# 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. We are extremely proud of this accomplishment.

Throughout 2007, VA made 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 material weakness, *Financial Management System Functionality*, VA continues its efforts to develop the Financial & Logistics Integrated Technology Enterprise (FLITE) program to integrate many disparate systems, standardize financial and logistics functional processes, and modernize the information technology environment. In 2007, VA completed the prerequisite planning for the FLITE program. 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 mapping for all 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 VA's 2007 quarterly and consolidated financial statements using a standardized and repeatable process. The system was expanded in 2007 to provide for the automated generation of footnotes.

Our success in improving the preparation of VA's financial statements and progress with the

Financial Reporting Data Warehouse resulted in VA's President's Management Agenda scorecard on Financial Performance moving to "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," 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 to remediate long-standing security weaknesses. Following the publication in 2006 of VA Directive 6500, "Information Security Program," corresponding VA Handbook 6500 was published in 2007 and provides the foundation for a comprehensive VA information security program.

During 2007, additional focus was placed on the *Financial Management Oversight* material weakness. Additional and clarifying financial policies and procedures were provided to VA's fiscal community, particularly in the area of internal control. During 2008, VA will address the 2007 audit report findings.

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 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. VA completed actions identified for year two of a 3-year plan, and no material weaknesses were identified. Remediation actions were implemented during 2007 to address findings identified in year one and two. 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 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 Departmentwide 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 259 employees migrated 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 2007 consolidated financial statements.

We are proud that in 2007, medical care collections continued to improve, totaling nearly $2.2 billion. VA plans to continue to increase these collections, reaching $2.3 billion in 2008.

VA also developed a Departmental managerial cost accounting (MCA) system to enable managers 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.

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

## Financial Highlights

Pursuant to requirements of 31 U.S.C. 3515(b), VA's principal financial statements have been prepared to report the financial position and results of operations of the Department. Deloitte & Touche LLP, performed the audit of the statements under the direction of the Office of Inspector General. The statements have been prepared from the books and records of the Department in accordance with generally accepted accounting principles for federal entities and the formats prescribed by the Office of Management and Budget.

VA received an unqualified opinion on the Department's financial statements for 2007 and 2006 from Deloitte & Touche LLP. As a result of its audit work, Deloitte & Touche LLP reported four material weaknesses, three of which are repeat material weaknesses. In addition, the auditors reported 13 Significant Deficiencies, three of which are not included in the material weaknesses.

VA programs operated at a net cost of $51.1 billion in 2007 compared with $101.5 billion in 2006. Again this year, the change in actuarial liability for future years' veterans' compensation is primarily responsible for the significant variation in net cost from year to year. The actuarial liability decreased by $26.1 billion during 2007 and increased by $31.2 billion during 2006. The decrease in actuarial liability for future years' veterans' compensation in 2007 was influenced by changes in COLA estimates as a result of economic projections included in the 2008 Mid-Session Budget review and the actual December 2007 COLA. Excluding the change in this actuarial liability from the net cost would result in an adjusted net cost for VA's programs of $76.2 billion and $69.3 billion for 2007 and 2006, respectively. Two VA programs, Medical Services and Compensation, accounted for the bulk of the increase in the adjusted net cost, $2.9 billion and $3.0 billion, respectively.

Assets and liabilities reported in VA's balance sheets do not show significant change with the exception of Fund Balance with Treasury, Public Accounts Payable, and Federal Employee and Veterans Benefits Liability. The majority of change in the Federal Employee and Veterans Benefits Liability, $26.1 billion, is driven by the actuarial estimate previously discussed. It should be noted that the future cash flows to liquidate the actuarial estimate liability are not supported by identifiable assets as they are anticipated to be funded from the future general revenues of the U.S. government. The Fund Balance with Treasury increased by $6.1 billion due to an increase in appropriations received in FY 2007 over the FY 2006 amounts and the timing of the monthly compensation and pension benefits payments.

Medical care collections continue to improve. In 2007 collections totaled nearly $2.2 billion, which builds on the $2 billion collected in 2006.

In the area of debt management, VA referred $422 million (99%) of eligible debt to Treasury for offset under the Treasury Offset Program (TOP). Under the cross-servicing program, VA referred $127 million (98%) of eligible debt for collection.

During 2007 the Department aggressively used the Governmentwide commercial purchase card program. Over 4.2 million transactions were processed, representing $2.6 billion in purchases. As a result of VA's daily electronic billing and payment process, VA earned over $42 million in refunds, compared to $37 million during 2006. These refunds are returned to VA entities for use in veterans programs.

Throughout 2007 VA continued to make operational enhancements, which resulted in improvements in interest paid, discounts earned, and audit recoveries. Interest improvements occurred largely because the Department centralized VHA-certified payments at the Financial Services Center (FSC) in Austin, Texas. Interest paid per million dollars disbursed improved more than 15 percent from $99 per million in 2006 to $84 per million in 2007, and VA earned 92 percent of its available discounts.

VA continues to work diligently to address the *IT Security Controls* and the *Financial Management System Functionality* material weaknesses. Additional focus was placed in 2007 on the *Financial Management Oversight* material weakness due to the expansion of this significant deficiency to other fiscal areas in VA (expanded beyond simply VHA as described in 2006). VA financial management made improvements throughout the year in providing additional and clarifying financial policies and procedures to VA's fiscal community, particularly in the area of internal controls. VA developed and implemented detailed remediation action plans to address the resolution of these material weaknesses.

VHA, VBA and NCA continue to be actively engaged in addressing financial management issues in all activities that have direct or indirect impact on financial records.

VBA is continuing its effort to centralize and/or consolidate finance functions. In January 2007, VBA consolidated the Committee on Waivers and Compromises (COWC) function to the Pension Maintenance Centers for Compensation, Vocational Rehabilitation and Employment, and employee debts. A joint VHA/VBA team is working on a plan to transfer finance functions related to automobile adaptive equipment to VHA. A pilot test will begin in the first quarter of FY 2008.

NCA implemented the business office concept to establish a single site for each of the primary activities: finance, acquisition, and asset management. Currently, a good portion of the major acquisition and associated accounting is accomplished by the operations support center in Quantico, with some support being provided by a VA medical center or regional office.

# Management Controls, Systems, and Compliance With Laws and Regulations

**Federal Managers' Financial Integrity Act**
The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish management controls over their programs and financial systems. Throughout the year, VA managers monitor and improve the effectiveness of management controls associated with their programs and financial systems. The results of monitoring and conducting other periodic evaluations provide the basis for the Secretary's annual assessment of and report on management controls. VA managers are required to identify material weaknesses relating to their programs and operations pursuant to sections 2 and 4 of the FMFIA as defined:

- Section 2 requires agencies to assess internal controls necessary to ensure compliance with applicable laws and regulations; protect against loss from waste, fraud, and abuse; and ensure receivables and expenditures are properly recorded.
- Section 2 also requires management's assessment of internal control over financial reporting.
- Section 4 requires agencies to assess nonconformance with governmentwide financial systems requirements.

**Management Assurances**
Department managers continue to take responsibility for establishing and maintaining effective internal controls over financial integrity and financial reporting, including safeguarding assets and complying with applicable laws and regulations. During 2007, the Former Secretary of Veterans Affairs maintained his leadership role in stressing that strong internal controls will enhance the Department's stewardship of taxpayers' assets and programs.

Management conducted its assessment of the effectiveness of internal controls over operations and compliance with applicable laws and regulations in accordance with the Federal Managers' Financial Integrity Act (FMFIA) and OMB Circular A-123, Management's Responsibility for Internal Control. After reviewing the results of the assessments outlined in the Statements of Written Assurance provided by the Under Secretaries, Assistant Secretaries, and other Key Officials, the Acting Secretary of Veterans Affairs provided a statement of qualified assurance. Four material weaknesses: "IT Security Controls," "Financial Management System Functionality" (previously identified as "Lack of an Integrated Financial Management System"), "Financial Management Oversight" (previously identified as "Operational Oversight"), and "Retention of Computer Generated Detail Records in Benefits Delivery Network (BDN) System - VBA," were identified as material weaknesses under FMFIA.

In addition, the Secretary provided a qualified assurance statement reflecting the status of internal controls over financial reporting for 7 of 11 key business processes as of June 30, 2007. VA conducted a limited scope assessment as of June 30, 2007, on the effectiveness of internal controls over financial reporting for six key business processes: Revenue Management; Property, Plant & Equipment; Budgetary Resources; Procurement Management; Risk Management; and Benefits Management (partial). Information Technology Management was also assessed, as it relates to these six processes. Assessment of internal controls over financial reporting for Funds Management and Financial Reporting was completed in 2006. Based on the results of VA's limited scope assessment, no material weaknesses were identified. VA can provide a qualified statement of assurance that internal controls over financial reporting were operating effectively.

# Condensed Consolidated Financial Statements

| DEPARTMENT OF VETERANS AFFAIRS | | | | |
|---|---|---|---|---|
| **CONDENSED CONSOLIDATED BALANCE SHEETS* (dollars in millions)** | | | | |
| **As of September 30,** | | **2007** | | **2006** |
| **ASSETS** | | | | |
| Fund Balance with Treasury | $ | 22,213 | $ | 16,129 |
| Investments and Other Assets - Intragovernmental | | 12,548 | | 13,033 |
| Accounts and Loans Receivable, net - Public | | 4,187 | | 3,500 |
| Property and Equipment, net | | 12,176 | | 11,638 |
| Other Assets | | 293 | | 310 |
| **TOTAL ASSETS** | **$** | **51,417** | **$** | **44,610** |
| **LIABILITIES** | | | | |
| Intragovernmental Liabilities | $ | 3,307 | $ | 3,067 |
| Federal Employee and Veterans Benefits Liability | | 1,129,527 | | 1,155,612 |
| Insurance Liabilities | | 11,217 | | 11,633 |
| Other Liabilities | | 15,975 | | 11,645 |
| **TOTAL LIABILITIES** | | **1,160,026** | | **1,181,957** |
| **NET POSITION** | | **(1,108,609)** | | **(1,137,347)** |
| **TOTAL LIABILITIES AND NET POSITION** | **$** | **51,417** | **$** | **44,610** |

| **CONDENSED CONSOLIDATED STATEMENTS OF NET COST* (dollars in millions)** | | | | |
|---|---|---|---|---|
| **for the Years Ended September 30,** | | **2007** | | **2006** |
| **NET PROGRAM COSTS** | | | | |
| 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 AND BURIAL** | | **(26,100)** | | **31,200** |
| **NET NON-PROGRAM COSTS** | | **953** | | **944** |
| **NET COST OF OPERATIONS** | **$** | **51,094** | **$** | **101,462** |

*For a full set of financial statements and footnotes, see Part III of the FY 2007 PAR at www.va.gov/budget/report

**DEPARTMENT OF VETERANS AFFAIRS**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION***
**(dollars in millions)**

**For the Years Ended September 30,**

| | **FY 2007** | **FY 2006** |
|---|---|---|
| **Cumulative Results of Operations** | | |
| Beginning Balance | $ (1,138,621) | $ (1,109,718) |
| Financing Sources, primarily Appropriations Used | 78,999 | 72,559 |
| Net Cost of Operations | 51,094 | 101,462 |
| **Net Change** | **27,905** | **(28,903)** |
| Ending Balance – Cumulative Results | $ (1,110,716) | $ (1,138,621) |
| **Unexpended Appropriations** | | |
| Beginning Balance | $ 1,274 | $ 2,306 |
| Appropriations Received | 79,817 | 71,747 |
| Appropriations Used and Other Changes | (78,984) | (72,779) |
| **Total Unexpended Appropriations** | **2,107** | **1,274** |
| **Total Net Position** | **$ (1,108,609)** | **$ (1,137,347)** |

* For a full set of financial statements and footnotes, see Part III of the FY 2007 PAR at www.va.gov/budget/report

| DEPARTMENT OF VETERANS AFFAIRS | | | | |
|---|---|---|---|---|
| **CONDENSED COMBINED STATEMENTS OF BUDGETARY RESOURCES*** **(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 |
| Net Increase in Budget Authority | | 87,603 | | 1,591 |
| **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** |
| **Obligated Balance, Net End of Period** | **$** | **12,911** | **$** | **87** |
| **Net Outlays** | **$** | **73,870** | **$** | **(331)** |

| **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 |
| Net Increase in Budget Authority | | 80,771 | | 581 |
| **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** | **$** | **92,906** | **$** | **6,288** |
| **Obligated Balance, Net End of Period** | **$** | **8,109** | **$** | **127** |
| **Net Outlays** | **$** | **70,510** | **$** | **(483)** |

* For a full set of financial statements and footnotes, see Part III of the FY 2007 PAR at www.va.gov/budget/report