Notes to Consolidated Financial Statements

For the Years Ended September 30, 2006 and 2005 (dollars in millions, unless otherwise noted).

1. Summary of Significant Accounting Policies

Basis of Presentation

The Department of Veterans Affairs' (VA) consolidated financial statements report all activities of VA components, including the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and staff organizations. The consolidated financial statements meet the requirements of the Chief Financial Officers Act (CFO) of 1990 and the Government Management Reform Act (GMRA) of 1994. The consolidated financial statements differ from the financial reports used to monitor and control budgetary resources, but are prepared from the same books and records. The statements should be read with the understanding that VA is a component unit of the U.S. Government. VA fiscal year (FY) 2006 and FY 2005 financial statements are presented in conformity with the Office of Management and Budget's (OMB) Circular A-136, Financial Reporting Requirements.

Reporting Entity

The mission of VA is to provide medical care, benefits, social support, and lasting memorials to veterans, their dependents, and beneficiaries [(38 U.S.C. Section 301(b) 1997)].

The Department is organized under the Secretary of VA. The Secretary's office includes a Deputy Secretary and has direct lines of authority over the Under Secretary for Health, the Under Secretary for Benefits, and the Under Secretary for Memorial Affairs. Additionally, six Assistant Secretaries, an Inspector General, a General Counsel, and the chairmen of the Board of Contract Appeals and the Board of Veterans' Appeals support the Secretary.

Budgets and Budgetary Accounting

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources, and facilitates compliance with legal constraints and controls over the use of federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of the purchase. Assets and liabilities that do not consume budgetary resources are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) standards. The Comptroller General of the United States, the Secretary of the Treasury, and the Director of the OMB sponsor FASAB, which determines federal accounting concepts and standards.

Revenues and Other Financing Sources

Exchange revenues are recognized when earned to the extent the revenue is payable to VA from other federal agencies or the public as a result of costs incurred or services performed on its behalf. Revenue is recognized at the point the service is rendered. Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by Treasury's Judgment Fund and post-retirement benefits for VA employees. Non-exchange revenue, e.g., donations, is recognized when received, and related receivables are recognized when measurable and legally collectible, as are refunds and related offsets.

Accounting for Intragovernmental Activities

VA, as a department of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these consolidated financial statements do not reflect the results of all financial decisions applicable to VA as though the Department were a stand-alone entity.

In order to prepare reliable financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements.

Fund Balance with Treasury

The Department of the Treasury (Treasury) performs cash management activities for all federal government agencies. The Fund Balance with Treasury represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Educational Assistance Trust Fund, the National Service Life Insurance (NSLI) Fund, the United States Government Life Insurance (USGLI) Fund, the Veterans Special Life Insurance (VSLI) Fund, General Post Fund, and the National Cemetery Gift Fund. The use of these funds is restricted.

Cash

Cash consists of Canteen Service and Loan Guaranty Program amounts held in commercial banks, cash held by non-federal trusts as well as Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Amounts relating to the Loan Guaranty Program represent deposits with trustees for offsets against loan loss claims related to sold loan portfolios. Funds held by non-federal trusts are restricted and may be used only in accordance with the terms of the trust agreements.

Investments

Investments are reported at cost and are redeemable at any time for their original purchase price. Insurance program investments, which comprise most of VA's investments, are in non-marketable Treasury special bonds and certificates. Interest rates for Treasury special securities are based on average market yields for comparable Treasury issues. Special bonds, which mature during various years through the year 2021, are generally held to maturity unless needed to finance insurance claims and dividends. Other program investments are in securities issued by Treasury, with the exception of non-federal Trust investments in mutual funds and the Loan Guaranty Program investments in trust certificates issued by the American Housing Trusts.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in American Housing Trust certificates I through V. The estimated allowance computations are based upon discounted cash flow analysis. Although VA continues to use the income from these subordinated certificates to cover the immediate cash requirements of the federal guarantee on loans sold under American Housing Trust certificates VI through XI and the Veterans Mortgage Trust program, the income is reimbursed to VA and is not used to pay the amount of the realized losses on guaranteed loan sales.

Accounts Receivable

Intragovernmental accounts receivable consists of amounts due from other federal government agencies. No allowances for losses are required.

Public accounts receivable consists mainly of amounts due for veterans' health care and amounts due for compensation, pension, and readjustment benefit overpayments. Allowances are based on prior experience. For FY 2006, contractual adjustments were 56 percent and bad debt allowances for medical-related receivables were 11 percent. For FY 2005, contractual adjustments were 54 percent and bad debt allowances for medical-related receivables were 9 percent. Educational–related receivables bad debt allowances were 38 percent for FY 2006 and 45 percent for FY 2005. Compensation and pension benefits overpayment-related bad debt receivables were 73 percent for FY 2006 and FY 2005.

VA is required by Public Law 96-466 to charge interest and administrative costs on benefits debts similar to charges levied on other debts owed the federal government. In a July 1992 decision, the then-VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. This decision continues to be VA policy.

Loans Receivable
Loans Receivable are recorded as funds are disbursed. For loans obligated prior to October 1, 1991, loan principal and interest receivable amounts are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience and an analysis of outstanding balances. For loans obligated after September 30, 1991, an allowance equal to the subsidy costs associated with these loans adjusts the loans receivable. This adjustment is due to the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows.

Inventories
Inventories consist of items such as precious metals held for sale and Canteen Service retail store stock and are valued at cost. VA follows the purchase method of accounting for operating supplies, medical supplies, and pharmaceutical supplies in the hands of end users. The purchase method provides that these items be expensed when purchased. VA defines an end user as a VA medical center, regional office, or cemetery.

Property, Plant, and Equipment
The majority of the general property, plant, and equipment is used to provide medical care to veterans and is valued at cost, including transfers from other federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Construction costs are capitalized as Construction in Progress until completion, and then transferred to the appropriate property account. Other includes items such as leasehold improvements and structures not classified as buildings. Individual items are capitalized if the useful life is 2 years or more and the unit price is $100,000 or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is also depreciated on a straight-line basis over its useful life, usually 5 to 20 years. There are no restrictions on the use or convertibility of general property, plant, and equipment. All VA heritage assets are multi-use facilities and are classified as general property, plant, and equipment.

Other Assets
Other assets consist of advance payments. Public advance payments are primarily to hospitals and medical schools under house staff contracts, grantees, beneficiaries, and employees on official travel. Intragovernmental advance payments are primarily to the General Services Administration (GSA) for rent and Government Printing Office (GPO) for supplies, printing, and equipment.

Heritage Assets
Heritage assets are properties that possess one or more of the following characteristics: historical or natural significance; cultural; educational or aesthetic value; or significant architectural characteristics. The monetary value of heritage assets is often not estimable or relevant. By nature they are expected to be maintained in perpetuity. VA has properties at medical centers and national cemeteries that meet the criteria for a heritage asset. During the reporting period, all maintenance expenses were recorded as incurred. Heritage assets are reported in terms of physical units. Generally, additions to VA's Heritage Asset inventory result from field station surveys, which identify items such as new collections or newly designated assets. Items are generally donated or existing VA assets are designated as heritage. Most are used for mission purpose and maintained in working order. Remaining items are mothballed.

Accounts Payable
Intragovernmental accounts payable consists of amounts owed to other federal government agencies. The remaining accounts payable consist of amounts due to the public.

Loan Guarantees
For direct loan obligations and loan guaranty commitments made after 1991, the resulting direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. The present value of the subsidy costs associated with direct loans and loan guarantees is recognized as a cost in the year the direct or guaranteed loan is disbursed. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimated will most likely require a future cash outflow to pay defaulted claims. Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The guaranteed loan sales liability represents the present value of the estimated cash flows to be paid by VA as a result of the guarantee. VA guarantees that the principal and interest payment due on a loan will be paid by the 15th of each month. If the payment is not made, VA allows the loan servicer to receive funds from a cash reserve account for the amount of the deficiency. VA guarantees the loans against losses at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

Debt
All intragovernmental debt is due to Treasury and is primarily related to borrowing by the Direct Loan and Loan Guaranty Program. The interest rates ranged from 4.73 to 4.99 percent in FY 2006 and from 2.94 to 4.72 percent in FY 2005. VA's financial activities interact with and are dependent upon those of the federal government as a whole.

Insurance Liabilities
Actuarial reserve liabilities for VA's insurance programs are based on mortality and interest rate assumptions at the time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest rate assumptions range from 2.25 to 5.0 percent for both the FY 2006 and FY 2005 calculations.

Annual Leave
The accrued annual leave balance is adjusted at the end of the fiscal year to reflect current pay rates for leave that has been earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not used, funding will be obtained from future financing sources.

Workers' Compensation Liability
The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. Claims incurred for benefits for VA employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by VA.

Workers' compensation is comprised of two components: (1) the accrued liability which represents money owed by VA to DOL for claims paid by DOL on behalf of VA through the current fiscal year, and (2) the actuarial liability for compensation cases to be paid beyond the current year.

Future workers' compensation estimates are generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases and for potential cases related to injuries incurred but not reported. The liability is determined by utilizing historical benefit payment patterns related to a particular period to estimate the ultimate payments related to that period.

Pension, Other Retirement Benefits, and Other Post-Employment Benefits
Each employing federal agency is required to recognize its share of the cost and imputed financing of providing pension and post-retirement health benefits and life insurance to its employees. Factors used in the calculation of these pensions and post-retirement health and life insurance benefit expenses are provided by the Office of Personnel Management (OPM) to each agency.

VA's employees are covered under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) to which VA makes contributions according to plan requirements. CSRS and FERS are multi-employer plans. VA does not maintain or report information about the assets of the plans, nor does it report actuarial data for the accumulated plan benefits. That reporting is the responsibility of OPM.

Veterans Benefits Liability
VA provides compensation benefits to veterans who are disabled by military service-related causes. Benefits are also provided to deceased veterans' beneficiaries. These benefits are provided in recognition of a veteran's military service. The liability for future compensation payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Various assumptions in the actuarial model, such as the number of veterans and dependents receiving payments, discount rates, cost of living adjustments, and life expectancy, impact the amount of the liability.

Litigation
VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations.

Non-Federal Trusts
VA has entered into enhanced-use leases to maximize use of underutilized VA property. In seven of these enhanced-use leases, the assets and liabilities were transferred to a non-federal trust. The assets, liabilities, and results of operations of these seven trusts are consolidated in VA's consolidated financial statements.

Estimates
The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

2. Non-Entity Assets

Entity and Non-Entity assets have been combined on the face of the balance sheet. Non-Entity assets relate primarily to patient funds.

Non-Entity Assets as of September 30,	2006	2005
Fund Balance with Treasury	$ 41	$ 47
Intragovernmental Accounts Receivable	1	1
Public Accounts receivable	16	13
Total Non-Entity Assets	$ 58	$ 61

3. Fund Balance with Treasury

Fund Balance with Treasury as of September 30,	2006	2005
Entity Assets		
Trust Funds	$ 80	$ 86
Revolving Funds	4,178	6,499
Appropriated Funds	11,618	10,288
Special Funds	171	158
Other Fund Types	41	9
Total Entity Assets	$ 16,088	$ 17,040
Non-Entity Assets		
Other Fund Types	41	47
Total Non-Entity Assets	41	47
Total Entity and Non-Entity Assets	$ 16,129	$ 17,087
Reconciliation of VA General Ledger Balances with Treasury		
Entity VA General Ledger	$ 17,824	$ 17,504
Reconciled Differences	(1,693)	(410)
Unreconciled Differences	(2)	(7)
Fund Balance with Treasury	$ 16,129	$ 17,087
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 5,134	$ 4,356
Unavailable	4,609	6,326
Obligated Balance not yet Disbursed	6,304	6,349
Deposit /Clearing Account Balances	82	56
Fund Balance with Treasury	$ 16,129	$ 17,087

4. Cash

Cash as of September 30,	2006	2005
Canteen Service	$ 1	$ 1
Agent Cashier Advance	4	4
Loan Guaranty Program	23	35
Funds Held by Non-Federal Trusts*	-	47
Total Cash	$ 28	$ 87

*Funds held by non-federal trusts are restricted and may be used only in accordance with the terms of the trust agreements.

5. Investments

Investment Securities as of September 30,	Interest Range	2006	2005
Intragovernmental Securities			
Special Bonds	3.25 – 8.75%	$ 12,591	$ 12,993
Treasury Notes*	2.875 – 4.375%	66	65
Treasury Bills	1.22 – 2.58%	26	26
Subtotal		12,683	13,084
Accrued Interest		190	202
Total Intragovernmental Securities		$ 12,873	$ 13,286
Other Securities			
Trust Certificates (Loan Guaranty)		138	178
Mutual Funds (Non-Federal Trusts)		45	-
Total Other Securities		$ 183	$ 178

*The investment in Treasury Notes includes unamortized premiums of $0.1 both as of September 30, 2006 and as of September 30, 2005. Premiums and discounts are amortized on a straight-line basis over the life of the investments.

Offset for Losses on Investments as of September 30,	2006	2005
Investments in Subordinate Certificates at Time of Sale	$ 424	$ 424
Cumulative Reductions	(285)	(241)
Subtotal	139	183
Allocation of Loss Provision	(1)	(5)
Trust Certificates (Loan Guaranty)	$ 138	$ 178

6. Accounts Receivable, Net

Accounts Receivable, Net as of September 30,	2006	2005
Intragovernmental Accounts Receivable, Net	$ 107	$ 72
Public Accounts Receivable		
Public Accounts Receivable, Gross	$ 2,419	$ 1,964
Allowance for Loss Provision	(1,256)	(1,044)
Net Public Accounts Receivable	$ 1,163	$ 920

7. Direct Loans and Loan Guarantees

Direct loan obligations and loan guarantee commitments made after 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990. The Act provides that the present value of the subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. Direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimates will most likely require a future cash outflow to pay defaulted claims.

Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The recorded value of loans receivable, net, and the value of assets related to direct loans are not the same as the proceeds that VA would expect to receive from selling its loans. VA operates the following direct loan and loan guaranty programs:

- Vocational Rehabilitation and Employment
- Education
- Insurance
- Loan Guaranty

Under the Loan Guaranty Program, a loan may be made to an eligible veteran by an approved private sector mortgage lender. VA guarantees payment of a fixed percentage of the loan indebtedness to the holder of such a loan, up to a maximum dollar amount, in the event of default by the veteran borrower. Occasionally, a delinquency is reported to VA and neither a realistic alternative to foreclosure is offered by the loan holder nor is VA in a position to supplementally service the loan. In such cases, VA determines, through an economic analysis, whether VA will authorize the holder to convey the property securing the loan (foreclosure) or pay the loan guarantee amount to the holder.

Direct Loans
Loans receivable related to direct loans represent the net value of assets related to acquired pre-1992 and post-1991 direct loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). For post-1991 loans, the assets are offset by an allowance for subsidy costs at present value. An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the direct loans are provided in the tables that follow:

Loans Receivable and Related Foreclosed Property From Direct Loans

as of September 30, 2006	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	$ 45	$ 5	$ -	$ -	$ 50
Direct Loans Obligated after 1991	894	17	82	28	1,021
Insurance Policy Loans	641	16	-	-	657
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					$ 1,728

Loans Receivable and Related Foreclosed Property From Direct Loans

as of September 30, 2005	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	$ 60	$ 5	$ -	$ -	$ 65
Direct Loans Obligated after 1991	956	23	(27)	33	985
Insurance Policy Loans	674	16	-	-	690
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					$ 1,740

Direct Loans Disbursed
The total amount of new direct loans disbursed for the years ended September 30, 2006 and 2005, was $145 and $192, respectively.

Provision for Losses on Pre-1992 Loans
The present value of the cost VA will bear as loans already guaranteed default is an element of the mortgage loan benefit that VA provides to veterans. This cost is reflected in the financial statements as an offset to the value of certain related assets.

The provision for losses on vendee loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The calculation is also based on the use of the average interest rate of U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding guaranteed loans will default over a 12-year period. For FY 2006, VA determined that these vendee loans have sufficient equity, due to real estate appreciation and buy-down of principal, to minimize or eliminate any potential loss to VA. The components of the provision are as follows:

Provision for Loss as of September 30,	2006	2005
Offsets Against Foreclosed Property Held for Sale	$ 45	$ 58
Total Provision for Loss	$ 45	$ 58

Subsidy Expense for Post-1991 Direct Loans

Pursuant to the Credit Reform Act, all direct loans established after September 30, 1991, will be subsidized. The subsidy expense for direct loans is as shown:

Direct Loan Subsidy Expense for the years ended September 30,	2006	2005
Interest Differential	$ (15)	$ (33)
Defaults*	9	5
Fees**	(2)	(3)
Other***	11	21
Subtotal	3	(10)
Interest Rate Reestimates	(22)	(31)
Technical Reestimates	(74)	(49)
Total Direct Loan Subsidy Expense	$ (93)	$ (90)

* Includes approximately $39 thousand and $50 thousand in defaults and other expenses for the Vocational Rehabilitation Program in FY 2006 and 2005 respectively.
** "Fees" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.
*** The "Other" expense for direct loans includes the estimated loss of scheduled principal and interest when vendee loans are sold.

Subsidy Rates for Direct Loans by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy rates for direct loans	
Interest Differential	(20.46%)
Defaults	11.71%
Fees	(2.12%)
Other	14.35%

Allowance for Subsidy for Direct Loans (Post-1991)
VA reports the allowance for subsidy for direct loans, subject to Credit Reform requirements. For these loans, the allowance for subsidy represents the present value of the estimated net cash flows to be paid by VA as a result of a disbursed direct loan. VA disburses a direct loan and receives an allowance for subsidy along with borrowing from Treasury. For FY 2006, the subsidy rate is (5.64) percent for Veterans Housing Direct – Vendee Loans, 9.18 percent for Veterans Housing Direct – Acquired Loans, and (13.79) percent for Native American Direct. In FY 2005, the subsidy rate was (5.12) percent for Veterans Housing Direct and (7.75) percent for Native American Direct. The allowance for subsidy as of September 30, 2006 and 2005 is $(82) and $27, respectively.

Schedule for Reconciling Subsidy Cost Allowance Balances

Beginning Balance, Changes and Ending Balance	**FY 2006**	**FY 2005**
Beginning balance of the allowance	$ 27	$ 166
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(15)	(33)
Default costs (net of recoveries)	9	5
Fees and other collections	(2)	(3)
Other subsidy costs	11	21
Total of the above subsidy expense components	3	(10)
Adjustments:		
Fees received	3	3
Foreclosed property acquired	(9)	(31)
Loans written off	(5)	(5)
Subsidy allowance amortization	(5)	(16)
Ending balance of the allowance before reestimates	14	107
Subsidy reestimates by component		
Interest rate reestimate	(22)	(31)
Technical/default reestimate	(74)	(49)
Total of the above reestimate components	(96)	(80)
Ending balance of the allowance	$ (82)	$ 27

Loan Guarantees
Loans receivable related to loan guarantees represent the net value of assets related to pre-1992 and post-1991 defaulted guaranteed loans and non-defaulted guaranteed loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy costs associated with loan guarantees are provided in the tables that follow:

Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30,

2006	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans Pre-1992 Guarantees	87	1	(72)	14	30
Defaulted Guaranteed Loans Post-1991	-	-	-	579	579
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 609

Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30,

2005	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans Pre-1992 Guarantees	102	1	(94)	18	27
Defaulted Guaranteed Loans Post-1991	-	-	-	553	553
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 580

Total Loans Receivable and Related Foreclosed Property, Net

As of September 30,	2006	2005
Total Direct Loans	$ 1,728	$ 1,740
Total Guaranteed Loans	609	580
Total Loans Receivable and Related Foreclosed Property, Net	$ 2,337	$ 2,320

Foreclosed Property

Prior to the foreclosure of property secured by a VA loan, VA obtains an independent appraisal of the property. This appraisal is reviewed by VA staff to make a determination of the fair market value. To determine the net value of the property, VA expenses such as costs for acquisition, management, and disposition of the property, as well as estimated losses on property resale, are subtracted from the estimated fair market value. As of September 30, 2006 and 2005, the estimated number of residential properties in VA's inventory was 6,490 and 7,288 respectively. For FY 2006 and FY 2005, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 10.4 months and 14.1 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 4,703 and 6,567 as of September 30, 2006 and 2005, respectively.

Guaranteed Loans as of September 30,	2006	2005
Guaranteed Loans Outstanding:		
Outstanding Principal Guaranteed Loans, Face Value	$ 203,186	$ 202,073
Amount of Outstanding Guarantee	61,277	62,114
New Guaranteed Loans Disbursed:		
Outstanding Principal Guaranteed Loans, Face Value	$ 24,638	$ 24,901
Amount of Outstanding Guarantee	6,485	6,808
Liabilities for Loan Guarantees Post 1991 (Present Value)	$ 3,272	$ 3,465

Guaranty Commitments

As of September 30, 2006, VA had outstanding commitments to guarantee loans that will originate in FY 2007. The number and amount of commitments could not be determined, as VA has granted authority to various lenders to originate VA loans that meet established criteria without prior VA approval. Nearly 99 percent of VA's guaranteed loans originate under this authority.

Subsidy Expense for Post-1991 Loan Guarantees

Pursuant to the Credit Reform Act, guaranteed loans closed after September 30, 1991, will be subsidized. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

Guaranteed Loan Subsidy Expenses for the years ended September 30,	2006	2005
Defaults	$ 327	$ 343
Fees*	(400)	(417)
Subtotal	(73)	(74)
Interest Rate Reestimates	(256)	(421)
Technical Reestimates	(479)	(1,025)
Total Guaranteed Loan Subsidy Expenses**	$ (808)	$ (1,520)

* The "Fees" expense includes estimated up-front fees collected when the loans are guaranteed and the present value of estimated annual fees from loan assumptions.

** A negative subsidy rate indicates cash inflows from interest and fees are greater than disbursements.

Loan Sale-Guaranteed Loan Subsidy Expense for the years ended September 30,

	2006	2005
Defaults	$ -	$ -
Other	-	-
Subtotal	-	-
Interest Rate Reestimates	(45)	(25)
Technical Reestimates	(39)	(42)
Total Loan Sale-Guaranteed Subsidy Expense	$ (84)	$ (67)

Total Subsidy Expense for the years ended September 30,

	2006	2005
Total Direct Loans	$ (93)	$ (90)
Total Guaranteed Loans	(808)	(1,520)
Total Sale Loans	(84)	(67)
Total Subsidy Expense	$ (985)	$ (1,677)

Subsidy Rates for Loan Guarantees by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loan guarantees reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Loan Guarantees

Defaults	1.39%
Fees	(1.70%)

Loan Sales

VA continues to have vendee loan sales to reduce the administrative burden of servicing vendee loans. During the period FY 1992 through FY 2006, the total loans sold amounted to $13.8 billion. Under the sale of vendee loans, certificates are issued pursuant to the Pooling and Servicing Agreement (the Agreement) among VA, the Master Servicer, and the Trustee. On the closing date of the certificates, VA transfers its entire interest in the related loans to the Trustee for the benefit of the related certificate holders pursuant to the Agreement. Under the Agreement, the Trust will issue certificates backed by mortgage loans and installment contracts. The Trust owns the mortgage loans and other property described in the offering and the Trust makes elections to treat certain of its assets as one or more Real Estate Mortgage Investment Conduits (REMIC) for U.S. federal income tax purposes. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. The certificates are issued as part of a designated series that may include one or more classes. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates and that guaranty is backed by the full faith and credit of the federal government.

VA may terminate the Trust, causing the early retirement of certificates, by purchasing all of the Trust's assets on any distribution date on or after the distribution date on which the current aggregate principal balance of all principal certificates is less than 1 percent of the original aggregate principal balance, or if VA determines that the Trust's REMIC status has been lost or a substantial risk exists that such status will be lost. In the event of termination, the certificate holder will be entitled to receive payment for the full principal balance of the certificates plus any accrued interest and unpaid interest through the related distribution date.

The Agreement requires the mortgage loans to be serviced generally in compliance with Fannie Mae and Freddie Mac standards and consistent with prudent residential mortgage loan servicing standards generally accepted in the servicing industry. Mortgage loans are serviced by Countrywide Home Loans, Inc. (Master Servicer). The Master Servicer is responsible for the performance of all of the servicing functions under the Agreement. The Master Servicer is entitled to be compensated by receiving: (1) a service fee of 0.2075 percent per annum payable monthly and calculated by multiplying the interest payment received by a fraction, the numerator of which is 0.2075 percent and the denominator of which is the mortgage interest rate on such loan; (2) earnings on investment of funds in the certificate account; and (3) all incidental fees and other charges paid by the borrowers and a portion of the liquidation proceeds in connection with the liquidated loans.

VA did not complete any sales during FY 2006 and FY 2005. The components of the vendee sales are summarized in the tables below:

Loan Sales
Years ended September 30,

	2006	2005
Loans Receivable Sold	$ -	$ -
Net Proceeds From Sale	-	(2)*
Loss (Gain) on Receivables Sold	$ -	$ (2)

* Misc. Proceeds from the Old Reserve Account

Outstanding Balance of Loan Sale Guarantees
All loans sold under the American Housing Trust (AHT VI through AHT XI) and the Vendee Mortgage (VMT 92-1 through 03-1) programs carry a full government guarantee. The outstanding balance for guaranteed loans sold is summarized in the table below:

Guaranteed Loans Sold
as of September 30,

	2006	2005
Outstanding Balance Guaranteed Loans Sold, Start of Year	$ 3,012	$ 4,188
Sold to the Public	-	-
Payments, Repayments, and Terminations	(648)	(1,176)
Outstanding Balance Guaranteed Loans Sold, End of Year	$ 2,364	$ 3,012

Liability for Loan Sale Guarantees (Post-1991)
VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs, subject to Credit Reform requirements. For these loans, the guaranteed loan sale liability represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee. These sales contain two types of guarantees for which VA pays net cash flow. VA guarantees that the principal and interest payment due on a

loan sold will be paid by the 15th of each month. If not paid by the borrower, VA allows the loan servicer to take funds from cash reserve accounts for the deficient amount. VA also guarantees the loan against loss at foreclosure. VA will not buy back the loans but will pay off the loan loss and foreclosure expenses. The subsidy rate for FY 2006 is 4.12 percent. For FY 2005 the subsidy rate was 3.69 percent. The liability for loan sale guarantees as of September 30, 2006 and 2005 is $102 and $188, respectively.

Schedule for Reconciling Loan Sale Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2006**	**2005**
Beginning balance of the liability	$ 188	$ 255
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	-	-
Other subsidy costs	-	-
Total of the above subsidy expense components	-	-
Adjustments:		
Claim payments to lenders	(15)	(10)
Interest accumulation on the liability balance	14	8
Other	-	2
Ending balance of the liability before reestimates	187	255
Subsidy reestimates by component		
Interest rate reestimate	(45)	(25)
Technical/default reestimate	(40)	(42)
Total of the above reestimate components	(85)	(67)
Ending balance of the liability	$ 102	$ 188

Liability for Loan Guarantees (Post-1991)
VA reports the liability on the guarantee of loans, subject to Credit Reform requirements. For these loans, the guaranteed loan liability represents the present value of the estimated net cash flows to be paid by VA as a result of a defaulted loan guarantee. VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to a legally specified maximum based on the value of individual loans. VA will pay the lender the guarantee and foreclosure expenses. If an agreement can be made with the veteran, VA may acquire the loan by refunding the lender for the loan. The FY 2006 and FY 2005 subsidy rate was (0.32) percent. The liability for loan guarantees as of September 30, 2006 and 2005 is $3,170 and $3,277, respectively.

Schedule for Reconciling Loan Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2006**	**2005**
Beginning balance of the liability	$ 3,277	$ 4,485
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	327	343
Fees and other collections	(400)	(417)
Total of the above subsidy expense components	(73)	(74)

Beginning Balance, Changes and Ending Balance	2006	2005
Adjustments:		
Fees received	439	411
Foreclosed property and loans acquired	120	23
Claim payments to lenders	(273)	(340)
Interest accumulation on the liability balance	189	218
Other – reestimate due to Hurricane Katrina	225	-
Ending balance of the liability before reestimates	3,904	4,723
Subsidy re-estimates by component		
Interest rate reestimate	(256)	(421)
Technical/default re-estimate	(478)	(1,025)
Total of the above reestimate components	(734)	(1,446)
Ending balance of the liability	$ 3,170	$ 3,277

Administrative Expense
Administrative expense on direct and guaranteed loans for each of the years ended September 30, 2006 and 2005 was $154.

8. Inventory and Related Properties

Inventories as of September 30,	2006	2005
Held for Current Sale	$ 65	$ 66
Other	4	10
Total Inventories	$ 69	$ 76

9. General Property, Plant and Equipment

Depreciation and amortization expense totaled $865 and $812 in FY 2006 and FY 2005, respectively.

General Property, Plant and Equipment as of Sept. 30, 2006	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	$ 370	$ (25)	$ 345
Buildings	15,876	(7,989)	7,887
Equipment	3,368	(1,937)	1,431
Other	2,014	(1,233)	781
Work in Progress	1,194	-	1,194
Total Property, Plant, and Equipment	$ 22,822	$ (11,184)	$ 11,638

General Property, Plant and Equipment as of Sept. 30, 2005	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	$ 323	$ (17)	$ 306
Buildings	15,457	(7,523)	7,934
Equipment	3,174	(1,889)	1,285
Other	1,923	(1,160)	763
Work in Progress	944	-	944
Total Property, Plant, and Equipment	$ 21,821	$ (10,589)	$ 11,232

Hurricane damage to the Gulfport VAMC resulted in a $19 reduction in the Net Book Value of Property, Plant and Equipment during FY 2005.

10. Liabilities Not Covered By Budgetary Resources

The total amount of VA liabilities not covered by budgetary resources was $1,158.9 billion and $1,127.5 billion as of September 30, 2006 and 2005, respectively, as shown in the following table.

Components of Unfunded Liabilities as of September 30,	2006	2005
Workers' Compensation*	$ 2,179	$ 2,133
Annual Leave	1,248	1,216
Judgment Fund	615	522
Environmental and Disposal	384	376
Accounts Payable – Canceled Appropriations	7	6
Veterans Compensation and Burial	1,153,800	1,122,600
Insurance	706	666
Total	$ 1,158,939	$ 1,127,519

* The actuarial estimate for workers' compensation provided by DOL was computed using interest rates of 5.31 percent for FY 2006 and 4.53 percent for FY 2005.

11. Federal Employee and Veterans Benefits

Federal Employee Benefits

Imputed Expenses-Employee Benefits years ended September 30,	2006	2005
Civil Service Retirement System	$ 294	$ 356
Federal Employees Health Benefits	939	874
Federal Employees Group Life Insurance	2	2
Total Imputed Expenses-Employee Benefits	$ 1,235	$ 1,232

Veterans Benefits

Certain veterans who die or are disabled from military service-related causes, as well as their dependents, receive compensation benefits. Also, veterans are provided with burial flags, headstones/markers, and grave liners for burial in a VA national cemetery or are provided a plot allowance for burial in a private cemetery. These benefits are provided in recognition of a veteran's military service and are recorded as a liability on the balance sheet.

Federal Employee and Veterans Benefits Liabilities as of September 30,	2006	2005
FECA	$ 1,812	$ 1,776
Compensation	1,149,900	1,118,800
Burial	3,900	3,800
Total Federal Employee and Veterans Benefits Liabilities	$ 1,155,612	$ 1,124,376

VA provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled from nonservice-related causes. The actuarial present value of the future liability for pension benefits is a non-exchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2006 and 2005 was $97 billion and $96.8 billion, respectively.

Assumptions Used to Calculate the Veterans Benefits Liability

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for the projected benefit payments to: (1) those beneficiaries, including veterans and survivors, currently receiving benefit payments; (2) current veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become veterans in the future. Future benefits payments to survivors of those veterans in classes (1), (2), and (3) are also incorporated into the projection.

All future benefits were discounted. Discount rates were based on rates for securities issued by Treasury on September 30, 2006, ranging from 4.59 to 4.93 percent, and on September 30, 2005, ranging from 4.11 to 4.74 percent. Beginning in FY 2004, the discount rates used were based on U.S. Treasury's spot rates rather than corresponding constant maturity rate, which were used in previous years**.** Benefit payments were assumed to occur at the midpoint of the fiscal year.

All calculations were performed separately by attained age for the Compensation and Pension programs, while the Burial liability was calculated on an aggregate basis.

Life expectancies of beneficiaries collecting benefits from the Compensation and Pension programs were based upon studies of mortality experience of those beneficiaries between 2002 and 2006. Life expectancies of veterans not yet collecting these benefits used in the calculation of the liability for future beneficiaries are based on mortality derived from the 2003 U.S. Life Table. Applying mortality improvements at a rate that varies by age of between 0.85 and 1.00 percent per annum brought both sets of mortality rates forward. In addition, rates of benefit termination of beneficiaries due to reasons other than mortality are also reflected.

The amount of benefits by beneficiary category and age were based on current amounts being paid, future cost of living adjustments (COLAs) to determine the average benefits per veteran for each future time period, and changes in other factors that affect benefits. A COLA of 3.3 percent was applied for FY 2007. For fiscal years after 2006, COLAs have been determined from OMB's estimates prepared in conjunction with the Administration's annual budget. Expected changes in benefits due to other reasons were also reflected.

Expected benefit payments have been explicitly modeled for the next 75 years. This period is the same as that used by the Office of the Chief Actuary of the Social Security Administration (SSA). However, unlike Social Security, (1) estimates of expected benefit payments after this 75-year period were incorporated in the liability based on extrapolations reflecting expected aggregate experience by beneficiary category between the years 70 and 75 and (2) SSA uses an open population model, while the C&P projections only reflect benefits associated with military service through September 30, 2006.

12. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $384 and $376 as of September 30, 2006 and 2005, respectively. The majority of the unfunded liabilities involve asbestos removal, lead abatement, replacement of underground oil and gasoline tanks, decommissioning of waste incinerators, and decontamination of equipment prior to disposal.

While some facilities have applied prevailing state regulations that are more stringent than federal guidelines, the Occupational Safety and Health Administration and Environmental Protection Agency regulations are the legal base behind the majority of VA’s environmental and disposal liabilities. Estimated liabilities for these projects are based on known contamination that exists today and have been computed by the facility engineering staff based on similar projects already completed, or by independent contractors providing work estimates.

13. Other Liabilities

Other liabilities are liabilities not reported elsewhere. They consist of Funded and Unfunded Liabilities. Funded liabilities are generally considered to be current liabilities. Unfunded liabilities are generally considered to be non-current liabilities.

Other Intragovernmental Funded Liabilities as of September 30,	2006	2005
Deposit and Clearing Account Liabilities	$ 46	$ 8
Accrued Expenses - Federal	66	123
Deferred Revenue	134	166
Resources Payable to Treasury	238	299
Custodial Liabilities*	964	1,631
General Fund Receipts Liability	17	32
Accrued VA Contributions for Employee Benefits	160	3
Total Other Intragovernmental Funded Liabilities	$ 1,625	$ 2,262

* The Custodial Liabilities Accounts include subsidy reestimates for loans made after September 30, 1991, which are subject to the provisions of the Credit Reform Act of 1990. The liability provision for future losses on credit reform guaranteed loans is comprised of a funded subsidy for each loan guaranteed at the rate equal to the amount of the present value of estimated loss to the government for the cohorts of loans. The subsidy amount for each cohort is reestimated annually to ensure amounts reflect the actual losses on guaranteed loans. Based on the reestimated amounts, additional subsidy funds are provided for or excess funds are returned.

Other Intragovernmental Unfunded Liabilities as of September 30,	2006	2005
Accrued FECA Liability	$ 363	$ 357
Unfunded Employee Liability	4	-
Total Other Intragovernmental Unfunded Liabilities	$ 367	$ 357

Other Public Funded Liabilities as of September 30,	2006	2005
Accrued Funded Annual Leave	$ 12	$ 11
Accrued Expenses	2,427	2,466
Accrued Salaries and Benefits	583	548
Contract Holdbacks	14	11
Deferred Revenue	(2)	1
Unredeemed Coupons	1	1
Deposit and Clearing Account Liability	35	47
Unearned Premiums	95	102
Insurance Dividends Left on Deposit and Related Interest Payable*	1,734	1,725
Dividend Payable to Policyholders	182	203
Capital Lease Liability	19	31
Total Other Public Funded Liabilities	$ 5,100	$ 5,146

* Interest earned on dividends left on deposit is paid annually to insurance policyholders on the policy anniversary dates.

Other Public Unfunded Liabilities as of September 30,	2006	2005
Annual Leave*	$ 1,248	$ 1,216
Accounts Payable from Cancelled Appropriation	7	6
Amounts due to non-federal trust	182	187
Judgment Fund-Unfunded**	616	522
Unpaid Policy Claims	1	-
Total Other Public Unfunded Liabilities	$ 2,054	$ 1,931

* Annual leave is accrued when earned and is adjusted at the end of the fiscal year to reflect current pay rates of cumulative leave earned but not taken. Sick and other types of leave are expensed as taken.
** The Judgment Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgment Fund on behalf of VA.

14. Leases

VA has both capital and operating leases. The capital lease liability is $19 and $31 as of September 30, 2006 and 2005, respectively. Real property leases reflect those that VA has committed to as of September 30, 2006. Due to the number of equipment operating leases and the decentralization of records, the future commitment for equipment operating is projected assuming annual increases between 4.2 and 4.7 percent. VA's FY 2006 operating lease costs were $280 for real property rentals and $89 for equipment rentals. The FY 2005 operating lease costs consisted of $248 for real property rentals and $85 for equipment rental. The following chart represents VA's operating lease commitments or costs for the next 5 years.

Leases:

Year	Real Property	Percentage	Equipment
2007	$ 241	4.7	$ 93
2008	224	4.3	97
2009	209	4.2	101
2010	198	4.2	105
2011	135	4.2	109

15. Insurance Programs

Through VA, the United States Government administers five life insurance programs and the Veterans' Mortgage Life Insurance program for certain totally disabled veterans. VA supervises the Service members' Group Life Insurance (SGLI) and the Veterans' Group Life Insurance (VGLI) programs, which provide life insurance coverage to members of the uniformed armed services, reservists, and post-Vietnam veterans. United States Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.

Administered Programs

The United States Government Life Insurance (USGLI) program was the government's first venture into life insurance. During World War I, the U.S. provided Marine Insurance to protect the interests of ship owners and merchants who were providing supplies to the allies in Europe. USGLI was the natural outgrowth of this Marine Insurance. The program was established to meet the needs of World War I veterans, but remained open to service members and veterans with service before October 8, 1940. The government became a self-insurer because private insurance companies were unwilling to assume the unpredictable risks associated with war. By establishing this program, Congress intended to avoid the financial burden imposed on the government by the pension programs that were established after previous wars. The government became the largest life insurer in the United States with the coverage provided by this program.

The National Service Life Insurance (NSLI) program covers policyholders who served during World War II. The program opened October 8, 1940, when it became clear that large-scale military inductions were imminent. Over 22 policies were issued under the NSLI program. The majority of policies VA administers directly are NSLI policies. This program remained open until April 25, 1951, when two new programs were established for Korean War service members and veterans.

The Veterans' Special Life Insurance (VSLI) program was established in 1951 to meet the insurance needs of veterans who served during the Korean Conflict, and the post-Korean period through January 1, 1957. During this period, all service members on active duty were covered for $10,000, at no cost, under a program known as Servicemen's Indemnity. They remained covered for 120 days after their discharge. The VSLI program allowed these newly discharged service members to apply for $10,000 of contract term insurance. Application had to be made during the 120-day period during which they remained covered by Servicemen's Indemnity. It was during this period that representatives of the commercial insurance industry began a major lobbying effort to get the government out of the insurance business because the programs were viewed as competition. As a result, the VSLI program was closed to new issues at the end of 1956, and coverage for individuals in the uniformed services was terminated. Approximately 800,000 VSLI policies were issued between 1951 and 1957.

In addition to VSLI coverage, which was provided to healthy veterans, the Insurance Act of 1951 also established the Service-Disabled Veterans Insurance (S-DVI) program for veterans with service-connected disabilities. S-DVI is open to veterans separated from the service on or after April 25, 1951, who receive a service-connected disability rating. New policies are still being issued under this program.

In 1964, Congress enacted legislation providing for a limited reopening of NSLI and VSLI, and the Veterans' Reopened Insurance (VRI) program was established. Beginning May 1, 1965, veterans who had been eligible to obtain insurance between October 8, 1940, and January 1, 1957, could once again apply for government life insurance. They had one year to apply for this "reopened" insurance, which was available only to disabled veterans. Approximately 228,000 VRI policies were issued. No term insurance policies were issued in this program.

The Veterans' Mortgage Life Insurance (VMLI) program began in 1971, and is designed to provide financial protection to cover eligible veterans' home mortgages in the event of death. VMLI is issued to those severely disabled veterans who have received grants for specially adapted housing from VA. These grants are issued to veterans whose movement is substantially impaired because of their disability. The maximum amount of VMLI allowed an eligible veteran is $90 thousand. The insurance is payable if the veteran dies before the mortgage is paid off and is payable only to the mortgage lender.

Supervised Insurance Programs
The Service members' Group Life Insurance (SGLI) program was established in 1965 for Vietnam-era service members. SGLI is supervised by VA and is administered by the Office of Service members' Group Life

Insurance (OSGLI) under terms of a group insurance contract. This program provides low-cost term insurance protection to service members.

In 1974, the Veterans' Group Life Insurance (VGLI) program became available. VGLI, like SGLI, is supervised by VA, but is administered by the OSGLI. VGLI provides for the conversion of SGLI coverage to lifetime term insurance protection after a service member's separation from service.

Public Insurance Carriers

VA supervises the administration of the SGLI and VGLI programs. Prudential Insurance Company of America (Prudential) provides insurance coverage directly for the SGLI and VGLI programs. VA has entered into a group policy with Prudential whereby Prudential and its reinsurers provide service members and veterans coverage in multiples of $50 thousand up to a maximum of $400 thousand. The basic SGLI coverage is provided to those members on active duty in the Army, Navy, Air Force, Marine Corps, Coast Guard, commissioned members of the Public Health Service and the National Oceanic and Atmospheric Administration. The Ready Reserve is also insured by SGLI, and includes reservists and members of the National Guard who are assigned to a unit or position in which they may be required to perform active duty or active duty for training. The VGLI coverage is comprised of separated and retired active duty members and reservists covered under Basic SGLI.

The Veterans' Opportunities Act of 2001 extended life insurance coverage to spouses and children of members insured under the SGLI program, effective November 1, 2001. For a spouse, up to $100 thousand of coverage can be purchased in increments of $10 thousand, not to exceed the amount of the service member's coverage. Each dependent child of every active duty service member or reservist insured under SGLI is automatically insured for $10 thousand free of charge.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their spouses are deducted from the service member's pay by the Armed Services components through the Department of Defense (DoD). DoD, through the Defense Finance and Accounting Service (DFAS), remits collected premiums to VA, which are then transmitted to Prudential. Prudential records the premiums and maintains investments in their accounting records separate and independent from the VA reporting entity. VA monitors Prudential's insurance reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. The reserves for the contingent liabilities are recorded in Prudential's accounting records and are not reflected in the VA reporting entity because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy.

Effective January 1, 1970, the Secretary of Veterans Affairs determined the costs that are traceable to the extra hazards of duty in the uniformed services, on the basis of the excess mortality incurred by members and former members of the uniformed armed services insured under SGLI, above what their mortality would have been under peacetime conditions. The Secretary is authorized to make adjustments regarding contributions from pay appropriations as may be indicated from actual experience.

Reserve Liabilities

The insurance reserves for administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and Veterans Insurance and Indemnities (VI&I) reserves are reported as liabilities not covered by budgetary resources. Reserves for SGLI and VGLI are maintained in Prudential's financial records since the risk of loss is assumed by Prudential. Actuarial reserve liabilities for the administered life insurance programs are based on the mortality and interest assumptions at time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest assumptions range from 2.25 to 5 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, and the 1980 CSO Basic Table.

Insurance Liability (Reserve) Balances

Insurance Liability (Reserve) Balances As of September 30, 2006

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 8,644	$ 140	$ 109	$ 8,893
USGLI	22	4	-	26
VSLI	1,555	10	25	1,590
S-DVI	320	3	364	687
VRI	340	1	4	345
VI&I	92	-	-	92
Subtotal	$ 10,973	$ 158	$ 502	$ 11,633
Less Liability not Covered by Budgetary Resources				(707)
Liability Covered by Budgetary Resources				$ 10,926

Insurance Liability (Reserve) Balances As of September 30, 2005

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 9,031	$ 156	$ 126	$ 9,313
USGLI	26	4	-	30
VSLI	1,535	10	28	1,573
S-DVI	313	2	329	644
VRI	359	2	4	365
VI&I	89	-	-	89
Subtotal	$ 11,353	$ 174	$ 487	$ 12,014
Less Liability not Covered by Budgetary Resources				(666)
Liability Covered by Budgetary Resources				$ 11,348

Insurance In-Force
The amount of insurance in-force is the total face amount of life insurance coverage provided by each administered and supervised program as of the end of the fiscal year. It includes any paid-up additional coverage provided under

these policies. Prudential and its reinsurers provided coverage to 5,918,519 and 5,964,000 insured for a face value of $1,096.7 billion and $1,137.4 billion as of September 30, 2006 and 2005, respectively. The face value of the insurance provided by Prudential and its reinsurers represents 98.5 and 98.4 percent of the total insurance in-force as of September 30, 2006 and 2005, respectively. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2006 Policies	2005 Policies	2006 Face Value	2005 Face Value
Supervised Programs				
SGLI Active Duty	1,503,000	1,530,000	$ 590,567	$612,000
SGLI Ready Reservists	768,500	826,500	285,930	325,650
SGLI Post Separation	120,000	126,000	46,580	35,428
SGLI Family - Spouse	1,041,000	988,000	102,416	96,956
SGLI Family - Children	2,058,000	2,076,000	20,580	20,760
VGLI	428,019	417,500	50,676	46,600
Total Supervised	5,918,519	5,964,000	$ 1,096,749	$1,137,394
Administered Programs				
NSLI	1,106,597	1,202,065	$ 12,360	$13,198
VSLI	199,262	206,501	2,453	2,490
S-DVI	181,093	175,200	1,802	1,728
VRI	48,206	52,881	454	488
USGLI	7,841	9,034	24	28
VMLI	2,438	2,514	166	167
Total Administered	1,545,437	1,648,195	$ 17,259	$18,099
Total Supervised and Administered Programs	7,463,956	7,612,195	$1,114,008	$1,155,493

Policy Dividends

The Secretary of VA determines annually the excess funds available for dividend payment. Dividends are based on an actuarial analysis of the individual programs at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. Policyholders can elect to: (1) receive a cash payment; (2) prepay premiums; (3) repay loans; (4) purchase paid-up insurance; or (5) deposit the amount in an interest-bearing account. A provision for dividends is charged to operations, and an insurance dividend is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs. Policy dividends for fiscal years 2006 and 2005 were $401 and $439, respectively.

16. Contingencies

VA is a party in various administrative proceedings, legal actions, and tort claims arising from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice. Certain legal matters to which VA may be a named party are administered and, in some instances, litigated by the Department of Justice. Generally, amounts (more than $2.5 thousand for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award are funded from the Judgment Fund, which is maintained by Treasury. Of the amounts paid from the Judgment Fund, malpractice cases claimed 70 percent in FY 2006 and 69 percent in FY 2005. Contract dispute payments for FY

2006 and FY 2005 were $19.8 and $18.8, respectively. The discrimination case payments for FY 2006 were $2.2 and $1.1 for FY 2005.

VA uses accepted actuarial methods to estimate the liability resulting from medical malpractice and other tort claim exposure. VA discounted future estimated payments using U.S. Treasury spot rates as of September 30, 2006 and 2005. Had these payments not been discounted, the associated liability would have been an additional $83 and $62, respectively.

VA has recorded a liability for pending legal claims that are estimated to be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is required or not. This liability was $616 for FY 2006 and $522 for FY 2005. The contract and personnel law cases where there was at least a reasonable possibility that a loss may occur were 8 cases totaling $17.2 for FY 2006 and 13 cases totaling $62.1 for FY 2005. VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. Judgment Fund accounting is shown below:

Judgment Fund
For the Years Ended September 30,

	2006	**2005**
Fiscal Year Settlement Payments	$ 91	$ 110
Less Contract Dispute and "No Fear" Payments	(22)	(20)
Imputed Financing-Paid by Other Entities	69	90
Increase (Decrease) in Liability for Claims	93	(21)
Operating Expense	$ 162	$ 69

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2006 will not materially affect VA's operations or financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. Fiscal year 2006 tort payments were $69.

The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2006 and 2005 was $35.4 and $25.1, respectively. Any payments due that may arise relating to cancelled appropriations will be paid out of the current year's appropriations in accordance with the provisions of the Expired Funds Control Act of 1990.

VA provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. While VA expects to continue to provide medical care to veterans in future years, an estimate of this amount cannot be reasonably made. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For the fiscal years 2002-2006, the average medical care cost per year was $25.7 billion.

17. Earmarked Funds

SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, requires disclosure of all earmarked funds for which VA has program management responsibility. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, and are required by statute to be used for designated activities or purposes. They are accounted for separately from the Government's general revenues. VA's earmarked funds consist of trusts, special and revolving funds and remain available over time. The "trust" funds do not involve a fiduciary relationship with an individual or group but are designated exclusively for a specific activity, benefit or purpose. The investments (Treasury Securities) are assets of earmarked funds and are available for authorized expenditures. Treasury Securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund the authority to draw upon the US Treasury for future expenditures. When the earmarked fund redeems its Treasury Securities to make expenditures, the US Treasury will finance those expenditures in the same manner that it finances all other expenditures.

Fund Name	Fund Type	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
Medical Care Collections Fund	Special	36x5287	P.L. 105-33 111 Stat 665	Third-party and patient co-payments for medical services.	Public, primarily insurance carriers.
Cemetery Gift Fund	Trust	36x8129	38 U.S.C. 1007	Donations for veterans' cemeteries.	Public donors.
National Service Life Insurance Fund	Trust	36x8132	38 U.S.C. 720	Premiums insure WWII veterans.	Public, veterans.
Post-Vietnam Era Education Assistance Program	Trust	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to veterans.	Veterans, DoD.
U.S. Government Life Insurance	Trust	36x8150	38 U.S.C. 755	Premiums insure WWI veterans.	Public, veterans.
Veterans Special Life Insurance Fund	Trust	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict veterans.	Public, veterans.
General Post Fund, National Homes	Trust	36x8180	38 U.S.C. 101-228	Donations for patient benefits.	Public, mostly veterans.
Canteen Service Revolving Fund	Revolving	36x4014	38 U.S.C. 78	Operates the canteen services at hospitals.	Revenue from sales.
National Cemetery Administration Facilities Operation Fund	Special	36x5392	P.L. 108-454	Proceeds benefit land and buildings.	Proceeds from leases.
Service-Disabled Veterans Insurance Fund	Revolving	36x4012	38 U.S.C. 1922	Provides insurance to veterans with service-connected disabilities	Public, veterans.
Servicemen's Group Life Insurance	Revolving	36x4009	38 U.S.C. 1965	Provides insurance to active duty, ready reservists, retired reservists and cadets attending service academies and ROTC.	Public, veterans.
Veterans Reopened Insurance Fund	Revolving	36x4010	38 U.S.C. 1925	Provides insurance to World War II and Korea veterans	Public, veterans.
Enhanced-Use Lease Trusts	Trust	N/A	38 U.S.C 8162	Lease underutilized VA property.	Public.

The following tables provide condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances:

Balance Sheet as of September 30, 2006	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	$ 33	$ 182	$ 70	$ 1	$ 286
Investments with Treasury	12,780	93	-	-	12,873
Other Assets	660	1,042	1	2	1,705
Total Assets	$ 13,473	$ 1,317	$ 71	$ 3	$ 14,864
Liabilities:					
Payables to Beneficiaries	$ 173	$ 14	$ 1	$ -	$ 188
Other Liabilities	13,552	202	-	-	13,754
Total Liabilities	13,725	216	1	-	13,942
Unexpended Appropriations	-	(6,965)	-	-	(6,965)
Cumulative Results of Operations	(252)	8,066	70	3	7,887
Total Liabilities & Net Position	$ 13,473	$ 1,317	$ 71	$ 3	$ 14,864

Statement of Net Cost for the Year Ended September 30, 2006	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Gross Program Costs	$ 1,383	$ 417	$ 2	$ -	$ 1,802
Less Earned Revenues	1,298	2,561	-	-	3,859
Net Program Costs	85	(2,144)	2	-	(2,057)
Costs Not Attributable to Program Costs	-	14	-	-	14
Net Cost of Operations	$ 85	$ (2,130)	$ 2	$ -	$ (2,043)

Statement of Changes in Net Position for the Year Ended September 30, 2006	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Net Position Beginning of Period	$ (205)	$ 911	$ 72	$ 3	$ 781
Budgetary and Other Financing Sources	38	(1,940)	-	-	(1,902)
Net Cost of Operations	(85)	2,130	(2)	-	2,043
Change in Net Position	(47)	190	(2)	-	141
Net Position End of Period	$ (252)	$ 1,101	$ 70	$ 3	$ 922

18. Exchange Transactions

Exchange Revenues
Although VA recognizes full cost per SFFAS No. 4, VHA has legislated exceptions to the requirement to recover the full cost to the federal government of providing services, resources, or goods for sale. Under "enhanced sharing authority," VHA facilities may enter into arrangements that are in the best interest of the federal government. In FY 2006, 67 contracts at 10 medical facilities were reviewed by the Management Quality Assurance Service (MQAS) to determine compliance with SFFAS No. 7 and the Chief Financial Officers Act of 1990. MQAS found 15 contracts (22 percent) had incomplete or outdated cost analyses and six contracts (9 percent) failed to recover full cost.

VA's Loan Guaranty Program collects rental fees on a small number of properties during the period when the property is titled to VA.

NCA leases lodges at 13 cemeteries to not-for-profit groups for no fee. These not-for-profit groups are required to provide the upkeep on the lodges and pay the costs for utilities, insurance, minor repairs and maintenance and any other costs associated with the lodges, and NCA pays for major repairs at these facilities. NCA also has 4 agricultural leases with private companies/individuals. NCA leases land for growing crops and, on certain leases, receives various services in exchange from the lessee such as brush cutting and removal services, backfilling and grading of roads, and welding services. In addition, NCA received fees for motion picture filming performed at 1 cemetery.

Exchange Transactions with Public
Exchange transactions with the public occur when prices are set by law or executive order and are not based on full cost or on market price. VA's Medical Care Collections Fund, "Conforming Amendments," changed the language of specific sections of 38 USC Chapter 17 to substitute "reasonable charges" for "reasonable cost." The VHA Chief Business Office (CBO) is responsible for implementing and maintaining these reasonable charges for billing third-party payers for services provided to insured veterans for treatment of nonservice-connected conditions.

Reasonable charges are used to bill for reimbursable health insurance, non-federal workers' compensation, tort feasor and no-fault or uninsured motorists insurance cases. Reasonable charges are based on provider charges in the market area of each VA facility. Under regulations issued pursuant to section 1729 and published at section 17.101, title 38, Code of Federal Regulations, third party payers may elect to pay VA's billed charges (less applicable deductible or co-payment amounts) for the care and services provided to veterans. Alternatively, third party payers may elect to pay VA an amount, generally known as usual and customary, that it would pay to other providers for care and services in the same geographic area.

Cost-based per diems are calculated annually to produce rates used to bill for medical care or services provided by the DA:

(a) in error or on tentative eligibility;
(b) in a medical workers' compensation (other than federal), humanitarian emergency;
(c) to pensioners of allied nations;
(d) for research purposes in circumstances under which VA medical care appropriation is to be reimbursed by VA research appropriation; and
(e) to beneficiaries of the Department of Defense or other federal agencies, when the care or service provided is not covered by an applicable sharing agreement.

These per diem costs are derived primarily from cost and workload data from a national cost allocation report.

VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for FY 2006 were $436 and for FY 2005 were $407. The loan guarantee lender participation fees collected for FY 2006 were $1.6. The lender participation fees collected for FY 2005 were $1.7.

Intragovernmental Exchange Transactions
This section discloses intragovernmental exchange transactions in which VA provides goods or services at a price less than the full cost, or does not charge a price at all, with explanations for disparities between the billing and full cost.

VA and DoD have authority to enter into agreements and contracts for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA's General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements, but the total amount billed below full cost is not readily available. VHA is in the process of developing mechanisms to report this information in the future. VBA collects funding from DoD in order to administer certain education programs. DoD transferred $377.8 during FY 2006 for the Post-Vietnam Era Education Assistance Program, Reinstated Entitlements Program for Survivors, and the New GI Bill for Veterans.

VA reports intragovernmental trading partner information to Treasury's Intragovernmental Reporting and Analysis System (IRAS).
VA and our trading partners are not able to completely reconcile all activity
and balances between trading partners due to several factors including transaction volumes, recognition timing issues and system limitations between trading partners.

When VA furnishes medical care or services for beneficiaries of other federal agencies, and that care or service is not covered by an applicable local sharing agreement, the billing rates used are determined and published annually by the VHA CFO. Similar to the tort rates, interagency billing rates are determined from cost and workload data in the Cost Distribution Report.

19. Net Cost of Veterans Affairs Programs

All of VA's net program costs are part of the 700 budget functional classification (Veterans Benefits and Services).

Schedule of Net Program Cost

For the Year Ended September 30, 2006 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
Production Costs												
Intragovernmental Costs	$ 3,182	$82	$ 56	$ 137	$ 19	$13	$ 15	$ 216	$ 7	$ 28	$ 359	$ 4,114
Less Earned Revenues	(132)	-	(38)	(2)	-	(378)	-	(309)	(787)	(1)	(1,049)	(2,696)
Net Intragovernmental Production Costs	3,050	82	18	135	19	(365)	15	(93)	(780)	27	(690)	1,418
Public Costs	28,747	1,019	806	62,844	3,733	2,856	694	(679)	1,397	449	1,688	103,554
Less Earned Revenues	(2,694)	-	(11)	-	-	(187)	-	(51)	(513)	-	(54)	(3,510)
Net Public Production Costs	26,053	1,019	795	62,844	3,733	2,669	694	(730))	884	449	1,634	100,044
Total Net Cost of Operations	$ 29,103	$ 1,101	$ 813	$ 62,979	$ 3,752	$ 2,304	$709	$ (823)	$ 104	$ 476	$ 944	$ 101,462

Schedule of Net Program Cost

For the Year Ended September 30, 2005 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
Production Costs												
Intragovernmental Costs	$ 3,213	$ 50	$ 52	$ 136	$ 18	$11	$ 14	$ 243	$ 6	$ 27	$ 77	$ 3,847
Less Earned Revenues	(95)	-	(31)	-	(8)	(286)	-	(664)	(840)	-	(1,280)	(3,204)
Net Intragovernmental Production Costs	3,118	50	21	136	10	(275)	14	(421)	(834)	27	(1,203)	643
Public Costs	27,832	492	653	226,760	3,617	2,675	686	(955)	1,536	805	2,111	266,212
Less Earned Revenues	(2,551)	-	(15)	-	-	(198)	-	(56)	(554)	-	(49)	(3,423)
Net Public Production Costs	25,281	492	638	226,760	3,617	2,477	686	(1,011)	982	805	2,062	262,789
Total Net Cost of Operations	$ 28,399	$ 542	$ 659	$ 226,896	$ 3,627	$ 2,202	$ 700	$ (1,432)	$ 148	$ 832	$ 859	$ 263,432

20. Disclosures Related to the Statements of Budgetary Resources

Apportionment categories of obligations incurred

Obligations **Years Ended September 30,**	**2006**	**2005**
Category A, Direct	$ 35,612	$ 31,691
Category B, Direct	40,237	41,934
Reimbursable	5,605	5,625
Exempt from Apportionment	1,222	348
Total Obligations	$ 82,676	$ 79,598

Borrowing Authority
Loan Guaranty had borrowing authority of $0.5 billion and $1.8 billion as of September 30, 2006 and 2005 respectively. The Vocational Rehabilitation Program had borrowing authority of $3.4 and $3.7 as of September 30, 2006 and 2005, for making direct loans. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to Vinnie MAC trusts. The Vocational Rehabilitation loans generally had duration of one year, and repayment was made from offsetting collections.

Adjustments to Budgetary Resources
During the reporting period, adjustments to budgetary resources available at the beginning of the year included VA appropriations that were subjected to a rescission that totaled $198. Additionally, unobligated balances of prior year recoveries of $3.4 were rescinded. Various VA program accounts received a cut in discretionary budget authority.

Permanent Indefinite Appropriations
VA has three permanent and indefinite appropriations. The Veterans Housing Benefit Program Fund covers all estimated subsidy costs arising from post-1991 loan obligations for veterans housing benefits. The Fund's objective is to encourage and facilitate the extension of favorable credit terms by private lenders to veterans for the purchase, construction, or improvement of homes to be occupied by veterans and their families. The Loan Guarantee Revolving Fund is a liquidating account that contains all of VA's pre-credit reform direct and guaranteed loans. It also holds fund balances received from reimbursements from financing accounts for loan modifications and rentals of foreclosed properties not yet transferred to financing accounts. The Native American Direct Loan Account was established to cover all subsidy costs arising from direct loan obligations related to a veteran's purchase, construction, or renovation of a dwelling on trust land.

Use of Unobligated Balances of Budget Authority
Available unobligated balances on the Statement of Budgetary Resources are composed of current fiscal year apportioned funds for annual, multi-year, and no-year appropriations from Congress as well as revolving and trust funds. Other balances not available are composed of expired appropriation unobligated amounts, which generally are not available for new obligations, but can be used to increase existing obligations under certain circumstances. This amount also includes unobligated funds that were not apportioned by OMB for FY 2006 use.

Unobligated VA funds are available for uses defined in VA's FY 2006 Appropriation Law (P.L. 109-114). These purposes include: veterans medical care, research, education, construction and maintenance of VA buildings, veterans and dependents benefits, veterans life insurance, loan guaranty programs, veterans burial benefits, and administrative functions. Various obligation limitations are imposed on individual VA appropriations.

Explanation of Differences Between Statement of Budgetary Resources and the Budget
As a result of an analysis of aged obligations, obligations were reduced by $34 for FY 2006 and $79 for FY 2005 on the Statements of Budgetary Resources for both FY 2006 and FY 2005. These adjustments were not reflected in the FACTS II data used to prepare the President's Budget. No other differences were identified as of the preparation date of the financial statements.

Undelivered Orders at the End of Period
The amount of budgetary resources obligated for undelivered orders at the end of 2006 and 2005 was $4,860 and $3,998 respectively.

Contributed Capital
The amount of contributed capital received during FY 2006 consisted of donations in the amount of $52.9 to the General Post Fund and $0.4 to the National Cemetery Gift Fund. For FY 2005 $41.0 was donated to the General Post Fund and $0.2 to the National Cemetery Gift Fund.

21. Disclosures Related to the Statements of Financing

The Statement of Financing section "Costs That Do Not Require Resources in the Current Period" includes only the fiscal year increases in liabilities not covered by budgetary resources. For existing liabilities, there will always be a difference between this section and the value of liabilities not covered by budgetary resources disclosed in Note 10 and included in the liabilities section of the Balance Sheet.

22. Dedicated Collections

In the federal government, dedicated collections are accounted for in trust funds and special funds. The term "trust funds" as used in this report and in federal budget accounting is frequently misunderstood. In the private sector, "trust" refers to funds of one party held by a second party (the trustee) in a fiduciary capacity. In the federal budget, the term "trust fund" means only that the law requires that funds be accounted for separately, used only for specified purposes, and that the account be designated as a "trust fund."

A change in law may change the future receipts and the terms under which the fund's resources are spent. The "trust fund assets" represent all sources of receipts and amounts due the trust fund regardless of source. This includes "related governmental transactions," which are transactions between two different entities within the federal government. The "Investments with Treasury" assets are comprised of investments in federal debt securities and related accrued interest. These securities will require redemption if a fund's disbursements exceed its receipts. Unless specifically provided for by law, trust funds may only place excess funds in federally backed investments (e.g., federal debt securities).

The table below summarizes the name, type, and purpose of the funds within VA that receive dedicated collections. All of the funds listed use the accrual basis of accounting. However, collections are reported as actually received in accordance with OMB Circular A-34. All of the funds generally receive authority to use current year contributions as well as a portion of previously contributed amounts.

Fund Name	Fund Type	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
Escrowed Funds for Shared Medical Equipment Purchases	Deposit	36x6019	106 Stat 1974	Receives payments from public companies involved in joint purchases of medical equipment.	Public, universities, pharmaceuticals & other medical organizations.
Personal Funds of Patients	Deposit	36x6020	38 U.S.C. 3204	Temporarily holds funds.	Public, patients.
Employee Allotments for Savings Bonds	Deposit	36x6050	31 U.S.C. 3105	Temporarily holds funds.	Employees.

The following tables provide condensed information on assets, liabilities, fund balances.

For the year ended September 30, 2006 Fund Symbol	6020	6050	TOTAL
Assets:			
Fund balance with Treasury	$ 40	$ 1	$ 41
Investments with Treasury	-	-	-
Other Assets	-	-	-
Total Assets	$ 40	$ 1	$ 41
Liabilities:			
Payables to Beneficiaries	-	-	-
Other Liabilities	40	1	41
Total Liabilities	40	1	41
Net Position:			
Cumulative Results	-	-	-
Total Liabilities & Net Position	$ 40	$ 1	$ 41

23. Reclassifications, Changes in Accounting Policy and Changes in Financial Statement Presentation

Earmarked Funds

VA has adopted a new accounting standard, Statement of Federal Financial Accounting Standards No. 27, Identifying and Reporting Earmarked Funds. Under this standard, certain VA funds are identified and reported as earmarked funds which have specifically identified revenues and other financing sources and are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. VA has disclosed earmarked funds in the Principal Statements.

Medical Care Cost Recovery Receivables

VA changed the method for determining the gross value of Medical Care Cost Recovery receivables and the related allowance for contractual adjustments. This revised process results in a preferable accounting treatment for determining the value of Medical Care Cost Recovery receivables. The Medical Remittance Advice (MRA) process determines the portion of a bill which generally would be paid by Medicare (by law, VA may not bill Medicare), and adjusts the receivable accordingly. Prior to this change, VA recorded the total bill amount and established an allowance for contractual adjustment for the Medicare portion. While the net receivable balance remains consistent, the MRA process more accurately reflects VA's gross receivable balance and allowance for loss provision.

Schedule of Net Program Cost

The FY 2005 Schedule of Net Program Cost contained in Footnote 19, Net Cost of Veterans Affairs Programs, has been changed to classify $2,202 of Employee Benefits costs as Intragovernmental Costs, as opposed to Public Costs as previously stated. These benefit payments were made to the Office of Personnel Management and are more appropriately shown as Intragovernmental Costs. Total Net Cost of Operations did not change. This change did not affect other statements.