Letter from the Chief Financial Officer

The Department of Veterans Affairs (VA) completed another successful year by receiving an unqualified audit opinion for the 10th consecutive year from our external auditors, Deloitte & Touche. We are extremely proud of this continued accomplishment.

VA continued to implement corrective actions to address the material weaknesses identified in the FY 2007 audit (Financial Management System Functionality, Information Technology Security Controls, Financial Management Oversight, and Retention of Computer Generated Detail Records in the Benefits Delivery Network (BDN) System). During this year, we successfully remediated and eliminated the material weakness Retention of Computer Generated Detail Records in the Benefits Delivery Network (BDN) System, reducing the total number of VA material weaknesses from four to three.

VA also made progress on the Financial Management System Functionality material weakness through our Financial & Logistics Integrated Technology Enterprise (FLITE) program. This important VA initiative is being developed to integrate disparate VA systems, standardize functional processes, and modernize the information technology environment across the entire VA. The FLITE program is following a multiple-year phased approach comprised of two major components: the logistics and asset management system component, known as the Strategic Asset Management (SAM) project, and the financial management component, known as the Integrated Financial Accounting System (IFAS) project.

In 2008 VA completed initial planning and documentation of business requirements for SAM and IFAS. Key program management activities were also implemented, including establishment of a Risk Management Control Board, base-lining the life cycle cost estimate, initiating organizational change management communications targeted toward stakeholders, and continued engagement of the FLITE Governance Structure to provide senior level oversight and guidance. The FLITE program also implemented the final planned interfaces into the Financial Reporting Data Warehouse production environment. This will substantially improve VA's ability to capture transaction details from targeted interface systems and reconcile data interfacing to the VA legacy Financial Management System (FMS) resulting in an enhanced reconciliation process between FMS and legacy subsidiary systems.

VA also made improvements to the intragovernmental accounting and reporting process. A Hyperion-based intragovernmental reporting tool was developed, and tested, and will be in production in the first quarter of FY 2009. This will significantly improve the accuracy of reporting VA's reciprocal intragovernmental accounts.

Progress has also been made in addressing the Information Technology (IT) Security Controls material weakness. The Department's overall information security posture has been improved with the establishment of the Information Protection and Risk Management (IPRM) organization to centralize security and privacy staff and business functions, increase accountability, and standardize security processes. With IPRM, VA has established the organizational foundation to ensure VA has a stronger security program well into the future. VA continues to implement the comprehensive Data Security - Assessment and Strengthening of Controls Program to govern the multiple, concurrent security activities already underway to remediate this material weakness.

During 2008, VA implemented initiatives related to remediating the Financial Management Oversight material weakness. VA procured contractor support to provide financial process improvement, audit readiness, and audit remediation services. VA also started the 3-year Financial Policy Improvement Initiative to ensure that financial policy and procedural information is standardized, accurate, clear, and readily available across the Department.

Corrective action plans for each of the three material weaknesses guide VA's efforts as we continue to work diligently and proactively to address and eliminate them. However, these weaknesses are complex and involve corrective actions over several years. OMB recognized VA's improvements by upgrading our "progress" score on the President's Management Agenda Financial Performance scorecard from "red" to "yellow."

We also continued efforts to ensure VA's compliance with OMB Circular A-123, Appendix A, Internal Control over Financial Reporting. Based on the approved implementation plan, VA completed the first full cycle of all actions identified for its 3-year plan. As a result of completing the assessment of VA's 11 key business processes, no material weaknesses were identified. Remediation actions were identified and implemented to address all findings.

VA successfully completed risk assessments, statistical sampling, and all requirements for programs under the Improper Payments Information Act (IPIA) of 2002. This year, VA maintained a "green" score for "progress" on the President's Management Agenda scorecard for Eliminating Improper Payments.

VA continued to advance e-Gov initiatives and aggressively worked with the General Services Administration and Electronic Data Systems, VA's e-Gov travel prime contractor, to implement an electronic travel solution for VA. VA completed Departmentwide implementation of FedTraveler on schedule in December 2007. For the e-Payroll e-Gov initiative, VA has successfully migrated 16,417 employees to the Defense Finance and Accounting Service for payroll servicing. The remaining VA population, 251,905, is scheduled to migrate in 2009.

VA's Franchise Fund is expected to receive its 11th successive unqualified audit opinion on its FY 2008 consolidated financial statements.

VA's Supply Fund received an unqualified opinion in 2007 on its balance sheet; this was the first independent audit by an outside audit firm on this component of the Supply Fund's financial statements.

We are proud that in FY 2008, medical care collections continued to improve to over $2.4 billion. VA plans to continue to increase these collections, reaching nearly $2.5 billion in FY 2009. Additionally, VA has developed a Departmental managerial cost accounting (MCA) system to enable managers to review and analyze cost data at the detail and programmatic levels. All MCA processes within VA's Administrations became operational during FY 2008.

We are proud of our many accomplishments, and know that 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
December 19, 2008

Financial Highlights

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Veterans Affairs (VA), pursuant to the requirements of 31 U.S.C. 3515(b). VA is a component of the U.S. Government, a sovereign entity. 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 OMB.

VA received an unqualified opinion on the Department's financial statements for 2008 and 2007 from the external auditors, Deloitte & Touche LLP. As a result of its audit work, Deloitte & Touche LLP reported three material weaknesses that are also repeat material weaknesses. In addition, the auditors reported 16 Significant Deficiencies, seven of which are not included in the material weaknesses.

VA programs operated at a net cost of $422.6 billion in 2008 compared with $51.1 billion in 2007. Again this year, the change in the actuarial liability for future years' veterans' compensation is primarily responsible for the significant variation in net cost from year to year. The actuarial liability increased by $339 billion during 2008 and decreased by $26.1 billion during 2007. The 2008 increase in actuarial liability was caused primarily by a change in the discount rates and changes in original compensation awards. Lower discount rates, which track the interest rates of Treasury securities, resulted in an increase in liability. Additionally, the liability increased significantly due to factoring in a considerable number of original compensation awards for Vietnam veterans suffering from diabetes and other diseases, the prevalence for which generally increases with age. Excluding the change in this actuarial liability from the net cost would result in an adjusted net cost for VA's programs of $82.5 billion and $76.2 billion for 2008 and 2007, respectively. Two VA programs, Medical Services and Compensation, accounted for the bulk of the increase in the adjusted net cost, $3 billion and $3 billion, respectively.

Assets and liabilities reported in VA's balance sheets do not show significant change from year to year 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, $339 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. Fund Balance with Treasury increased $4.1 billion primarily due to higher appropriations received as a result of providing improved healthcare to a higher number of patients and an increase in veterans' benefits as a result of the growth in compensation and pension claims. In FY 2008, VA received appropriations of $92.7 billion. This compares to $82.6 billion of appropriations received in 2007. In 2008 VA provided disability compensation, death compensation, and pensions to 3.7 million people. More than 5.5 million people received care in VA health care facilities in 2008.

Medical care collections continue to improve. In FY 2008, collections totaled $2.4 billion. MCCF exceeded the FY 2008 goal of $2.2 billion by $128.5 million (105.6 percent of the FY 2008 goal), which builds on the $2.1 billion collected in FY 2007. VA plans to continue to increase these collections, reaching $2.5 billion in FY 2009.

In the area of debt management, in 2008, VA referred $577 million (98.8 percent) of eligible debt to Treasury for offset under the Treasury Offset Program (TOP). Under the cross-servicing program, VA referred $108 million (96.9 percent) of eligible debt to Treasury for collection.

During 2008, the Department aggressively used the Governmentwide commercial purchase card program. Over 4.8 million transactions were processed, representing $3.0 billion in purchases. The electronic billing and payment process for centrally billed accounts earned VA over $49 million in credit card refunds compared to $42 million during 2007. These refunds are returned to VA entities for use in veterans programs.

Throughout 2008, 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, while the percentage of discounts earned increased because of operational improvements implemented at the FSC and VA's National Acquisition Center. Interest paid per million dollars disbursed improved almost 18 percent from $84 per million in 2007 to $69 per million in 2008, and VA earned nearly 93 percent ($6.4 million) of its available discounts.

VA continues to work diligently to address its three audit material weaknesses. Improvements were made in VA financial management throughout the year in providing additional and clarifying financial policies and procedures to VA's fiscal community, particularly in the area of internal controls. VHA's Business Process Improvement Committee (BPIC) continued to work toward improving VHA's internal controls and reforming VHA business processes to improve financial performance.

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

VBA implemented the Centralized Administrative Accounting System in 2008. This system allows the regional offices to process the majority of their accounting transactions online with a direct interface into the VA financial management system. This system has improved our business process by eliminating the need to create paper documents and fax them to VBA's Administrative and Loan Accounting Center for input into the financial management system. A joint VHA/VBA team has developed a plan and procedures for the transfer of finance functions related to automobile adaptive equipment to VHA. This concept is being pilot-tested with three VBA regional offices and VHA medical centers.

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 general acquisition, finance, and asset management 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 2008, the 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 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 Secretary of Veterans Affairs provided a statement of qualified assurance. The following three material weaknesses are identified under FMFIA: "Financial Management System Functionality," "Information Technology Security Controls," and "Financial Management Oversight."

VA assessed its internal control over financial reporting as of June 2008 for all 11 key business processes identified from FY 2006: Funds Management; Revenue Management; Property, Plant & Equipment; Budgetary Resources; Risk Management; Benefits Management (Part 1); Procurement Management; Benefits Management (Part 2); Financial Reporting; Grants Management; and Human Capital Management. Information Technology Management was also reviewed, as it relates to each of the key processes. During FY 2008, VA completed Benefits Management (Part 2); Financial Reporting; Grants Management; and Human Capital Management.

Management's assessment of internal control over financial reporting included an evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting and finance policies, and our overall control environment. Based on the results of VA's internal control assessment, no additional material weaknesses were identified in 2008.

Condensed Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS

CONDENSED CONSOLIDATED BALANCE SHEETS* (dollars in millions)

As of September 30,		2008		2007
ASSETS				
Fund Balance with Treasury	$	26,292	$	22,213
Investments and Other Assets - Intragovernmental		12,569		12,548
Accounts and Loans Receivable, net - Public		4,668		4,187
General Property and Equipment, net		13,068		12,176
Other Assets		317		293
TOTAL ASSETS	**$**	**56,914**	**$**	**51,417**
LIABILITIES				
Intragovernmental Liabilities	$	3,562	$	3,307
Federal Employee and Veterans Benefits Liability		1,468,605		1,129,527
Insurance Liabilities		10,751		11,217
Other Liabilities		15,954		15,975
TOTAL LIABILITIES		**1,498,872**		**1,160,026**
NET POSITION		**(1,441,958)**		**(1,108,609)**
TOTAL LIABILITIES AND NET POSITION	**$**	**56,914**	**$**	**51,417**

CONDENSED CONSOLIDATED STATEMENTS OF NET COST* (dollars in millions)

for the Years Ended September 30,		2008		2007
NET PROGRAM COSTS				
Medical Care	$	35,019	$	32,013
Medical Education		1,367		1,267
Medical Research		917		843
Compensation		37,869		34,897
Pension		3,978		3,902
Education		2,537		2,348
Vocational Rehabilitation and Employment		787		722
Loan Guaranty		(565)		(200)
Insurance		118		94
Burial		448		355
NET PROGRAM COSTS BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITIES		**82,475**		**76,241**
COMPENSATION AND BURIAL		**339,000**		**(26,100)**
NET NON-PROGRAM COSTS		**1,147**		**953**
NET COST OF OPERATIONS	**$**	**422,622**	**$**	**51,094**

*For a full set of financial statements and footnotes, see Part III of the FY 2008 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 2008	**FY 2007**
Cumulative Results of Operations		
Beginning Balance	$ (1,110,716)	$ (1,138,621)
Financing Sources, primarily Appropriations Used	87,386	78,999
Net Cost of Operations	422,622	51,094
Net Change	**(335,236)**	**27,905**
Ending Balance – Cumulative Results	$ (1,445,952)	$ (1,110,716)
Unexpended Appropriations		
Beginning Balance	$ 2,107	$ 1,274
Appropriations Received	89,084	79,817
Appropriations Used and Other Changes	(87,197)	(78,984)
Total Unexpended Appropriations	**3,994**	**2,107**
Total Net Position	**$ (1,441,958)**	**$ (1,108,609)**

*For a full set of financial statements and footnotes, see Part III of the FY 2008 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, 2008

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources		
Unobligated Balance at the Beginning of the Period	$ 18,312	$ 2,950
Net Increase in Budget Authority	89,275	3,400
Total Budgetary Resources	**$ 107,587**	**$ 6,350**
Status of Budgetary Resources		
Obligations Incurred	$ 97,028	$ 3,065
Unobligated Balance Available	7,907	-
Unobligated Balance Not Yet Available	2,652	3,285
Total Status of Budgetary Resources	**$ 107,587**	**$ 6,350**
Obligated Balance, Net End of Period	**$ 15,924**	**$ 62**
Net Outlays	**$ 86,146**	**$ (1,145)**

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 a full set of financial statements and footnotes, see Part III of the FY 2008 PAR at www.va.gov/budget/report.

Summary of Financial Statement Audit

During 2008, VA developed remediation plans and is taking actions to correct the material weaknesses "Financial Management System Functionality," "Information Technology Security Controls," and "Financial Management Oversight." During 2008, VA resolved "Retention of Computer Generated Detail Records in Benefits Delivery Network (BDN) System - VBA." Material weaknesses were identified by VA's independent auditors or by VA management.

Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Management Oversight	✓				✓
IT Security Controls	✓				✓
Financial Management System Functionality	✓				✓
Retention of Computer Generated Detail Records in Benefits Delivery Network (BDN) System - VBA	✓		✓		
Total Material Weaknesses	4	0	1	0	3