system of internal administrative and accounting controls (in effect, an internal control structure) in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act (FMFIA) of 1982. (See appendix VI for a discussion of VA's reporting on the status of its internal control and accounting systems in accordance with the FMFIA's requirements.)

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that (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.

For purposes of this report, we have classified the VA's significant internal control policies and procedures over accounting applications, such as purchases, entitlements and loan processing, payroll, revenue and receipts, and life insurance policy premiums and payment processing, into the following areas:

- medical care and construction;
- veterans benefits;
- housing credit assistance;
- life insurance; and
- administration and other, including all payroll.

For all the areas listed, we obtained an understanding of the design of relevant policies and procedures that comprise the control structure, determined whether they have been placed in operation, and assessed control risk. We also performed tests of control procedures that were sufficient to evaluate their operational effectiveness for all of the areas listed above. In the medical care area, the control testing was substantially performed for us by VA's Inspector General (IG). The IG also supplemented our control testing in the veterans benefits area. However, neither we nor the IG tested control procedures for all functions within the areas. For example, in the veterans benefits area, we tested the processing of compensation and pension benefits; however, we did not test control procedures relative to the national cemetery operational component of VA's veterans benefits. Furthermore, we did not assess the internal control structure in certain miscellaneous funds, such as the General Post Fund and the Supply Fund. For these excluded areas, it was more efficient to expand our audit tests to substantiate the balances of accounts associated with the respective control area. Substantive audit tests, which we also performed to some extent for all of the control areas listed, can also serve to identify weaknesses in internal control structures.

We considered VA's FMFIA reports, as well as the IG's reports on financial matters and internal accounting control policies and procedures, in making our risk assessment. As previously stated, we also relied on the IG's testing of controls in the medical care area and certain controls in the veterans benefits area.

Our consideration of the internal control structure, made for the limited purpose described in the first paragraph, would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined below. For this reason, we do not express an opinion on VA's internal control structure, taken as a whole, or within the functional areas listed above. However, our study and evaluation disclosed that, despite implementation of certain corrective actions, two matters involving the design or operation of the internal control structure disclosed as reportable conditions in our fiscal year 1988 report continue to exist and warrant disclosing in this report. These two conditions involve

- accounting for VA's property and equipment and related depreciation and
- VA's controls over automated data processing (ADP) software maintenance and data integrity.

In addition, we noted two other matters involving VA's internal control structure and its operation that we are presenting in this report as reportable conditions. These matters involve weaknesses in VA's internal control procedures ability to

- prevent erroneous veterans benefit payments from continuing after the death of a veteran or other benefit recipient and
- recover erroneous benefit payments made after the death of the benefit recipient.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect VA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Only the first condition, VA's property and equipment and depreciation accounting, is

considered to be a material weakness from the standpoint of the potential effect on the fair presentation of the financial statements.<sup>1</sup> Under government auditing standards, a reportable condition is a material weakness when the design or operation of specific elements of the internal control structure do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our opinion on VA's consolidated financial statements was qualified as a result of the material weakness in VA's ability to account for its property and equipment.

## Inconsistent Adherence to Property and Equipment Capitalization and Depreciation Policies Continues

Our fiscal year 1989 audit disclosed that property accounting weaknesses found in our fiscal year 1988 audit continued. In our fiscal year 1988 report on internal accounting controls, we reported that VA had issued revised instructions to assist VA field units in implementing its capitalization and depreciation policies and had made other improvements in property accounting. However, we reported that there continued to be inconsistent adherence to management policies with respect to the capitalization and depreciation of buildings, which led to inaccurate "real" property account balances. This problem was due, in part, to VA's real property accounting system. This manual system does not provide for either a consistent capitalization of improvements to buildings and other structures or a centralized review of the amounts recorded. Our fiscal year 1988 audit and previous audits identified the following problems with VA's real property accounting:

- Items purchased with operating funds were expensed rather than capitalized in accordance with generally accepted accounting principles<sup>2</sup> and VA's policy.
- Construction project costs were transferred from work-in-process to completed facilities either before utilization or not until a significant period of time had elapsed after a completed facility was placed in use.

<sup>1</sup>The consideration of materiality differs under FMFIA from that in an audit of financial statements in accordance with generally accepted government auditing standards. Under the latter, the auditor considers materiality in relation to the financial statement amounts. As prescribed in the Office of Management and Budget's implementing guidance for FMFIA, materiality for FMFIA purposes should be considered in relation to factors such as an actual misstatement of a specified amount (\$10 million) or percentage (5 percent) of a budget line item, or non-conformance in a subsidiary or program system that prevents compliance of the primary accounting system with government accounting standards.

<sup>2</sup>Generally accepted accounting principles for federal agencies are contained in title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies.



- Depreciation was not calculated in accordance with generally accepted accounting principles and VA's policy.

During our fiscal year 1989 audit we found that the above problems with construction work-in-process costs and related depreciation still existed. For example, our tests at the VA Finance Center identified \$141.7 million in construction appropriations work-in-process costs as of September 30, 1989, on seven projects that should have been capitalized in fiscal years 1988 and 1989 but were not. Our testing at five medical centers also identified \$31.8 million in other construction projects that were not timely transferred from the work-in-process account to the buildings account in fiscal year 1989 and \$15.2 million in fiscal year 1989 construction costs that were transferred prematurely to the buildings account in fiscal years 1987 and 1989. Delays in capitalizing completed construction projects cause understatements of depreciation accounts, while premature capitalization actions cause overstatements of depreciation accounts.

In addition, consistent with the weaknesses we identified as a result of our fiscal year 1988 audit, we further identified instances of capitalizable maintenance and repair improvement costs that were expensed. For example, we found instances where capitalizable architectural and engineering costs and VA contract labor costs were expensed. We also identified cases of inconsistent accounting for asbestos removal costs. For example, at two medical centers, two asbestos removal projects costing \$2.2 million were capitalized and at three other centers, three projects costing about \$458 thousand were expensed.

We believe that these conditions are primarily the result of (1) the lack of understanding of VA's capitalization requirements by both VA medical center fiscal and facilities engineering personnel, and (2) VA's inability to ensure that these fiscal and engineering personnel use standard procedures and guidelines to timely and properly capitalize construction costs and related depreciation.

Our fiscal year 1989 financial audit also disclosed that differences continue to exist between the automated nonexpendable (equipment) property system and the corresponding general ledger control account. Although required by generally accepted accounting principles, some VA medical centers either did not always perform periodic reconciliations of these accounts or did not make adjustments to correct discrepancies when identified. Also, VA's nonexpendable property system (i.e., the subsidiary record which supports the general ledger equipment control

account) continues to contain individual equipment items costing less than \$5,000, although the generally accepted accounting principle sets the capitalization threshold at \$5,000 and above. VA officials have stated that they included items below the \$5,000 capitalization threshold in order to improve accountability. However, including these items will continue to cause VA's reported value for capitalized equipment to be overstated unless a separate system is established to maintain accountability over items with capitalizable values of less than \$5,000.

Because of these control weaknesses, the \$8.4 billion reported value of land, buildings, and equipment as of September 30, 1989, is not accurate. The deficiencies also affect the accuracy of the reported depreciation expense allocable to the use of the buildings and equipment. However, we were unable to quantify the extent to which VA's reported values for property and equipment and related depreciation expense were misstated.

VA has included a fixed asset module (designed to include both real property and equipment) in its new financial management system. This new system is targeted for implementation by the end of fiscal year 1992. However, development plans for the new system do not provide for (1) correcting the current recorded values of real property, and (2) improving coordination between field station facilities engineering personnel, acquisition and material management personnel, and finance office personnel. Without first taking these actions, the new system will not be effective in correcting VA's problems in real property and equipment accounting.

## Certain ADP Software Maintenance and Data Integrity Control Weaknesses Continue

Similar to our earlier audits (GAO/AFMD-89-23, November 30, 1988, and GAO/AFMD-89-69, September 15, 1989), our fiscal year 1989 audit disclosed weaknesses with ADP software maintenance, data integrity controls, and system documentation and application controls at VA's data processing centers. Specifically, our fiscal year 1989 audit disclosed the following instances in which the same or similar ADP internal control weaknesses continued to exist.

- At the Austin Data Processing Center (DPC), we found that there continues to be a lack of independent testing of some modifications to existing application software. In the payroll area, for example, we found that in-house programmers rather than independent system auditors performed tests on about one-third of the software program changes made in the last 6 months of calendar year 1989. In these cases, the

system auditors certified program changes based on a review of output provided by programmers, tested by programmers, using test files that could be changed by programmers.

- We also found that the Austin DPC continued to have inadequate control over access to payroll, personnel, financial, and loan information. We found, for instance, that ten system programmers and one contractor employee had unrestricted access to all VA's computer resources when such access was not justified. In addition, we also found that the Austin DPC continued to lack a formal and operationally-tested contingency plan to guide its operations in the event of a catastrophe.
- At the Hines DPC, we found continuing inadequate system documentation and weak application controls over benefit payment transactions. For example, during our 1989 audit, we found that transaction counts could not always be reconciled between software programs because the various programs used different methods to count records.
- At the Philadelphia DPC, we found that only 2 of the 11 ADP control weaknesses that we identified during our fiscal year 1987 and fiscal year 1988 audits have been corrected. The remainder were not addressed or received only partial correction. Among the examples of control weaknesses that have not been corrected are (1) the lack of documented, operationally-tested contingency plans, and (2) the lack of a policy requiring recertification of sensitive computer application programs on a regular schedule.

VA also identified many of the same data processing control problems in its December 31, 1989, FMFIA report and plans to take corrective action. (See appendix VI).

## Controls Ineffective in Preventing Erroneous Benefit Payments on Behalf of Deceased Recipients

VA has erroneously made compensation and pension payments on behalf of deceased veterans and their survivors because its control procedures do not provide for the consideration of all sources of death information in determining whether benefit payments should be continued. VA relies primarily on voluntary reporting by relatives or others and notice of death information from its other programs without also obtaining death information from other readily available sources—the Social Security Administration (SSA). The death information VA currently relies on is not accurate because (1) voluntarily provided death information is not received in all cases and (2) all recipients of VA compensation and pension payments are not necessarily recipients of other VA services. Consequently, VA cannot effectively identify when to terminate benefit

payments. Accordingly, VA continued to make unauthorized compensation and pension benefit payments sometimes for as long as 7 years, until the needed death information was received.

As shown in VA's consolidated financial statements, VA provided more than \$16 billion in veterans' benefits during fiscal year 1989, of which more than \$15.1 billion was for disability compensation and pension benefits. VA had about 3.6 million cases of such benefit payments during fiscal year 1989. Since only the benefit recipient is entitled to the benefits, payments should be terminated promptly when the recipient dies. However, if surviving relatives or other knowledgeable persons do not report benefit recipients' deaths to the VA in a timely manner, or VA does not obtain death information as a result of the beneficiary's participating in other VA programs, VA continues making the benefit payments.

We analyzed six cases of erroneous benefit payments which one field station had identified and initiated collection action. These erroneous payments, which involved cases under VA's service-connected disability and service-connected death compensation programs, totaled \$160,563. The two largest payments were \$44,456 and \$54,800. Of the total, \$135,817 has not been recovered by VA. In all six cases, VA did not have timely knowledge of the benefit recipient's death. This resulted in the benefit payments being continued for various periods—5 years after the death of the benefit recipients in two cases and 7 years in one case.

Another recent GAO report discusses this matter in greater detail.<sup>3</sup> In general, this report showed (1) the feasibility of VA obtaining SSA death information and the potential for utilizing the information to prevent the continuing payment of erroneous benefit payments after the death of the benefit recipient, (2) the potential total annual erroneous payments to be an estimated \$5.7 million, and (3) GAO's recommendation to resolve the problem. Accordingly, we are not making any recommendations with respect to this weakness in this report.

## Weak Controls Impede Recovering Erroneous Benefit Payments

VA's centralized accounts receivable division (CARD) has responsibility for collecting compensation and pension accounts receivable representing erroneous benefit payments made after the death of the recipient. The division does not have effective procedures to ensure recovery of such payments made by the U.S. Treasury through checks or the electronic

<sup>3</sup>Veterans' Benefits: VA Needs Death Information From Social Security to Avoid Erroneous Payments (GAO/HRD-90-110, July 27, 1990).

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transfer of funds to financial institutions for deceased recipient accounts.

Financial institutions (such as banks) are liable<sup>4</sup> for all of the payments by electronic transfer that are made after the death of the recipient of a federal government benefit. To recover such payments, the U.S. Treasury (after being notified of erroneous payments by the applicable program agency) sends a Notice of Reclamation (form TFS 133) to the respective financial institutions requesting return of the outstanding amount.<sup>5</sup> This action may result in full, partial, or no recovery. If the financial institution does not return the full amount of the outstanding balance, the institution is required to identify for the Veterans Administration the names and addresses of individuals who withdraw from the account after the benefit recipient's death.

The federal program agency is responsible for attempting the collection of any outstanding amount from the withdrawer. If the program agency is unsuccessful, the U.S. Treasury may recover the remaining amount by debiting the financial institution's federal reserve account.<sup>6</sup>

Our test of accounts receivable at the end of fiscal year 1989 and subsequent inquiries with CARD officials indicate that CARD does not have effective procedures to

- initiate initial recovery efforts against financial institutions and
- take follow-up action for recovery from financial institutions where CARD attempts to collect the payments from persons who have drawn down the deceased recipient's account have been unsuccessful.

As a result of centralizing this function at CARD, the division has experienced problems because it lacks current policy and procedural guidance. VA's central office is aware of the problems and is in the process of developing guidance. In addition, approximately 15,000 current accounts are being reviewed to determine the status of any amounts owed VA, collection efforts taken to date, and the need for any follow-up efforts. VA estimates the value of these accounts to be about \$3 million.

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<sup>4</sup>31 C.F.R. 210.12 [54 Fed. Reg. 50,618 (1989)].

<sup>5</sup>The sum of all payments received after death or legal incapacity, minus any amount returned to, or recovered by, the government.

<sup>6</sup>The financial institution can limit its liability if it did not know about the death when the payments were deposited.

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## Conclusions

VA continues to experience problems with inconsistent adherence to management capitalization and depreciation policies. VA has also continued to capitalize equipment items that do not meet management capitalization policies. These problems have led to inaccurate reporting of the value of VA's equipment and property. VA has also continued to experience weaknesses in its controls over computer software maintenance, data integrity, and test contingency plans at its data processing centers. Finally, VA lacks sufficient internal control policy and procedural guidance to identify and collect erroneous benefit payments made to deceased veterans. As a result, an estimated \$3 million in erroneous benefit payments may have been outstanding at the end of fiscal year 1989.

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## Recommendations

We recommend that the Secretary of Veterans Affairs direct the

- Assistant Secretary for Finance and Planning to revise existing internal control and accounting policies and procedures for VA's property, equipment, and related depreciation to meet the requirements of generally accepted accounting principles;
- Assistant Secretaries for Finance and Planning and Acquisition and Facilities to jointly develop policies and procedures for properly recording and reporting transactions affecting the capitalization of VA's construction and maintenance and repair projects to be followed at VA's Finance Center as well as at all field engineering stations;
- Assistant Secretaries for Finance and Planning and for Acquisition and Facilities to jointly establish policies and procedures to (1) remove all equipment items from the equipment system data base that do not meet VA's capitalization threshold, (2) distinguish the capitalized equipment from non-capitalized equipment for accounting purposes, (3) reconcile and make necessary adjustment for the capitalized equipment component of the equipment property system to agree with the general ledger control account balance, and (4) determine an appropriate method for maintaining the general control account and the subsidiary system in balance;
- Assistant Secretary for Information Resources Management and the Chief Benefits Director to jointly revise existing automated data processing internal control policy and procedures to ensure that each of VA's three data processing centers provide for (1) independent testing of all software program code changes, (2) limiting programmers' access to systems' operating programs and production programs and data files to that which is necessary to carry out their job requirements, and (3) a documented and operationally-tested contingency plan; and

- 
- Assistant Secretary for Finance and Planning and the Chief Benefits Director to jointly issue policy and procedural guidance to ensure the prompt identification and recovery of all erroneous benefit payments.

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## **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.

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## **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 recommendations. In addition, VA officials advised us of corrective actions they plan to implement relative to our recommendations in fiscal years 1991 and 1992. We believe VA's planned actions, if successfully implemented, will address the identified problems.

# Report on Compliance With Laws and Regulations

We have audited the consolidated financial statements of the Department of Veterans Affairs for the fiscal years ended September 30, 1989 and 1988, 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, 1989. Our report on compliance with laws and regulations for the year ended September 30, 1988, is presented in GAO/AFMD-89-69, dated September 15, 1989.

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. 5322) 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 relating 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. The results of our tests for fiscal year 1989 indicate that, for the items tested, VA complied with those provisions of laws and regulations which could have a material effect on the financial



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**Appendix III  
Report on Compliance With Laws  
and Regulations**

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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.

# Financial Statements

## Consolidated Statements of Financial Position

As Of September 30, 1989 AND 1988  
(Dollars in Thousands)

	1989	(Restated) 1988
<b>ASSETS:</b>		
Cash with U.S. Treasury and on hand	\$ 4,944,590	\$ 5,386,884
Advances, Accounts, and Loans Receivable, net (note 8)	3,030,615	3,094,018
Investments (note 7)	13,150,114	12,651,054
Foreclosed Property Held for Sale	679,343	818,833
Land, Buildings, and Equipment Net of Accumulated Depreciation (note 9)	8,396,514	7,729,963
Other Assets	154,557	158,865
Future Financing Sources (note 1)	\$ 4,795,035	\$ 5,812,540
<b>TOTAL ASSETS</b>	<b>\$35,150,768</b>	<b>\$35,652,157</b>
<b>LIABILITIES, TRUST FUND BALANCES, AND EQUITY:</b>		
Accounts Payable, Principally to the Public	\$ 1,124,236	\$ 1,099,294
Accrued Compensation and Pension Benefits	56,700	724,086
Accrued Payroll and Payroll Related Liabilities	1,171,729	1,102,511
Dividends on Credit or Deposit (note 6)	867,393	785,238
Insurance Dividends Payable (note 6)	1,030,883	997,184
Other Liabilities	375,214	346,127
Liability for Federal Employee Compensation Act (note 1)	1,211,088	1,024,309
Liability for Losses on Guaranteed Loans (note 5)	2,872,857	3,663,488
Insurance Policy Reserves (note 6)	9,111,844	8,890,318
Reserve for Participating Policyholders Interest	3,069,419	3,128,559
Borrowings from Treasury	1,730,078	1,730,078
<b>TOTAL LIABILITIES</b>	<b>22,421,441</b>	<b>23,491,192</b>
<b>TRUST FUND BALANCES</b>	<b>671,870</b>	<b>746,443</b>
<b>EQUITY OF THE U.S. GOVERNMENT:</b>		
Unrealized Appropriations:		
Invested Capital	8,593,501	8,111,422
Deferred Appropriations	263,850	275,763
Unobligated Balances	1,210,631	1,210,724
Undelivered Orders	1,999,475	1,816,613
<b>TOTAL EQUITY OF THE U. S. GOVERNMENT</b>	<b>12,057,457</b>	<b>11,414,522</b>
<b>TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY</b>	<b>\$35,150,768</b>	<b>\$35,652,157</b>

The accompanying notes are an integral part of these statements. Supplemental schedules include financial information by major program area.

**Appendix IV  
Financial Statements**

**Consolidated Statements of Operations**

**For Fiscal Years 1989 AND 1988  
(Dollars in Thousands)**

	1989	(Restated) 1988
<b>OPERATING EXPENSES AND INSURANCE PROVISIONS:</b>		
Operating Expenses by Category:		
Personnel Compensation and Fringe Benefits	\$ 7,901,100	\$ 7,515,281
Veterans Benefits	16,244,282	15,939,277
Claims and Indemnities	1,290,059	3,276,447
Depreciation	687,344	412,099
Supplies and Materials	1,820,715	1,655,902
Contractual Services	1,447,612	1,472,964
Rent, Communications, and Utilities	569,723	532,269
Other	157,130	88,350
<b>Total Operating Expenses</b>	<b>30,117,965</b>	<b>30,892,589</b>
Insurance Provisions		
Dividends to Policyholders	991,022	952,507
Servicemen's Group Life Insurance Reserves	13,761	3,416
<b>Total Insurance Provisions</b>	<b>1,004,783</b>	<b>955,923</b>
	<b>\$31,122,748</b>	<b>\$31,848,512</b>
<b>OPERATING REVENUE AND FINANCING SOURCES:</b>		
Operating Revenues:		
Premium Income	\$ 871,235	\$ 873,912
Interest Income	1,439,742	1,397,700
Loan Origination fees	141,057	135,118
Reimbursements and Other	599,449	545,242
<b>Total Operating Revenue</b>	<b>3,051,483</b>	<b>2,951,972</b>
Financing by Source:		
Appropriations and Financing Sources Realized	28,905,979	27,425,521
Funds to be Provided by Future Financing Sources	(1,017,507)	1,196,272
Transfers, Reimbursements, and Other	182,793	274,747
<b>Total Financing Sources</b>	<b>28,071,265</b>	<b>28,896,540</b>
	<b>\$31,122,748</b>	<b>\$31,848,512</b>

The accompanying notes are an integral part of this statement. Supplemental schedules include financial information by major program area.

**Appendix IV  
Financial Statements**

**Consolidated Statements of Changes in Financial Position and Reconciliation to Budget**

**For Fiscal Years 1989 AND 1988  
(Dollars In Thousands)**

	1989	(Restated) 1988
<b>NET USE OF RESOURCES:</b>		
Operating Expenses	\$30,117,965	\$30,892,589
Items Requiring (Providing) Funds:		
Decrease (Increase) in Future Liability Provisions (Note 1)	582,326	(1,336,772)
Depreciation	(687,344)	(412,099)
Decrease in Accounts Receivable	(208,312)	(91,713)
Decrease in Accounts Payable and Accruals	509,010	186,200
Revenues Accounted for as		
Offsetting Collections	(2,155,413)	(2,141,152)
Funds Used By Operations	28,158,232	27,097,053
Non-Operating Uses:		
Dividends (note 6)	991,022	952,507
Acquisitions of Land, Buildings, and Equipment	1,154,466	1,090,664
Purchase of Foreclosed Property Held for Sale	1,483,189	1,630,545
Issuance and Repurchase of Loans and Liens	1,184,918	1,174,472
Other, Net	(50,312)	(23,441)
Financing Activities:		
Sale of Foreclosed Property Held for Sale	(1,714,851)	(1,661,608)
Sale of Loans, without Recourse	(433,331)	(296,683)
Loan/Lien Repayments/Optional Income Settlements	(302,383)	(353,607)
Revenues Collected for Treasury	(430,269)	(338,924)
<b>NET USE OF BUDGETARY RESOURCES (OUTLAYS)</b>	<b>30,040,681</b>	<b>29,270,978</b>
<b>SOURCES OF BUDGETARY RESOURCES PROVIDED</b>		
Current Year Appropriation, Adjusted	29,260,543	28,363,176
Contract Authority and Reappropriation	84,343	(121,192)
Proceeds of Loan Sales With Recourse		389,259
Interest on Government Securities	1,033,241	998,165
Net Transfers, Reimbursements, and Other	(238,492)	(382,838)
Funds Returned to Treasury	(208,040)	(183,882)
<b>TOTAL RESOURCES PROVIDED</b>	<b>29,931,595</b>	<b>29,062,688</b>
<b>DECREASE IN U.S. TREASURY AND IMPREST FUNDS</b>	<b>(109,086)</b>	<b>(208,290)</b>
Funds Exchanged for U.S. Government Securities	(333,208)	(411,469)
<b>NET DECREASE IN U.S. TREASURY AND IMPREST FUNDS</b>	<b>(442,294)</b>	<b>(619,759)</b>
<b>U.S. TREASURY AND IMPREST FUNDS:</b>		
Beginning of Year	5,386,884	6,006,643
End of Year	\$4,944,590	\$5,386,884

*The accompanying notes are an integral part of this statement. Supplemental schedules include financial information by major program area.*

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 Department of Veterans Affairs 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; 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 VA is responsible and present 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; however, for financial reporting purposes under accrual accounting, operating expenses are recognized currently, while expenditures for capital and other long-term assets are capitalized and not recognized as expenses until they are consumed in VA's operations. Financing sources for these expenses, which derive from both 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, 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 that year's accrued amount of such expenses. The cumulative amount of these accruals is reflected in 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, primarily accrued payroll and related liabilities and liabilities for federal employees compensation act and losses on guaranteed loans.

### Operating Revenue And Other Financing Sources Recognition

Interest income, which is earned primarily from the investments of VA's life insurance program, is recognized on the accrual basis. Insurance premiums are recognized as revenue when due. Loan origination fees, which during fiscal year (FY) 1989 were charged to veterans at a rate of one percent of the loan principal, were recognized as revenues at the time of the guaranty.

### Cash With the Department of the Treasury And On Hand

VA does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the Department of the Treasury. The balance in the Treasury represents the right to draw on the Treasury for allowable expenditures. Cash advanced to imprest fund cashiers totaled \$8.8 million as of September 30, 1989, and \$9.0 million as of September 30, 1988.

### 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 \$1,999,475,000 and \$1,816,613,000 as of September 30, 1989, and September 30, 1988, respectively. Of these amounts, \$943,535,000 in FY 1989, and \$1,011,475,000 in FY 1988 related to construction projects of both long- and short-term duration. The remainder was principally comprised of obligations for medical supplies and equipment that 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.

### Accrued Compensation and Pension Benefits

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

### Losses on Guaranteed Loans

Upon foreclosure of a guaranteed loan, VA may be required to pay the maximum claim, acquire the property, or acquire the property and pay less than the maximum claim pursuant to criteria established in title 38, U.S.C. S. 1816. Thus, when VA acquires the property, the cost is comprised of the claimed amount paid the lender less net proceeds from the sale of the property. VA incurs an additional cost for direct home (vendee) loans, issued upon the sale of foreclosed properties that subsequently default.

Estimated losses on anticipated defaults of guaranteed loans are recorded as expenses when the loans are guaranteed. 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 to (1) direct home loans receivable when such loans are issued (see Note 8); (2) foreclosed property held for sale when property is acquired, in order to record such property at its net realizable value; and (3) investments in subordinate securities to reflect the estimated loss of principal for the securities due to their subservient position. The remainder of the provision for loan losses is classified as a liability for future loan losses.

### Annual, Sick, and Other Types of Leave

Annual leave is accrued 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 experience-based estimates of claims incurred but not reported, and for incurred death and permanent disability installment claims. These liabilities are included in Accounts Payable.

### Dividends Payable

Dividends from VA's insurance programs are recorded as a liability when declared by the Secretary 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, Servicemen's Group Life Insurance (SGLI) Trust Fund, and the General Post Fund. These funds are accounted for separately and can be used only for specified purposes. Since they are not available to fund general purpose governmental activities they 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 benefit overpayment accounts receivable for which outlay authority is not available until collection.

### Workers Compensation

Legal actions brought by employees of 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 DOL claims are paid; however, payment on these bills is deferred two years to allow for funding through the budget process. Using actuarial estimates provided by the DOL, VA has recorded FECA liabilities for balances billed to VA by DOL and for estimates 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

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 VA, as if VA were a stand-alone entity.



**Appendix IV  
Financial Statements**

- o VA's consolidated financial statements are not intended to report the Department's proportionate share of the Federal deficit or of public borrowing, including interest thereon. Financing for budget appropriations reported on 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 VA.
- o Financing for major and minor construction projects was obtained through budget appropriations. To the extent that this financing was derived from public borrowing, no interest has been capitalized because such borrowings are recorded in total by the Department of the Treasury and are not allocated to individual Departments and Agencies.
- o Since the Department of the Treasury 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 FY 1989, VA held foreclosed properties for an estimated average of 6.5 months. Based on this estimate and the average interest rate for the public debt (9.0 percent), the holding costs associated with the foreclosed property held for sale were approximately \$59 million in FY 1989.
- o VA's Housing Credit Assistance program has a liability of \$1.7 billion to the Department of the Treasury. 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. Legislation has been proposed in the "Department of Veterans Affairs FY 1991 Budget Submission" consisting of a technical amendment to waive this liability.
- o During FY 1989, many of VA's employees continued to participate in the contributory Civil Service Retirement System (CSRS), to which VA makes matching contributions; however, VA does not report CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees because this data in total is reported only by the Office of Personnel Management.
- o On January 1, 1987, the new Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Employees hired after December 31, 1983, are automatically covered by FERS, while employees hired prior to December 31, 1983 may elect to either join FERS or remain in CSRS. One of the primary differences between FERS and CSRS is that FERS offers a savings plan to which VA will automatically contribute one percent of basic pay, as well as, match employee contributions up to an additional four percent of basic pay.

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

Appendix IV  
Financial Statements

VA's total contributions for CSRS and FERS participants, including contributions to the Social Security Administration, during FY 1989 and FY 1988 were as follows:

	1989	1988
CSRS	\$266,504,389	\$274,869,684
FERS	284,554,646	227,139,124
FICA	142,646,157	120,831,572
Total VA contributions	<u>\$693,705,192</u>	<u>\$622,840,380</u>

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.

- o Certain legal matters to which VA may be a named party are administered and, in some instances, litigated and paid by other Federal agencies. These primarily relate to allegations of medical malpractice but also include other tort claims and contract disputes. Generally, amounts (more than \$2,500 for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award pertaining to these litigations are funded from a special appropriation called the Judgment Fund, which is maintained on deposit with the Department of the Treasury. Since VA, except for contract dispute payments, is not required to reimburse the Judgment Fund for payments made on VA's behalf, 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 \$42 million and \$35 million in FY 1989 and FY 1988, respectively. Amounts requiring reimbursements to the Judgment Fund by VA for contract dispute payments were \$6.1 million and \$.8 million in FY 1989 and FY 1988, respectively.

### NOTE 3: RESTATEMENT OF FISCAL YEAR 1988 STATEMENTS

The FY 1988 consolidated statement of financial position and consolidated statement of operations and changes in financial position and reconciliation to budget have been restated to present VA Life Insurance Reserves on a Generally Accepted Accounting Principles (GAAP) basis. These reserves had been presented on a statutory basis. The principal change was to introduce a new liability entitled Participating Policyholders Interest. (See Note 6 for a complete explanation of this change.)

### NOTE 4: FUTURE LIABILITY FOR COMPENSATION AND PENSIONS

Veterans or their dependents receive compensation benefits if the veteran was disabled or died from military service-connected cause. 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.

**Appendix IV  
Financial Statements**

The compensation and pension benefits for FY 1989 and FY 1988 were:

<u>Fiscal Year</u>	<u>Compensation</u>	<u>Pension</u>
1989	\$11,210,351,000	\$3,845,134,000
1988	\$10,864,549,000	\$3,826,974,000

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 9.0 percent discount rate, of projected annual benefit payments. Projected benefit payments were based on assumed cost of living increases ranging from 3.6 percent to 4.7 percent for 1990-1994 and 3.3 percent to 4.0 percent for succeeding years. In addition, the mortality and accession rates used in calculations were based on trends in the current veteran population.

Since calculation was not based on an independent actuarial study, there exists 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 succeeding fiscal years are as follows (dollars in thousands):

1990	\$ 14,021,180
1991	12,652,843
1992	11,450,555
1993	10,383,477
1994	9,462,396
1995 and succeeding	77,276,309
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Total	<u>\$135,246,760</u>

No liability for future compensation and pension benefits has been included in the Consolidated Statement of Financial Position.

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

Residential loans guaranteed by VA are originated by private lenders and are not recorded in the financial statements of VA. The face amount of such loans outstanding as of September 30, 1989 and September 30, 1988 was \$152 billion and \$150 billion, respectively, and the guaranteed amount of outstanding loans as of both September 30, 1989 and September 30, 1988 was approximately \$60 billion. The guaranty, in effect, transfers some or all of the risk of default from the lender to VA. At the time of default, VA has the option to either pay the guarantee amount or pay a reduced amount and acquire the property from the lender. VA assumes this risk to provide a benefit to the veteran who obtains a mortgage with interest rates that are usually lower than conventional mortgage rates and with no downpayment.

Vendee and Direct Loans

The total amounts of vendee loans and loans of the direct loan program as of September 30, 1989 and 1988, (dollars in thousands) are:

	<u>1989</u>	<u>1988</u>
Vendee loans	\$1,177,452	\$1,056,100
Direct loans	<u>60,343</u>	<u>77,372</u>
	<u>\$1,237,795</u>	<u>\$1,133,472</u>

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.

**Appendix IV  
Financial Statements**

The provision for losses on guaranteed loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The provision calculation is also based on the use of the average interest rate of the U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding guaranteed loans will default over a twelve-year period as follows (dollars in thousands):

1990	\$ 837,065
1991	639,024
1992	485,247
1993	351,027
1994	251,600
1995 and succeeding	<u>416,291</u>
	<u>\$2,980,254</u>

The discount rate used in the computation was 8.9 percent for FY 1989 and 8.8 percent for FY 1988.

The components of the provisions are as follows (dollars in thousands):

	<u>Year ended September 30,</u>	
	<u>1989</u>	<u>1988</u>
Offsets against loans receivable	\$ 116,352	\$ 156,077
Offsets against foreclosed property held for sale	100,407	144,081
Offset against investments	90,638	45,824
Liability for losses on guaranteed loans	<u>2,672,857</u>	<u>3,663,488</u>
	<u>\$2,980,254</u>	<u>\$4,009,470</u>

### 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 12 years, because those requests will also include anticipated inflows and outflows of resources for nonoperating use such as for transfer, purchase and sale of properties, and issuance and repayment of loans, sale of loans, and the receipt of the one percent funding fee.

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

**Appendix IV  
Financial Statements**

**Recourse loan sales**

During FY 1988, VA sold approximately \$379 million in loans with recourse marketing agreements for \$365 million. Under the terms of the agreements, VA will repurchase the loans sold if default occurs. Any losses from defaults of repurchased loans are borne by VA, which has estimated the potential loss on the amount of such loans outstanding and has recorded this loss as a component of the provisions for loan losses at approximately \$568 million and \$647 million as of September 30, 1989 and September 30, 1988, respectively. There were no recourse loan sales during FY 1989.

**Non-recourse loan sales**

During FY 1989 and FY 1988, VA conducted five nonrecourse loan sales. The components of the sales are summarized as follows (dollars in thousands):

	-----FY 1988-----		-----FY 1989-----			
	American Housing Trust I	American Housing Trust II	American Housing Trust III	American Trust Trust IV	Whole Loans	Total
Loans receivable sold	\$308,937	\$234,346	\$278,103	\$364,670	\$58,134	\$1,244,190
Proceeds from Sale:						
Cash*	185,557	134,284	171,165	236,208	49,432	776,646
Investment in subordinated certificates of securities	<u>105,059</u>	<u>91,391</u>	<u>94,557</u>	<u>116,695</u>	<u>0</u>	<u>407,702</u>
	<u>290,616</u>	<u>225,675</u>	<u>265,722</u>	<u>352,903</u>	<u>49,432</u>	<u>\$1,184,348</u>
Loss on loans receivable sold	<u>\$ 18,321</u>	<u>\$ 8,671</u>	<u>\$ 12,381</u>	<u>\$ 11,767</u>	<u>\$ 8,702</u>	<u>\$ 59,842</u>

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

### American Housing Trust I

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

### American Housing Trust II

On September 23, 1988, VA completed its second sale of nonrecourse loans to the American Housing Trust (AHT II). Under the terms of the sale, VA sold approximately \$234 million of its vendee loans to AHT II, which in turn, sold the loans as mortgage pass-through certificates. The mortgage pass-through certificates consisted of two senior classes of certificates that were offered to the public and subordinate certificates that were assigned to 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. Principal and interest payments on the senior certificates are guaranteed by the American Loan Guarantee Association. Under the securities structure, principal and interest payments to VA are subordinate payments to to the senior certificate holders.

### American Housing Trust III

On February 23, 1989, VA completed its third sale of non-recourse loans to the American Housing Trust (AHT III). Under the terms of the sale, VA sold approximately \$278 million of its vendee loans to AHT III, which in turn, sold the loans as mortgage pass-through certificates. The mortgage pass-through certificates consisted of four senior classes of certificates that were offered to the public and subordinated certificates that were assigned to VA as partial proceeds from the sale of the loans.

The face value of the subordinate certificates at the time of sale was approximately \$95 million. Principal and interest payments on the senior certificates are guaranteed by the American Loan Guarantee Association. Under the securities structure, principal and interest payments to VA are subordinate payments to to the senior certificate holders.

### American Housing Trust IV

On August 24, 1989, VA completed its fourth sale of nonrecourse loans to the American Housing Trust (AHT IV). Under the terms of the sale, VA sold approximately \$364 million of its vendee loans to AHT IV, which in turn, sold the loans as mortgage pass-through certificates. The mortgage pass-through certificates consisted of three classes of certificates that were offered to the public and subordinated certificates that were assigned to VA as partial proceeds from the sale of the loans.

The face value of the subordinate certificates at the time of sale was approximately \$117 million. Principal and interest payments on the senior certificates are guaranteed by the American Loan Guarantee Association. Under the securities structure, principal and interest payments to VA are subordinate payments to the senior certificate holders.

### Whole Loans

On March 23, 1989, VA sold more than \$58 million in seasoned vendee loans without recourse.

### Offset For Losses on investments

As of September 30, 1989, and September 30, 1988, an allowance has been recorded to reflect the estimated loss of principal as a result of the subordinated position. The estimated allowance computation was based upon historical loan defaults. The net investment balances are as follows:

	As of September 30, 1989				
	American Housing Trust I	American Housing Trust II	American Housing Trust III	American Trust Trust IV	Total
Investment in subordinated certificates of securities	\$104,887	\$91,391	\$94,557	\$116,695	\$407,530
Allocation of loss provision	<u>24,473</u>	<u>17,221</u>	<u>21,753</u>	<u>27,191</u>	<u>90,638</u>
Net investment	<u>\$ 80,414</u>	<u>\$74,170</u>	<u>\$72,804</u>	<u>\$ 89,504</u>	<u>\$316,892</u>



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	<u>American Housing Trust I</u>	<u>American Housing Trust II</u>	<u>Total</u>
Investment in subordinated certificates of securities	\$105,059	\$91,391	\$196,450
Allocation of loss provision	<u>18,788</u>	<u>27,036</u>	<u>45,824</u>
Net investment	<u>\$ 86,271</u>	<u>\$64,355</u>	<u>\$150,626</u>

The investments are carried at cost, adjusted for the estimated foreclosures, because 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 (dollars in thousands):

	<u>As of September 30,</u>	
	<u>1989</u>	<u>1988</u>
Foreclosed property held for sale	\$779,750	\$962,914
Allocation of loss provision	<u>100,407</u>	<u>144,081</u>
Net	<u>\$679,343</u>	<u>\$818,833</u>

**Guarantee Commitments**

AS of September 30, 1988, VA had outstanding commitments to guarantee loans which will originate in FY 1990. The number of commitments could not be determined, as VA has granted authority to various lenders to originate VA loans that meet established criteria without prior VA approval.

## Participation Certificates

During FY 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).

Over the life of FAFT, VA transferred interest payments to GNMA for coverage of the periodic interest payments on the PCs. GNMA invested funds not needed to meet current interest payments on behalf of VA. When the final series matured in August 1988, VA received \$165 million from GNMA as VA's share of interest income to the investment.

## SUBSEQUENT EVENT - GUARANTY AND INDEMNITY FUND

On December 18, 1989, legislation was enacted (Public Law 101-237) which established a new fund (the Guaranty and Indemnity Fund) to finance the operation of VA's loan guaranty program for loans made on or after January 1, 1990, except manufactured (mobile) home loans and most administrative costs of operating the program. This legislation, which, among other things, also increased the required loan origination fee in cases where there is no downpayment on a loan and decreased the fee for guaranteed loans with a downpayment, will change the operating results and cash flow requirements of not only the direct and loan guaranty funds but also the overall loan guaranty program. This legislation will not change the unfunded loss (about \$2.7 billion) incurred on the outstanding direct and guaranteed loans as of September 30, 1989.

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**NOTE 6: INSURANCE PROGRAMS**

VA administers the following life insurance programs that 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, 1989 and 1988

<u>Program</u>	<u>Number of policies</u> (thousands)		<u>Amount of insurance</u> (millions)		<u>Principal veterans group covered</u>
	<u>1989</u>	<u>1988</u>	<u>1989</u>	<u>1988</u>	
NSLI	2,737	2,824	\$21,025	\$21,317	WW II
USGLI	43	48	159	178	WW I
VSLI	306	327	2,839	2,989	KOREA
VRI	124	127	847	869	WW II/KOREA
SDVI	173	176	1,572	1,599	WW II/KOREA/ VIETNAM
<b>TOTAL</b>	<b><u>3,383</u></b>	<b><u>3,502</u></b>	<b><u>\$26,442</u></b>	<b><u>\$26,952</u></b>	

**Insurance Reserves**

In FY 1989, VA adopted the policy of presenting insurance reserves in the financial statements in accordance with generally accepted accounting principles (GAAP) for the federal sector (GAO Policy and Procedures Manual for Guidance of Federal Agencies: Title 2). The FY 1988 financial statements have been restated to make the change retroactive to that year. Prior to this change, the insurance reserves as reflected in the financial statements were based on assumptions prescribed by Federal statute. Thus, the reserves as presented in FY 1988 and earlier statements were based on statutory standards and were called "statutory insurance reserves."

Insurance reserves for NSLI, USGLI, VSLI, VRI, and SDVI are designed to earmark funds that will be required to pay guaranteed policy benefits over future premiums and investment income. The reserves are based on an actuarial computation of the present value of amounts that will be required to pay the guaranteed policy benefits. The two most important factors used to compute these reserves are assumed investment yields and mortality rates. Under statutory standards, which are oriented toward solvency considerations, these factors are generally very conservative, thereby resulting in a higher reserve requirement and smaller profits for distribution to owners or, in VA's case, policyholders prior to claims for the guaranteed policy benefits. For VA's insurance programs, these factors are prescribed by Federal statutes and VA will therefore continue utilizing the statutory determined reserves for policyholder dividend considerations.

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GAAP-determined reserves are oriented toward allocation of revenues, costs, and expenses and are computed based on recent mortality experience and interest assumptions. For VA's GAAP insurance reserves, interest rate assumptions ranged from 7.0 percent to 8.5 percent; these percentages are expected to hold true for at least the next 10 years. The GAAP mortality assumptions are based on actual mortality experience of VA's insurance programs, with a provision for adverse deviation. The statutory required interest rates range from 2.3 percent to 4.5 percent, while the statutory mortality assumptions include the American Experience Table, the 1941 Commissioner's Standard Ordinary (CSO) Table, and the 1958 CSO Basic Table. (Actual average investment yield for VA's insurance program securities was 9.69 percent as of September 30, 1989, and 9.67 percent as of September 30, 1988.) As a result of these differences, the insurance policy reserves under GAAP are lower than insurance policy reserves computed with statutory assumptions. The difference in the GAAP insurance reserves and statutory reserves for VA's whole life policies with participating rights (NSLI, USGLI, VSLI, and VRI) represents future benefits (dividends) that inure to program participants based on statutory requirements and practices. This difference is called Participating Policyholders' Interest in Accumulated Participating Earnings, commonly referred to as Participating Policyholders' Interest. Since the difference will inure to policyholders, it is presented in the liability section of the Consolidated Statement of Financial Position as a liability to participating policyholders.

The GAAP insurance reserve balances as of September 30, 1989, are shown below (dollars in thousands):

<u>Program</u>	<u>Death Benefits</u>	<u>Death Benefit Annuities</u>	<u>Disability Income and Waiver of Premium</u>	<u>Other</u>	<u>GAAP Reserve Total</u>
NSLI	\$6,207,685	\$409,994	\$784,965	\$176,144	\$7,578,788
USGLI	92,449	25,963	1,678	981	121,071
VSLI	578,620	3,132	114,546	3,914	700,212
SDVI	273,593	1,486	129,038		404,117
VRI	280,033	1,247	26,376		307,656
<b>TOTAL</b>	<b>\$7,432,380</b>	<b>\$441,822</b>	<b>\$1,056,603</b>	<b>\$181,039</b>	<b>\$9,111,844</b>

The GAAP insurance reserve balances as of September 30, 1988, are shown below (dollars in thousands):

<u>Program</u>	<u>Death Benefits</u>	<u>Death Benefit Annuities</u>	<u>Disability Income and Waiver of Premium</u>	<u>Other</u>	<u>GAAP Reserve Total</u>
NSLI	\$5,915,734	\$432,333	\$836,172	\$190,874	\$7,375,113
USGLI	103,629	28,697	2,234	1,090	135,650
VSLI	534,224	3,484	119,481	3,362	660,551
SDVI	266,395	2,294	148,269		416,958
VRI	273,744	1,289	27,013		302,046
<b>TOTAL</b>	<b>\$7,093,726</b>	<b>\$468,097</b>	<b>\$1,133,169</b>	<b>\$195,326</b>	<b>\$8,890,318</b>

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The Participating Policyholders' Interest as of September 30, 1989, and September 30, 1988, in the five insurance programs are shown below (dollars in thousands):

Participating Policyholders' Interest

<u>Program</u>	<u>9/30/89</u>	<u>9/30/88</u>
NSLI	\$2,445,533	\$2,504,541
USGLI	42,743	46,896
VSLI	424,482	416,462
SDVI		
VRI	156,661	160,660
<b>TOTAL</b>	<b><u>\$3,069,419</u></b>	<b><u>\$3,128,559</u></b>

The statutory insurance reserve balances as of September 30, 1989, are shown below (dollars in thousands):

<u>Program</u>	<u>Death Benefits</u>	<u>Death Benefit Annuities</u>	<u>Disability Income and Waiver of Premium</u>	<u>Other</u>	<u>Statutory Reserve Total</u>
NSLI	\$8,527,424	\$409,994	\$784,965	\$176,144	\$9,898,527
USGLI	130,221	25,963	1,678	981	158,843
VSLI	954,650	3,132	114,546	3,914	1,076,242
SDVI	273,593	1,486	129,038		404,117
VRI	414,573	1,247	26,376		442,196
<b>TOTAL</b>	<b><u>\$10,300,461</u></b>	<b><u>\$441,822</u></b>	<b><u>\$1,056,603</u></b>	<b><u>\$181,039</u></b>	<b><u>\$11,979,925</u></b>

The statutory insurance reserve balances as of September 30, 1988, are shown below (dollars in thousands):

<u>Program</u>	<u>Death Benefits</u>	<u>Death Benefit Annuities</u>	<u>Disability Income and Waiver of Premium</u>	<u>Other</u>	<u>Statutory Reserve Total</u>
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
<b>TOTAL</b>	<b><u>\$10,042,392</u></b>	<b><u>\$468,097</u></b>	<b><u>\$1,133,169</u></b>	<b><u>\$195,326</u></b>	<b><u>\$11,838,984</u></b>

Operating expenses as reflected in the Schedule of Expenses, Dividends, Revenues, and Financing Sources are also affected by the use of GAAP rather than statutory principles. Under GAAP, the operating expenses were \$103 million higher in FY 1989, and \$104 million higher in FY 1988.

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Certain premium items are also accounted for differently under GAAP than under statutory principles. Specifically, the liability for unearned advance premiums and the receivable that is set up for uncollected premiums are all lower under GAAP principles.

### Policy Dividends

The Secretary of Veterans Affairs 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 their dividends 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 Consolidated Statement of Financial Position represents the amount of dividends potentially payable in the next twelve months. Dividends shown in the Consolidated Statement of Changes in Financial Position and Reconciliation to Budget represents the amount of dividends paid in the last twelve months. Dividends to policyholders shown in the Consolidated Statement of Operations represents the amount of dividends paid in the preceding twelve months plus the change in the SGLI trust fund balance.

A provision for dividends is charged to operations and an insurance dividend payable is established when gains to operations exceed those necessary to maintain the solvency of the insurance programs. These excess earnings are distributed to policyholders in the form of dividends. During FY 1989 and FY 1988, total dividends declared for all insurance programs amounted to \$1,004,930 and \$960,600, respectively.

Dividends paid during FY 1989 and FY 1988 were as follows (dollars in thousands):

<u>Program</u>	<u>Dividends Paid</u>	
	<u>1989</u>	<u>1988</u>
NSLI	\$855,243	\$823,485
USGLI	11,133	12,132
VSLI	91,906	83,769
VRI	<u>32,740</u>	<u>33,121</u>
TOTAL	<u>\$991,022</u>	<u>\$952,507</u>

The payment of termination dividends in the VRI program began in 1985 to ensure that those whose insurance was terminating receive an equitable share of surplus. Termination dividends are included in the above figures and amount to approximately \$250,000 paid in FY 1989 and \$250,000 paid in FY 1988.

### 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 paid-up insurance at a reduced amount.

### Group Life Insurance Programs

VA supervises the administration of the Servicemen's Group Life Insurance (SGLI) and Veterans Group Life Insurance (VGLI) programs and directly administers the Veterans' Mortgage Life Insurance (VMLI) program. SGLI is supervised by VA but directly administered by 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 Reserved Officer Training Corp.

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. VA also determines the adequacy of the SGLI insurance policy reserves maintained by Prudential. 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, 1989, had a balance a \$165.3 million. On September 30, 1988, this balance was \$151.5 million. This balance is used as a premium stabilization fund to augment premium payments remitted by the insureds.

SGLI Insurance In Force	<u>1989</u>	<u>1988</u>
Number of Policies	3,475,004	3,509,029
Amount (in millions)	\$172,855.9	\$174,537.1

VGLI provides 5-year term insurance to all servicemen separated from active duty, usually at the end of their 120-day free SGLI coverage. At the end of the term period of VGLI insurance, the veteran has the right to obtain an individual life insurance policy at a standard rate from any company participating in the SGLI program.

VGLI Insurance In Force	<u>1989</u>	<u>1988</u>
Number of Policies	298,552	282,195
Amount (in millions)	\$13,335.7	\$12,066.8

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The Veterans Mortgage Life Insurance (VMLI) program is administered directly by VA. Under this program, severely disabled veterans can obtain insurance coverage of up to \$40,000 on the outstanding balance of their home mortgage. Coverage ceases at age 70. Premiums are based on standard mortality tables and 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	<u>1989</u>	<u>1988</u>
Number of Policies	5,190	5,416
Amount (in millions)	\$171.1	\$185.5

**Insurance Administrative Expenses**

Except for the SGLI/VGLI and VRI programs, administrative costs are not charged to VA life insurance programs. Administrative costs charged to the SGLI/VGLI program were \$324,000 in 1989 and \$306,000 in 1988. Administrative costs charged to the VRI program were \$1,156,000 in 1989 and \$1,304,000 in 1988. Administrative costs for the other insurance programs (USGLI, NSLI, VSLI, SDVI) borne by VA appropriations totaled \$27,212,000 in 1989 and \$25,988,000 in 1988.

**NOTE 7: INVESTMENTS**

Insurance program investments, which comprise most of VA's investments, are in non-marketable U.S. Treasury special bonds and certificates. Interest rates for Treasury special securities are based on average market yields for similar Treasury issues. The special bonds, which mature during various years through the year 2002, 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. As of September 30, 1989, investment securities consist of the following (dollars in thousands):

<u>Security</u>	<u>Interest Range</u>	<u>Insurance Programs</u>	<u>Other Programs</u>	<u>Total</u>
Special Bonds	6.375-13.75%	\$12,764,482		\$12,764,482
Bonds	7.875-8.5%		\$ 2,251	2,251
Notes	6.75-14.25%		26,433	26,433
Treasury Bills	7.9-8.37%		40,000	40,000
Other	Various		316,948	316,948
		<u>\$12,764,482</u>	<u>\$385,632</u>	<u>\$13,150,114</u>



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As of September 30, 1988, investment securities consisted of the following (dollars in thousands):

<u>Security</u>	<u>Interest Range</u>	<u>Insurance Programs</u>	<u>Other Programs</u>	<u>Total</u>
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	8.375-14.625%		21,006	21,006
Treasury Bills	6.7-7.5%		32,000	32,000
Other	Various		150,682	150,682
		<u>\$12,445,115</u>	<u>\$205,939</u>	<u>\$12,651,054</u>

Other VA programs with investments are Housing Credit and Medical Programs. All Insurance and Medical program investments are in securities issued by the Department of the Treasury. Housing Credit program investments are in trust certificates that were issued by the American Housing Trust, a private entity not associated in any way with the Government.

**NOTE 8: RECEIVABLES**

**Accounts**

Non-Federal accounts receivable principally represent amounts due from individuals for Education Loan defaults, Compensation and Pension overpayments, and amounts due from third party insurers for health care of veterans. The latter totaled to \$176,758,000 and \$157,224,000 as of September 30, 1989, and September 30, 1988.

Federal accounts receivable are mostly accrued interest payments due on VA investments, from the Department of the Treasury.

Although VA is an active participant in Federal Debt Collection programs such as the IRS Income Tax Refund Offset, Federal Salary Offset, Litigation, Referral to Credit Reporting Agencies, and Referral to Private Collection Agencies, there are still a number of accounts where all possible collection actions will be unsuccessful. Based on VA's experience, an allowance for losses has been established at approximately 50 percent for outstanding Medical and Benefit Program debts from individuals and at 100 percent for Housing Credits debts reported for individuals.

**Advances**

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.

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**Loans**

Current loans receivable are amounts due under VA's Housing Credit Assistance Program, including Home Loan Guaranty and Direct Loan defaults, amounting to \$2,511,453,000 and \$1,971,100,000 as of September 30, 1989, and September 30, 1988, respectively. Allowances for loss on these loans receivable resulting from defaults were \$2,508,942,000 and \$1,969,072,000 as of September 30, 1989, and September 30, 1988, respectively. The remaining allowance for loss relates to active home loans and is based on the Provision for Losses computation (see Note 5 for a full disclosure of the Provision for losses computation).

Non-current loans receivable represent amounts due from loans and liens against VA-issued life insurance policies and also amounts owed to VA's Housing Credit Assistance Program beyond the next 12 months. Insurance policy loans do not have a fixed repayment schedule. Home loans have a firm repayment schedule over the life of the loans, which is generally 30 years; however, it is VA practice to sell these home loans rather than hold them to maturity. (See Note 5 for a complete explanation of VA's loan sales.)

Home loans authorized but not closed amounted to \$96,719,000 and \$138,239,000 as of September 30, 1989, and September 30, 1988, respectively.

**RECAP OF THE TYPE OF RECEIVABLES AND RELATED ALLOWANCES**

The tables below recap the receivables and allowances after a reclassification of the Housing Credit program defaults from accounts to loans receivable.

The receivables as of September 30, 1989, consist of:

	<u>Current</u>	<u>Non-Current</u>	<u>Total</u>
<u>Accounts:</u>			
Individuals/Corporations	\$ 985,788	\$ - 0 -	\$ 985,788
Federal Government	387,576	- 0 -	387,576
Less: Allowances for Loss	<u>510,041</u>	- 0 -	<u>510,041</u>
Accounts Receivable, net	<u>863,323</u>	- 0 -	<u>863,323</u>
<u>Advances:</u>			
Individuals/Corporations	52,464	- 0 -	52,464
Federal Government	<u>92,681</u>	- 0 -	<u>92,681</u>
Total Advances	<u>145,145</u>	- 0 -	<u>145,145</u>
<u>Loans</u>			
Individuals	2,872,029	1,793,241	4,665,270
Less: Allowances for Loss	<u>2,540,447</u>	<u>102,676</u>	<u>2,643,123</u>
Loans, Net	<u>331,582</u>	<u>1,690,565</u>	<u>2,022,147</u>
Net Receivables	<u>\$1,340,050</u>	<u>\$1,690,565</u>	<u>\$3,030,615</u>

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

	<u>Current</u>	<u>Non-Current</u>	<u>Total</u>
<u>Accounts:</u>			
Individuals/Corporations	\$ 940,079	\$ 132	\$ 940,211
Federal Government	368,401	461	368,862
Less: Allowances for Loss	<u>494,048</u>		<u>494,048</u>
Accounts Receivable, net	<u>814,432</u>	<u>593</u>	<u>815,025</u>
<u>Advances:</u>			
Individuals/Corporations	53,432	- 0 -	53,432
Federal Government	<u>133,660</u>	- 0 -	<u>133,660</u>
Total Advances	<u>187,092</u>	- 0 -	<u>187,092</u>
<u>Loans</u>			
Individuals	2,587,658	1,644,686	4,232,344
Less: Allowances for Loss	<u>2,015,799</u>	<u>124,644</u>	<u>2,140,443</u>
Loans, Net	<u>571,859</u>	<u>1,520,042</u>	<u>2,091,901</u>
Net Receivables	<u>\$1,573,383</u>	<u>\$1,520,635</u>	<u>\$3,094,018</u>

**NOTE 9: PROPERTY AND EQUIPMENT**

**Fixed Assets**

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 \$687,344,000 in FY 1989 and \$412,100,000 in FY 1988.

Property and equipment consisted of the following as of September 30, 1989 (dollars in thousands):

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Land	\$ 100,624		\$ 100,624
Buildings	6,600,981	1,950,577	4,650,404
Equipment	3,313,322	1,871,124	1,442,198
Other	866,746	337,392	529,354
Construction in Progress	<u>1,673,934</u>		<u>1,673,934</u>
TOTAL	<u>\$12,555,607</u>	<u>\$4,159,093</u>	<u>\$8,396,514</u>

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Property and equipment consisted of the following as of September 30, 1988  
(dollars in thousands):

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
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	<u>1,319,480</u>		<u>1,319,480</u>
TOTAL	<u>\$11,474,738</u>	<u>\$3,744,775</u>	<u>\$7,729,963</u>

**Leases**

VA leases facilities, primarily office space and medical facilities, from General Services Administration (GSA). These leases are cancellable without penalty. In addition, VA has operating leases with the public for office, data processing, and other equipment. In FY 1989 and FY 1988, rent expenses for such leases from GSA amounted to approximately \$90 million each year; while leases from the public amounted to \$68 million and \$65 million, respectively.

**Subsequent Events**

Hurricane Hugo caused wind, rain, and flood damage to VA Medical Centers on the east coast. Particularly hard hit was the Medical Center in Charleston, South Carolina. The California earthquake caused structural damage to VA Medical Centers in the Northern California area. The Medical Center in Palo Alto, California suffered the most severe damage. Public Law 101-130 brought relief in the form of funds from The President's Unanticipated Needs for Natural Disasters Account. The FY 1990 Medical Care Appropriation received \$16.6 million to offset immediate repairs and emergency operating costs (\$1.0 million for hurricane and \$15.6 million for earthquake relief). The FY 1990 Major Construction Projects Appropriation received \$41.2 million for earthquake related projects.

**NOTE 10: CONTINGENCIES**

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, such legal settlements of tort claims awards in excess of \$2,500, as well as, contract disputes are paid from a Government wide Judgment Fund appropriation maintained by the Department of the Treasury, with an agency having to reimburse the fund for only contract dispute payments (see Note 2). Contract dispute act cases that were pending as of September 30, 1989, and which will ultimately result in payment out of VA appropriations, if the cases are decided against the government, totaled approximately \$12.5 million.

VA is involved in several legal actions, which, if decided against VA, would ultimately be charged to VA Appropriations. Although VA is unable to predict the final outcome of the lawsuits, VA's ultimate liability could be in the tens of millions of dollars. If such judgments were to occur, VA would most likely be required to seek supplemental appropriations from Congress.

In the opinion of VA's management and Office of General Counsel, the ultimate resolution of legal actions still pending as of September 30, 1989, will not materially affect VA's operations or financial position, especially when consideration is given to the availability of the Judgment Fund appropriation to pay some court settled legal cases.

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**Supplemental Schedules**

The following four schedules provide further detail, by major program area, of (1) assets, liabilities, and Government equity; (2) revenue, financing sources, and expenses; (3) sources and uses of funds by major program area; and (4) budgeted and actual outlays.

- o The medical program area includes financial data for the medical care program, including VA's 172 medical facilities, medical research and administration, and construction. The construction program was included because most of its activities relate to medical facilities.
- o The veterans benefits area includes compensation, pension, and education programs as well as 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 Department as a whole and the National Cemetery System. Also included are costs of managing the Supply Fund and automated data processing systems.

Except the cost charged to three of the life insurance programs (SGLI/VGLI & VRI) 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 and Other section.

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**Schedule of Assets, Liabilities, and Equity by Major Program as of September 30, 1989**

(Dollars in Thousands)

	Medical and Construction	Veterans Benefits	Housing Credit Assistance	Life Insurance	Admin and Other	Consoli- dated
<b>ASSETS:</b>						
Cash with U.S. Treasury and on hand	\$3,644,045	\$895,877	\$219,028	\$18,658	\$367,182	\$4,944,590
Advances, Accounts, and Loans Receivable, Net	335,418	282,611	993,419	1,331,975	87,192	3,030,615
Investments	68,684		316,948	12,764,482		13,150,114
Foreclosed Property Held for Sale			679,343			679,343
Land, Buildings, and Equipment Net of Accumulated Depreciation	8,392,403				4,111	8,396,514
Other Assets	23,341			1,049	130,167	154,557
Future Financing Sources	1,778,732		2,484,717	366,707	168,879	4,795,035
<b>TOTAL ASSET</b>	<b>\$14,240,823</b>	<b>\$978,288</b>	<b>\$4,693,455</b>	<b>\$14,482,871</b>	<b>\$755,531</b>	<b>\$35,150,768</b>
<b>LIABILITIES, TRUST FUND BALANCES, AND EQUITY:</b>						
<b>LIABILITIES:</b>						
Accounts Payable, Principally to the Public	\$644,957	\$15	\$88,541	\$167,242	\$223,481	\$1,124,236
Accrued Compensation and Pension Benefits		56,700				56,700
Accrued Payroll and Payroll Related Liabilities	1,074,471				97,258	1,171,729
Dividends on Credit or Deposit				867,393		867,393
Insurance Dividends Payable				1,030,863		1,030,863
Other Liabilities	240,028		14,225	70,772	50,191	375,214
Liability for Federal Employees Compensation Act	1,102,090				108,998	1,211,088
Liability for Losses on Guaranteed Loans			2,672,857			2,672,857
Insurance Policy Reserves				9,111,844		9,111,844
Reserve for Participating Policyholders Interest				3,069,419		3,069,419
Borrowings from Treasury			1,730,078			1,730,078
<b>TOTAL LIABILITIES</b>	<b>3,081,544</b>	<b>56,715</b>	<b>4,505,701</b>	<b>14,317,553</b>	<b>479,928</b>	<b>22,421,441</b>
<b>TRUST FUND BALANCES</b>	<b>28,782</b>	<b>477,770</b>		<b>165,318</b>		<b>671,870</b>
<b>EQUITY OF THE U.S. GOVERNMENT:</b>						
<b>Unrealized Appropriations:</b>						
Invested Capital	8,427,788				155,713	8,583,501
Deferred Appropriations		263,850				263,850
Unobligated Balances	640,988	174,316	187,753		7,574	1,210,631
Undelivered Orders	1,881,521	5,637	1		112,316	1,999,475
<b>TOTAL EQUITY OF THE U.S. GOVERNMENT</b>	<b>11,150,297</b>	<b>443,803</b>	<b>187,754</b>		<b>275,603</b>	<b>12,057,457</b>
<b>TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY</b>	<b>\$14,240,823</b>	<b>\$978,288</b>	<b>\$4,693,455</b>	<b>\$14,482,871</b>	<b>\$755,531</b>	<b>\$35,150,768</b>

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**Schedule of Assets, Liabilities, and Equity by Major Program as of September 30, 1988**

(Dollars in Thousands)						
	<i>Medical and Construction</i>	<i>Veterans Benefits</i>	<i>Housing Credit Assistance</i>	<i>Life Insurance</i>	<i>Admin and Other</i>	<i>Consolidated</i>
<b>ASSETS:</b>						
Cash with U.S. Treasury and on hand	\$ 3,524,877	\$ 1,213,776	\$ 318,747	\$ 18,328	\$ 311,156	\$ 5,386,884
Advances, Accounts, and Loans Receivable, Net	325,132	286,020	1,015,793	1,357,825	109,248	3,094,018
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			1,225	134,538	158,865
Future Financing Sources	1,751,577	87,259	3,450,553	376,717	146,434	5,812,540
<b>TOTAL ASSETS</b>	<b>\$13,407,028</b>	<b>\$1,587,055</b>	<b>\$5,754,608</b>	<b>\$14,199,210</b>	<b>\$704,256</b>	<b>\$35,652,157</b>
<b>LIABILITIES, TRUST FUND BALANCES, AND EQUITY:</b>						
<b>LIABILITIES:</b>						
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	73,954	47,676	346,127
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 Policy Reserve				8,890,318		8,890,318
Reserve for Participation Policyholders Interest				3,128,559		3,128,559
Borrowings from Treasury			1,730,078			1,730,078
<b>TOTAL LIABILITIES</b>	<b>2,755,880</b>	<b>724,130</b>	<b>5,530,922</b>	<b>14,047,700</b>	<b>432,560</b>	<b>23,491,192</b>
<b>TRUST FUND BALANCES</b>	<b>24,108</b>	<b>570,825</b>		<b>151,510</b>		<b>746,443</b>
<b>EQUITY OF THE U.S. GOVERNMENT:</b>						
<b>Unrealized Appropriations:</b>						
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
<b>TOTAL EQUITY OF THE U.S. GOVERNMENT</b>	<b>10,627,040</b>	<b>292,100</b>	<b>223,686</b>		<b>271,696</b>	<b>11,414,522</b>
<b>TOTAL LIABILITIES, TRUST FUND BALANCES, AND EQUITY</b>	<b>\$13,407,028</b>	<b>\$1,587,055</b>	<b>\$5,754,608</b>	<b>\$14,199,210</b>	<b>\$704,256</b>	<b>\$35,652,157</b>



**Appendix IV  
Financial Statements**

**Schedule of Expenses, Dividends, Revenue, and Financing Sources by Major Program for Fiscal Year 1989**

(Dollars in Thousands)

	<i>Medical and Construction</i>	<i>Veterans Benefits</i>	<i>Housing Credit Assistance</i>	<i>Life Insurance</i>	<i>Admin. and Other</i>	<i>Consoli- dated</i>
<b>OPERATING EXPENSES AND DIVIDENDS:</b>						
Expenses By Category:						
Personnel Compensation and Fringe Benefits	\$ 7,266,797			\$ 1,081	\$633,222	\$ 7,901,100
Veterans' Benefits		\$16,244,282				16,244,282
Claims and Indemnities	274		\$109,956	1,179,586	243	1,290,059
Depreciation	686,525				819	687,344
Supplies and Materials	1,803,554				17,161	1,820,715
Contractual Services	1,370,988			133	76,491	1,447,612
Rent, Communications, and Utilities	418,692			266	150,765	569,723
Other	128,565				28,565	157,130
<b>Total Operating Expenses</b>	<b>11,675,395</b>	<b>16,244,282</b>	<b>109,956</b>	<b>1,181,066</b>	<b>907,266</b>	<b>30,117,985</b>
Insurance Provisions:						
Dividends to Policyholders				991,022		991,022
SGLI Reserve				13,761		13,761
<b>Total Dividends</b>				<b>1,004,783</b>		<b>1,004,783</b>
	\$11,675,395	\$16,244,282	\$109,956	\$2,185,849	\$907,266	\$31,122,748
<b>OPERATING REVENUE AND FINANCING SOURCES:</b>						
Operating Revenues:						
Premium Income				871,235		\$ 871,235
Interest Income			\$165,338	1,274,404		1,439,742
Loan Origination Fees			141,057			141,057
Reimbursements and Other	\$ 302,812	\$ 132,356	6,486	42,464	\$115,331	599,449
<b>Total Operating Revenue</b>	<b>302,812</b>	<b>132,356</b>	<b>312,881</b>	<b>2,188,103</b>	<b>115,331</b>	<b>3,051,463</b>
Financing by Source:						
Appropriations and Financing Sources Realized	11,347,429	16,016,392	762,911	7,756	771,491	28,905,979
Funds to be Provided						
by Future Financing Sources	25,154	(87,259)	(965,836)	(10,010)	20,444	(1,017,507)
Transfers, Reimbursements, and Other		182,793				182,793
<b>Total Financing Sources</b>	<b>11,372,583</b>	<b>16,111,926</b>	<b>(202,925)</b>	<b>(2,254)</b>	<b>791,935</b>	<b>28,071,265</b>
	\$11,675,395	\$16,244,282	\$109,956	\$2,185,849	\$907,266	\$31,122,748

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**Schedule of Expenses, Dividends, Revenue, and Financing Sources by Major Program for Fiscal Year 1988**

(Dollars in Thousands)

	<i>Medical and Construction</i>	<i>Veterans Benefits</i>	<i>Housing Credit Assistance</i>	<i>Life Insurance</i>	<i>Admin and Other</i>	<i>Consolidated</i>
<b>OPERATING EXPENSES AND DIVIDENDS:</b>						
Expenses By Category:						
Personnel Compensation and Fringe Benefits	\$ 6,903,251			\$ 1,175	\$610,855	\$ 7,515,281
Veterans' Benefits		\$15,939,277				15,939,277
Claims and Indemnities	124		\$2,031,537	1,244,418	368	3,276,447
Depreciation	411,798				301	412,099
Supplies and Materials	1,839,354				16,548	1,655,902
Contractual Services	1,399,564			145	73,255	1,472,964
Rent, Communications, and Utilities	393,764			290	138,215	532,269
Other	59,560				28,790	88,350
<b>Total Operating Expenses</b>	<b>10,807,415</b>	<b>15,939,277</b>	<b>2,031,537</b>	<b>1,246,028</b>	<b>868,332</b>	<b>30,892,589</b>
Insurance Provisions:						
Dividends to Policyholders				952,507		952,507
SGLI Reserve				3,416		3,416
<b>Total Dividends</b>				<b>955,923</b>		<b>955,923</b>
	\$10,807,415	\$15,939,277	\$2,031,537	\$2,201,951	\$868,332	\$31,848,512
<b>OPERATING REVENUE AND FINANCING SOURCES:</b>						
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)	78,848	\$109,799	545,242
<b>Total Operating Revenue</b>	<b>314,643</b>	<b>108,133</b>	<b>297,080</b>	<b>2,182,317</b>	<b>109,799</b>	<b>2,951,972</b>
Financing by Source:						
Appropriations and						
Financing Sources Realized	10,211,450	15,509,385	940,194	14,058	750,434	27,425,521
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
<b>Total Financing Sources</b>	<b>10,492,772</b>	<b>15,831,144</b>	<b>1,794,457</b>	<b>19,634</b>	<b>758,533</b>	<b>28,896,540</b>
	\$10,807,415	\$15,939,277	\$2,031,537	\$2,201,951	\$868,332	\$31,848,512

**Appendix IV  
Financial Statements**

**Schedule of Sources and Uses of Resources and Reconciliation to Budget by Major Program for Fiscal Year 1989**

(Dollars in Thousands)

	<i>Medical and Construction</i>	<i>Veterans Benefits</i>	<i>Housing Credit Assistance</i>	<i>Life Insurance</i>	<i>Admin. and Other</i>	<i>Consoli- dated</i>
<b>NET USE OF RESOURCES:</b>						
Operations:						
Operating Expenses	\$11,675,395	\$16,244,282	\$109,956	\$1,181,066	\$907,266	\$30,117,965
Items Requiring (Providing) Funds:						
(Increase) Decrease in Future						
Liability Provisions	(169,989)		990,631	(221,526)	(18,810)	582,326
Depreciation	(686,525)				(819)	(687,344)
Increase (Decrease) in Accounts Receivable	(15,628)	(6,879)	(167,290)	2,444	(20,959)	(208,312)
Decrease (Increase) in						
Accounts Payable and Accruals	(99,345)	674,399	34,576	(68,698)	(31,922)	509,010
Revenues Accounted for as						
Offsetting Collections	(302,812)	(315,149)	(312,881)	(1,109,240)	(115,331)	(2,155,413)
Resources Used (Provided) by Operations	10,401,116	16,596,653	654,992	(215,954)	721,425	28,158,232
Non-Operating Uses:						
Dividends				991,022		991,022
Acquisitions of Land, Buildings, and Equipment	1,127,907				26,559	1,154,466
Purchase of Foreclosed Property Held for Sale			1,483,189			1,483,189
Issuance and Repurchase of Loans and Liens		(2,588)	1,073,002	114,504		1,184,918
Other, Net	(582)		(45,358)		(4,372)	(50,312)
Financing Activities:						
Sale of Foreclosed Property Held for Sale			(1,714,851)			(1,714,851)
Sale of Loans, without Recourse, Net			(433,331)			(433,331)
Loan/Lien Repayments/Opt Income Settlements			(139,824)	(162,559)		(302,383)
Revenues Collected for Treasury	(146,003)	(284,266)				(430,269)
<b>NET USE OF BUDGETARY RESOURCES (OUTLAYS)</b>	<b>11,382,438</b>	<b>16,309,799</b>	<b>877,819</b>	<b>727,013</b>	<b>743,612</b>	<b>30,040,681</b>
<b>SOURCES OF BUDGETARY RESOURCES PROVIDED</b>						
Intra-agency Transfers	(15,000)	(4,250)		4,250	15,000	0
Current Year Appropriation, Adjusted	11,683,957	15,996,050	778,100	9,220	793,216	29,260,543
Contract Authority		84,343				84,343
Interest on Government Securities				1,033,241		1,033,241
Net Transfers, Reimbursements, and Other	46,215	(284,268)			(439)	(238,492)
Funds Returned to Treasury	(199,726)	(175)			(8,139)	(208,040)
<b>TOTAL RESOURCES PROVIDED</b>	<b>11,515,446</b>	<b>15,791,700</b>	<b>778,100</b>	<b>1,046,711</b>	<b>799,638</b>	<b>29,931,595</b>
<b>INCREASE (DECREASE) IN</b>						
U.S. TREASURY AND IMPREST FUNDS						
Funds Exchanged for U.S. Government Securities	(13,840)			(319,368)		(333,208)
<b>NET INCREASE (DECREASE) IN</b>						
U.S. TREASURY AND IMPREST FUNDS						
	119,168	(518,099)	(99,719)	330	56,026	(442,294)
<b>U.S. TREASURY AND IMPREST FUNDS:</b>						
Beginning of Year	3,524,877	1,213,776	318,747	18,328	311,156	5,386,884
End of Year	\$3,644,045	\$695,677	\$219,028	\$18,658	\$367,182	\$4,944,590

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**Schedule of Sources and Uses of Resources and Reconciliation to Budget by Major Program for Fiscal Year 1988**

(Dollars in Thousands)

	<i>Medical and Construction</i>	<i>Veterans Benefits</i>	<i>Housing Credit Assistance</i>	<i>Life Insurance</i>	<i>Admin and Other</i>	<i>Consolidated</i>
<b>NET USE OF RESOURCES:</b>						
<b>Operations:</b>						
Operating Expenses	\$10,807,415	\$15,939,277	\$2,031,537	\$1,246,028	\$868,332	\$30,892,589
<b>Items Requiring (Providing) Funds:</b>						
Increase in Future Liability Provisions	(72,274)		(944,590)	(312,759)	(7,149)	(1,336,772)
Depreciation	(411,798)				(301)	(412,099)
Increase (Decrease) in Accounts Receivable	5,643	(23,671)	(109,869)	(1,440)	37,624	(91,713)
Decrease (Increase) in Accounts Payable and Accruals	(133,513)	555,950	(136,871)	(86,080)	(13,298)	188,200
Revenues Accounted for as Offsetting Collections	(314,643)	(382,880)	(237,080)	(1,096,751)	(109,798)	(2,141,152)
<b>Resources Used (Provided) by Operations</b>	<b>9,880,830</b>	<b>16,088,676</b>	<b>603,127</b>	<b>(251,002)</b>	<b>775,422</b>	<b>27,097,053</b>
<b>Non-Operating Uses:</b>						
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)	1,080,084	107,900		1,174,472
Other, Net	(844)		(36,562)		13,965	(23,441)
<b>Financing Activities:</b>						
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)
<b>NET USE OF BUDGETARY RESOURCES (OUTLAYS)</b>	<b>10,839,572</b>	<b>15,855,011</b>	<b>1,139,038</b>	<b>635,643</b>	<b>801,714</b>	<b>29,270,978</b>
<b>SOURCES OF BUDGETARY RESOURCES PROVIDED</b>						
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)	(146,048)		(28,323)	(382,838)
Funds Returned to Treasury	(177,323)	(932)			(5,627)	(183,882)
<b>TOTAL RESOURCES PROVIDED</b>	<b>10,764,008</b>	<b>15,219,482</b>	<b>1,337,883</b>	<b>1,012,455</b>	<b>728,860</b>	<b>28,062,688</b>
<b>INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS</b>						
Funds Exchanged for U.S. Government Securities	(75,564)	(635,529)	198,845	378,812	(72,854)	(208,290)
	(33,177)			(378,292)		(411,469)
<b>NET INCREASE (DECREASE) IN U.S. TREASURY AND IMPREST FUNDS</b>	<b>(108,741)</b>	<b>(635,529)</b>	<b>198,845</b>	<b>(1,480)</b>	<b>(72,854)</b>	<b>(619,759)</b>
<b>U.S. TREASURY AND IMPREST FUNDS:</b>						
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

**Appendix IV  
Financial Statements**

**Budgeted and Actual Outlays by Function and Program for Fiscal Year 1989**

(Dollars in Thousands)

	<i>President's Budget</i>	<i>Budgeted Outlays Enacted Bill</i>	<i>Actual Outlays</i>
<b>HOSPITAL AND MEDICAL CARE:</b>			
Medical Care	\$10,296,229	\$10,384,408	\$10,514,539
Medical and Prosthetic Research	202,154	206,036	184,940
Medical Administration	46,956	46,721	45,094
Construction	544,823	696,180	703,018
Proposed Legislation	23,999		
All Other	(79,958)	(81,596)	(65,153)
<b>Total Hospital and Medical Care</b>	<b>11,034,203</b>	<b>11,251,749</b>	<b>11,362,436</b>
<b>BENEFITS:</b>			
<b>Income Security for Veterans:</b>			
Compensation	10,671,000	10,796,200	11,649,655
Pensions	3,983,600	3,924,300	4,024,002
Burial and Other Benefits	144,800	149,618	142,196
Proposed Legislation	320,433		
Reinstated Entitlement for Survivors		8,789	639
<b>Subtotal Income Security</b>	<b>14,999,833</b>	<b>14,878,907</b>	<b>15,816,492</b>
<b>Education, Training, and Rehabilitation:</b>			
Readjustment Benefits (G.I. Bill)	606,100	375,000	379,165
Post-Vietnam Era Education	88,945	72,530	105,118
Veterans Job Training	4,651	19,585	14,811
All Other	(215,632)	(6,918)	(5,787)
Proposed Legislation	(202)		
<b>Subtotal Education, Training, and Rehabilitation</b>	<b>463,662</b>	<b>460,197</b>	<b>463,307</b>
<b>Total Benefits</b>	<b>15,463,495</b>	<b>15,339,104</b>	<b>16,309,799</b>
<b>HOUSING CREDIT ASSISTANCE:</b>			
Loan Guaranty	683,000	1,111,900	997,762
Proposed Legislation	880,126		
Direct Loans	(26,800)	(23,900)	(19,943)
<b>Total Housing Credit Assistance</b>	<b>1,536,326</b>	<b>1,088,000</b>	<b>977,819</b>
<b>INSURANCE PROGRAMS</b>			
Proposed Legislation	4,250		
<b>Total Insurance Programs</b>	<b>675,384</b>	<b>738,190</b>	<b>727,013</b>
<b>ADMINISTRATION</b>			
Other Benefits and Services	776,596	779,354	743,612
<b>Total Administration</b>	<b>776,596</b>	<b>779,354</b>	<b>743,612</b>
<b>TOTAL VETERAN ADMINISTRATION</b>	<b>\$29,508,004</b>	<b>\$29,196,397</b>	<b>\$30,040,681</b>

*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).*

**Appendix IV  
Financial Statements**

**Budgeted and Actual Outlays by Function and Program for Fiscal Year 1988**

(Dollars in Thousands)

	<i>Budgeted Outlays</i>		
	<i>President's Budget</i>	<i>Enacted Bill</i>	<i>Actual Outlays</i>
<b>HOSPITAL AND MEDICAL CARE:</b>			
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	43,483	40,483
Construction	816,263	571,313	649,456
Proposed Legislation			
All Other	(199,781)	(57,165)	(92,987)
<b>Total Hospital and Medical Care</b>	<b>10,515,333</b>	<b>10,849,543</b>	<b>10,839,572</b>
<b>BENEFITS:</b>			
Income Security for Veterans:			
Compensation	10,389,000	10,357,900	11,251,859
Pensions	3,839,500	3,895,800	3,934,821
Burial and Other Benefits	141,687	141,688	141,674
Proposed Legislation	235,450		
Reinstated Entitlement for Survivors		8,034	(755)
<b>Subtotal Income Security</b>	<b>14,585,637</b>	<b>14,343,422</b>	<b>15,327,599</b>
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		
<b>Subtotal Education, Training, and Rehabilitation</b>	<b>643,074</b>	<b>526,717</b>	<b>527,412</b>
<b>Total Benefits</b>	<b>15,228,711</b>	<b>14,870,139</b>	<b>15,855,011</b>
<b>HOUSING CREDIT ASSISTANCE:</b>			
Loan Guaranty	253,500	568,100	1,218,842
Proposed Legislation	(389,823)		
Direct Loans	(29,600)	(67,000)	(79,804)
<b>Total Housing Credit Assistance</b>	<b>(165,923)</b>	<b>501,100</b>	<b>1,139,038</b>
<b>INSURANCE PROGRAMS</b>			
Proposed Legislation	4,250		
<b>Total Insurance Programs</b>	<b>682,548</b>	<b>599,297</b>	<b>635,643</b>
<b>ADMINISTRATION</b>			
Other Benefits and Services	804,696	803,088	801,714
<b>Total Administration</b>	<b>804,696</b>	<b>803,088</b>	<b>801,714</b>
<b>TOTAL VETERAN ADMINISTRATION</b>	<b>\$27,045,365</b>	<b>\$27,623,167</b>	<b>\$29,270,978</b>

*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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# Statement of VA's Appropriation Authority

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To provide an annual accounting and reporting of appropriations, we are presenting statements which show the status of VA's (1) appropriations authority, including "M" accounts, and (2) unobligated surpluses, including merged surplus, during fiscal year 1989. We believe that the Congress and agency management need a greater assurance that unused and unliquidated appropriations are accounted for properly. Part of achieving such an assurance is to report summary activity and year-end balances of agencies' appropriation authority with the audited financial statements. We have utilized VA as an example of the model report structure that we believe should be included as part of the basic statements in federal agencies' financial statements.

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## What Are Expired Appropriation, Surplus Authority, "M", and Merged Surplus Accounts?

In order to streamline a cumbersome process for certifying separate payments from appropriation account balances that were being maintained forever, the Congress, in 1956, established the current system of expired appropriation, surplus authority, "M", and merged surplus accounts for federal agency use in recording and accounting for transactions affecting appropriations which are no longer available for new obligations.

At the end of the period that an unexpired appropriation is available for new obligation (1 year for annual and 2 or more years for multiple-year appropriations), two separate actions take place. First, with respect to the obligated appropriations that remain unliquidated (obligated balances), the balances are reclassified as expired appropriation accounts in the agencies' records. Second, the portion of the appropriation that has not been obligated (unobligated balances) is withdrawn to the U.S. Treasury, where it is designated as surplus authority.

The expired appropriation and surplus authority balances each retain their fiscal year identity for 2 years. After 2 years, any remaining expired appropriation balances are transferred to "M" accounts, and any remaining surplus authority balances are transferred to merged surplus accounts. Surplus authority balances, however, are available during the 2 years for restoration to an expired appropriation for funding an increase in a valid obligation or an unexpected related charge that can be clearly associated with the given fiscal year and appropriation.

"M" accounts are accounts into which obligated balances under appropriations are transferred at the end of the second full fiscal year following expiration. The obligated balances, however, remain on an

agency's books. The "M" accounts allow for the payment of obligations charged, or chargeable, to appropriation accounts that are over 2 years old.

Merged surplus accounts are part of Treasury's general fund. They represent the undisbursed and unobligated balances of prior year appropriations that have been transferred from surplus authority or that have resulted from downward adjustments of obligations in the "M" accounts. The merged surplus accounts are maintained by appropriation type without regard to the fiscal year in which the appropriation was made. Under limited circumstances, merged surplus funds are available for restoration to the applicable agency's "M" account to pay upward adjustments in obligations or previously unrecorded prior obligations.

## Accounting for VA's Appropriations During Fiscal Year 1989

VA accounts for all of its funds to show availability and usage for operations and capital assets during a year. However, year-by-year transaction data have not been easily available to date. VA, similar to most federal agencies, begins each fiscal year with (1) obligated appropriation balances that were reserved in the prior fiscal years to pay for undelivered orders and (2) multiple-year and no-year appropriations that are unexpired (still available for initial obligations). In addition, new appropriations are provided for the current fiscal year. VA may also obtain restoration of funds from surplus authority or merged surplus accounts. The total appropriations, depending on purpose, are applied to finance operations and capital assets. Any amount not required is withdrawn to surplus accounts at Treasury. At year-end, the excess of appropriation amounts available over the amounts applied or withdrawn remains in VA's records.

We have developed two statements, included in tables V.1 and V.2, which show unexpired expired, and no-year appropriations, as well as surplus authority and "M" and merged surplus accounts available to VA. As such, managers and the Congress will be provided a vehicle to better track and monitor these accounts.

As shown in table V.1 under the column labeled totals, VA began fiscal year 1989 with \$3.0 billion in appropriations, comprised of \$1.8 billion in unliquidated, obligated balances (undelivered orders) and \$1.2 billion in unobligated and unexpired appropriations. In addition, VA received new annual, multiple-year and no-year appropriations to finance the majority of its operational and capital needs (\$29.3 billion in fiscal year 1989) and a restoration of certain amounts from its merged surplus



**Appendix V  
Statement of VA's Appropriation Authority**

account with the U.S. Treasury (\$3.4 million). Accordingly, VA had total appropriations available for its use of \$32.3 billion during fiscal year 1989.

**Table V.1: Statement of VA Appropriations Used and Remaining Available for Obligation or Expenditure During Fiscal Year 1989**

Dollars in thousands

Item	Annual and multiple-year appropriation accounts			M Account	No-year	Totals
	Unexpired	Expired				
	1989	1988	1987			
Appropriations provided:						
Balance of undelivered orders at 10-1-88	\$72,586	\$448,134	\$87,868	\$72,325	\$1,135,701	\$1,816,614
Balance of unobligated amounts at 10-1-88	14,629	N/A	N/A	179 <sup>a</sup>	1,195,916	1,210,724
1989 appropriations (net of increases and decreases)	12,020,060	N/A	N/A	N/A	17,240,483	29,260,543
Restorations	N/A	0	0	3,439	N/A	3,439
<b>Amounts available</b>	<b>12,107,275</b>	<b>448,134</b>	<b>87,868</b>	<b>75,943</b>	<b>19,572,100</b>	<b>32,291,320</b>
Less appropriations applied:						
Operations	11,123,174	97,659	(12,788)	(6,058) <sup>b</sup>	16,659,285	27,861,272
Capital assets	165,262	252,043	40,912	34,896	661,353	1,154,466
Withdrawals to surplus accounts with Treasury at year-end	2,297	25,295	21,011	16,873	N/A	65,476
Undelivered orders transferred to M account	N/A	N/A	38,733	(38,733)	N/A	N/A
<b>Amounts remaining</b>	<b>\$816,542</b>	<b>\$73,137</b>	<b>\$0</b>	<b>\$68,965</b>	<b>\$2,251,462</b>	<b>\$3,210,106</b>
Distribution of amounts remaining:						
Balance of undelivered orders at 9-30-89	\$793,581	\$73,137	\$N/A	\$68,965	\$1,063,792	\$1,999,475
Balance of unobligated amounts at 9-30-89	22,961	N/A	N/A	N/A	1,187,670	\$1,210,631
<b>Total</b>	<b>\$816,542</b>	<b>\$73,137</b>	<b>\$0</b>	<b>\$68,965</b>	<b>\$2,251,462</b>	<b>\$3,210,106</b>

Note: The entry N/A (not applicable) indicates that amounts are not normally reported for these categories.

<sup>a</sup>Represents an unobligated balance of an appropriation resulting from an excess of receivables over payables and is unavailable for new obligations.

<sup>b</sup>Represents refunds and deobligations of previously expensed items.

Table V.1 also shows the application of the appropriations authority available during fiscal year 1989 and the amounts available at year-end. Thus, the statement accounts for the total appropriation authority available to VA during fiscal year 1989. Of the \$32.3 billion appropriation authority available to VA during the fiscal year, VA used \$27.9 billion

to finance operations and \$1.2 billion to finance acquisition of capital assets. In addition, \$65.5 million was withdrawn to VA's surplus authority and merged surplus accounts with the U.S. Treasury, resulting in an amount remaining at year-end for carryover to the subsequent year of \$3.2 billion. Also shown is the required transfer to VA's "M" account of \$38.7 million obligated appropriations that remained unliquidated 2 years after the appropriations expired in 1987.

The \$3.2 billion remaining available at the end of fiscal year 1989 was comprised of \$2.0 billion of obligated appropriations covering undelivered orders and \$1.2 billion of unobligated balances in unexpired multiple-year and no-year appropriations that remained available to VA for new obligations subsequent to fiscal year 1989.

**Table V.2: Statement of VA's Surpluses From Expired Appropriations—Fiscal Year 1989**

Dollars in thousands

Item	Annual and multiple-year expired appropriations			Merged surplus	No-year	Totals
	1989	1988 <sup>a</sup>	1987 <sup>a</sup>			
Balance 10-1-88	N/A	\$4,141	\$120,594	\$1,249,567	N/A	\$1,374,302 <sup>b</sup>
Amounts withdrawn current year-end	2,297	25,295	21,011	16,873	N/A	65,476
Reduction for amounts restored in 1989	N/A	0	0	(3,439)	N/A	(3,439)
Transferred to merged surplus	N/A	N/A	(141,605) <sup>c</sup>	141,605	N/A	N/A
<b>Balance 9-30-89</b>	<b>\$2,297</b>	<b>\$29,436</b>	<b>\$0</b>	<b>\$1,404,607</b>	<b>N/A</b>	<b>\$1,436,339<sup>b</sup></b>

Note: The entry N/A (not applicable) indicates that amounts are not normally reported for these categories.

<sup>a</sup>Figures for 1988 and 1987 represent surplus authority.

<sup>b</sup>Does not include a total amount of \$917,127,364 for certain other appropriations and funds such as personal funds of patients, miscellaneous benefit and insurance expenses, and trust funds that are unidentifiable by appropriation number.

<sup>c</sup>Equals the cumulative amount of unobligated appropriations in surplus authority that was transferred to VA's merged surplus account at the end of the year as legally required.

Table V.2 shows the status, including fiscal year transactions, of VA's unobligated appropriations surpluses with the U.S. Treasury for fiscal year 1989. The amounts withdrawn at current year-end of \$65.5 million reflect the portions of appropriations that were withdrawn from VA at the end of fiscal year 1989. These amounts were added to VA's surplus authority and merged surplus balances with the U.S. Treasury accounts, as shown on table V.1. In addition, the merged surplus balance was reduced for the \$3.4 million that was restored to VA's "M" account,

resulting in a year-end total surplus authority and merged surplus account balance as of September 30, 1989, of \$1.4 billion. The table also includes a transaction which shows the cumulative amount of unobligated appropriations in surplus authority that was transferred, as legally required, to the merged surplus account after 2 years in expired status.

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## Relationship of Appropriation Tables With Audited Financial Statements

The \$3.2 billion remaining available at the end of fiscal year 1989—undelivered orders of \$2.0 billion and unobligated balances of \$1.2 billion—is reported in the equity section of the consolidated statement of financial position. In addition, the appropriations used to finance capital assets (\$1.2 billion) and VA's 1989 adjusted appropriations of \$29.3 billion are reported on the consolidated statement of changes in financial position and reconciliation to budget for fiscal year 1989. As indicated in our opinion on VA's financial statements, our audit of the statements of financial position and changes in financial position and reconciliation to budget disclosed that these balances are fairly presented in the financial statements in accordance with generally accepted accounting principles.

We believe that statements of the status of agencies' appropriations similar to tables V.1 and V.2 need to be included as basic statements in federal agencies' annual financial statements. These statements of appropriations would then be within the scope of a financial audit of the agencies' financial statements and as such the auditor's opinion would provide the Congress and agency management formal assurance that amounts and transactions affecting undelivered orders and unobligated balances are fairly presented on the statements.

# Summary of VA's Federal Managers' Financial Integrity Act Reports

This appendix summarizes the open internal control and accounting system weaknesses and related corrective actions information contained in VA's 1983 through 1989 Federal Managers' Financial Integrity Act (FMFIA) reports. The act requires that the reports reflect the results of VA management's assessments and detailed reviews of the internal control systems operating within all department programs, activities, organizations, and functions; and of the agency's financial management systems' conformance with accounting principles, standards, and other requirements established by the Comptroller General of the United States.

With regard to the relationship between our audit and the financial management system review and reporting requirements of FMFIA, our audit primarily focused on the internal control and accounting systems needed to produce VA's financial statements. As such, we did not examine all of the financial management systems that VA must consider when planning and conducting its FMFIA reviews and when preparing its annual FMFIA report. We are, therefore, not in a position to attest to the adequacy of all financial management related disclosures in the FMFIA reports.

In the future, however, we believe that auditors, when conducting financial audits, should examine all of an agency's financial management systems and attest to the adequacy of the financial management system representations made in the FMFIA report. This additional audit reporting will provide the Administration and the Congress with a more complete picture of the integrity and reliability of an agency's financial systems, reports, and other related information.

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## Background

The Federal Managers' Financial Integrity Act was enacted in September 1982 to strengthen internal control and accounting systems throughout the federal government and help reduce fraud, waste, abuse, and misappropriation of federal funds. The act provided, for the first time, the requirement for agency managers to identify and remedy long-standing internal control and accounting systems problems.

Section 2 of the act requires that agency systems of internal control comply with internal control standards prescribed by the Comptroller General and provide reasonable assurance that

- obligations and costs are in compliance with applicable laws;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

**Appendix VI  
Summary of VA's Federal Managers' Financial  
Integrity Act Reports**

- 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 the assets.

Section 4 of the act requires that the agency head's annual Financial Integrity Act report include a separate report on whether the agency's accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements.

## VA Reports Annually on Material Weaknesses

The weaknesses reported by VA over the past years encompass general management activities as well as specialized services or programs. We have categorized the material weaknesses VA has reported in its annual reports to the President and the Congress, as follows.

**Table VI.1: Categories of Reported Material Weaknesses—1983 Through 1989**

	1983	1984	1985	1986	1987	1988	1989
Automated data processing	X	X	X		X	X	X
Eligibility and entitlement	X	X	X				
Credit management	X	X	X	X	X	X	
Personnel and organizational management	X	X		X			X
Procurement	X	X	X	X	X	X	
Property management	X	X	X	X	X	X	X
Cash management	X	X	X	X	X	X	
Accounting and financial systems	X	X	X	X	X	X	X

In its fiscal year 1989 report, VA (1) disclosed new material weaknesses, (2) listed previously identified internal control and accounting system weaknesses which remain to be corrected, and (3) reported having corrected weaknesses. A total of 28 material weaknesses were reported as uncorrected in 1989 under Sections 2 and 4 of the act. Eleven of these were identified during the 1989 review. Of the remaining 17 previously identified weaknesses, 14 were reported between 1983 and 1986. In addition, in its 1989 report, VA reported completing corrective actions during 1989 on four previously reported material weaknesses, and it downgraded the credit management category weakness to an area of "significant concern."

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## Material Internal Control Weaknesses

In its 1989 Federal Managers' Financial Integrity Act report, VA identified 20 material internal control weaknesses requiring correction under Section 2 of the act. Four of the weaknesses were reported in such functional categories as ADP, Property, and Personnel and Organizational Management. The remaining 16 weaknesses were reported within the category entitled Program or Project Management. The following is a brief discussion of some of the weaknesses in each category and the planned corrective actions.

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## Automated Data Processing

Two weaknesses were identified. The first related to a need, first reported in 1984, for backup processing capacity at an alternate site if a catastrophic event were to occur. VA noted that although needed funding had not been approved, the agency had identified the applicable systems and necessary requirements and anticipated developing a detailed plan for backing up critical systems by the beginning of fiscal year 1992.

The second weakness, first reported in 1988, was that VA needed to improve its operating system and security software controls at its Austin Data Processing Center. This finding was identified earlier by GAO, the VA Inspector General, and the President's Council on Integrity and Efficiency. VA reported that it had completed 55 of 66 actions needed to correct this weakness and expected to complete the remaining actions by November 1989.

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## Property Management

One uncorrected weakness was unsatisfactory internal controls over linen inventory, which led to losses estimated at approximately \$4 million for the first 6 months in 1988. For corrective action, VA planned to analyze the 1988 linen inventory to contact those sites with the highest losses and then develop an action plan to address the internal control problems related to the linen losses.

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## Personnel and Organizational Management

In 1989, VA identified a new material weakness in this category. VA cited GAO and IG reports which identified a number of payroll problems at VA field stations. Examples of problems cited include failure to comply with VA policy in making cash payments and problems ensuring that all authorized loans are received and processed. VA management believes its inability to retain competent payroll clerks because of grade restrictions further inhibits its ability to ensure controls are properly executed. Their action plan to correct the weakness includes complying with

existing VA policies, preparing reconciliations, processing loans, and improving accuracy and completeness.

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**Program/Project  
Management**

This category contained 14 material weaknesses, 9 identified in 1989 and 5 identified from 1983 through 1988. Examples of weaknesses in this category include (1) undocumented construction changes resulting in one project being 6 years late and incurring \$19 million in extra costs, (2) ineffective ADP support resulting in loan servicing problems and excessive foreclosure rates, (3) ineffective monitoring of lenders making loans guaranteed by VA under its home loan program, (4) the failure to obtain authority to obtain income data from the Internal Revenue Service and the Social Security Administration in order to reduce the number of beneficiary overpayments, (5) failure to verify physicians' credentials and state licenses, and (6) failure to reconcile general ledger accounts and perform related follow-up activities for three financial management systems.

VA reported that corrective actions for each of these weaknesses are in various stages of completion. Corrective actions range from conducting reviews and audits, obtaining more up-to-date software, submitting certifications that policies and procedures are being implemented, to revising existing policies. VA anticipates that corrective actions will be completed between fiscal year 1990 and fiscal year 1995.

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**Accounting and Financial  
Management System  
Weaknesses**

In its 1989 report, VA reported that its financial management systems had achieved overall compliance with the requirements specified in the act. They reported a total of 44 financial management systems in operation involving activities such as payroll/personnel; administration; construction; financial reports and budget formulation; compensation, pension, and education activities; loan guaranty activities; and insurance activities. VA reports 42 of these systems are accounting systems.

During 1989, VA identified no new accounting system weaknesses. It did, however, report that eight previously identified weaknesses under Section 4 of the act had still not been corrected, five of which had been first reported in 1985. Weaknesses were reported, in priority order, in six different systems. Examples of weaknesses and proposed corrective actions are as follows:

- Personnel and Accounting Integrated Data System. As early as 1985, VA reported that this system was not easily adaptable to meeting changing

user needs and that there were no clearly defined and well-documented audit trails and processing controls. To correct these problems, VA is redesigning the system and expects that full corrective actions will be implemented by fiscal year 1992 or 1993.

- **Loan Guaranty System.** This system had two uncorrected weaknesses. The first, reported in 1986, was that VA's decentralized funding process for loan guaranty programs failed to provide VA's central office with adequate fund control over the \$3.6 billion project obligations in the program. In its 1989 report, VA stated that its new Disbursing, Accounting and Budgeting System (DABS), which is part of a larger modernization initiative at VA targeted for completion in 1996, will provide centralized fund control when implemented in 1991.

The second weakness was related to controls over the estimated \$1.3 billion in disbursements processed by the loan guaranty system. VA reported that controls over disbursements have been essentially manual and that because it operates in a decentralized environment, the ability to detect duplicate payments is questionable. VA believes that implementation of the DABS system, in 1991, will correct this weakness.

- **Centralized Accounting System for Constructing Appropriations.** In 1985, VA reported that this system was unable to easily adapt to changing user requirements and external requirements during the system's life cycle. The system was designed in the 1960s and lacks features which facilitate prompt system maintenance. VA plans to replace this system with its new Financial Management System in 1992.
- **Centralized Accounting for Local Management System.** Two weaknesses were reported for this system. The first weakness, first identified in 1985, was similar to the problem of inflexibility reported for the Centralized Accounting System for Construction. VA expects that the new Financial Management System, scheduled for completion in 1992, will correct this weakness.

The second weakness was first identified in 1988 and concerns the need for controls over assets. VA stated that controls over real property are essential to the production of reliable financial statements and that its failure to consistently implement capitalization and depreciation policies had resulted in a qualified GAO opinion on its consolidated financial statements for 1986 and 1987. To illustrate, due to the lack of documents supporting the cost of many items and the lack of consistent adherence to management policies relating to the capitalization and depreciation of buildings, account balances were inaccurate. VA reported



that its new Financial Management System, scheduled for 1992 implementation, will include a fixed assets module to standardize real property recordkeeping on a departmentwide basis.

- Compensation, Pension, and Education System. VA reports identifying, for the first time in 1985, problems in this system which processes over \$15 billion annually. In its 1989 FMFIA report, VA cites weaknesses identified by GAO during financial statement audits. For example, VA referred to a 1989 GAO conclusion that VA had not developed basic controls in its benefits systems to help ensure that payment transactions were properly processed. It also stated that some of those problems have existed for years. Corrections to this system are included in a larger plan to improve the delivery of veterans benefits and services through technology. VA believes that although the entire project and system conversion to an integrated environment will not occur until 1996 or 1997, two milestones for the Compensation and Pension System will be the conversion of its master files to disk by 1991 and implementation of new modernized systems at all Department sites by the end of fiscal year 1994.
- Insurance System. In 1985, VA first identified this system, which accounts for five government insurance programs totaling about \$28 billion in coverage to 3.6 million policyholders, as having material weaknesses. It reported that this 1960s system is coded in an obsolete computer language and, as recently as 1988, was found to lack formal documentation supporting the Department's life insurance statements. VA reported in 1989 that by the middle of 1990 the documentation problem should be corrected. However, it reported that full correction of all material weaknesses in this system is not expected until 1992 or 1993.

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## Additional Special Concerns Also Reported

In addition to reporting material internal control and accounting system weaknesses, VA's 1989 FMFIA report also disclosed seven areas identified by the Office of Management and Budget (OMB) and VA officials as highly vulnerable to fraud, waste, or abuse. These "high risk" areas include the following:

- Physician Employment Screening. This issue concerns the need to verify physicians' credentials and certifications and was reported as a material internal control weakness under the program management category in 1989.
- Drug Control. Drug stock management and inventory control problems were identified in 1983 and were reported by VA as a material internal control weakness in the program management category.

- Departmental Follow-up Systems. This issue concerns VA's lack of an adequate follow-up system to track the correction of problems identified in audits and internal control assessments.
- Oversight and Review in VA Loan Guaranty Program. OMB sees this as a high-risk area because of the program's similarities to the Department of Housing and Urban Development's Federal Housing Administration program and has urged the Secretary to consider a concentrated review of the VA program's internal controls and operations.
- Procedures for Constructing Health Care Facilities. VA reported this high-risk area as a material internal control weakness in its 1989 report under the program/project management category. In its 1989 report, VA stated that the weakness was first identified in 1983 and corrected in 1989. However, it goes on to say that contracting and contract administration remains a material weakness and that VA has developed a corrective action plan for this area.
- Compensation and Pension. OMB has indicated that the integrity of VA's compensation and pension programs requires further assurance. VA reports in 1989 that it has recognized the need to establish a nationwide income verification system to eliminate or significantly reduce benefit overpayments caused by misreporting of income by pension beneficiaries. This concern was reported as a material internal control weakness in VA's 1989 report under the program/project management category.
- Review of Internal Controls. The internal controls review process is viewed by both OMB and VA as a high priority. VA reports that the review process is being redefined to provide reasonable assurance that proper attention is paid to each of VA's problem areas and that a linkage is established between material weaknesses and their legislative, budgetary, or other resource solutions.

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As previously stated, we are advocating that, similar to a discussion and analysis of operating results, agencies include summaries of their annual FMFIA reports in their future annual reports. We believe it would be beneficial to the Congress, the President, and other users to receive an annual report complete with an independent auditor's attestation of management's representations in the form of an opinion on the financial statements and on the FMFIA report. Finally, as a result of our audit, we are not aware of any information which would contradict the matters included in VA's FMFIA reports and summarized in this appendix.

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