Department of Veterans Affairs
Office of Inspector General

Audit of VA's Consolidated Financial Statements for Fiscal Years 2008 and 2007

Report No. 08-00870-24

November 17, 2008

VA Office of Inspector General
Washington, DC 20420

DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

TO: Secretary of Veterans Affairs (00)

SUBJECT: Audit of VA's Consolidated Financial Statements for Fiscal Years 2008 and 2007

1. We contracted with the independent public accounting firm, Deloitte & Touche LLP, to audit VA's consolidated financial statements as of September 30, 2008 and 2007 and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of Deloitte and Touche LLP's audit are presented in the attached reports.

2. Deloitte and Touche LLP provided an unqualified opinion on VA's fiscal year 2008 and 2007 consolidated financial statements. They also identified three material weaknesses, all of which are repeat conditions from the prior year's audit. They are (i) financial management system functionality, (ii) information technology security controls and (iii) financial management oversight.

3. Deloitte and Touche LLP reported that VA is not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996 because VA did not substantially comply with Federal financial management systems requirements. They also noted two other instances of non-compliance with law and referenced a violation of the Antideficiency Act reported by the Secretary to the President of the United States and the Director of the Office of Management and Budget in October 2008 related to activity in fiscal year 2007.

4. Deloitte & Touche LLP is responsible for the attached auditor's report dated November 17, 2008, 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. The independent auditors will follow up on these internal control findings and evaluate the adequacy of corrective actions taken during the FY 2009 audit of VA's consolidated financial statements.

Linda A. Halliday

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Attachments

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of the Department of Veterans Affairs ("VA") as of September 30, 2008 and 2007, 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 Office of Management and Budget ("OMB") Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards 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 financial position of VA as of September 30, 2008 and 2007, and its 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 17, 2008, 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 17, 2008

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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 Secretary and the Inspector General 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, 2008, and have issued our report thereon dated November 17, 2008. 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 Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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 on 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.

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.

Member of
Deloitte Touche Tohmatsu

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 matters in Sections I and II 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 15, 2007 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 three significant deficiencies identified as "Financial Management System Functionality," "Information Technology (IT) Security Controls," and "Financial Management Oversight" 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 17, 2008

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)

The VA operates different legacy financial systems to support its missions including a core accounting system and business line specific financial systems, such as the Financial Management System (FMS), Benefits Delivery Network (BDN), the Fixed Asset Package, and medical center systems. The business line financial systems provide summary transactions to the core general ledger system to generate the VA's consolidated financial statements. Many of these systems are outdated, leading to inefficiencies in the reliable, timely and consistent preparation, processing, and analysis of financial information for VA's consolidated financial statements and are inherently more difficult to integrate than systems based on newer technologies.

To assist in managing the preparation of consolidated financial statements, VA management implemented a reporting system (MinX) to automate the preparation of the consolidated financial statements in fiscal year 2006. Although it has provided significant 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. VA management continues to work to remediate the integration and functionality issues but significant challenges remain. Key examples of significant deficiencies resulting from the legacy systems are:

***Conditions*:**

- VA closes its general ledger system at year-end on September 30 and then allows additional entries to be recorded in a "period 13" general ledger. Under the current process, period 13 is kept open on October 1 for one day. However, many entries cannot be identified and recorded in just one day and need to be recorded after period 13 is closed. These entries often are the result of routine account analysis and reconciliation. Business lines also need more time to record their normal recurring or year-end entries. Because the general ledger is closed after October 1, VA uses the MinX reporting system as a de facto general ledger.

  This limitation contributes to a significant number of manual entries being posted through the MinX reporting system at year-end to prepare the financial statements. Further, since the MinX reporting system does not automatically carry forward prior year adjustments to the beginning balance of the following year, to make sure those entries carry forward, VA makes rollover adjusting entries at the beginning of a new fiscal year in MinX. As a result, entries are booked, reversed, and then rebooked, creating significant risk of error. For example, during the fiscal year 2008 closing procedures, a one-sided "plug" entry was recorded in MinX and was not detected.

- Due to the lack of integration between the business line financial systems and FMS, VBA could not provide certain sub-ledgers to support the amount recorded in the FMS, such as a detailed listing of Veterans Services Network (VETSNET) accounts receivable, detailed support for miscellaneous "A-28" adjusting entries to Compensation and Pension (C&P) benefit expenses, and a detailed transaction listing to support certain education deductions from overpayments to veterans.
- The BDN and VETSNET systems do not retain detail transactional data supporting the general ledger activity for more than 60 to 90 days. During fiscal year 2008, VBA put into operation a Data Warehouse that allowed BDN and VETSNET data to be retained and retrieved to support the financial statements. No formal internal control policies and procedures were established for the transfer of data to the Data Warehouse, or for the maintenance of such data.
- The Fixed Asset Package (FAP) does not readily provide information to support activity in the related general ledger accounts. The FAP cannot readily identify all current year property, plant and equipment additions and reclassifications of work in process due to system limitations.
- The VETSNET system does not include data mining capabilities to allow financial management the ability to analyze transactions at a level needed to prepare routine reconciliations.
- Automated inventory systems at the Consolidated Mail Order Pharmacy (CMOP) facilities were primarily developed for operations and accordingly cannot provide the data needed to record the proper cost of inventory for financial statement purposes. Automated systems implemented at the CMOP facilities have different software versions which prevent standardized control and summary reports from being generated.
- While a central database to record contracts, Electronic Contract Management System (ECMS), has been established, no system is in place to track all obligations and purchases made by the VA by vendor. For example, VA must rely on vendors to supply sales data on medical center purchases from the Federal Supply Schedule Contracts administered by the VA's National Acquisition Center.

***Criteria*:**

31 U.S.C. § 902(a) (3) states that an agency Chief Financial Officer shall "develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which—

> (A) complies with applicable accounting principles, standards, and requirements, and internal control standards;
> (B) complies with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget;
> (C) complies with any other requirements applicable to such systems; and
> (D) provides for—
>> (i) complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management…"

OMB Circular A-127, *Financial Management Systems,* states that agency 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…."

***Cause*:**

Many of these systems are outdated, leading to inefficiencies in the reliable, timely and consistent preparation, processing, and analysis of financial information for VA's consolidated financial statements and are inherently more difficult to integrate than systems based on newer technologies.

Effect:

The system deficiencies result in significant manual workarounds and the posting of a large number of general ledger adjustments that increase the risk of processing errors and 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, retain critical accounting data, and reduce the number of adjusting entries required.

VA management should inventory all 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)

The VA continued to make progress in addressing information technology (IT) security weaknesses during fiscal year 2008. The Office of Chief Information Officer (OCIO) took action to remediate elements of the IT security weaknesses reported in prior years. In Fiscal Year 2008, the OCIO revised information security directives and handbooks, implemented Federal Information Processing Standards (FIPS) Publication 140-2 encryption for specific storage devices, performed a Certification and Accreditation (C&A) process for Major Applications (MA) and General Support Systems (GSS), and updated security awareness training and privacy training. In addition, the OCIO, utilizing the Office of IT Oversight and Compliance (ITOC), continued to conduct IT security assessments across the VA.

While progress has been made, management has acknowledged many IT security weaknesses require multi-year solutions. In Fiscal Year 2008, legacy IT infrastructure security weaknesses remain pervasive due to the lack of effective implementation and enforcement of an agency-wide information security program. These security weaknesses continue to place VA's program and financial data at risk. Our assessment of the general and application controls of VA's key IT infrastructure and financial systems identified the following conditions.

Conditions:

Agency-wide Security Program

- Information security deficiencies were not effectively mitigated resulting in a large backlog in the VA Plan of Action and Milestones (POA&M) system. In addition POA&M did not contain necessary documentation to support that deficiencies were adequately evaluated and remediated prior to closure.
- The risk assessments conducted for financial management systems did not always accurately identify the existence or effectiveness of certain system controls, and appropriate control recommendations were not consistently identified in the risk assessments.

Access Control

- Password standards were not consistently implemented and enforced across multiple VA systems including the network domain, mainframe systems and databases supporting key financial applications.
- Access to BDN and Veterans Health Information Systems and Technology Architecture (VistA) applications were not adequately restricted for system users and IT personnel.
- Review of user access to multiple financial applications, security violations, and system audit logs were not consistently performed or documented.

Segregation of Duties

- Legacy application VistA contained users with access to both Create and Approve purchase orders. In addition, IT personnel had Update access to the production environment supporting VistA and BDN applications.

Change Control

- Change control policy and procedures for authorizing, testing and approval were not consistently implemented and enforced to reduce the risk of data integrity issues related to VETSNET, BDN, VistA and Insurance System.
- VETSNET data updates were performed outside of the standard change control process.
- Systems were not patched in a timely manner to mitigate vulnerabilities.

Service Continuity

- A service continuity plan at the departmental level was not fully developed to provide overall guidance, direction, and coordination for entity-wide IT service continuity.
- Testing of contingency plans for financial management systems at selected facilities and data centers was not routinely performed and documented to meet the requirements of VA Handbook 6500.

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:

At the end of Fiscal Year 2007, the OCIO issued Directive/Handbook 6500 that established the policy, procedures, and operational requirements of the information security program. While VA management has taken positive steps toward reducing the number of deficiencies, the consistent and proactive enforcement of the established security policies and procedures continue to be a challenge for a large, geographically dispersed organization such as VA that supports a diverse portfolio of legacy applications and newly implemented systems. The amount of accumulated deficiencies continues to require multi-year resource commitment.

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.

In addition, inconsistent or inadequate contingency planning and testing increases the risk the VA would not be able to recover their systems and data in the timeframe required by the business owners to support their operations and financial reporting requirements.

Recommendations:

VA management should continue to devote resources, analyze the cause of reported deficiencies and prioritize remediation activities to accomplish its security and control objectives. Key tasks should include, but are not limited to, the following:

- Continue to provide necessary training and improve the quality of risk assessments. Assign proper resources to implement corrective action plans to remediate deficiencies reported in the POA&M system. Proactively apply controls to all key financial management systems based on the lessons learned developed through audits and management self-assessments.
- Provide actionable steps for ensuring that user access to VA financial management systems 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.
- Support proper segregation of duties by providing adequate human resources and configuring financial management systems. In addition, perform proper management oversight of incompatible activities.
- Facilitate a consistent enforcement of change control polices and procedures for the development, testing, and implementation of changes to VA financial applications.
- Complete and implement service continuity procedures that will provide effective guidance, communication, and coordination of service continuity planning and testing activities; perform contingency plan testing in compliance with the VA Handbook 6500.

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

Conditions:

We have identified nine 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 nine 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 - VHA***
  Veterans Health Administration (VHA) financial management did not perform adequate reviews to ensure that invalid obligations were de-obligated timely and that expenses were accrued and recorded in the correct period.
- ***Property, Plant and Equipment - VHA***
  VHA financial management demonstrated little evidence of improvement over monitoring internal controls and accounting for property, plant and equipment, including capitalization and disposals. Poor communications between financial and facilities management contributed to this internal control finding.

- ***Environmental and Disposal Liabilities - VHA***
  VHA financial management did not effectively monitor proper accounting and reporting of environmental liabilities. Environmental data provided by facilities management to support the accrual often did not meet documentation requirements for financial accounting purposes.
- ***Accrual for Unbilled Receivables and Allowance for Contractual Adjustments - VHA***
  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.
- ***Benefit Expense Reconciliation - VBA***
  We noted there was a lack of reconciliations being performed on the monthly benefit payments to veterans, and the corresponding amounts recorded in the general ledger (FMS).
- ***Outsourced Portfolio Loan Servicing - VBA***
  The VA contracts with an outside contractor to service the mortgage loans in its portfolio. The files maintained by the outside contractor did not contain a copy of the original loan document, or modifications to the original loan documents for some mortgage loans selected for testing.
- ***Compensation and Pension Actuarial Liability Calculation - VBA***
  VBA management has not completely reconciled recorded expense data to inputs in the actuarial liability model, provided the external actuary with all relevant data, or considered the impact of this relevant data to the liability.
- ***VA Housing Model - VBA***
  VBA management did not perform an effective review of the formulas within the Variable Default model.
- ***Software - Office of Information and Technology (OI&T)***
  Management was unable to gather actual expenditures to properly record software costs on a timely basis.

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 human 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 was 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 nine deficiencies discussed above.

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- We noted the following with respect to accrued services payable and undelivered orders.

- During our medical center site visits, we noted several instances where accrued services payable and undelivered orders were not properly monitored in accordance with VA policy to ensure they were valid and correctly calculated.

  -- We noted instances of invalid residual balances for obligations and accrued services payable that should have been de-obligated or closed out.

  -- We also noted potential duplicate transactions, an outstanding payable for equipment that was received in fiscal year 2006, and a wrong accrual period. In one instance, prepaid expenses were expensed and not recorded as an advance payment and undelivered order.

- The FMS has an automatic accrual "flag" function which when activated allows expenses to be recorded in the correct accounting period. However, we noted both manual and system problems with this function:
  - -- We noted instances where the accrual flag was not manually set when it needed to be, or where it was incorrectly activated for equipment and other services resulting in recognition of an expense before the item was received.
  - -- Due to a limitation in FMS, the automatic accrual function cannot cross fiscal years unless there is manual intervention. Without manual intervention, services will be fully accrued at year-end regardless of future activity. As a result, we noted several instances where services were fully accrued as of September 30, 2007 although those services were to be provided during fiscal year 2008. This resulted in classification errors between expenditures, undelivered orders and accrued services payable.
- We noted instances where invoices had not been received, but an estimate for work performed should have been accrued under work in process.

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- Invalid undelivered orders or accrued services payable occurred because of the lack of adequate review and follow-up procedures with individuals who initiated the purchase orders. Medical center staff identified the system limitation where FMS did not allow the accrual flag to continue past the current fiscal year without manual intervention. No process was in place to accrue for construction or other products that did not use receiving reports unless invoices had been received from vendors or contractors.

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:

- Consider a system control to identify payments as final to help eliminate residual balances.
- Ensure medical center staff are trained on the proper use of the accrual flag; specifically, when to set it and how to manually intervene so that accruals can cross fiscal years; and ensure staff properly use the function.
- Seek a solution to the FMS limitation that prevents accruals from automatically crossing fiscal years.
- Enhance the tool used in monitoring aged undelivered orders to include construction orders.

2. 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:

- Completed projects were not always transferred from work in process to property in service, and depreciated on a timely basis.

- Some assets remained capitalized even though they were traded in or disposed of and were no longer property of VA.

- Some discrepancies existed in the estimated useful life of equipment as recorded in the fixed assets subsidiary ledger and the VA Supply Catalog.

- A portion of a project was incorrectly coded to an expense account, rather than recorded as an asset.

- An MRI machine purchased on behalf of another medical center was incorrectly capitalized by the medical center that purchased the asset. The medical center that had custody of the asset should have recorded the machine in their accounting records. Instead, that medical center only included the machine in their Equipment Inventory Listing (EIL) for accountability purposes.

- A panic alarm system was not capitalized because the various individual components, i.e. installation costs, computer equipment, and software licenses, were below the capitalization threshold. A capitalizable account should have been used for the components since they were part of one system and in the aggregate exceeded the capitalization threshold.

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- These exceptions were caused at least in part because of:

- Lack of timely communication between accounting and facilities management.
- Lack of adequate reviews and controls in place to ensure that assets that are no longer in VA's possession are taken off the books.
- Misinterpretation of accounting policy regarding capitalization threshold and related accounts.
- Ineffective communication between two medical centers resulted in incorrect recording of an asset.
- To a large extent, accounting is reliant on effective communications from facilities management on the status of projects. This communication has not been effective.

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.
- Work-in-process projects are reviewed for completion dates and are recorded timely as property in service. Management should consider enhancing the fixed assets reporting module to include project estimated completion date to assist in monitoring of the untimely transfer to property in service.
- Management should put procedures in place to ensure that projects no longer in use are removed from the general ledger.
- Management should review the estimated useful life of equipment recorded in the fixed asset subsidiary ledger with the VA Supply Catalog for consistency.
- Ensure that inventory procedures include that assets are recorded in the proper location.
- When acquiring systems, ensure that procedures are in place to capitalize all components of the system.

3. Environmental and Disposal Liabilities—VHA*

Condition- During our medical center site visits, we noted that stations had recorded estimates for environmental and disposal liabilities. However, at certain stations in the selection, balances were not supported by sufficient information such as the "RSMeans Guide" or other industry tools and publications or surveys, as required by Office of Finance Bulletin 07GB1.01. Often the support provided by facilities management was not sufficient to support the environmental liability calculation. In addition, stations currently use inconsistent methodologies for estimating their liabilities.

Criteria- With respect to clean-up costs, *SFFAS 6 – Accounting for Property, Plant and Equipment Recognition and Measurement* states:

> "Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing…"

With respect to maintenance of documentation, *GAO Internal Control Standards* states:

> "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained."

Cause- Medical center staff did not prepare and maintain sufficient documentation, or ensure calculations were prepared in accordance with VA policy, and were periodically reviewed.

Effect- Recorded estimates may be inaccurate if they cannot be supported by documentation.

Recommendation- We recommend that the VHA CFO, in coordination with the VISN CFOs, take action to ensure that these estimates are supported by auditable information such as vendor quotes, use of RSMeans Guide, and other industry tools. Management should analytically review the environmental liability balances by station and perform spot checks to promote compliance.

4. 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.

- 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 actual amounts.

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

Cause- VHA central office did not perform a sufficient financial management review.

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.

5. Benefit Expense Reconciliation – VBA

Condition- We noted that VBA financial management was not performing critical reconciliations on veteran benefit payments as follows:

The following deficiencies support the finding identified:

- **Compensation & Pension (C&P) Benefit Expense Reconciliation**
  Veterans Benefit Administration (VBA) financial management did not perform reconciliations of C&P benefit expense between the two systems which calculate and initiate such payments (BDN and VETSNET) and FMS on a monthly basis prior to March 2008.

- **Education Benefit Expense Reconciliation**
  VBA financial management did not perform reconciliation of education benefit expense between BDN and FMS on a monthly basis prior to March 2008, and could not provide a detail transaction listing to support certain education deductions from overpayments to veterans reported in the FMS.

Cause- The operational causes for the deficiencies include a lack of resources with the appropriate skills to appropriately prepare and review the requisite reconciliations.

Criteria- In accordance with "Standards for Internal Control in the Federal Government," issued by the Government Accountability Office (GAO):

"Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other activities people take in performing their duties."

Effect- Recording financial data without sufficient monitoring and control procedures increases the likelihood that an error in the financial statements will occur and that it will go undetected. In addition, the inability to provide detail transaction listings for items recorded in FMS could result in accounting errors going uncorrected or inappropriate disbursements being made and going undetected.

Recommendation– VBA financial management should review its financial management organizational structure to determine if the financial management organization has sufficient authority and resources to prepare and review the necessary reconciliations on a monthly basis. Resources need to include adequate staff that is trained and knowledgeable to effectively perform the required reconciliations and analyses. Any initiative should promote strong financial management and coordination amongst all operational levels to ensure financial management can promote change within the overall organization.

6. Compensation and Pension Actuarial Liability Calculation – VBA*

Condition- We performed reconciliations of the actuarial model inputs and FMS expense data to ensure the accuracy, existence and completeness of VA data used by the model. Based on testing, we noted differences that could potentially significantly affect the actuarial liability.

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

Cause- VBA financial management did not perform sufficient reconciliations of the actuarial model inputs to FMS expense data.

Effect- VBA financial management has not provided the actuary with all of the relevant data and accurate data nor have they considered the impact of this relevant data to the liability.

Recommendation- We recommend that VBA financial management prepare a reconciliation between the BDN net payment file and the gross summary payment file provided to the actuary. Reconciling items identifying data relevant to the calculation of the estimated liability should be provided to the actuary. Also, we recommend the data used in the model for burial expenses be checked for accuracy.

7. Outsourced Portfolio Loan Servicing - VBA

Condition- The VA contracts with an outside contractor to service the mortgage loans in its portfolio. The files maintained by the outside contractor should have the source documents needed to support the initial loan and any subsequent modifications of the loan documents. We selected 45 loan files from the outside contractor to test various attributes for compliance with policies and procedures. The following exceptions were noted with respect to the attributes tested:

--Five loan files did not contain a copy of the original loan document supporting the mortgage loan.

--Four loan files contained the original mortgage loan documents but did not contain the modifications to the original loan documents that appear to have been executed based on the carrying amount of the mortgage loan on VA's general ledger.

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. Effective internal controls over new loan set up require that appropriate supporting documentation is obtained to verify key terms and amounts.

Cause- The outside contractor retains documents provided to it when the loan is initially set up but the outside contractor is not required to have a checklist to assure that required documents are provided to it nor does it follow up on documents not provided.

Effect- Mortgage loans receivable on VA's general ledger may not be supported by source documentation and such amounts may be recorded at inaccurate amounts in the financial statements.

Recommendation- We recommend that polices are established to require the outside contractor to use a checklist to assure that all needed documents are provided to it at the time the loan is initially set up. In addition, the outside contractor should be responsible for following up with the VA, lender, title company and/or law firm associated with the closing or modification of the mortgage loan to obtain any missing documents.

8. VA Housing Model - VBA

Condition- The loan guaranty program performs a calculation periodically to reestimate the projected default rates and resulting estimated costs to the VA on its guaranteed and direct loans. The Variable Default Model is used to calculate the required reestimate adjustments each year. A component of the model is the default rate curve which estimates the number and amount of defaults on guaranteed and direct loans in future periods. During our review of the model, we noted a formula used for the calculation of estimated defaults for certain guaranteed loans was incorrect. When the correct formula was applied, an adjustment was necessary to properly reflect the reestimate for the Loan Guaranty program.

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. Effective internal controls over financial reporting require that management establishes policies and procedures that provide reasonable assurance of reliable accounting estimates, including procedures to ensure that the Variable Default Model calculations are proper and effective in producing reasonable reestimates.

Cause- Lack of sufficient controls to ensure that the Variable Default Model calculations are accurate.

Effect- Reestimates reported by management could be materially misstated.

Recommendation- VBA financial management should ensure that the Variable Default Model formulas and calculations are correct.

9. Capitalization of Software Development Costs – Office of Management

Condition- Although certain VA program offices have established work-in-process accounts to capture software projects that are in the development phase, we noted certain program offices incorrectly expensed them. Management was unable to support recorded amounts in work-in-process accounts.

Criteria- SFFAS 10 Accounting for Internal Use Software, Recognition, Measurement, and Disclosure – Capitalized Cost

Paragraph 16 - For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage. Such cost should be limited to cost incurred after:

a. management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed and software will be used to perform the intended function with an estimated service life of 2 years or more and

b. the completion of conceptual formulation, design, and testing of possible software project alternatives (the preliminary design stage).

Cause- VA does not have a systematic process of tracking all projects that are on-going to ensure that all projects that are in the development phase are tracked and recorded in the general ledger.

Effect- Understatement of general property, plant and equipment and overstatement of operating and net program costs.

Recommendations- We recommend that the CFO in coordination with the CIO establish a systematic process whereby costs incurred that meet the capitalization criteria of SFFAS 10 are accumulated within the general ledger on a timely basis. This would include the accumulation of both direct and indirect costs after management authorizes and commits to a software project. To facilitate this process, training should be provided to individuals responsible for and involved in this process to ensure that appropriate treatment of costs has occurred. This would include accounting staff responsible for classifying certain expenditures within the general ledger and employees who are involved in project development who must track and segregate their time eligible for capitalization.

10. Property, Plant and Equipment Activity Rollforward - VHA*

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 VHA CFO develop reports to support actual property, plant and equipment activities that occurred during the year and to ensure balances on the reports reconcile back to the financial statements.

11. Inventory - VHA

Condition- VHA maintains inventories of prescription medications at the Consolidated Mail Outpatient Pharmacies (CMOPs) located in seven states. Inventory is managed through automated systems which streamline receiving, processing, and dispensing information. During our audit, we noted limitations in the usage and capabilities of the CMOPs automated inventory systems. Automated systems use different software versions which prevent standardized control and summary reports from being issued. Also, the systems cannot provide the data needed to record the proper cost of inventory for financial statement purposes.

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."

"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."

Cause- These systems were primarily developed for operations, rather than for financial statement reporting.

Effect- VHA does not have the ability to efficiently record inventory on the financial statements.

Recommendations- VHA should consider enhancing financial functionality with their present inventory system. Also, periodic physical counts, and a year-end physical count should be taken to validate the accuracy of the perpetual system.

12. Operating Lease Commitments - Office of Management*

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- Information needed to prepare the footnote is maintained at each individual medical center, and there is no systematic methodology to accumulate the information on a VA-wide basis.

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.

13. Intra-Governmental Reconciliations and Related Controls - Office of Management*

Condition- Unreconciled differences exist throughout the year and at year-end, primarily with the VA's trading partner, the Department of Defense. Also, unreconciled differences are not aged to determine how long they have been outstanding.

Criteria- The Treasury Financial Manual, Bulletin No. 2007-03 section VII, outlines the difference resolution procedures that trading partners must follow. These rules apply to all intra-governmental trading partners.

Cause- VA does not have sufficient data from their trading partners to properly reconcile all the accounts. VA does not elevate its differences with the Department of Defense to the CFOs Council's Intragovernmental Dispute Resolution Committee for resolution of differences within 60 days of their identification in the material differences report.

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

Recommendation- All significant differences should be resolved with trading partners as outlined in Section VII, Resolving Intra-governmental Disputes and Major Differences, including the escalation of unresolved differences to the CFOs Council's Intragovernmental Dispute Resolution Committee. Differences should be aged to assist in the resolution of outstanding items.

14. Statement of Net Cost - Office of Management*

Condition- VA does not have an effective process to collect, document and validate 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.

15. Payroll Agreed-Upon Procedures Report - Review of Reports Supporting OPM Submission – Office of Management*

Condition- On a semiannual 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. These procedures were complicated by inaccurate ad-hoc reports generated from the legacy PAID payroll system. Reportable differences between the ad-hoc payroll reports and the submission to OPM were noted in our agreed-upon procedures report.

Criteria- In accordance with "Standards for Internal Control in the Federal Government," issued by the Government Accountability Office (GAO):

"Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other activities people take in performing their duties.'

Cause- The reports did not receive a primary review by VA personnel with a financial accounting background that would have allowed the reviewer to detect reportable differences between the ad-hoc reports and the OPM submissions.

Effect- Inaccurate reports could impact the evaluation by OPM of the VA's Retirement, Health Insurance, and Life Insurance obligations.

Recommendation- We recommend that ad-hoc reports generated from the PAID legacy financial system used to support OPM submissions receive a primary financial review by an appropriate level of management with a sufficient financial background as necessary for appropriate internal control. This reviewer should ensure that differences are resolved. We recommend programming adjustments to correct the ad-hoc reports as necessary to support the standard supplemental reporting requirements of the VA to OPM.

16. Payroll Agreed-Upon Procedures Report – Maintenance of Official Personnel Files – Office of Human Resources and Administration

Condition- In connection with required testing of payroll compliance to support the financial statements, Deloitte noted that official personnel files could not be located to support one salary and five health insurance deductions from a sample of 25 selected employees.

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:

> "Personnel Action Processing: Incumbent-related information such as date of hire, service computation date, retirement service date, severance pay date, Civil Service Retirement System, Federal Employees Retirement System, Federal Employees Group Life Insurance and Thrift Savings Plan eligibility dates, Federal Employee Health Benefits enrollment date, step increase and prior military service information must also be recorded. There is also a need for the capability to correct or cancel these actions, and provide the necessary audit trail."

Cause- Management stated that the missing files are due to migration of a high volume of personnel files from paper to electronic format.

Effect- Incomplete personnel files may not properly support salary and withholding amounts recorded in the financial system.

Recommendation- We recommend that the VA implement a tracking mechanism to ensure that paper personnel files are properly accounted for during the transition to electronic personnel files.

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 15, 2007, we reported four material weaknesses in the areas of (1) Financial Management System Functionality, (2) Information Technology (IT) Security Controls, (3) Financial Management Oversight, and (4) Retention of Computer Generated Detail Records in BDN system. The Retention of Computer Generated Detail Records in BDN system has been addressed, and is no longer reported as a material weakness this year.

Other

The VA engaged an independent public accounting firm to assist in an internal control assessment pursuant to OMB Circular A-123 Appendix A, *Management's Responsibility for Internal Control*. During fiscal year 2008 the firm issued seven reports titled *Findings and Recommendation* and also reported significant deficiencies.

SECTION III - COMPLIANCE AND OTHER MATTERS

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, and assessed control risk as required by OMB Bulletin No. 07-04, as amended. 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, as amended, 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. Except as discussed below, the results of our tests disclosed no instances of noncompliance which are required to be reported herein under *Government Auditing Standards*. Items with an asterisk (*) are repeat conditions included in last year's report.

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," and "Information Technology (IT) Security Controls" 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- We selected sample transactions to test various attributes for the VA's compliance with the Debt Collection Improvement Act of 1996 ("DCIA"). The following exceptions were noted with respect to the attributes tested:

- Interest and administrative costs are required to be charged to VA's delinquent debtors. The rates are determined by the Treasury on a yearly basis. However, VBA did not charge interest or administrative costs on delinquent payments from veterans related to certain education loans, and payments due to VBA Life Insurance.

- Write-off of accounts receivable greater than $100,000 are required to be approved by the Department of Justice. We tested 3 write-offs from VBA that should have had this approval and noted one such write-off that was not approved by the Department of Justice.

- VBA – Life Insurance did not follow the requirements for cross servicing and Treasury offset during the prescribed timeframes for several of the selections tested. The DCIA requires federal agencies to refer debt to Treasury for cross servicing if they are delinquent for a period of 180 days.

- VBA – Life Insurance did not maintain adequate documentation to support actions taken to demonstrate timely compliance with DCIA and VA policies on debt collection for many of the selections tested.

- VBA – Life Insurance did not follow up on delinquent debt in a timely manner for many of the selections tested.

Criteria-

- 38 U.S.C. § 501(a) and 5315, and 38 CFR 1.919 require VA to charge interest on any amount owed the United States.

- 31 U.S.C. § 3711 describes VA's requirement to submit debt to Treasury for cross-servicing, and to obtain approval from Department of Justice to write-off debts in excess of $100,000.

Cause- In July 1992, a former VA Deputy Secretary instructed VA to not charge interest or administrative costs on compensation and pension debts. The accounts receivable write-offs greater than $100,000 must be manually sent to Department of Justice for approval and VA does not have automated, systematic procedures across the organization to assure appropriate procedures are followed for debt collection. Adequate documentation was not maintained for delinquent debt files.

Effect- These findings represent noncompliance by VBA with Debt Collection Improvement Act (DCIA) of 1996

Recommendation- We recommend the VBA CFO, in coordination with the Veterans Integrated Service Network CFOs should take action to:

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

- Ensure that systematic debt collection procedures are in-place and effective.

3. Non-compliance with 5 U.S.C. §552A subsection D5 –VBA*

Condition- There were several instances in our testing of VBA 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- 5 U.S.C. §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 over the retention of documents in the veteran files.

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

Recommendation- We recommend that the VBA implement procedures to ensure that all documents that should be retained in the veteran files are retained and can be located.

4. Other

In October 2008, the Secretary reported a violation of the Anti-Deficiency Act (ADA), 31 U.S.C. 1341(a) in connection with activity related to fiscal year 2007 at VBA. The Secretary reported that the violation occurred on September 28, 2007, when redemption of debt payments to the Treasury exceeded the available unobligated budgetary resources, and the remaining budgetary resources were less than unpaid obligations at the end of the fiscal year. The VA has identified a number of steps to be taken to prevent a reoccurrence of the violation.

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: NOV 17 2008

From: Assistant Secretary for Management (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2008 and 2007

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 2008 and 2007, and are pleased with the receipt of an unqualified opinion. We are also proud that we were able to meet the FY 2008 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, Financial Management 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. We will forward copies of each of these plans to you during the second quarter of FY 2009, and will keep you apprised of our progress in remediating these weaknesses throughout FY 2009.

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

Robert J. Henke