Letter from the Chief Financial Officer

The Department of Veterans Affairs (VA) completed another successful year by receiving an unqualified audit opinion for the 9th consecutive year from our external auditors, Deloitte & Touche. We are extremely proud of this accomplishment.

Throughout FY 2007, VA made improvements and progress in remediating our three audit material weaknesses – *Financial Management System Functionality* (previously identified as *Lack of an Integrated Financial Management System), Information Technology Security Controls,* and *Financial Management Oversight* (previously identified as *Operational Oversight)*.

To address the Department's material weakness, *Financial Management System Functionality*, VA continues its efforts to develop the Financial & Logistics Integrated Technology Enterprise (FLITE) program. The FLITE initiative will integrate many disparate systems, standardize financial and logistics functional processes, and modernize the information technology environment supporting financial and logistics management within VA. In FY 2007, VA completed the prerequisite planning for the FLITE program. As a component of FLITE, VA is also continuing to implement a Financial Reporting Data Warehouse. This warehouse will improve the quality, timeliness and accuracy of feeder system data interfaced to VA's core Financial Management System (FMS) and simplify reconciliations. During 2007, VA completed system mapping for all of the nine major feeder system interfaces, and two of the interfaces, PAID and Loan Service and Claims, were implemented in the warehouse as scheduled.

In addition, the Hyperion Financial Management reporting system, initiated in 2006, was used to produce the 2007 quarterly and consolidated financial statements. This system is now completely producing VA's consolidated

financial statements using a standardized and repeatable process. The system was expanded in 2007 to provide for the automated generation of footnotes to the financial statements.

As a result of our successful efforts in improving the preparation of VA's financial statements and our progress with the Financial Reporting Data Warehouse, VA's President's Management Agenda scorecard on Financial Performance is "yellow" for progress.

To further address the material weakness in *Information Technology Security Controls*, VA developed the "Data Security – Assessment and Strengthening of Controls Program," which is an over-arching and cross-cutting remediation plan designed to correct deficiencies and eliminate vulnerabilities in information security. This program will enable completion of hundreds of tasks required to remediate long-standing security weaknesses. Following the publication in 2006 of VA Directive 6500, "Information Security Program," the corresponding VA Handbook 6500 was published in 2007; they provide the foundation for a comprehensive information security program throughout VA.

During 2007, additional focus was placed on the *Financial Management Oversight* material weakness as a result of the expansion of this significant deficiency to other fiscal areas in the

Department. VA developed and continues implementation of a detailed remediation plan to address the resolution of this material weakness. Throughout the year, additional and clarifying financial policies and procedures were provided to VA's fiscal community, particularly in the area of internal control. During FY 2008, expanded focus will be placed on addressing the auditors' FY 2007 audit report findings.

VA is starting a 3-year Financial Policy Improvement Initiative to assist in the remediation of two material weaknesses: *Financial Management Oversight* and *Financial Management System Functionality*. The primary objective of this initiative is to ensure that financial policy and procedural information is standardized, accurate, clear, and readily available across the Department.

Each of these three weaknesses involves corrective action plans over multiple years and VA continues to work diligently and proactively to address these weaknesses. VA will develop a corrective action plan in FY 2008 to address the new material weakness, *Retention of Computer Generated Detail Records in Benefits Delivery Network (BDN) System – VBA*.

We also continued efforts to ensure VA's compliance with OMB Circular A-123, Appendix A, Internal Controls over Financial Reporting. Based on the approved implementation plan, VA completed actions identified for year two of a 3-year plan. As a result of the completion of the limited scope assessment on the effectiveness of internal controls for five of the remaining nine business processes, no material weaknesses were identified. Remediation actions were implemented during 2007 to address findings identified in year one for two key business processes, "Financial Reporting" and "Funds Management." In addition, remediation plans were developed to address findings identified in year two, and planning for the third year is underway. VA also continued to meet existing and new requirements under OMB Circular A-123, including travel card requirements under Appendix B, and new Improper Payments Information Act (IPIA) requirements under Appendix C.

VA successfully completed risk assessments, statistical sampling, and all requirements for programs under the IPIA. VA achieved all audit recovery targets for improper payments and met three out of five reduction targets. VA also received approval from OMB to remove VA's Insurance program from IPIA reporting requirements until FY 2009. In addition, because the Vocational Rehabilitation & Employment program does not meet the 2.5 percent or $10 million threshold in annual erroneous payments, VA requested that this program be removed from future annual reporting. This year, VA achieved a "green" score for progress on the President's Management Agenda scorecard on Eliminating Improper Payments.

VA continued to advance Presidential e-Gov initiatives and aggressively worked with the General Services Administration and Electronic Data Systems, the e-Gov travel prime contractor, to implement an electronic travel solution for VA. VA will complete department-wide implementation of FedTraveler on schedule in December 2007. In the e-Payroll area, VA successfully migrated 1,250 employees to the Defense Finance and Accounting Service for payroll servicing in September 2006, and an additional migration of 259 employees was completed in October 2007. The remaining VA population will migrate in FY 2008 – 2009.

VA's Franchise Fund, which received permanent status in 2006, is expected to receive its 10th successive unqualified audit opinion on its FY 2007 consolidated financial statements.

We are proud that in FY 2007, medical care collections continued to improve. Collections totaled nearly $2.2 billion. VA plans to continue to increase these collections, reaching $2.3 billion in FY 2008. Additionally, VA has developed a Departmental managerial cost accounting (MCA) system to enable managers at all levels to review and analyze cost data at the detail and programmatic levels. We expect all MCA processes within VA's Administrations to be operational during FY 2008.

Under the Government Performance and Results Act, we continuously assessed and refined our performance measures, quality of data, and compilation procedures. We developed procedures to assure our stakeholders that we have the most useful and accurate performance data available.

We are proud of our many accomplishments, but realize a lot of work remains. We continually strive to improve our financial stewardship and have set new goals to improve our performance. We will continue to promote sound business practices and improve accountability while fulfilling our mission of service to our Nation's veterans.

Robert J. Henke
November 15, 2007

Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS		
CONSOLIDATED BALANCE SHEETS (dollars in millions)		
As of September 30,	**2007**	**2006**
ASSETS		
INTRAGOVERNMENTAL		
Fund Balance with Treasury (Note 3)	$ 22,213	$ 16,129
Investments (Note 5)	12,427	12,873
Accounts Receivable, Net (Note 6)	79	107
Other Assets	42	53
TOTAL INTRAGOVERNMENTAL ASSETS	**34,761**	**29,162**
PUBLIC		
Investments (Note 5)	177	183
Accounts Receivable, Net (Note 6)	1,329	1,163
Loans Receivable, Net (Note 7)	2,858	2,337
Cash (Note 4)	34	28
Inventories and Related Properties, Net (Note 8)	54	69
General Property, Plant and Equipment, Net (Note 9)	12,176	11,638
Other Assets	28	30
TOTAL PUBLIC ASSETS	**16,656**	**15,448**
TOTAL ASSETS	**$ 51,417**	**$ 44,610**
LIABILITIES		
INTRAGOVERNMENTAL		
Accounts Payable	$ 115	$ 92
Debt	1,052	983
Other Liabilities (Note 13)	2,140	1,992
TOTAL INTRAGOVERNMENTAL LIABILITIES	**3,307**	**3,067**
PUBLIC		
Accounts Payable	3,938	835
Liabilities for Loan Guarantees (Note 7)	3,769	3,272
Federal Employee and Veterans Benefits Liability (Note 11)	1,129,527	1,155,612
Environmental and Disposal Liabilities (Note 12)	558	384
Insurance Liabilities (Note 15)	11,217	11,633
Other Liabilities (Note 13)	7,710	7,154
TOTAL PUBLIC LIABILITIES	**1,156,719**	**1,178,890**
TOTAL LIABILITIES	**1,160,026**	**1,181,957**
NET POSITION		
Unexpended Appropriations – Earmarked Funds (Note 17)	(9,184)	(6,965)
Unexpended Appropriations – All Other Funds	11,291	8,239
Cumulative Results of Operations – Earmarked Funds (Note 17)	10,076	7,849
Cumulative Results of Operations – All Other Funds	(1,120,792)	(1,146,470)
TOTAL NET POSITION	**(1,108,609)**	**(1,137,347)**
TOTAL LIABILITIES AND NET POSITION	**$ 51,417**	**$ 44,610**

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS		
CONSOLIDATED STATEMENTS OF NET COST (dollars in millions)		
for the Years Ended September 30,	**2007**	**2006**
NET PROGRAM COSTS (NOTE 19)		
Medical Care	$ 32,013	$ 29,103
Medical Education	1,267	1,101
Medical Research	843	813
Compensation	34,897	31,879
Pension	3,902	3,752
Education	2,348	2,304
Vocational Rehabilitation and Employment	722	709
Loan Guaranty	(200)	(823)
Insurance	94	104
Burial	355	376
NET PROGRAM COSTS BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITIES	**76,241**	**69,318**
Compensation	(26,000)	31,100
Burial	(100)	100
SUBTOTAL	(26,100)	31,200
NET NON-PROGRAM COSTS	953	944
NET COST OF OPERATIONS (NOTE 19)	**$ 51,094**	$ **101,462**

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Earmarked Funds	All Other Funds	Eliminations	FY 2007 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 7,887	$ (1,146,470)	$ (38)	$ (1,138,621)
Budgetary Financing Sources				
Appropriations Used	-	78,983	-	78,983
Nonexchange Revenue	-	9	-	9
Donations	27	-	-	27
Transfer without Reimbursement	42	-	(42)	-
Other Financing Sources (Non-Exchange)				
Donations of Property	19	1	-	20
Transfers In/Out Reimbursement	-	(1,448)	1,206	(242)
Imputed Financing	-	1,408	-	1,408
Other	-	-	(1,206)	(1,206)
Total Financing Sources	88	78,953	(42)	78,999
Net Cost of Operations	(2,181)	53,275	-	51,094
Net Change	**2,269**	**25,678**	**(42)**	**27,905**
Ending Balance – Cumulative Results	$ 10,156	$ (1,120,792)	$ (80)	$ (1,110,716)
Unexpended Appropriations				
Beginning Balance	$ (6,965)	$ 8,201	$ 38	$ 1,274
Budgetary Financing Sources				
Appropriations Received	-	79,817	-	79,817
Appropriations Transferred In/Out	(2,219)	2,210	42	33
Other Adjustments	-	(35)	-	(35)
Appropriations Used	-	(78,982)	-	(78,982)
Total Budgetary Financing Sources	(2,219)	3,010	42	833
Total Unexpended Appropriations	**$ (9,184)**	**$ 11,211**	**$ 80**	**$ 2,107**
Total Net Position	**$ 972**	**$ (1,109,583)**	**$ -**	**$ (1,108,609)**

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Earmarked Funds	All Other Funds	Eliminations	FY 2006 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 781	$ (1,115,470)	$ 4,971	$ (1,109,718)
Budgetary Financing Sources				
Appropriations Used	-	72,561	-	72,561
Nonexchange Revenue	-	9	-	9
Donations	28	-	-	28
Transfer without Reimbursement	5,009	-	(5,009)	-
Other Financing Sources (Non-Exchange)				
Donations of Property	25	1	-	26
Transfers In/Out Reimbursement	1	(1,369)	1,156	(212)
Imputed Financing	-	1,303	-	1,303
Other	-	-	(1,156)	(1,156)
Total Financing Sources	5,063	72,505	(5,009)	72,559
Net Cost of Operations	(2,043)	103,505	-	101,462
Net Change	**7,106**	**(31,000)**	**(5,009)**	**(28,903)**
Ending Balance – Cumulative Results	$ 7,887	$ (1,146,470)	$ (38)	$ (1,138,621)
Unexpended Appropriations				
Beginning Balance	$ -	$ 7,277	$ (4,971)	$ 2,306
Budgetary Financing Sources				
Appropriations Received	-	71,747	-	71,747
Appropriations Transferred In/Out	(6,965)	1,971	5,009	15
Other Adjustments	-	(234)	-	(234)
Appropriations Used	-	(72,560)	-	(72,560)
Total Budgetary Financing Sources	(6,965)	924	5,009	(1,032)
Total Unexpended Appropriations	**$ (6,965)**	**$ 8,201**	**$ 38**	**$ 1,274**
Total Net Position	**$ 922**	**$ (1,138,269)**	**$ -**	**$ (1,137,347)**

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 20) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources		
Unobligated Balance at the Beginning of the Period	$ 16,958	$ 3,560
Recoveries of Prior Year Obligations	6	-
Budget Authority		
Appropriations Received	82,630	-
Borrowing Authority	-	590
Spending Authority from Offsetting Collections		
Earned	5,261	1,522
Change in Unfilled Customer Orders	(250)	-
Subtotal	87,641	2,112
Nonexpenditure Transfers, net	33	-
Permanently Not Available	(77)	(521)
Total Budgetary Resources	**$ 104,561**	**$ 5,151**
Status of Budgetary Resources		
Obligations Incurred	$ 86,249	$ 2,201
Unobligated Balance Available	15,702	-
Unobligated Balance Not Yet Available	2,610	2,950
Total Status of Budgetary Resources	**$ 104,561**	**$ 5,151**
Change in Obligated Balance		
Obligated Balance, Net Beginning of Period	$ 8,109	$ 127
Obligations Incurred	86,249	2,201
Less Gross Outlays	(81,747)	(2,267)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(6)	-
Change in Uncollected Customer Payments from Federal Sources	306	26
Obligated Balance, Net End of Period	**$ 12,911**	**$ 87**
Net Outlays		
Gross Outlays	$ 81,747	$ 2,267
Less Offsetting Collections	(5,317)	(1,548)
Less Distributed Offsetting Receipts	(2,560)	(1,050)
Net Outlays	**$ 73,870**	**$ (331)**

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 20) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources		
Unobligated Balance at the Beginning of the Period	$ 16,135	$ 5,707
Recoveries of Prior Year Obligations	3	-
Budget Authority		
Appropriations Received	74,577	-
Borrowing Authority	-	522
Spending Authority from Offsetting Collections		
Earned	5,404	1,792
Change in Unfilled Customer Orders	1,087	-
Subtotal	81,068	2,314
Nonexpenditure Transfers, net	15	-
Permanently Not Available	(315)	(1,733)
Total Budgetary Resources	**$ 96,906**	**$ 6,288**
Status of Budgetary Resources		
Obligations Incurred	$ 79,948	$ 2,728
Unobligated Balance Available	13,966	-
Unobligated Balance Not Yet Available	2,992	3,560
Total Status of Budgetary Resources	**$ 96,906**	**$ 6,288**
Change in Obligated Balance		
Obligated Balance, Net Beginning of Period	$ 8,230	$ 77
Obligations Incurred	79,948	2,728
Less Gross Outlays	(78,911)	(2,653)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(3)	-
Change in Uncollected Customer Payments from Federal Sources	(1,155)	(25)
Obligated Balance, Net End of Period	**$ 8,109**	**$ 127**
Net Outlays		
Gross Outlays	$ 78,911	$ 2,653
Less Offsetting Collections	(5,336)	(1,767)
Less Distributed Offsetting Receipts	(3,065)	(1,369)
Net Outlays	**$ 70,510**	**$ (483)**

The accompanying Notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

For the Years Ended September 30, 2007 and 2006 (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) 2007 and FY 2006 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, an Executive-In-Charge for Human Resources and Administration, 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.

Transferring Budget Authority to Other Agencies

The VA is a party to allocation transfers with the Department of Defense (DoD) as a transferring (parent) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U. S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g. budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived.

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 2022, 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. VA continues to use the income from these subordinated certificates to fund the American Housing Trust Reserve Fund, which is used in turn to fund deficiencies in scheduled monthly principal and interest on the loans as well as to cover any realized losses incurred in the prior month. Any excess funds in the Reserve Fund are reimbursed to VA upon request.

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 2007, contractual adjustments were 56 percent and bad debt allowances for medical-related receivables were 10 percent. For FY 2006, contractual adjustments were 56 percent and bad debt allowances for medical-related receivables were 11 percent. Educational–related receivables bad debt allowances were 36 percent for FY 2007 and 38 percent for FY 2006. Compensation and pension benefits overpayment-related bad debt receivables were 68 percent for FY 2007 and 73 percent for FY 2006.

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 their nature they are expected 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 both FY 2007 and FY 2006. 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 2007 and FY 2006 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 other than disclosed in Note 16, Contingencies.

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,		2007		2006
Fund Balance with Treasury	$	47	$	41
Intragovernmental Accounts Receivable		1		1
Public Accounts receivable		22		16
Total Non-Entity Assets	$	70	$	58

3. Fund Balance with Treasury

Fund Balance with Treasury as of September 30,		2007		2006
Entity Assets				
Trust Funds	$	76	$	80
Revolving Funds		3,476		4,178
Appropriated Funds		18,433		11,618
Special Funds		178		171
Other Fund Types		3		41
Total Entity Assets	$	22,166	$	16,088
Non-Entity Assets				
Other Fund Types		47		41
Total Non-Entity Assets		47		41
Total Entity and Non-Entity Assets	$	22,213	$	16,129
Reconciliation of VA General Ledger Balances with Treasury				
Entity VA General Ledger	$	23,630	$	17,824
Reconciled Differences		(1,419)		(1,693)
Unreconciled Differences		2		(2)
Fund Balance with Treasury	$	22,213	$	16,129
Status of Fund Balance with Treasury				
Unobligated Balance				
Available	$	7,282	$	5,134
Unavailable		3,623		4,609
Obligated Balance not yet Disbursed		11,079		6,304
Deposit /Clearing Account Balances		229		82
Fund Balance with Treasury	$	22,213	$	16,129

4. Cash

Cash as of September 30,		
	2007	**2006**
Canteen Service	$ 1	$ 1
Agent Cashier Advance	4	4
Loan Guaranty Program	29	23
Total Cash	$ 34	$ 28

5. Investments

Investment Securities as of September 30,			
Intragovernmental Securities	Interest Range	**2007**	**2006**
Special Bonds	3.25 – 8.75%	$ 12,151	$ 12,591
Treasury Notes*	3.875 – 6.0%	70	66
Treasury Bills	3.921 – 5.038%	26	26
Subtotal		12,247	12,683
Accrued Interest		180	190
Total Intragovernmental Securities		$ 12,427	$ 12,873
Other Securities			
Trust Certificates (Loan Guaranty)		$ 130	$ 138
Mutual Funds (Non-Federal Trusts)		47	45
Total Other Securities		$ 177	$ 183

*The investment in Treasury Notes includes unamortized premiums of $0.3 as of September 30, 2007 and $0.1 as of September 30, 2006. 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,	**2007**	**2006**
Investments in Subordinate Certificates at Time of Sale	$ 424	$ 424
Cumulative Reductions	(294)	(285)
Subtotal	130	139
Allocation of Loss Provision	-	(1)
Trust Certificates (Loan Guaranty)	$ 130	$ 138

6. Accounts Receivable, Net

Accounts Receivable, Net
as of September 30,

		2007		2006
Intragovernmental Accounts Receivable, Net	$	79	$	107
Public Accounts Receivable				
Public Accounts Receivable, Gross	$	2,745	$	2,419
Allowance for Loss Provision		(1,416)		(1,256)
Net Public Accounts Receivable	$	1,329	$	1,163

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, 2007

	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)	$ 36	$ 12	$ (1)	$ -	$ 47
Direct Loans Obligated after 1991	868	13	620	32	1,533
Insurance Policy Loans	608	15	-	-	623
Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net					$ 2,203

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

Direct Loans Disbursed
The total amount of new direct loans disbursed for the years ended September 30, 2007 and 2006, was $127 and $145, 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 2007, 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.

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,

	2007	2006
Interest Differential	$ (13)	$ (15)
Defaults*	11	9
Fees**	(1)	(2)
Other***	9	11
Subtotal	6	3
Interest Rate Reestimates	(220)	(22)
Technical Reestimates	(323)	(74)
Total Direct Loan Subsidy Expense	$ (537)	$ (93)

* Includes approximately $8 thousand and $39 thousand in defaults and other expenses for the Vocational Rehabilitation Program in FY 2007 and 2006 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	(24.24%)
Defaults	14.96%
Fees	(1.91%)
Other	18.17%

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 2007, the subsidy rate is (3.46) percent for Veterans Housing Direct – Vendee Loans, 10.43 percent for Veterans Housing Direct – Acquired Loans, and (13.46) percent for Native American Direct. In FY 2006, the subsidy rate was (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. The allowance for subsidy as of September 30, 2007 and 2006 is $(620) and $(82), respectively.

Schedule for Reconciling Subsidy Cost Allowance Balances

Beginning Balance, Changes and Ending Balance

	FY 2007	FY 2006
Beginning balance of the allowance	$ (82)	$ 27
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(13)	(15)
Default costs (net of recoveries)	11	9
Fees and other collections	(1)	(2)
Other subsidy costs	9	11
Total of the above subsidy expense components	6	3
Adjustments:		
Fees received	3	3
Foreclosed property acquired	3	(9)
Loans written off	(5)	(5)
Subsidy allowance amortization	(2)	(5)
Ending balance of the allowance before reestimates	(77)	14
Subsidy reestimates by component		
Interest rate reestimate	(220)	(22)
Technical/default reestimate	(323)	(74)
Total of the above reestimate components	(543)	(96)
Ending balance of the allowance	$ (620)	$ (82)

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, 2007

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	$ 80	-	(74)	11	$ 17
Defaulted Guaranteed Loans Post-1991	5	-	-	633	638
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 655

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

Total Loans Receivable and Related Foreclosed Property, Net

as of September 30,	2007	2006
Total Direct Loans	$ 2,203	$ 1,728
Total Guaranteed Loans	655	609
Total Loans Receivable and Related Foreclosed Property, Net	$ 2,858	$ 2,337

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 costs such as 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, 2007 and 2006, the estimated number of residential properties in VA's inventory was 6,975 and 6,490 respectively. For FY 2007 and FY 2006, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 11.3 months and 10.4 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 4,696 and 4,703 as of September 30, 2007 and 2006, respectively.

Guaranteed Loans
as of September 30,

		2007		2006
Guaranteed Loans Outstanding:				
Outstanding Principal Guaranteed Loans, Face Value	$	207,644	$	203,186
Amount of Outstanding Guarantee		61,456		61,277
New Guaranteed Loans Disbursed:				
Outstanding Principal Guaranteed Loans, Face Value	$	24,889	$	24,638
Amount of Outstanding Guarantee		6,438		6,485
Liabilities for Loan Guarantees Post 1991 (Present Value)	$	3,769	$	3,272

Guaranty Commitments
VA guaranteed 133,313 loans in FY 2007. The FY 2007 total guaranty amount is $6.4 billion. The total amount of loans guaranteed is $25 billion.

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,

		2007		2006
Defaults	$	312	$	327
Fees*		(394)		(400)
Subtotal		(82)		(73)
Interest Rate Reestimates		(37)		(256)
Technical Reestimates		193		(479)
Total Guaranteed Loan Subsidy Expenses**	$	74	$	(808)

* 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,

		2007		2006
Defaults	$	-	$	-
Other		-		-
Subtotal		-		-
Interest Rate Reestimates		58		(45)
Technical Reestimates		13		(39)
Total Loan Sale-Guaranteed Subsidy Expense	$	71	$	(84)

Total Subsidy Expense
for the years ended September 30,

		2007		2006
Total Direct Loans	$	(537)	$	(93)
Total Guaranteed Loans		74		(808)
Total Sale Loans		71		(84)
Total Subsidy Expense	$	(392)	$	(985)

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	1.27%
Fees	(1.63)%

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 2007, 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. The Master Servicer is responsible for performing all the servicing functions under the separate Pooling and Servicing Agreements created for each Vendee Mortgage Trust. On the most recent Loan Sales, the Master Servicer is Countrywide Home Loans, Inc. The Master Servicer is entitled to be compensated by retaining, from amounts received on each Mortgage Loan or Real Estate Owned (REO) Mortgage Loan (including REO Proceeds and Liquidation Proceeds) that are allocable to interest in accordance with the related Mortgage Note or, in the case of REO Proceeds and Liquidation Proceeds an amount equal to such amount allocable to interest multiplied by a fraction, the numerator of which is 0.2075% and the denominator of which is the Mortgage Rate for the related Mortgage Loan.

Additional servicing compensation in the form of prepayment charges, assumption fees, and late payment charges shall be retained by the Master Servicer as received. The Master Servicer also shall be entitled to withdraw and retain, as additional compensation, investment income on amounts on deposit in the Certificate Account. The Master Servicer shall be entitled to receive as additional compensation the interest earned on amounts remitted by the Master Servicer to the Trustee and deposited by the Trustee in the Distribution Account. The Master Servicer shall be required to pay all expenses incurred by it in connection with its servicing activities hereunder (including, without limitation, the fees and expenses of the Trustee, and the fees of the Sub-Servicers under the respective Sub-Servicing Agreements, if any) and shall not be entitled to reimbursement therefore except as specifically provided in each Pooling and Servicing Agreement.

VA did not complete any sales during FY 2007 and FY 2006.

Outstanding Balance of Loan Sale Guarantees

The outstanding balance for guaranteed loans sold is summarized in the table below:

Guaranteed Loans Sold as of September 30,	**2007**	**2006**
Outstanding Balance Guaranteed Loans Sold, Start of Year	$ 2,364	$ 3,012
Sold to the Public	-	-
Payments, Repayments, and Terminations	(406)	(648)
Outstanding Balance Guaranteed Loans Sold, End of Year	$ 1,958	$ 2,364

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 2007 and 2006 is 3.99 percent and 4.12 percent, respectively. The liability for loan sale guarantees as of September 30, 2007 and 2006 is $166 and $102, respectively.

Schedule for Reconciling Loan Sale Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2007**	**2006**
Beginning balance of the liability	$ 102	$ 188
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	(12)	(15)
Interest accumulation on the liability balance	4	14
Other	-	-
Ending balance of the liability before reestimates	94	187
Subsidy reestimates by component		
Interest rate reestimate	59	(45)
Technical/default reestimate	13	(40)
Total of the above reestimate components	72	(85)
Ending balance of the liability	$ 166	$ 102

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 2007 and FY 2006 subsidy rate was (0.36) and (0.32) percent, respectively. The liability for loan guarantees as of September 30, 2007 and 2006 is $3,603 and $3,170, respectively.

Schedule for Reconciling Loan Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance

	2007	2006
Beginning balance of the liability	$ 3,170	$ 3,277
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	312	327
Fees and other collections	(394)	(400)
Total of the above subsidy expense components	(82)	(73)
Adjustments:		
Fees received	432	439
Foreclosed property and loans acquired	(24)	120
Claim payments to lenders	(178)	(273)
Interest accumulation on the liability balance	129	189
Other – reestimate due to Hurricane Katrina	-	225
Ending balance of the liability before reestimates	3,447	3,904
Subsidy re-estimates by component		
Interest rate reestimate	(37)	(256)
Technical/default re-estimate	193	(478)
Total of the above reestimate components	156	(734)
Ending balance of the liability	$ 3,603	$ 3,170

Administrative Expense

Administrative expense on direct and guaranteed loans for each of the years ended September 30, 2007 and 2006 was $154.

8. Inventories and Related Properties

Inventories
as of September 30,

	2007	2006
Held for Current Sale	$ 53	$ 65
Other	1	4
Total Inventories	$ 54	$ 69

9. General Property, Plant and Equipment

Depreciation and amortization expense totaled $895 and $865 in FY 2007 and FY 2006, respectively.

General Property, Plant and Equipment
as of Sept. 30, 2007

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	$ 421	$ (32)	$ 389
Buildings	16,411	(8,497)	7,914
Equipment	3,409	(1,911)	1,498
Other	2,108	(1,306)	802
Work in Progress	1,573	-	1,573
Total Property, Plant, and Equipment	$ 23,922	$ (11,746)	$ 12,176

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

10. Liabilities Not Covered By Budgetary Resources

The total amount of VA liabilities not covered by budgetary resources was $1,133.2 billion and $1,158.9 billion as of September 30, 2007 and 2006, respectively, as shown in the following table.

Components of Unfunded Liabilities
as of September 30

	2007	2006
Workers' Compensation*	$ 2,208	$ 2,179
Annual Leave	1,365	1,248
Judgment Fund	650	615
Environmental and Disposal	558	384
Accounts Payable – Canceled Appropriations	8	7
Veterans Compensation and Burial	1,127,700	1,153,800
Insurance	741	706
Total	$ 1,133,230	$ 1,158,939

* The actuarial estimate for workers' compensation provided by DOL was computed using interest rates of 5.08 percent and 5.31 percent to discount the projected annual benefit payments as of FY 2007 and FY 2006, respectively.

11. Federal Employee and Veterans Benefits

Federal Employee Benefits: Imputed Expenses-Employee Benefits

Years ended September 30,	**2007**	**2006**
Civil Service Retirement System	$ 276	$ 294
Federal Employees Health Benefits	1,049	939
Federal Employees Group Life Insurance	2	2
Total Imputed Expenses-Employee Benefits	$ 1,327	$ 1,235

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,

	2007	**2006**
FECA	$ 1,827	$ 1,812
Compensation	1,123,900	1,149,900
Burial	3,800	3,900
Total Federal Employee and Veterans Benefits Liabilities	$ 1,129,527	$ 1,155,612

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, 2007 and 2006 was $81.4 billion and $97 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, 2007, ranging from 3.97 to 4.99 percent, and on September 30, 2006, ranging from 4.59 to 4.93 percent.
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 2007. 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, 2007.

12. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $558 and $384 as of September 30, 2007 and 2006, 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.

The medical facility in Gulfport/Biloxi was significantly damaged by Hurricane Katrina. The facility was closed pending assessments of damages and operational feasibility. Environmental liability amounts cannot be reasonably determined, but management believes they will not materially impact VA operations.

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,		
	2007	2006
Deposit and Clearing Account Liabilities	$ 37	$ 46
Accrued Expenses - Federal	109	66
Deferred Revenue	94	134
Resources Payable to Treasury	210	238
Custodial Liabilities*	1,200	964
General Fund Receipts Liability	5	17
Accrued VA Contributions for Employee Benefits	103	160
Total Other Intragovernmental Funded Liabilities	$ 1,758	$ 1,625

* 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,		
	2007	2006
Accrued FECA Liability	$ 378	$ 363
Unfunded Employee Liability	4	4
Total Other Intragovernmental Unfunded Liabilities	$ 382	$ 367

Other Public Funded Liabilities as of September 30,		
	2007	2006
Accrued Funded Annual Leave	$ 12	$ 12
Accrued Expenses	2,765	2,427
Accrued Salaries and Benefits	701	583
Contract Holdbacks	18	14
Deferred Revenue	(3)	(2)
Unredeemed Coupons	1	1
Deposit and Clearing Account Liability	12	35
Unearned Premiums	88	95
Insurance Dividends Left on Deposit and Related Interest Payable*	1,725	1,734
Dividend Payable to Policyholders	172	182
Capital Lease Liability	17	19
Total Other Public Funded Liabilities	$ 5,509	$ 5,100

* 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,	2007	2006
Annual Leave*	$ 1,365	$ 1,248
Accounts Payable from Cancelled Appropriation	8	7
Amounts due to non-federal trust	178	182
Judgment Fund-Unfunded**	650	616
Unpaid Policy Claims	0	1
Total Other Public Unfunded Liabilities	$ 2,201	$ 2,054

* 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 (see Note 16, Contingencies).

14. Leases

VA has both capital and operating leases. The capital lease liability is $17 and $19 as of September 30, 2007 and 2006, respectively. Real property leases reflect those that VA has committed to as of September 30, 2007. Due to the number of equipment operating leases and the decentralization of records, the future commitment for equipment operating leases is projected assuming annual increases between 4.1 and 4.5 percent. VA's FY 2007 operating lease costs were $299 for real property rentals and $101 for equipment rentals. The FY 2006 operating lease costs consisted of $280 for real property rentals and $89 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
2008	$ 239	4.5	$ 106
2009	201	4.4	111
2010	181	4.2	115
2011	142	4.1	120
2012	117	4.1	126

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 million 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 policy. This program provides low-cost term insurance protection to service members and their families.

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.

The Traumatic Injury Protection (TSGLI) program became effective December 1, 2005. TSGLI, which automatically covers all who participate in SGLI, provides for insurance payments to members who suffer a serious traumatic injury in service. These payments range from $25,000 to a maximum of $100,000, depending on the type and severity of injury.

Public Insurance Carriers

VA supervises the administration of the SGLI and VGLI programs. VA has entered into a group policy with Prudential Insurance Company of America 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. Prudential administers the TSGLI program under an Administrative Services Only agreement with VA. Under the law, DoD pays for any claim costs for this program in excess of premiums collected.

The Secretary of Veterans Affairs determines the claim 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 costs so identified by the

Secretary are paid by the uniformed services, not from the service members' premiums, as are all other programs costs.

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 and its reinsurers. 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, the 1980 CSO Basic Table, and the 2001 CSO Table.

Insurance Liability (Reserve) Balances

As of September 30, 2007

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 8,229	$ 127	$ 93	$ 8,449
USGLI	19	3	-	22
VSLI	1,565	9	23	1,597
S-DVI	329	3	400	732
VRI	318	2	3	323
VI&I	94	-	-	94
Subtotal	$ 10,554	$ 144	$ 519	$ 11,217
Less Liability not Covered by Budgetary Resources				(741)
Liability Covered by Budgetary Resources				$ 10,476

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 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 5,859,136 and 5,918,519 insured for a face value of $1,069.8 billion and $1,096.7 billion as of September 30, 2007 and 2006, respectively. The face value of the insurance provided by Prudential and its reinsurers represents 98.5 percent of the total insurance in-force as of September 30, 2007 and 2006. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2007 Policies	2006 Policies	2007 Face Value	2006 Face Value
Supervised Programs				
SGLI Active Duty	1,496,000	1,503,000	$ 582,600	$ 590,567
SGLI Ready Reservists	755,500	768,500	271,299	285,930
SGLI Post Separation	102,000	120,000	38,909	46,580
SGLI Family - Spouse	1,050,000	1,041,000	103,480	102,416
SGLI Family - Children	2,025,000	2,058,000	20,250	20,580
VGLI	430,636	428,019	53,260	50,676
Total Supervised	5,859,136	5,918,519	$ 1,069,798	$ 1,096,749
Administered Programs				
NSLI	1,013,557	1,106,597	$ 11,516	$ 12,360
VSLI	191,735	199,262	2,406	2,453
S-DVI	187,904	181,093	1,885	1,802
VRI	43,720	48,206	418	454
USGLI	6,720	7,841	21	24
VMLI	2,368	2,438	165	166
Total Administered	1,446,004	1,545,437	$ 16,411	$ 17,259
Total Supervised and Administered Programs	7,305,140	7,463,956	$ 1,086,209	$ 1,114,008

Policy Dividends
The Secretary of VA determines annually the excess funds available for dividend payment. Only administered policies are eligible for dividends. 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 2007 and 2006 were $365 and $401, 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 84 percent in FY 2007 and 70 percent in FY 2006. Contract dispute payments for FY 2007 and FY 2006 were $5.4 and $19.8, respectively. The discrimination case payments for FY 2007 were $3.3 and $2.2 for FY 2006.

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, 2007 and 2006. Had these payments not been discounted, the associated liability would have been an additional $79 and $83, 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 $650 for FY 2007 and $616 for FY 2006. The contract and personnel law cases where there was at least a reasonable possibility that a loss may occur were 18 cases totaling $228.7 for FY 2007 and 8 cases totaling $17.2 for FY 2006. 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,

	2007	2006
Fiscal Year Settlement Payments	$ 89	$ 91
Less Contract Dispute and "No Fear" Payments	(8)	(22)
Imputed Financing-Paid by Other Entities	81	69
Increase (Decrease) in Liability for Claims	(35)	93
Operating Expense	$ 46	$ 162

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2007 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 2007 tort payments were $81.

The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2007 and 2006 was $21.2 and $35.4, 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 2003-2007, the average medical care cost per year was $27.1 billion.

Haas v. Nicholson

The United States Court of Appeals for Veterans Claims (Veterans Court) issued a decision in Haas v. Nicholson, 20 Vet. App. 257 (2006), that reversed a decision of the Board of Veterans' Appeals, which denied service connection for disabilities claimed as a result of exposure to herbicides. VA disagrees with the court's decision in Haas and has appealed to the United States Court of Appeals for the Federal Circuit. Pending a decision on appeal, the Veterans Court has stayed cases affected by the Haas decision pending before that court or at VA. If the appeal is ultimately unsuccessful, the adjudication of any stayed cases will resume and new adjudications must conform to the decision on appeal, with the consequence that a liability for potential additional benefit costs may exist, but the estimated amount or range of the possible liability cannot reasonably be made at this time. No claims have been paid or accrued as of this date.

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, 2007

	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	$ 40	$ 191	$ 69	$ 1	$ 301
Investments with Treasury	12,330	96	-	-	12,426
Other Assets	626	1,106	1	2	1,735
Total Assets	$ 12,996	$ 1,393	$ 70	$ 3	$ 14,462
Liabilities and Net Position:					
Payables to Beneficiaries	$ 168	$ 15	$ 1	$ -	$ 184
Other Liabilities	13,108	197	1	-	13,306
Total Liabilities	$ 13,276	$ 212	$ 2	$ -	$ 13,490
Unexpended Appropriations	-	(9,184)	-	-	(9,184)
Cumulative Results of Operations	(280)	10,365	68	3	10,156
Total Liabilities & Net Position	$ 12,996	$ 1,393	$ 70	$ 3	$ 14,462

Statement of Net Cost
for the Year Ended September 30, 2007

	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Gross Program Costs	$ 1,292	$ 467	$ 3	$ -	$ 1,762
Less Earned Revenues	1,222	2,750	-	-	3,972
Net Program Costs	70	(2,283)	3	-	(2,210)
Costs Not Attributable to Program Costs	-	29	-	-	29
Net Cost of Operations	$ 70	$ (2,254)	$ 3	$ -	$ (2,181)

Statement of Changes in Net Position
for the Year Ended September 30, 2007

	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Net Position Beginning of Period	$ (252)	$ 1,101	$ 70	$ 3	$ 922
Budgetary and Other Financing Sources	42	(2,173)	-	-	(2,131)
Net Cost of Operations	(70)	2,254	(3)	-	2,181
Change in Net Position	(28)	81	(3)	-	50
Net Position End of Period	$ (280)	$ 1,182	$ 67	$ 3	$ 972

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 and Net Position:					
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 2007, 72 contracts at 11 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 7 contracts (10 percent) had incomplete or outdated cost analyses and two contracts (3 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 three agricultural licenses with private companies/individuals. NCA licenses land for growing crops and, on certain licenses, receives various services in exchange from the licensee 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 three cemeteries.

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 VA:

(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 2007 were $435 and for FY 2006 were $436. The loan guarantee lender participation fees collected for FY 2007 were $1.5. The lender participation fees collected for FY 2006 were $1.6.

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 $426.2 during FY 2007 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, 2007 (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	$ 4,582	$ 95	$ 97	$ 223	$ 27	$ 16	$ 18	$ 93	$ 8	$ 46	$ 70	$ 5,275
Less Earned Revenues	(113)	-	(35)	2	-	(427)	-	(743)	(742)	-	(1,064)	(3,122)
Net Intragovernmental Production Costs	4,469	95	62	225	27	(411)	18	(650)	(734)	46	(994)	2,153
Public Costs	30,450	1,172	794	8,672	3,875	2,962	704	513	1,310	209	1,996	52,657
Less Earned Revenues	(2,906)	-	(13)	-	-	(203)	-	(63)	(482)	-	(49)	(3,716)
Net Public Production Costs	27,544	1,172	781	8,672	3,875	2,759	704	450	828	209	1,947	48,941
Total Net Cost of Operations	$ 32,013	$ 1,267	$ 843	$ 8,897	$ 3,902	$ 2,348	$ 722	$ (200)	$ 94	$ 255	$ 953	$ 51,094

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

20. Disclosures Related to the Statements of Budgetary Resources

Apportionment categories of obligations incurred
Obligations
Years Ended September 30,

	2007	2006
Category A, Direct	$ 38,989	$ 35,612
Category B, Direct	43,473	40,237
Reimbursable	5,959	5,605
Exempt from Apportionment	29	1,222
Total Obligations	$ 88,450	$ 82,676

Borrowing Authority
Loan Guaranty had borrowing authority of $0.7 billion and $0.5 billion as of September 30, 2007 and 2006 respectively. The Vocational Rehabilitation Program had borrowing authority of $2.7 and $3.4 as of September 30, 2007 and 2006, 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 $14.5. Additionally, unobligated balances of prior year recoveries of $6.2 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 2007 use.

Unobligated VA funds are available for uses defined in VA's FY 2007 Appropriation Law (P.L. 110-005) and Supplemental Appropriations Law (P.L. 110-028). 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 on the Statements of Budgetary Resources. This adjustment was 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 2007 and 2006 was $5,690 and $4,860 respectively.

Contributed Capital
The amount of contributed capital received during FY 2007 consisted of donations in the amount of $45.5 to the General Post Fund and $0.1 to the National Cemetery Gift Fund. For FY 2006 $52.9 was donated to the General Post Fund and $0.4 to the National Cemetery Gift Fund.

21. 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, 2007

Fund Symbol	**6020**	**6050**	**TOTAL**
Assets:			
Fund balance with Treasury	$ 38	$ 1	$ 39
Investments with Treasury	-	-	-
Other Assets	-	-	-
Total Assets	$ 38	$ 1	$ 39
Liabilities:			
Payables to Beneficiaries	1	-	1
Other Liabilities	37	1	38
Total Liabilities	38	1	39
Net Position:			
Cumulative Results	-	-	-
Total Liabilities & Net Position	$ 38	$ 1	$ 39

22. Reconciliation of Net Cost of Operations to Budget

The objective of the information shown below is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and non-budgetary resources available to the VA with its net cost of operations. In previous years this reconciliation was accomplished by presenting the Statement of Financing as a Basic Financial Statement.

DEPARTMENT OF VETERANS AFFAIRS		
RECONCILIATION OF NET COSTS OF OPERATIONS TO BUDGET (dollars in millions)		
for the Years Ended September 30,	**2007**	**2006**
Resources Used to Finance Activities		
Obligations Incurred	$ 88,450	$ 82,676
Less Spending Authority from Offsetting Collections and Adjustments	(6,539)	(8,286)
Obligations Net of Offsetting Collections and Adjustments	81,911	74,390
Less Offsetting Receipts	(3,610)	(4,434)
Net Obligations	78,301	69,956
Donations of Property	20	25
Transfers-out	(241)	(213)
Imputed Financing	1,408	1,303
Total Resources Used to Finance Activities	**79,488**	**71,071**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(1,078)	320
Resources that Finance the Acquisition of Assets	(3,736)	(4,005)
Resources that Fund Expenses Recognized in Prior Periods	(633)	(611)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	2,842	3,488
Total Resources that Do Not Fund Net Costs of Operations	(2,605)	(808)
Total Resources Used to Finance the Net Cost of Operations	**76,883**	**70,263**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	118	29
Increase in Environmental and Disposal Liability	174	9
Reestimates of Credit Subsidy Expense	(402)	(1,110)
Increase in Exchange Revenue Receivable from the Public	(276)	(265)
Increase (Decrease) in Veterans Benefits Actuarial Liability	(26,045)	31,263
Depreciation and Amortization	895	870
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	314	227
Loss on Disposition of Assets	134	86
Other	(701)	90
Total Costs That Do Not Require Resources in the Current Period	**(25,789)**	**31,199**
Net Cost of Operations	**$ 51,094**	**$ 101,462**

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

Offsetting Receipts

The FY 2007 presentation of Offsetting Receipts within the Statement of Budgetary Resources has changed to conform to the Department of Treasury reporting in the Budget of the United States Government. The line item "Less Distributed Offsetting Receipts" includes only distributed offsetting receipts. In the prior period both distributed and undistributed receipts were reported on this line.

Earmarked Funds

In FY 2006 VA 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.

Department of Veterans Affairs
Office of Inspector General

REPORT OF THE AUDIT OF THE DEPARTMENT OF VETERANS AFFAIRS CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEARS 2007 AND 2006

Report No. 07-01016-21 November 15, 2007

VA Office of Inspector General
Washington, DC 20420

DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Acting Secretary

Report of Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2007 and 2006

1. Attached is the Report of Audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements (CFS) for Fiscal Years (FY) 2007 and 2006, as required by the Chief Financial Officers Act of 1990. The Office of Inspector General contracted with the independent public accounting firm, Deloitte & Touche LLP, to perform the audit of VA's FY 2007 CFS.

2. The independent auditors' report by Deloitte & Touche LLP provides an unqualified opinion on VA's FYs 2007 and 2006 CFS. The report on internal control identifies four material weaknesses. Three of the four material weaknesses are repeat conditions from the prior year audit and identified as (i) financial management system functionality (modified), (ii) information technology security controls and (iii) financial management oversight (modified). The fourth material weakness, retention of computer generated detail records in Benefit Delivery Network (BDN) system was identified in FY 2007.

3. The report on compliance with laws and regulations continues to show that VA is not in substantial compliance with the financial management system requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. The material weaknesses in internal control over financial reporting indicate that VA's financial management systems did not substantially comply with the Federal financial management systems requirements as required by FFMIA section 803(a).

4. Deloitte & Touche LLP is responsible for the attached auditor's report dated November 15, 2007, and the conclusions expressed in the report. We do not express opinions on VA's financial statements or internal control or on whether VA's financial management systems substantially complied with FFMIA; or conclusions on compliance with laws and regulations.

5. The independent auditors will follow up on these internal control findings and evaluate the adequacy of corrective actions taken during the audit of the VA's FY 2008 CFS.

Belinda J. Finn

BELINDA J. FINN
Assistant Inspector General
For Auditing

Attachment

Deloitte & Touche LLP
555 12th Street N.W.
Suite 500
Washington, DC 20004-1207
USA

Tel: +1 202 879 5600
Fax: +1 202 879 5309
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Inspector General and the Acting Secretary
of Department of Veterans Affairs

We have audited the accompanying consolidated balance sheets of the Department of Veterans Affairs ("VA") as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources for the years then ended which collectively comprise VA's basic financial statements. These 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 auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the requirements of Office of Management and Budget ("OMB") Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and the OMB Bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of VA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of VA as of September 30, 2007 and 2006, and the respective net costs, changes in net position, and budgetary resources thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2007, on our consideration of VA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

November 15, 2007

Member of
Deloitte Touche Tohmatsu

Deloitte.

Deloitte & Touche LLP
555 12th Street N.W.
Suite 500
Washington, DC 20004-1207
USA

Tel: +1 202 879 5600
Fax: +1 202 879 5309
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Inspector General and the Acting Secretary of
Department of Veterans Affairs

We have audited the basic financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2007, and have issued our report thereon dated November 15, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the requirements of the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered VA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion in the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the VA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the VA's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

Member of
Deloitte Touche Tohmatsu

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

We identified the following matters involving the internal control over financial reporting and its operation that we consider to be significant deficiencies. The significant deficiencies that we identified in our prior year report dated November 14, 2006 are identified in this report as "Repeat Condition".

Deficiencies described in Section I include significant departures from certain requirements of OMB Circular A–127, *Financial Management Systems*; Circular A–123, *Management's Responsibility for Internal Control*; and Circular A–130, *Management of Federal Information Resources*. We consider each of the four significant deficiencies identified as "Financial Management System Functionality," "Information Technology (IT) Security Controls," "Financial Management Oversight" and "Retention of Computer Generated Detail Records in Benefit Delivery Network (BDN) System" to be material weaknesses.

Distribution

This report is intended solely for the information and use of the VA Office of Inspector General, the management of VA, the Office of Management and Budget, the U.S. Government Accountability Office, Office of the President, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

November 15, 2007

SECTION I — MATERIAL WEAKNESSES

We consider each of the following deficiencies in VA's internal control over financial reporting to be a material weakness:

A. Financial Management System Functionality – Material Weakness (Repeat Condition)

VA management implemented a reporting system to automate the preparation of the consolidated financial statements in fiscal year 2006 which has improved the financial reporting process for fiscal year 2007. Although we noted some improvement, we identified continuing difficulties with the legacy systems related to the reliable, timely and consistent preparation, processing, and analysis of financial information for VA's consolidated financial statements. Key examples of significant deficiencies are described below.

Conditions:

- A significant number of manual adjusting entries are required at year-end to prepare the financial statements. This is indicative of systems which do not effectively and efficiently support reliable, timely and consistent preparation, processing and analysis of financial information. In addition, management has chosen to manually "rollover" entries from prior year adjustments in its reporting system, MinX.

- The legacy payroll and property systems do not readily provide information to support activity in the related general ledger accounts. The Personnel and Accounting Integrated Data (PAID) system cannot produce reports to support all accrued annual leave activity, including payroll adjustments, such as timesheet adjustments and expired leave balances. The Fixed Asset Package (FAP) cannot readily identify all current year property, plant and equipment additions and reclassifications of work in process due to system limitations.

Criteria:

OMB Circular A–127, *Financial Management Systems* states:

"A financial system supports the financial functions required to track financial events, provide financial information significant to the financial management of the agency, and/or required for the preparation of financial statements. A financial system encompasses automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions. A financial system may include multiple applications and controls that are integrated through a common database or are electronically interfaced, as necessary, to meet defined data and processing requirements."

"The term "financial management systems" means the financial systems and the financial portions of mixed systems necessary to support financial management."

"Financial management systems shall be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems."

"An agency's financial management system should generate reliable, timely, and consistent information necessary for meeting management's responsibilities, including the preparation of financial statements."

"Transaction detail supporting SGL accounts shall be available in the financial management systems and directly traceable to specific SGL account codes."

OMB Circular A–123, *Management's Responsibility for Internal Control* states:

"The management control processes necessary to ensure that 'reliable and timely information is obtained, maintained, reported and used for decision making' are set forth, including prompt and appropriate recording and classification."

Cause:

There are inherent system weaknesses to assemble, compile, and review the necessary financial information for annual financial reporting requirements and to perform needed analyses.

Effect:

Significant manual workarounds and the posting of a large number of general ledger adjustments increase the risk of processing errors and, in turn, the risk of misstatements in the financial statements.

Recommendation:

The VA Chief Information Officer (CIO) and Chief Financial Officer (CFO) should work to improve system functionality in order to better support preparation of the financial statements and reduce the number of adjusting entries required.

VA management should inventory all non-systematic or manual workaround processes performed during the year-end closing period and continue to make improvements through adjustment of timing, refinement and consolidation of these processes.

B. Information Technology (IT) Security Controls – Material Weakness (Repeat Condition)

During fiscal year 2007, the Office of CIO (OCIO) issued Directive 6500, *Information Security Program*, and began to reorganize information technology (IT) resources and reporting structures. In September 2007, the OCIO also issued Handbook 6500 that is designed to assist the organization in implementing its information security programs as described in Directive 6500. In addition, management of major data centers and selected program offices have taken actions to remediate elements of IT security control weaknesses reported in our prior year reports.

However, legacy IT infrastructure and longstanding security control weaknesses due to the lack of effective implementation and enforcement of an agency-wide information security program continue to place VA's program and financial data at risk. Our assessment of the general and application controls of VA's key financial systems identified the following conditions.

Conditions:

Agency-wide Security Program

- Many key information security control procedures have not been updated and/or implemented to enforce security control over program and financial management systems throughout the organization in a uniform manner.
- The risk assessments for critical financial management systems were not consistently conducted in conformity with standards of the National Institute of Standards and Technology (NIST) Special Publication 800-30, *Risk Management Guide for Information Technology Systems*, to reflect VA's information security challenges and to facilitate effective mitigation of such challenges.

Access Control

- Strong system access authentication mechanisms and administration of user access have not been consistently implemented and enforced.
- Information systems were not patched in a consistent and timely manner.
- Access privileges were not restricted by proper system access profiles for users and IT personnel. nor were the access activities monitored on a routine basis.
- Intrusion detection mechanisms were not always operating consistently.

Segregation of Duties

- Legacy financial management systems and procedures have not been structured to enforce proper segregation of duties among IT personnel and end users within key financial management systems.

Service Continuity

- A service continuity plan at the departmental level has not been fully implemented to provide overall guidance, direction, and coordination for entity-wide IT service continuity.
- Testing of the service continuity plan "Continuity of Operations Plan" for financial management systems at selected program offices and certain data centers has not been routinely scheduled and adequately performed.

Change Control

- Standard change control policy and procedures have not been implemented to enforce financial application development and change management controls.

Criteria:

E-Government Act 2002, Title III, *Federal Information Security Management Act of 2002* states:

"Each agency shall develop, document, and implement an agency-wide information security program to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source."

OMB A-130, Appendix III, *Security of Federal Automated Information Resources* states:

"Agencies shall implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated in general support systems and major applications."

Cause:

VA operated under a decentralized IT management structure until fiscal year 2006. One legacy of this structure was the lack of current and cohesive policies and procedures in major information security areas. Development, implementation and enforcement of these policies and procedures play an important role in the effective management of agency-wide information security programs and the success of the resulting security controls employed to protect financial information systems.

Effect:

Information security control weaknesses place sensitive information, including financial information and veterans' medical and benefit information, at risk of inadvertent or deliberate misuse, fraudulent use, improper disclosure, theft, or destruction, possibly occurring without detection.

Recommendations:

VA senior leadership should continue to pursue a more centralized approach to facilitate the effective implementation and enforcement of information security controls. VA should continue its effort to prioritize its resources in accomplishing its management agenda. Key tasks should include, but are not limited to, the following:

- Take an agency-wide approach to implement information security programs to guide information security control operations in accordance with standards established by NIST and OMB. Establish and communicate chain of command and accountability to enforce and monitor compliance with information security control policies and procedures.
- Provide actionable steps for ensuring that user access to VA financial management systems, including general support systems and major applications, is authorized based on need; that system logical security settings and updates are properly implemented for all interconnected networks, systems, and applications; and that proper oversight of system activities is performed.
- Configure systems to support proper system segregation of duties and provide adequate human resources and management oversight to complement system controls.

- Complete and implement a service continuity plan that will provide effective guidance, communication and coordination of service continuity planning. Perform routine testing to validate the effectiveness of the service continuity planning throughout the agency.
- Develop and implement a standard change control framework that guides the development and implementation of change management procedures for VA financial applications.

C. Financial Management Oversight – Material Weakness (Repeat Condition)

Conditions:

We have identified eight significant deficiencies that support the need for enhanced management oversight. Most of these deficiencies relate to observations also identified in prior years that remain uncorrected. When aggregated, the series of deficiencies has a recurring theme of inadequate or ineffective management oversight, thus resulting in an overall material weakness.

In the past management has attempted a number of approaches to remediate the recurring deficiencies. Management has provided training and become more involved in the process overall. Since these approaches have not proven effective, management should review the root cause of each issue and the reason that attempts to remediate the issue have been met with limited success.

The following eight significant deficiencies support the overall material weakness and are also described in greater detail in Section II of this report:

- ***Accrued Services Payable and Undelivered Orders***
  Veterans Health Administration (VHA) financial management did not perform adequate reviews in each of these areas.

- ***Accounts Receivable***
  VHA financial management did not perform sufficient follow-up of accounts receivable collections, and review of write-offs and allowances.

- ***Property, Plant and Equipment***
  VHA financial management demonstrated little evidence of improvement over monitoring internal controls and accounting for property, plant and equipment, including capitalization and disposals.

- ***Environmental and Disposal Liabilities***
  VHA financial management did not effectively monitor proper accounting and reporting of environmental liabilities.

- ***Payroll Agreed-Upon Procedures Report***
  The Central Office could not produce reports to support payroll data submissions to the Office of Personnel Management. Its review process did not detect the inaccuracies on reports generated from the PAID system until identified by our procedures.

- ***Accrual for Unbilled Receivables and Allowance for Contractual Adjustments***
  VHA financial management has not initiated adequate processes to review the allowance for contractual adjustments and information used in the calculation of accrual for unbilled receivables to assure these amounts are recorded in accordance with generally accepted accounting principles.

- ***Adjusting Entries and Reconciliation Review***
  There are deficiencies in Veterans Benefits Administration's (VBA) management review of journal entries and reconciliations that resulted in financial adjustments as a result of our audit process.

- ***Compensation and Pension Actuarial Liability***
  VBA management has not provided the external actuary with all relevant data nor has VBA management considered the impact of this relevant data to the liability.

Criteria:

Management must maintain a system of internal controls in accordance with *Standards for Internal Control in the Federal Government* issued by the Government Accountability Office (GAO). These five standards for internal control include:

- Control Environment – It provides the discipline and structure as well as the climate which influences the quality of internal control.
- Risk Assessment – It is the identification and analysis of relevant risks associated with achieving control objectives.
- Control Activities – They are the policies, procedures, techniques, and mechanisms that enforce management's directives.
- Information and Communications – Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.
- Monitoring – Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Cause:

The operational causes for the deficiencies highlighted above vary. Common issues include a lack of resources with the appropriate skills and a significant volume of transactions. In addition, as in the case of environmental liabilities and property, plant and equipment, the solution requires routine communication with non-financial functions such as facilities management. If the essential financial accounting work has not been performed or performed inadequately, various levels of financial management should be in place to properly monitor, identify and detect these issues. VA's decentralized structure makes management of control processes more difficult.

Effect:

Recording financial data without sufficient review and monitoring increases the likelihood that an error in the financial statements will occur and that it will go undetected.

Recommendation:

Management should review its financial management organizational structure to determine if the financial management organization has sufficient authority and resources to solicit support to improve financial management at all levels of the organization. Any initiative should have support from the Secretary to promote strong financial management and coordination amongst all operational levels to ensure financial management can promote change within the overall organization. This may require additional funding and resources but it also requires a fundamental commitment from all operational levels. VA should also assess the resource and control challenges associated with operating in a highly decentralized accounting function. While the assessment is being performed, management should develop an immediate interim review and monitoring plan to detect and resolve issues in each of the eight deficiencies discussed above.

D. Retention of Computer Generated Detail Records in BDN System – Material Weakness

Conditions:
We noted that VBA retains certain computer generated transaction details from the BDN system for approximately 60 to 90 days; as such, management was unable to provide supporting detail to substantiate certain amounts recorded in the financial statements.
Also large differences for Compensation and Pension and Education programs existed between BDN, a subsidiary ledger, and FMS, the general ledger and management was unable to provide support for these differences.

Criteria:
Benefit Systems Requirements, formerly published by the Joint Financial Management Improvement Program and now under the responsibility of the Financial Systems Integration Office, states:
"Audit Trails Process

Adequate audit trails are critical to provide support for transactions and balances maintained by the benefits system. While audit trails are essential to auditors and system evaluators, they are also necessary for day-to-day operation of the system. For example, they allow for the detection and systematic correction of errors that arise.

Mandatory Requirements

To support the Audit Trails process, the benefits system must:

- Provide audit trails to trace transactions from source documents, original input, other systems, system-generated transactions, and internal assignment transactions through the system.
- Provide transaction details to support account balances.
- Provide audit trails to trace source documents and transactions through successive levels of summarization to the financial statements and the reverse.
- Provide audit trails to identify changes made to system parameters and tables that would affect the processing or reprocessing of any financial transactions.
- For all types of transactions, provide capability to select items for review based on user-defined criteria. Examples of selection criteria are accounting period, amount, and payee.
- Provide audit trails that identify document input, change, approval, and deletions by originator.

- Provide the capability to record the user ID, date, and time updated for each transaction affecting the general and subsidiary ledger accounts."

Cause:

Management has informed us that this deficiency is due to system limitations in BDN and the high volume of transactions processed on a daily basis.

Effect:

Management cannot provide support for certain balances in the general ledger after 60 to 90 days from the transaction date.

Recommendation:
Policies and procedures should be implemented to ensure that computer generated transaction detail is maintained for an appropriate number of years in order to provide adequate support and audit trail for balances recorded in the financial statements.

SECTION II — SIGNIFICANT DEFICIENCIES

We consider the following deficiencies in VA's internal control over financial reporting to be significant deficiencies. Items with an asterisk (*) are repeat conditions included in a letter we issued to management last year.

1. Accrued Services Payable, and Undelivered Orders —VHA*

Condition- During our medical center site visits, we noted instances where accrued services payable and undelivered orders were not properly monitored and reviewed to ensure they were valid transactions.

Criteria- OMB Circular A-123, *Management's Responsibility for Internal Control,* requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause- Inadequate financial management oversight at the medical centers.

Effect- Accrued services payable and undelivered orders balances could be misstated during the year, and in some cases, unauthorized transactions may not be detected.

Recommendation- We recommend that the VHA CFO, in coordination with the Veterans Integrated Service Network (VISN) CFOs, take action to review and monitor accrued services payable and undelivered orders on a monthly basis. Large or old payables or undelivered order balances should be reviewed to ensure validity.

2. Accounts Receivable —VHA*

Condition- We noted the following with respect to accounts receivable (both medical care and non-medical care).

- Incorrect non-medical care allowance for bad debts and no central office analytical reviews of station balances.
- Receivable was booked before earned.
- Lack of timely follow-up of accounts receivable.
- Incorrect calculation of interest expense.

Criteria- OMB Circular A-123, *Management's Responsibility for Internal Control,* requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause- Inadequate financial management oversight at the medical centers.

Effect- The accounts receivable balance and its related allowance have a higher risk for misstatement.

Recommendation- We recommend that the VHA CFO, in coordination with the VISN CFOs, take action to implement proper follow-up procedures of accounts receivable and to ensure calculating and recording of allowance estimates and transactions correctly. In addition, VHA CFO should review the allowance estimates for reasonableness on a regular basis.

3. Property, Plant and Equipment (PP&E) – Estimated Useful Life and Recording of Transactions —VHA*

Condition- During our medical center site visits, we noted the following:

- Work in process projects were not capitalized on a timely basis.
- Assets that are no longer property of VA remained capitalized.
- Transactions that should have been expensed were capitalized due to unclear operating procedures.
- The estimated useful lives were not consistent with VA policy.

Criteria- OMB Circular A-123, *Management's Responsibility for Internal Control,* requires that management be responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

Cause- Inadequate financial management oversight at the medical centers and inadequate communication with facilities management.

Effect- PP&E and related expense accounts may be misstated.

Recommendation- We recommend that VHA CFO, in coordination with the VISN CFOs, take action to ensure better coordination between financial and facilities management, that work-in-process projects are reviewed for completion dates and timely capitalization, and that estimated useful lives are consistent with VA policy. In addition, management should put procedures in place to ensure that projects no longer in use are removed from the general ledger.

4. Environmental and Disposal Liabilities—VHA*

Condition- We noted that many stations were not updating the estimate for, or documentation of, environmental and disposal liabilities on a timely basis. In addition, inconsistent methodologies for calculating environmental and disposal liabilities were noted throughout the medical centers. Furthermore, we noted that the Austin Financial Services Center reverses the estimate on an annual basis to force the stations to review and re-book an updated estimate. In certain instances, medical centers were not aware that balances had been reversed.

Criteria- In accordance with the Federal Financial Accounting and Auditing Technical Release Number 2, an agency is required to recognize a liability for environmental cleanup costs resulting from past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable.

Cause- Inadequate communication and review with facilities management and no review of station balances by central office.

Effect- As a result of our audit, numerous stations were required to post significant adjustments during the fourth quarter to correctly state environmental and disposal liabilities.

Recommendation- We recommend that the VHA CFO, in coordination with the VISN CFOs, take action to ensure that these estimates are updated and recorded timely and that appropriate documentation is maintained to support these estimates. To ensure consistency in reporting and reasonable estimates, management should develop standard procedures that address the requirements and methodologies for the estimating and recording of environmental liabilities, improve communication with facilities management, and ensure central office reviews are conducted.

5. Payroll Agreed-Upon Procedures Report

Condition- On an annual basis, VA is required to submit a Report of Withholdings and Contributions for Health Benefits, Life Insurance, and Retirement to the U.S. Office of Personnel Management (OPM) on which we issue an agreed-upon procedures report. As in past years, significant effort was expended by both Deloitte & Touche LLP and VA in performing the agreed-upon procedures due to inaccurate reports generated from the PAID system. As a result, significant differences were noted by our agreed-upon procedures report.

Criteria- In accordance with OMB Circular A-127, *Financial Management Systems*,

"A financial system supports the financial functions required to track financial events, provide financial information significant to the financial management of the agency, and/or required for the preparation of financial statements."

"An agency's financial management system should generate reliable, timely, and consistent information necessary for meeting management's responsibilities, including the preparation of financial statements."

"The agency financial management system shall be able to provide financial information in a timely and useful fashion to …comply with internal and external reporting requirements…,"

Cause- Limitations with the PAID legacy system.

Effect- Inaccurate reports could impact the calculation of imputed pension costs.

Recommendation- We recommend that the VA CFO review reports generated from the PAID system for accuracy and make programming adjustments as necessary to support standard reports that allow VA to meet this reporting requirement more efficiently, accurately, and timely.

6. Accrual for Unbilled Receivables and Allowance for Contractual Adjustments—VHA

Condition- The following conditions were noted during the review of accounts receivable:

- Accrual for unbilled receivables is calculated using a three-month moving average of change in accounts receivable, write-offs and collections multiplied by the number of days it takes to bill a receivable after services are provided. However, management has not validated the reasonableness of the accrual methodology by analyzing actual billings subsequent to the accounting period. In addition, we noted that the days to bill information is calculated by a separate division within VHA which was not aware that the information was to be used for financial statements.

- The allowance for contractual adjustments for medical care accounts receivables is a system calculated percentage. During our review, we noted that management had not reviewed the reasonableness of the allowance based on prior year actuals.

Criteria- GAO's *Standards for Internal Control in the Federal Government* state that managers need to compare actual performance to planned or expected results and analyze significant differences.

Cause- Inadequate financial management review at VHA central office.

Effect- Accounts receivable balances could be misstated as a result of an inadequate accrual.

Recommendation- We recommend that VHA CFO validate the methodology for the accrual for unbilled receivables and the allowance for contractual adjustments by comparing actual activity to prior estimates.

7. **Adjusting Entries and Reconciliation Review***

Condition- As part of our audit of adjusting entries for compensation, pension and education, specifically relating to the statement of budgetary resources, we noted instances where the entry was either not posted or posted with an incorrect amount. These errors were not identified during the VBA review process.

During our audit of property management, we noted that the reconciliation between Centralized Property Tracking System and FMS was not prepared correctly. We also noted that accrual errors were identified on the reconciliation however they were not investigated by VBA in a timely manner.

Criteria- Appropriate review and reconciliation is the basis of a sound internal control environment. The *Standards for Internal Control in the Federal Government* includes reconciliation and review of financial data.

Cause- These deficiencies are due to inadequate management review of financial information. We noted that in most instances, controls to detect these deficiencies are designed, but they are not implemented and operating effectively.

Effect- Relying on financial data without sufficient review and monitoring processes may increase the likelihood that an error in the financial statements will go undetected.

Recommendations- Management reviews should be performed as part of the accounting process. In addition, VA should consider reconciliations as a control and work to resolve any significant differences noted therein to ensure that balances reported in the financial statements are accurate.

8. **Accrued Annual Leave***

Condition- A tremendous amount of effort was expended to prepare the support for the year-end accrued annual leave balances and associated activities during the year by using the PAID system. The reports used to support leave activity did not capture payroll adjustments such as timesheet adjustments and expired leave balances, causing differences between the report and the general ledger.

Criteria- In accordance with OMB Circular A-127, *Financial Management Systems*, "A financial system supports the financial functions required to track financial events, provide financial information significant to the financial management of the agency, and/or required for the preparation of financial statements."

Cause- Lack of effective system functionality and inadequate financial management oversight.

Effect- Inaccurate financial information may not be detected timely.

Recommendation- We recommend that the VA CIO and CFO develop reports to support the annual leave balances in the PAID system to ensure timely, reliable, and consistent accrued annual leave information is available and reconciled when used to prepare the financial statements.

9. Operating Lease Commitments*

Condition- VA does not have an effective process to accumulate information on their future lease commitments for equipment. This information is needed to complete footnote disclosures.

Criteria- OMB Circular A-136, *Financial Reporting Requirements,* requires the disclosure of future lease commitments for each of the next five years and total remaining lease commitment thereafter.

Cause- Decentralization of records.

Effect- Footnote disclosure may not reflect all future commitments.

Recommendation- We recommend that the CFOs for each administration and officials from Veterans Affairs Central Office develop a process to gather operating lease information for year-end disclosure requirements.

10. Intra-Governmental Reconciliations and Related Controls

Condition- VA has drafted policies and procedures to address the requirements of Intra-governmental Business Rules issued by OMB Memorandum M-07-03, but these draft policies and procedures have not been issued in final form. In addition, unreconciled differences exist primarily with the VA's trading partner, the Department of Defense.

Criteria- The Financial Manual, Bulletin No. 2007-03, outlines business rules for intra-governmental transactions. These rules apply to all intra-governmental business, specifically transactions that entail the exchange of goods and services, investments, borrowings and transfers between Federal entities.

Cause- VA does not have sufficient data from their trading partners to properly reconcile all the accounts. In addition, during our audit, we found the draft intra-governmental internal control procedures had not yet been issued in final form.

Effect- Significant unreconciled differences may result with trading partners and inaccurately reflect the related intercompany accounts on both the VA's and individual trading partner's stand-alone financial statements.

Recommendation- We recommend the draft policy and procedures be reviewed to ensure compliance with all the Intra-governmental Business Rules outlined in the Treasury Financial Manual Bulletin No 2007-03. All significant differences should be resolved with trading partners as outlined in Section VII, Resolving Intra-governmental Disputes and Major Differences. VA should also consider the impact of these differences and assess the need for adjustments or write-offs as part of their year-end financial reporting cycle.

11. Property, Plant and Equipment

Condition- The Fixed Asset Package (FAP) provides the capability to retroactively enter acquisitions. While this practice may correctly reflect the actual acquisition dates of specific assets, it may cause difficulty for FAP to identify current year only additions based on acquisition dates. In addition, the system cannot identify reclassifications of work-in-process projects to various capitalized or expense accounts.

Criteria- In accordance with OMB Circular A-127, *Financial Management Systems*,
"A financial system supports the financial functions required to track financial events, provide financial information significant to the financial management of the agency, and/or required for the preparation of financial statements."

Cause- System limitation.

Effect- Inaccurate financial information may not be detected.

Recommendation- We recommend that the VA CIO and CFO develop reports to support actual property, plant and equipment activities occurred during the year and to ensure balances on the reports reconcile back to the financial statements.

12. Compensation and Pension Actuarial Liability

Condition- The model provided to an external actuary to calculate the C&P actuarial liability does not consider hold back and offsets for incarcerated veterans and severance pay provided by the Department of Defense.

Criteria- In order for an external actuary to accurately estimate the C&P actuary liability, they must be provided with all relevant data.

Cause- VBA management has not provided the external actuary with all relevant data nor has VBA management considered the impact of this relevant data to the liability.

Effect- The external actuary does not have all the relevant information to calculate the actuarial liability.

Recommendation- We recommend that VBA management prepare a reconciliation between the BDN payment file and the gross summary file each time a file is provided to an external actuary. Reconciling items identifying data relevant to the calculation of the estimated liability should be provided to an external actuary.

13. Statement of Net Cost

Condition- VA does not have an effective process of collecting, documenting and validating the cost drivers, allocations, and factors used in MinX to prepare the statement of net cost.

Criteria- OMB Circular A–123, *Management's Responsibility for Internal Control*, states:

"The management control processes necessary to ensure that 'reliable and timely information is obtained, maintained, reported and used for decision making' are set forth, including prompt and appropriate recording and classification."

The Chief Financial Officers (CFO) Act of 1990 contains several provisions related to managerial cost accounting, one of which states that an agency's CFO should develop and maintain an integrated accounting and financial management system that provides for the development and reporting of cost information and the systematic measurement of performance.

Cause- VA does not have an automatic cost allocation system that can identify and accumulate the information needed to prepare the statement of net cost.

Effect- The current process, which uses Excel spreadsheets is inefficient and error prone due to the numerous manual inputs that could cause a potential error in the financial statements and statement of net cost footnote disclosures.

Recommendation- VA should develop an entity-wide system to ensure that costs are accurately and consistently tracked throughout all business lines and provides information needed to prepare the statement of net cost. This will reduce the need for manual inputs thereby reducing the risk of potential errors in the financial statements and footnote disclosures.

Follow-Up on Previous Report

In our *Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance Based Upon the Audit Performed in Accordance with Government Auditing Standards* dated November 14, 2006, we reported three material weaknesses in the areas of (1) Lack of an Integrated Financial Management System, (2) Information Technology (IT) Security Controls, and (3) Operational Oversight. These conditions continue to be reported as material weaknesses this year. The Integrated Financial Management System weakness is referred to as Financial Management System Functionality, and the Operational Oversight material weakness is referred to as Financial Management Oversight in the current year.

SECTION III - COMPLIANCE AND OTHER MATTERS

With respect to the internal controls related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they have been placed in operation, as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on internal control over reported performance measures and accordingly, we do not provide an opinion on such controls.

In addition, we considered VA's internal control over Supplementary Information by obtaining an understanding of VA's internal control, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on these internal controls and accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether VA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards* and are described below.

1. **Non-compliance with FFMIA**

   Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U. S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance and evaluative criteria issued by OMB in Circular A-127.

   The material weaknesses in internal control over financial reporting discussed above and identified as "Financial Management System Functionality," "Information Technology (IT) Security Controls," and "Retention of Computer Generated Detail Records in BDN System" indicate that VA's financial management systems did not substantially comply with the Federal financial management systems requirements as required by FFMIA section 803(a).

2. **Non-compliance with Debt Collection Improvement Act***

   Condition- Several instances of non-compliance with the Debt Collection Improvement Act of 1996 (DCIA) were noted.

   - A few medical centers selected for review had incorrect interest calculations due to manual errors, incorrect percentage rates and other unexplained errors.

   - Interest and administrative costs should be charged to VA's delinquent debtors. The rates are determined by the Treasury on a yearly basis. However, VBA did not charge interest on Life Insurance delinquent debts nor Compensation and Pension ("C&P") Chapter 30 or Chapter 1606 Education receivables.

   Criteria- Public Law 96-466, 38 U.S.C. 501(a) and 5315, and 38 CFR 1.919 gave VA specific authority to charge interest on any amount owed the United States.

Cause- The condition is a combination of the inability of the Hines system to calculate interest on VBA debts, inadequate financial management oversight at the medical centers, and the former VA Deputy Secretary's decision in July 1992 to not charge interest on compensation and pension debts.

Effect- Accounts receivable could be misstated.

Recommendation- We recommend the VBA CFO and VHA CFO, in coordination with the VISN CFOs, should take action to:

- Ensure accurate calculation of interest.

- Implement policies and procedures to administer the requirements of Public Law 96-466 and Title 38 with respect to interest and administrative charges or propose a legislative remedy to request a waiver of these requirements for the Veterans C&P programs.

3. Non-compliance with USC Title 5, 552A –VBA*

Condition- There were several files that could not be located for testing during VBA testing as well as instances where the appropriate documents were not available to substantiate the amounts recorded. Some of these were comprised of instances where key forms were missing from the veteran's file.

Criteria- USC Title 5, 552A subsection D5 states:

"An agency should maintain all records which are used by the agency in making any determination about any individual with such accuracy, relevance, timeliness, and completeness as is reasonably necessary to assure fairness to the individual in the determination."

Cause- Inadequate control of the retention of the veteran file records due to the fact that the files were manually stored and some of those files were subsequently transferred to off site locations and not adequately tracked.

Effect- VA is not in compliance with USC Title 5, 552A, subsection D5, as it relates to several veteran files. Also the balances recorded in FMS cannot be substantiated due to the lack of supporting documentation.

Recommendation - We recommend that the VA implement procedures to ensure that veteran file records are properly retained and can be located.

In addition, we noted other matters involving the internal control and compliance over financial reporting that will be reported to VA in a separate letter.

Department of Veterans Affairs

Memorandum

Date: November 15, 2007

From: Assistant Secretary for Management (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2007 and 2006

To: Assistant Inspector General for Auditing (52)

1. We have reviewed the Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2007 and 2006, and are pleased with the receipt of an unqualified opinion. We are also proud that we were able to meet the FY 2007 reporting timeline established by the Office of Management and Budget. Please extend to your staff and the staff of Deloitte & Touche, LLP our appreciation for their detailed planning, hard work, and cooperation during this year's audit.

2. The Department's senior officials and I, as well as program managers in VHA, VBA, NCA, and affected staff offices, are aware of the results of the audit. We will continue to focus on completing corrective actions as detailed in the remediation plans for the three material weaknesses, Financial Management System Functionality (previously identified as Lack of an Integrated Financial Management System), Financial Management Oversight (previously identified as Operational Oversight), and Information Technology Security Controls. These existing remediation plans will be revised and expanded, as needed, to address the findings and recommendations in your audit report. A remediation plan will be developed for the new audit material weakness, Retention of Computer Generated Detail Records in Benefits Delivery Network (BDN) System - VBA. We will forward copies of each of these plans to you during the second quarter of FY 2008, and will keep you apprised of our progress in remediating these weaknesses throughout FY 2008.

3. Thank you again for your efforts in bringing us to another successful conclusion of the audit cycle.

Robert J. Henke

Required Supplementary Stewardship Information

These materials are not audited

1. Non-Federal Physical Property

Annually, VA provides funding to state governments for the purchase, construction, or major renovation of physical property owned by the state. In most cases these grant programs involve matching funds from the states.

Grant Program Costs					
Years Ended September 30,	**2007**	**2006**	**2005**	**2004**	**2003**
State Extended Care Facilities	$ 138	$ 85	$ 183	$ 66	$ 121
State Veterans Cemeteries	46	18	36	34	30
Total Grant Program Costs	$ 184	$ 103	$ 219	$ 100	$ 151

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day health care for veterans, and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, hospital, and day health care for veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last 5 fiscal years, the State Home Construction Grant Program has awarded grants in excess of $626 million. VA also provides per diem payment for the care of eligible veterans in state homes.

Since the cemetery program was established in 1980, VA has awarded grants totaling more than $308 million to 39 states and the Commonwealths of Guam and the Northern Marianas. The program provides up to 100 percent of the cost to establish, expand, or improve state veterans' cemeteries. States provide the land and agree to operate the cemeteries.

2. Human Capital

Investment in human capital comprises those expenses for education and training programs for the general public that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal federal education and training of civilian employees.

Veterans and Dependents Education Years ended September 30,		2007		2006
Program Expenses				
Education and Training-Dependents of Veterans	$	450	$	430
Vocational Rehabilitation and Education Assistance		3,095		2,943
Administrative Program Costs		243		232
Total Program Expenses	$	3,788	$	3,605
Program Outputs (Participants)				
Dependent Education		79,134		79,430
Veterans Rehabilitation		69,409		71,627
Veterans Education		490,826		461,488

Veterans and Dependents Education Years ended September 30,	2005	2004
Program Expenses		
Education and Training-Dependents of Veterans	$ 405	$ 320
Vocational Rehabilitation and Education Assistance	2,779	2,517
Administrative Program Costs	226	230
Total Program Expenses	$ 3,410	$ 3,067
Program Outputs (Participants)		
Dependent Education	75,072	67,420
Veterans Rehabilitation	71,956	75,409
Veterans Education	444,359	409,695

Veterans and Dependents Education Year ended September 30,	2003
Program Expenses	
Education and Training-Dependents of Veterans	$ 266
Vocational Rehabilitation and Education Assistance	2,309
Administrative Program Costs	288
Total Program Expenses	$ 2,863
Program Outputs (Participants)	
Dependent Education	64,582
Veterans Rehabilitation	71,549
Veterans Education	400,289

Program Outcomes
VA's education and training programs are intended to provide higher education to dependents who might not be able to participate otherwise. Veterans' rehabilitation and employment programs are provided to service-disabled veterans; they are designed to improve employability and promote independence for the disabled. Educational programs for active duty personnel, reservists, and veterans provide higher education assistance to those who are eligible under the MGIB and the Veterans Educational Assistance Program. Education and training assistance is provided to dependents of veterans who died of service-connected disability or whose service-connected disability was rated permanent and total. The Vocational Rehabilitation and Employment program provides evaluation services, counseling, and training necessary to assist veterans in becoming employable and maintaining employment to the extent possible. The program is open to veterans who have a 10 percent or greater service-connected disability rating and are found to have a serious employment handicap. The Veterans Education program provides educational assistance to eligible servicemembers and veterans.

3. Health Professions Education

Health Professions Education					
Years Ended September 30,					
	2007	**2006**	**2005**	**2004**	**2003**
Program Expenses					
Physician Residents and Fellows	$ 469	$ 462	$ 438	$ 420	$ 404
Associated Health Residents and Students	81	65	63	62	60
Instructional and Administrative Support	606	452	430	401	367
Total Program Expenses	$ 1,156	$ 979	$ 931	$ 883	$ 831
Program Outputs					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	33,775	31,290	30,903	29,179	28,000
Medical Students	18,728	17,289	16,750	16,740	16,000
Nursing Students	27,515	24,870	22,675	20,275	17,000
Associated Health Residents and Students	20,875	18,990	16,862	16,921	15,000
Total Program Outcomes	100,893	92,439	87,190	83,115	76,000

Program Outcomes
VA's education mission contributes to high quality health care of veterans by providing a climate of scientific inquiry between trainees and teachers; application of medical advances more readily through an academic setting; supervised trainees who provide clinical care; and educational programs that enable VA to recruit highly qualified health care professionals.

The Veterans Health Administration (VHA) conducts education and training programs to enhance the quality of care provided to veterans within the VA health care system. Building on the long-standing, close relationships among VA and the Nation's academic institutions, VA plays a leadership role in defining the education of future health care professionals that helps meet the changing needs of the Nation's health care delivery system. Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. Through its partnerships with affiliated academic institutions, VA conducts the largest education and training effort for health professionals in the Nation. Each year, over 100,000 medical and other students receive some or all of their clinical training in VA facilities through affiliations with over 1,200 educational institutions including 107 medical schools. Many have their health profession degrees and contribute substantially to VA's ability to deliver cost-effective and high-quality patient care during their advanced clinical training at VA.

4. Research and Development (R&D)

Investments in research and development comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other benefits.

Program Expense
Year ended September 30, 2007

	Basic	Applied	Development	Total
Medical Research Service	$ 171.3	$ 56.9	$ -	$ 228.2
Rehabilitative Research and Development	4.8	24.5	24.4	53.7
Health Services Research and Development	-	58.2	-	58.2
Cooperative Studies Research Service	32.9	41.0	-	73.9
Medical Research Support	-	408.6		408.6
Total Program Expenses	$ 209.0	$ 589.2	$ 24.4	$ 822.6

Program Expense
Year ended September 30, 2006

	Basic	Applied	Development	Total
Medical Research Service	$ 172.1	$ 57.2	$ -	$ 229.3
Rehabilitative Research and Development	5.4	27.1	21.7	54.2
Health Services Research and Development	-	59.7	-	59.7
Cooperative Studies Research Service	30.6	38.2	-	68.8
Medical Research Support	-	353.0		353.0
Total Program Expenses	$ 208.1	$ 535.2	$ 21.7	$ 765.0

Program Expense Year ended September 30,				2005
	Basic	Applied	Development	Total
Medical Research Service	$ 154.4	$ 59.4	$ -	$ 213.8
Rehabilitative Research and Development	4.9	23.9	19.6	48.4
Health Services Research and Development	-	61.7	-	61.7
Cooperative Studies Research Service	.5	47.8	-	48.3
Medical Research Support	-	381.7	-	381.7
Total Program Expenses	$ 159.8	$ 574.5	$ 19.6	$ 753.9

Program Expense Year ended September 30,				2004
	Basic	Applied	Development	Total
Medical Research Service	$ 172.9	$ 81.8	$ -	$ 254.7
Rehabilitative Research and Development	3.5	27.9	17.0	48.4
Health Services Research and Development	-	61.8	-	61.8
Cooperative Studies Research Service	-	27.7	-	27.7
Medical Research Support	-	452.0	-	452.0
Prosthetic Research Support	-	4.8	-	4.8
Total Program Expenses	$ 176.4	$ 656.0	$ 17.0	$ 849.4

Program Expense Year ended September 30,				2003
	Basic	Applied	Development	Total
Medical Research Service	$ 141.0	$ 80.7	$ -	$ 221.7
Rehabilitative Research and Development	3.1	27.5	20.3	50.9
Health Services Research and Development	-	61.5	-	61.5
Cooperative Studies Research Service	-	27.0	-	27.0
Medical Research Support	-	402.9	-	402.9
Prosthetic Research Support	-	4.7	-	4.7
Total Program Expenses	$ 144.1	$ 604.3	$ 20.3	$ 768.7

In addition, VHA researchers received grants from the National Institutes of Health in the amount of $630 million and $198 million in other grants during FY 2007. These grants went directly to researchers and are not considered part of the VA entity. They are being disclosed here but are not accounted for in the financial statements.

Program Outputs/Outcomes

For FY 2007, VA's R&D general goal related to stewardship was to ensure that VA medical research programs met the needs of the veteran population and contributed to the Nation's knowledge about disease and disability. Target levels were established for the: (1) percent of funded research projects relevant to VA's health-care mission in designated research areas and (2) number of research and development projects. Strategies were developed in order to ensure that performance targets would be achieved.

Research and Development Measures-Actual
Years ended September 30,

	2007	2006	2005	2004	2003
Percent of Funded Research Projects Relevant to VA's Health-Care Mission	100.00%	100.00%	94.3%	97.1%	95.6%
Number of Research and Development Projects	2,019	2,190	2,107	2,165	2,075

VA's Medical Research Program goal is to be the premier research organization, leading our Nation's efforts to discover knowledge and create innovations that promote and advance the health and care of veterans and the Nation. To achieve this goal, VA targets research projects that address special needs of veteran patients and balance research resources among basic and applied research to ensure a complementary role between the discovery of new knowledge and the application of these discoveries to medical practice.

Required Supplementary Information

These materials are not audited

1. 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.

Heritage Assets in Units **As of September 30,**	**2007**	**2006**
Art Collections	211	29
Buildings and Structures	1,543	1,860
Monuments/Historic Flag Poles	984	1,093
Other Non-Structure Items	225	177
Archaeological	34	11
Cemeteries	158	156
Total Heritage Assets in Units	3,155	3,326

2. Deferred Maintenance

Deferred maintenance is classified as not performed when it should have been or as scheduled but delayed to a future period. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained and managed in a safe and effective manner; therefore, deferred maintenance is not applicable to them.

VA facilities reported their cost estimates for deferred maintenance by utilizing the Facility Condition Assessment Survey.

Deferred Maintenance **As of September 30,**	**2007**	**2006**
General PP&E	$ 3,524	$ 2,554
Heritage Assets	183	39
Total Deferred Maintenance	$$ 3,707	$ 2,593

3. Schedule of Budgetary Activity Year Ended September 30, 2007

	Total Budgetary Resources	Obligations Incurred	Spending Authority from Offsetting Collections and Adjustments	Obligated Balance net, Oct. 1	Obligated Balance net, Sept. 30	Total Outlays
VHA						
0152 Medical Admin	$ 3,919	$ 3,746	$ 44	$ 490	$ 552	$ 3,640
0160 Medical Care	28,250	27,221	165	3,452	4,425	26,083
0162 Medical Facilities	4,635	4,140	29	989	1,555	3,545
0167 Medical Facilities	1,418	1,382	30	469	710	1,111
All Other	4,349	1,598	306	1,412	1,424	1,280
Total	$ 42,571	$ 38,087	$ 574	$ 6,812	$ 8,666	$ 35,659
VBA						
0102 Compensation, Pension, & Burial Benefits	$ 38,917	$ 37,674	$ -	$ 91	$ 3,163	$ 34,600
0137 Readjustment Benefits	3,750	3,455	426	43	72	2,999
4127 Direct Loan Financing	269	296	235	96	43	114
4129 Guaranteed Loan Financing	4,586	1,779	1,260	32	41	511
8132 National Service Life Insurance Fund	9,735	1,406	268	1,457	1,428	1,169
All Other	4,367	2,090	1,755	456	466	325
Total	$ 61,624	$ 46,700	$ 3,944	$ 2,175	$ 5,213	$ 39,718
NCA						
Total	$ 214	$ 208	$ -	$ 55	$ 81	$ 182
ADM						
0151 General Operating Expenses	$ 2,024	$ 1,847	$ 356	$ 270	$ 283	$ 1,478
4537 Supply Fund	2,758	1,281	1,366	(1,090)	(1,204)	30
All Other	521	327	299	13	(41)	82
Total	$ 5,303	$ 3,455	$ 2,021	$ (806)	$ (962)	$ 1,590
Total of all Business Lines	$ 109,712	$ 88,450	$ 6,539	$ 8,236	$ 12,998	$ 77,149