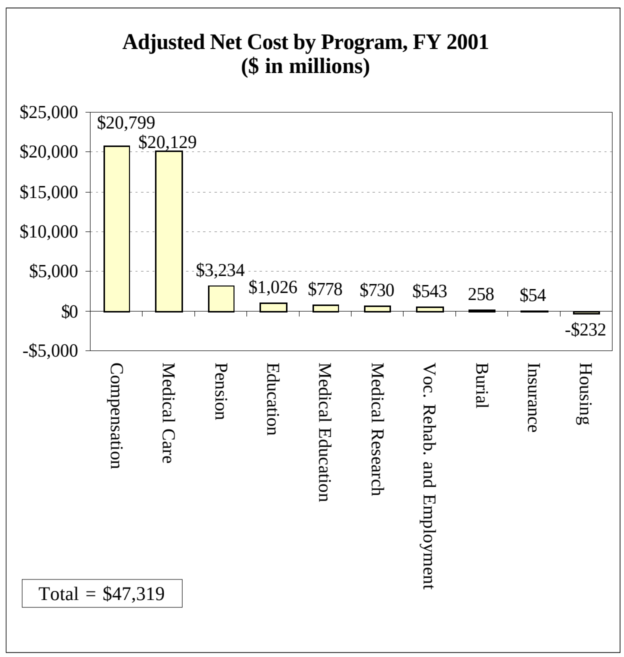
FINANCIAL HIGHLIGHTS

- Pursuant to the requirements of 31 U.S.C. 3515 (b), VA's financial statements report the financial position and results of operations of the Department. The audit of the statements was performed by Deloitte & Touche LLP, under the direction of the Office of Inspector General. VA received an unqualified opinion on the Department's financial statements from the auditors in FY 2001 (which includes explanatory paragraphs relating to the adoption of Statement of Federal Financial Accounting Standards (SFFAS) Nos. 10 and 21, a change in the fixed asset capitalization policy, and the restatement, all discussed in Note 21 of the FY 2001 Annual Accountability Report), continuing the success first achieved in FY 1999. While the statements have been prepared from the books and records of the Department in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources prepared from the same books and records. The statements are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so. For more information on VA's financial statements, refer to the FY 2001 Annual Accountability Report.

- As discussed in Note 21 to the Financial Statements, subsequent to the issuance of the FY 2000 Financial Statements, VA management determined that the calculation of the Veterans Benefits actuarial liability contained material errors. The errors relate to FY 2000 and prior periods. In accordance with VA's election to early adopt SFFAS No. 21, which requires that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period, the accompanying FY 2000 Financial Statements have been restated to reflect the correction of the calculation errors. The FY 2000 Financial Statements have also been restated to correct an error in the Judgment Fund liability calculation. The following financial highlights give effect to the restatement.

- VA's programs operated at a net cost of $187.3 billion in FY 2001, compared with a net cost of $108.8 billion in FY 2000. The calculation of the actuarial liability for future years' veterans compensation and burial benefits, which increased by $139.4 billion during FY 2001 and by $64 billion in FY 2000, heavily impacts each year's cost. The most significant



sources of change associated with the Compensation and Pension (C&P) programs between September 30, 2000 and September 30, 2001 were the overall decrease in interest rates between these two dates and the number of new compensation awards made for diabetes. Excluding the change in this actuarial liability from the net cost would result in an adjusted net cost for VA's programs of $47.9 billion and $44.8 billion for FY 2001 and FY 2000, respectively. The majority of this increase applies to two programs – Compensation, $1.2 billion and Medical Care, $1.1 billion.

- An examination of assets and liabilities reported on VA's balance sheets reveals four lines with changes greater than $1 billion. The largest is the increase in the Federal Employee and Veterans Benefit Liabilities, related to the increase in the actuarial liability for future Compensation and Burial benefit payments. It should be noted that the future cash flows to liquidate this liability are not supported by any identifiable assets, as they are anticipated to be funded from the future general revenues of the U.S. Government. Loans Receivable, Net, increased by $1 billion in FY 2001 primarily due to two factors: First, the events of September 11th delayed the September 28th sale of VA-held loans to private investors. Second, changes in the economic assumptions in the OMB credit reform subsidy model used to calculate housing loan subsidies generated a downward reestimate. Finally, Fund Balance with Treasury, which represents the right of VA to draw on the Treasury to pay allowable expenses, includes the Compensation & Pension payment for September. While generally paid on the last day of the preceding month, this fiscal year ended on a Sunday. A corresponding Public Accounts Payable is also reported.

- Collections for the Medical Care Collection Fund continued to improve, with a total of $0.8 billion collected in FY 2001 – a significant increase over the FY 2000 total of $0.6 billion. VA has developed a Revenue Cycle Improvement Plan to increase collections to $1.4 billion by FY 2005. In addition, the amounts reported for patient and third-party insurers' medical debt continue to increase due to a change in billing methodology. VA now bills for medical services based on "reasonable charges" rather than "reasonable cost." Amounts collected under this program are retained by VA and used for medical care purposes.

- The Department continued its aggressive use of the governmentwide commercial purchase card program. Purchase card disbursements for FY 2001 were over $1.5 billion, covering 2.6 million transactions and earning VA credit card rebates from Citibank totaling over $15.2 million. This is a 12 percent increase over the rebates earned in FY 2000 ($13.5 million).

- In the area of debt management, VA exceeded the goal established with the Department of the Treasury for the Treasury Offset Program. In FY 2001, VA referred a total of $0.33 billion representing 92 percent of eligible debt to Treasury, up from 67 percent referred in FY 2000. Under the Treasury Cross-servicing Program, VA referred $0.3 billion in FY 2001, representing 94 percent of eligible debt. This is an increase from 17 percent referred in FY 2000.

- Under 38 U.S.C. 8161, et seq., VA may enter into long-term (up to 75 years) outleases of VA property in return for fair consideration including goods, services, or space beneficial to VA's mission. In some cases, the lessee provides "in-kind" consideration through a third party, including an independent trust. Once established, the independent trust assumes obligations to provide in-kind consideration to the Department. VA is not party to the Trust Agreement and does not "own" or control the trust, and has no beneficial, residual or other interest in the trust estate other than the assets that are specifically deposited into the enhanced-use leasing account for the purpose of providing in-kind consideration to VA. This arrangement has proven to be very beneficial to the Department in the several enhanced-use leases now in place. Consequently, as the Department uses the enhanced-use leasing program to address its capital and resource requirements, VA anticipates that most of its "in-kind" benefits will be received through these types of third-party providers.