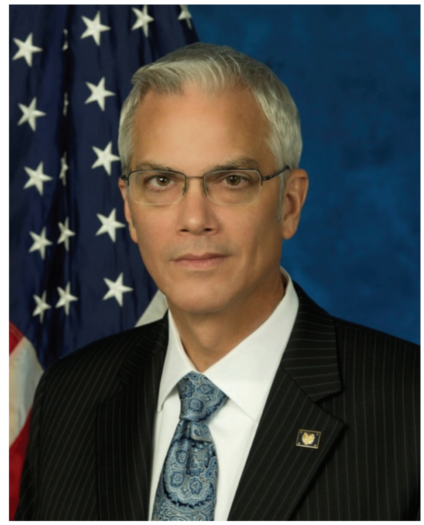
Letter from the Chief Financial Officer

November 15, 2011

The Department of Veterans Affairs (VA) is very pleased to have received its 13th consecutive unqualified ("clean") audit opinion on the Department's consolidated financial statements.



Following the elimination of three material weaknesses in 2010, VA continued to make additional progress by reducing the number of significant deficiencies in 2011. Work continued in 2011 to address the one remaining material weakness, Information Technology Security Controls. This material weakness will be carried forward into 2012.

The clean opinion and reduction in signficant deficiencies would not have been possible without the exceptional leadership of VA's financial management senior executive team. Ed Murray, Shirley Pratt, Katherine Palmer, Paul Kearns, Jamie Manker and Ron Walters deserve special thanks for their leadership over the past year. VA's success in 2011 reflects the dedication and hard work of our staff throughout the Department. Congratulations to all who helped make 2011 a year of high achievement in VA financial management.

Based on an assessment of our financial management priorities that was completed in 2010, VA developed a set of 11 financial management initiatives. These financial management priorities drove our efforts during this past year, and are helping us meet our financial management goals of: Reducing Operating Costs, Eliminating Improper Payments, Strengthening Internal Controls, and Enhancing Data and Analysis. These initiatives are also setting the stage for a lower-risk financial management system replacement at the appropriate time in the future.

In support of Secretarial transformation objectives, we successfully completed 7 of the 11 initiatives and made substantial progress on the remaining 4 that are multi-year projects. VA completed a Departmentwide effort to enforce and improve internal controls and segregation of duties for obligation processing of $14 billion (Form 1358), thus remediating long-standing GAO and OIG findings. VA also completed a major element of the Systems to Drive Performance initiative by delivering a set of dashboards that provides cost and workload program data to management. This will support and enhance decision-making related to budget, performance, and resource allocation, allowing management to derive greater value out of VA resources.

Additionally, by September 30, 2011, VA met all mandates of the American Recovery and Reinvestment Act (Recovery Act) and USAspending.gov in support of these Administration priorities. By September 30, 2011, VA had made outlays totaling over $1.569 billion (85 percent) of Recovery Act funds. For USAspending.gov, VA reported 100 percent of all required contract, grant, loan, and other assistance program spending. Finally, VA completed an important component of the financial management portion of the Secretary's Integrated Operating Model (IOM) major initiative and provided financial management training to nearly 5,400 employees in VA's financial management workforce (80 percent).

In addition to the priority initiatives, VA also completed its 3-year Financial Policy Improvement Initiative (FPII) to update its entire body of Departmental financial policies. VA successfully updated 169 chapters; these policies are available on VA's Intranet. The Office of Finance will continue the progress made under the FPII by continuing to review, update, and publish VA financial policy to maintain compliance with Federal guidance. Going forward, all policies will be reviewed every 3 years and updated as appropriate.

VA's Franchise Fund is expected to receive its 14th successive unqualified audit opinion on its 2011 consolidated financial statements. In addition, the Supply Fund received an unqualified opinion in 2010 and anticipates an unqualified opinion again in 2011.

VA is dedicated to ensuring the proper stewardship of resources entrusted to it by Congress and the American people. 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 enhance our performance. We will continue to promote sound business practices and improve accountability which ultimately results in what's most important – more and better services to our Nation's Veterans.

W. Todd Grams

Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS		
CONSOLIDATED BALANCE SHEETS (dollars in millions)		
AS OF SEPTEMBER 30,	**2011**	**2010**
ASSETS		
INTRAGOVERNMENTAL		
Fund Balance with Treasury (Note 3)	$ 40,211	$ 43,155
Investments (Note 5)	10,032	10,711
Accounts Receivable, Net (Note 6)	6	29
Other Assets	784	873
TOTAL INTRAGOVERNMENTAL ASSETS	**51,033**	**54,768**
PUBLIC		
Investments (Note 5)	186	184
Accounts Receivable, Net (Note 6)	1,934	1,808
Loans Receivable, Net (Note 7)	2,105	3,185
Cash (Note 4)	18	20
Inventories and Related Property, Net (Note 8)	71	56
General Property, Plant and Equipment, Net (Note 9)	18,686	16,730
Other Assets	30	42
TOTAL PUBLIC ASSETS	**23,030**	**22,025**
TOTAL ASSETS	**$ 74,063**	**$ 76,793**
Heritage Assets (Note 10)		
LIABILITIES		
INTRAGOVERNMENTAL		
Accounts Payable	$ 23	$ 16
Debt (Note 11)	1,680	1,655
Other Liabilities (Note 15)	1,296	1,859
TOTAL INTRAGOVERNMENTAL LIABILITIES	**2,999**	**3,530**
PUBLIC		
Accounts Payable	1,139	4,929
Liabilities for Loan Guarantees (Note 7)	5,062	4,885
Federal Employee and Veterans Benefits Liabilities (Note 13)	1,535,591	1,476,662
Environmental and Disposal Liabilities (Note 14)	884	879
Insurance Liabilities (Note 17)	11,113	11,732
Other Liabilities (Note 15)	7,573	7,394
TOTAL PUBLIC LIABILITIES	**1,561,362**	**1,506,481**
TOTAL LIABILITIES	**1, 564,361**	**1,510,011**
Commitments and Contingencies (Note 18)		
NET POSITION		
Unexpended Appropriations – Earmarked Funds (Note 19)	-	-
Unexpended Appropriations – All Other Funds	12,048	14,385
Cumulative Results of Operations – Earmarked Funds (Note 19)	899	892
Cumulative Results of Operations – All Other Funds	(1,503,245)	(1,448,495)
TOTAL NET POSITION	**$ (1,490,298)**	**$ (1,433,218)**
TOTAL LIABILITIES AND NET POSITION	**$ 74,063**	**$ 76,793**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS CONSOLIDATED STATEMENTS OF NET COST (dollars in millions) FOR THE YEARS ENDED SEPTEMBER 30,	2011	2010
NET PROGRAM COSTS BY ADMINISTRATION (Note 21 & 24)		
Veterans Health Administration		
Gross Cost	$ 56,240	$ 51,765
Less Earned Revenue	(3,719)	(3,681)
Net Program Cost	52,521	48,084
Veterans Benefits Administration		
Gross Cost	67,395	59,922
Less Earned Revenue	(2,027)	(2,057)
Net Program Cost	65,368	57,865
National Cemetery Administration		
Gross Cost	279	274
Less Earned Revenue	-	-
Net Program Cost	279	274
Indirect Administrative Program Costs		
Gross Cost	4,494	4,204
Less Earned Revenue	(673)	(672)
Net Program Cost	3,821	3,532
NET PROGRAM COSTS BY ADMINISTRATION BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITIES	**121,989**	**109,755**
CHANGES IN ACTUARIAL LIABILITIES (Note 13)		
COMPENSATION:		
Changes in Experience	(10,700)	122,400
Changes in Discount Rate Assumptions	51,900	110,500
Changes in Cost of Living Adjustment (COLA) Rate Assumptions	4,000	(45,700)
Other Changes	13,500	35,800
TOTAL COMPENSATION	58,700	223,000
BURIAL:		
Changes in Experience	(100)	-
Changes in Discount Rate Assumptions	200	300
Other Changes	100	500
TOTAL BURIAL	200	800
NET (GAIN)/LOSS FROM ACTUARIAL LIABILITY CHANGES	**58,900**	**223,800**
NET COST OF OPERATIONS (Note 21)	**$ 180,889**	**$ 333,555**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	(Note 19) Earmarked Funds	All Other Funds	Eliminations	FY 2011 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 892	$ (1,448,295)	$ (200)	$ (1,447,603)
Budgetary Financing Sources				
Appropriations Used	-	124,513	-	124,513
Nonexchange Revenue	-	13	-	13
Donations and Forfeitures of Cash and Cash Equivalents	25	-	-	25
Transfer In/Out Without Reimbursement	(2,775)	2,775	-	-
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	24	2	-	26
Transfers In/Out Without Reimbursement	-	-	-	-
Imputed Financing	-	1,978	-	1,978
Other	-	(409)	-	(409)
Total Other Financing Sources	(2,726)	128,872	-	126,146
Net Cost/(Benefit) of Operations	(2,733)	183,622	-	180,889
Net Change	**7**	**(54,750)**	**-**	**(54,743)**
Ending Balance – Cumulative Results	899	(1,503,045)	(200)	(1,502,346)
Unexpended Appropriations				
Beginning Balance	-	14,185	200	14,385
Budgetary Financing Sources				
Appropriations Received	-	122,580	-	122,580
Appropriations Transferred In/Out	-	93	-	93
Other Adjustments	-	(497)	-	(497)
Appropriations Used	-	(124,513)	-	(124,513)
Total Budgetary Financing Sources	-	(2,337)	-	(2,337)
Total Unexpended Appropriations	**-**	**11,848**	**200**	**12,048**
Total Net Position	**$ 899**	**$ (1,491,197)**	**$ -**	**$ (1,490,298)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2010

	(Note 19) Earmarked Funds	All Other Funds	Eliminations	FY 2010 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 998	$ (1,294,257)	$ (154)	$ (1,293,413)
Cumulative Change in Accounting Principle (Note 13)	-	66,500	-	66,500
Beginning Balance, As Adjusted	998	(1,227,757)	(154)	(1,226,913)
Budgetary Financing Sources				
Appropriations Used	-	111,501	-	111,501
Nonexchange Revenue	-	11	-	11
Donations and Forfeitures of Cash and Cash Equivalents	24	-	-	24
Transfer In/Out Without Reimbursement	(2,801)	2,847	(46)	-
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	36	1	-	37
Transfers In/Out Without Reimbursement	-	-	-	-
Imputed Financing	-	1,601	-	1,601
Other	-	(309)	-	(309)
Total Other Financing Sources	(2,741)	115,652	(46)	112,865
Net Cost/(Benefit) of Operations	(2,635)	336,190	-	333,555
Net Change	**(106)**	**(220,538)**	**(46)**	**(220,690)**
Ending Balance – Cumulative Results	892	(1,448,295)	(200)	(1,447,603)
Unexpended Appropriations				
Beginning Balance	-	1,844	154	1,998
Budgetary Financing Sources				
Appropriations Received	-	123,922	-	123,922
Appropriations Transferred In/Out	-	62	46	108
Other Adjustments	-	(142)	-	(142)
Appropriations Used	-	(111,501)	-	(111,501)
Total Budgetary Financing Sources	-	12,341	46	12,387
Total Unexpended Appropriations	**-**	**14,185**	**200**	**14,385**
Total Net Position	**$ 892**	**$ (1, 434,110)**	**$ -**	**$ (1,433,218)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 22) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources (Note 22)		
Unobligated Balance brought forward, October 1	$ 23,791	$ 2,373
Adjustment to Unobligated Balance brought forward, October 1	-	-
Recoveries of Prior Year Unpaid Obligations	8	-
Budget Authority		
Appropriations Received	126,430	-
Borrowing Authority	-	1,471
Spending Authority from Offsetting Collections		
Earned	5,199	4,444
Change in Unfilled Customer Orders	(8)	-
Subtotal	155,420	8,288
Nonexpenditure Transfers, Net	93	-
Permanently Not Available	(506)	(1,448)
Total Budgetary Resources	**$ 155,007**	**$ 6,840**
Status of Budgetary Resources		
Obligations Incurred	$ 131,889	$ 3,410
Unobligated Balance Available	20,345	-
Unobligated Balance Not Available	2,773	3,430
Total Status of Budgetary Resources	**$ 155,007**	**$ 6,840**
Change in Obligated Balance		
Unpaid Obligations Balance, brought forward, October 1	$ 20,068	$ 279
Adjustment to Unpaid Obligations brought forward, October 1	-	-
Obligations Incurred	131,889	3,410
Less Gross Outlays	(135,513)	(3,404)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(8)	-
Change in Uncollected Customer Payments from Federal Sources	85	1
Obligated Balance, Net End of Period	**$ 16,521**	**$ 286**
Net Outlays		
Gross Outlays	$ 135,513	$ 3,404
Less Actual Offsetting Collections	(5,276)	(4,445)
Less Distributed Offsetting Receipts	(3,056)	(264)
Net Outlays	**$ 127,181**	**$ (1,305)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 22) (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2010

	Budgetary	Non-Budgetary Credit Program
Budgetary Resources (Note 22)		
Unobligated Balance brought forward, October 1	$ 11,210	$ 2,580
Adjustment to Unobligated Balance brought forward, October 1	-	(4)
Recoveries of Prior Year Unpaid Obligations	3	-
Budget Authority		
Appropriations Received	127,863	-
Borrowing Authority	-	1,463
Spending Authority from Offsetting Collections		
Earned	5,414	3,785
Change in Unfilled Customer Orders	(344)	
Subtotal	144,146	7,824
Nonexpenditure Transfers, Net	108	-
Permanently Not Available	(137)	(1,358)
Total Budgetary Resources	**$ 144,117**	**$ 6,466**
Status of Budgetary Resources		
Obligations Incurred	$ 120,326	$ 4,093
Unobligated Balance Available	21,175	-
Unobligated Balance Not Available	2,616	2,373
Total Status of Budgetary Resources	**$ 144,117**	**$ 6,466**
Change in Obligated Balance		
Unpaid Obligations Balance, brought forward, October 1	$ 16,669	$ 50
Adjustment to Unpaid Obligations brought forward, October 1	-	4
Obligations Incurred	120,326	4,093
Less Gross Outlays	(117,236)	(3,902)
Less Recoveries of Prior Year Unpaid Obligations, Actual	(3)	-
Change in Uncollected Customer Payments from Federal Sources	312	34
Obligated Balance, Net End of Period	**$ 20,068**	**$ 279**
Net Outlays		
Gross Outlays	$ 117,236	$ 3,902
Less Actual Offsetting Collections	(5,383)	(3,820)
Less Distributed Offsetting Receipts	(3,291)	(398)
Net Outlays	**$ 108,562**	**$ (316)**

The accompanying notes are an integral part of these Consolidated Financial Statements.

Notes to Consolidated Financial Statements

For the Years Ended September 30, 2011, and 2010 (dollars in millions, unless otherwise noted)

1. Summary of Significant Accounting Policies

Organization

The mission of VA is to provide medical care, benefits, social support, and lasting memorials to Veterans, their dependents, and beneficiaries [(38 U.S.C. Section 301(b) 1997)]. The Department is organized under the Secretary of VA. The Secretary's office includes a Deputy Secretary and has direct lines of authority over the Under Secretary for Health, the Under Secretary for Benefits, and the Under Secretary for Memorial Affairs. Additionally, six Assistant Secretaries, an Inspector General, a General Counsel, an Executive-In-Charge for Human Resources and Administration, and the chairmen of the Board of Contract Appeals and the Board of Veterans' Appeals support the Secretary.

Reporting Entity and Basis of Presentation

The Department of Veterans Affairs' (VA) consolidated financial statements, including the Combined Statements of Budgetary Resources, report all activities of VA components. VA components include the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and Indirect Administrative Program Costs. The consolidated financial statements meet the requirements of the Chief Financial Officers Act (CFO) of 1990 and the Government Management Reform Act (GMRA) of 1994. The principal financial statements have been prepared to report the financial position and results of operations of VA, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of VA in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities and 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, which are prepared from the same books and records. The statements should be read with the realization that VA is a component of the U.S. Government, a sovereign entity. VA's fiscal year end is September 30th.

Accounting for Intragovernmental Activities

VA, as a department of the Federal Government, interacts with and is dependent upon the financial activities of the Federal Government as a whole. Therefore, these consolidated financial statements do not reflect the results of all financial decisions applicable to VA as though the Department were a stand-alone entity.

In order to prepare reliable financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements.

Basis of Accounting

The principal financial statements are prepared in accordance with GAAP as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and OMB Circular A-136, *Financial Reporting Requirements*, as revised. The Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, establishes a hierarchy of GAAP for Federal financial statements. The principal financial statements prepared in accordance with GAAP include the consolidated financial statements prepared on an accrual basis of accounting and the combined statements of budgetary resources which reflect the appropriation and consumption of budget and spending authority and other budgetary resources before eliminations. The consolidated financial statements include the balance sheets, statements of net cost, and statements of changes in net position.

Budgets and Budgetary Accounting

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources, and facilitates compliance with legal constraints and controls over the use of federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of purchase. Assets and liabilities that do not consume budgetary resources are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

The Combined Statements of Budgetary Resources are the basic financial statements that report the Department's Budgetary Resources, Status of Budgetary Resources, and Net Outlays for the year ended and the Change in Obligated Balance as of year-end. Specific forms of budget authority that the Department receives are appropriations, borrowing authority and spending authority from offsetting collections. Detail on the amounts shown in the Combined Statements of Budgetary Resources is included in the Required Supplementary Information section on the Schedule of Budgetary Activity shown by major account. The Combined Statements of Budgetary Resources are prepared on a combined basis, not a consolidated basis and therefore, do not include intra-entity eliminations.

See Note 22 for further disclosure on Budgets and Budgetary Accounting.

Revenues and Other Financing Sources

Exchange revenues, which are primarily medical revenues, are recognized when earned from other federal agencies or the public as a result of costs incurred or services performed on their behalf. Medical revenue is earned by VA when services are provided and are billable to the first party (Veterans) and third party insurance companies. Revenues earned but unbilled are estimated using historical average data. An allowance for contractual adjustments from insurance companies and uncollectible amounts is determined using historical average data. Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by the Department of the Treasury (Treasury) Judgment Fund and post-retirement benefits for VA employees paid by the Office of Personnel Management (OPM). Nonexchange revenue, (e.g., donations) is recognized when received, and the related receivables, refunds, and offsets are recognized when measurable and legally collectible.

Transferring Budget Authority to Other Agencies

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

budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived.

Federal Credit Reform Act of 1990

Direct loan obligations and loan guarantee commitments made after 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990 (the Credit Reform Act). The financial statement disclosures herein are also in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 2, *Accounting for Direct Loans and Guarantees*, as amended. The Credit Reform Act provides that the present value of the estimated net cash flows to be paid by VA for subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed as a result of its borrowing from Treasury. Direct loans and guaranteed loans receivable are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value.

The subsidy costs related to direct loans and guaranteed loans receivable consist of the interest rate differential between the loans to Veterans and the borrowing from Treasury, estimated default costs, net of recoveries, offsets from fees and collections, and other estimated subsidy costs affecting cash flows. Adjustments to the allowance for subsidy costs affecting cash flows consist of fees received, foreclosed property acquired, loans written off, subsidy allowance amortization and reestimates of interest rates and application of loan technical/default provisions approved by OMB.

When the present value of cash inflows to the VA is less than the present value of cash outflows made by the VA, a subsidy cost is incurred by the VA and reported as an allowance for subsidy costs that reduces direct loans and guaranteed loans receivable reported in the consolidated balance sheet. However, a negative subsidy occurs when the present value of cash inflows to the VA exceeds the present value of cash outflows made by the VA. The resulting negative subsidy is reported as an allowance for subsidy costs that increases direct loans and guaranteed loans receivable reported in the consolidated balance sheet.

The cash flow costs used to calculate the present value of the liability for loan guarantees and loan sale guarantees consist of the estimated default costs, net of recoveries, fees and other collections, adjustments for fees received, foreclosed property and loans acquired, claim payments to lenders, interest accumulation on the liability balance and changes in reestimates of interest rates and application of loan technical/default provisions approved by OMB.

Fund Balance with Treasury

Treasury performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Veterans Educational Assistance (VEAP) Trust Fund, the National Service Life Insurance (NSLI) Fund, the United States Government Life Insurance (USGLI) Fund, the Veterans Special Life Insurance (VSLI) Fund, the General Post Fund, and the National Cemetery Gift Fund. The use of these funds is restricted.

Revolving funds, used by the Supply Fund and Franchise Fund, finance a cycle of business-like operations through amounts received from the sale of products or services. The collections are used to finance its spending, usually on a self-sustaining basis. Revolving funds record the collections and the outlays in the same Treasury account. A revolving fund is a form of permanent appropriation receiving authority to spend their collections and do not generally receive appropriations.

Appropriated funds are general fund expenditure accounts established to record amounts appropriated by law for the general support of Federal Government activities and the subsequent expenditure of these funds. It includes spending from both annual and permanent appropriations.

Special funds are an appropriation account established to record appropriations, obligations, and outlays financed by the proceeds of special fund receipts which are dedicated collections by law for a specific purpose or program. Medical Care Collections Fund and Lease of Land and Building (NCA Facilities Operation Fund) are special funds.

Cash

Cash consists of Canteen Service and Loan Guaranty Program amounts held in commercial banks, cash held by non-federal trusts as well as Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Amounts relating to the Loan Guaranty Program represent deposits with trustees for offsets against loan loss claims related to sold loan portfolios. Funds held by non-federal trusts are restricted and may be used only in accordance with the terms of the trust agreements.

Investments

Investments are reported at cost net of amortized premiums or discounts and accrued interest, which approximates market value, and are redeemable at any time for their original purchase price. Insurance program investments, which comprise most of VA's investments, are in non-marketable Treasury special bonds and certificates. Interest rates for Treasury special securities are initially set based on average market yields for comparable Treasury issues. Special bonds, which mature during various years through the year 2025, are generally held to maturity unless needed to finance insurance claims and dividends. Other program investments are in securities issued by Treasury, with the exception of non-federal Trust investments in mutual funds and the Loan Guaranty Program investments in housing trust certificates.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in housing trust certificates. The estimated allowance computations are based upon discounted cash flow analysis. VA continues to use the income from these subordinated housing trust certificates to fund the housing trust reserve fund (Reserve Fund), which is used in turn to fund deficiencies in scheduled monthly principal and interest on the loans as well as to cover any realized losses incurred in the prior month. Any excess funds in the Reserve Fund are reimbursed to VA upon request.

Accounts Receivable

Accounts receivable are recorded at net realizable value measured as the carrying amount less an allowance for loss provision or contractual adjustment for medical care as considered necessary. Contractual adjustments are provided on amounts due from the Medical Care Collection Fund (MCCF) third party receivables and insurance companies. Probable losses on accounts receivable are provided using the allowance method. The allowance is determined based on VA's historical experience and collection efforts and the contractual nature of the balance due. Uncollectible amounts are written off against the allowance for loss provision or contractual adjustment for medical care once VA determines an amount, or a portion thereof, to be uncollectible.

Accounts receivable consists of intragovernmental accounts receivable and public accounts receivable. Intragovernmental accounts receivable consists of amounts due from other Federal Government agencies primarily for reimbursement of costs and lease payments receivable. All amounts due from Federal Government agencies are considered fully collectible; therefore, no allowance for loss provision is recognized.

Public accounts receivable consists primarily of (a) amounts due for Veterans' health care, (b) amounts due for compensation, pension, and readjustment benefit overpayments, (c) amounts due for education benefits and readjustment overpayments and (d) other miscellaneous receivables due primarily for general fund advances, insurance, Loan Guaranty receivables and medical research.

VA is required by Public Law (P.L.) 96-466 to charge interest and administrative costs on benefit debts similar to charges levied on other debts owed the Federal Government. VA's current policy is not to charge interest on compensation, pension debts and certain education benefits based on a July 1992 decision by the then-VA Deputy Secretary.

Loans Receivable

Loans receivable consist of direct loans and guaranteed loans receivable. Included in direct loans are vendee loans, acquired loans, and Native American direct loans. These three types of loans receivable are part of the VA Loan Guaranty Program. Direct loans also include loans on Veterans' insurance policies. The loans receivable are secured by the underlying real estate and insurance policies. The present value of the cost VA will bear as guaranteed loans default is an element of the mortgage loan benefit that VA provides to Veterans. This cost is reflected in the financial statements as an offset to the value of certain related assets.

Vendee loans are direct loans issued to a third part borrower for the acquisition price of foreclosed real estate sold by VA after the transfer of the property to VA by a private sector mortgage lender upon default of a loan subject to the VA Loan Guaranty Program. Acquired loans are VA guaranteed loans in default that VA purchases from the private sector mortgage lender and services the loan with the Veteran directly after VA determines the Veteran can service the debt service payments. Native American direct loans are special financing that enables Native Americans to purchase a home on federally recognized trust land. All three types of loans are part of the VA loan guaranty program.

Veterans that are government life insurance policyholders with permanent plan coverage or paid-up additional insurance can borrow against the cash value of their policy, creating an insurance policy direct loan. The loan amount may not exceed 94 percent of the cash surrender value of the policy or the paid-up additional insurance. Prior to November 2, 1987, policy loans were issued at fixed rates depending on the fund and time period. The remaining fixed rate loans are at 4 percent and 5 percent. All policy loans issued since November 2, 1987, have a variable interest rate with a minimum of 5 percent and a maximum of 12 percent. Rate changes are tied to the ten-year constant maturities, U.S. Treasury Securities Index and may only change on October 1. The variable rate has been 5 percent since October 1, 2001.

The interest due is equal to the interest rate times the loan balance as of the loan anniversary date. Any interest for the year not paid within 20 days of the anniversary date is added to the loan balance. Policyholders may repay loans at their discretion as long as the loan amount plus accumulated interest does not exceed 94 percent of the cash surrender value. If this occurs, the policyholder is notified that their policy will be surrendered unless a minimum payment is received within 90 days. At the policyholder's death or the maturity of the policy, any loan indebtedness is deducted from the insurance proceeds.

Loans receivable for direct loans are recorded as funds are disbursed. The carrying amount of direct loans receivable includes the remaining balance of the amount dispersed, interest receivable, an allowance for loan losses using the allowance method for pre-1992 loans, the present value of an allowance for subsidy costs for post-1991 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property.

Loans receivable for defaulted guaranteed loans are recorded when amounts are dispersed by VA to fund its guaranty with the lender for defaulted loans and represents the net value of the assets related to the pre-1992 and post-1991 guaranteed loans that defaulted. The carrying amount of the guaranteed loans receivable includes the amount dispersed by VA for its guaranty under the defaulted loans, an allowance for loan losses using the allowance method for pre-1992 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property.

For loans obligated prior to October 1, 1991, the loan loss allowance is estimated based on past experience and an analysis of outstanding balances. For loans obligated after September 30, 1991, the allowance for subsidy costs adjustment is due to the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows.

The provision for losses on vendee loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The calculation is also based on the use of the average interest rate of U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding vendee or direct loans will default over a 12-year period. For 2011 and 2010, VA determined that these vendee loans have sufficient equity, due to real estate appreciation and buy-down of principal, to minimize or eliminate any potential loss to VA.

The amount recorded for foreclosed property is estimated based upon the present value of future cash flows to be received upon the disposition of the property. To determine the future cash flows from a foreclosed property, VA obtains an independent appraisal of the property to determine fair market value which is reduced by estimated future carrying and disposal costs such as acquisition, management, selling and transfer costs and estimated gains or losses on property resale.

VA accrues interest on performing and non-performing loans receivable until the outstanding balance is paid in full. Performing loans receivable are those loans where the amount due on the outstanding balance is paid in full by the established due date. Non-performing loans receivable are those loans where the amount due on the outstanding balance is not paid in full by the established due date which results in a delinquency of the indebtedness. Interest receivable is accrued on the non-performing loan balance until the amount due is paid to a current status, debt is paid in full or otherwise resolved through compromise, waiver of the charges or termination of collection action. VA charges a fixed interest rate on loans issued for the duration of the loan term, including any delinquency period. The interest rate is set at loan inception based on three benchmark interest rates tracked by VA. VA will apply payments received from the debtor first to penalties and administrative costs, second to interest receivable and third to outstanding debt principal.

The recorded value of loans receivable, net, and the value of assets related to direct loans receivable are not the same as the proceeds that VA would expect to receive from selling its loans. It is at least reasonably possible that the proceeds from the sale of its loans will differ from the reported carrying value of the loans receivable and the underlying value of their related assets resulting in a realized gain or loss on sale.

Inventories

Inventories consist primarily of items such as Canteen Service retail store stock held for current sale and are valued at cost. VA follows the purchase method of accounting for operating supplies, medical supplies, and pharmaceutical supplies in the hands of end users. The purchase method provides that these items be expensed when purchased. VA defines an end user as a VA medical center, regional office, or cemetery.

Property, Plant, and Equipment

The majority of the general property, plant, and equipment is used to provide medical care to Veterans and is valued at cost, including transfers from other federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Construction costs are capitalized as Construction Work in Progress until completion, and then transferred to the appropriate property account. Other Structures and Capital Leases includes items such as leasehold improvements and structures not classified as buildings.

Individual items are capitalized if the useful life is two years or more and the unit price is $100,000 or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is also depreciated on a straight-line basis over its useful life, usually 5 to 20 years.

Internal use software is also subject to the $100,000 threshold for capital assets. The costs subject to capitalization, including design, development, and testing, are accumulated in Software in Development until a project is successfully tested and placed in service. The costs are amortized on a straight-line basis, and the amortization term is in accordance with the planned life cycle established during the software's planning phase.

There are no restrictions on the use or convertibility of general property, plant, and equipment. For disclosure regarding Heritage Assets see Note 10.

Other Assets

Intragovernmental Other Assets primarily consist of Intragovernmental Advances - Federal and are primarily to the Army Corps of Engineers (Corps) and the General Services Administration (GSA). Substantially all of the Public Assets consist of Public Advance Payments made by VHA primarily to hospitals and medical schools under house staff contracts, grantees and beneficiaries, with the balance of the advances being made to employees on official travel.

Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other Federal Government agencies and accounts payable from cancelled appropriations. The remaining accounts payable consist of amounts due to the public. Accrued expenses are classified as Other Liabilities except when specifically required to be reclassified to Accounts Payable under Treasury reporting requirements.

Loan Guarantees

VA provides loan guarantees under two types of guaranty programs. Under one program, a loan may be made to an eligible Veteran by an approved private sector mortgage lender. VA guarantees payment of a fixed percentage of the loan indebtedness to the holder of such a loan, up to a maximum dollar amount, in the event of default by the Veteran borrower. VA determines, through an economic analysis, whether VA will authorize the loan holder to convey the property securing the loan (foreclosure) or pay the loan guarantee amount to the holder in the event of default.

VA reports the liability on the guarantee of loans in accordance with the requirements of the Credit Reform Act. For these loans, the Liability for Loan Guarantees represents the present value of the estimated net cash outflows considered most likely to be paid by VA as a result of a claim against the guarantee on a defaulted loan. VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to a legally specified maximum based on the value of individual loans. VA will pay the lender the guarantee and foreclosure expenses.

The second loan guaranty program involves the sale of direct loans. VA will bundle vendee and acquired loans and sell them to a third party investor (Trust) pursuant to a sale agreement. Under the sale agreement, the Trust owns the mortgage loans acquired in the sale and will issue certificates backed by the mortgage loans and installment contracts. The certificates represent interests in the assets of the Trust and investors are paid from the Trust's assets. On the closing date of the certificates, VA transfers its entire interest in the related loans receivable and collateral to the Trustee for the benefit of the related certificate holders pursuant to the sale agreement. It is at least reasonably possible that the proceeds from the sale of VA's loans will differ from the reported carrying value of those loans and the underlying value of their related assets resulting in a realized gain or loss on sale. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates backed by the full faith and credit of the Federal Government.

VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs in accordance with the requirements of the Credit Reform Act. For these loans, the Liability for Loan Guarantees represents the present value of the estimated net cash outflows considered most likely to be paid by VA arising from a claim against the guarantee. These loan sales contain two types of guarantees for which VA pays net cash flow. VA guarantees that the principal and interest payment due on a loan will be paid by the 15th of each month. If the payment is not made by the borrower, VA allows the loan servicer to take funds from a cash reserve account for the amount of the deficiency. VA also guarantees the loans against loss at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

Insurance Liabilities

Insurance Liabilities for VA's life insurance programs include policy reserves, unearned premiums, insurance dividends left on deposit and related interest payable, accrued interest payable on insurance policies and dividends payable to policyholders.

Actuarial reserve liabilities for VA's insurance programs for 2011 and 2010 are based on mortality and interest rate assumptions that vary by fund, type of policy, and type of benefit. The interest rate assumptions range from 2.25 to 5.0 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, and the 1980 CSO Basic Table.

National Service Life Insurance (NSLI) basic policy reserves for permanent plans are based on the American Experience Table with 3 percent interest, except for the Modified Life plans, which are based on the 1958 CSO Basic Table with 3 percent interest, and paid-up additions purchased by dividends, which are based on the 1980 CSO Basic Table with 5 percent interest. The reserve for Term policies is based on the 1980 CSO Basic Table with 5 percent interest and the age 70 rate (the capped premium) of $6.18 per month per $1,000 face amount.

United States Government Life Insurance (USGLI) permanent plan policy reserves are based on the American Experience Table with 3.5 percent interest and are held on a net single premium basis.

Veterans Special Life Insurance (VSLI) permanent plan policy reserves are based on the X-18 Table at 2.5 percent interest, except for paid-up additions, which are based on the 1980 CSO Basic Table with 5 percent interest. The reserve for Term policies is computed on a complete contract basis, utilizing the 1941 CSO Table with 2.25 percent interest for renewal ages 69 and younger. For renewal ages 70 and older, the reserve is based on the 1980 CSO Basic Table with 5 percent interest and the age 70 rate (the capped premium) of $5.87 per month per $1,000 face amount.

Service-Disabled Veterans Insurance (S-DVI) permanent plan policy reserves are based on the 1941 CSO Table at 3.5 percent interest using ratebook premiums. The reserve for 5-Year Term policies is based on varying ratios of the 1941 CSO Table at 3.5 percent interest using ratebook premiums and is computed on a complete contract basis. The mortality ratios start at 250 percent for ages 50 and below and grade down to 100 percent of the table for ages 65 and older. The reserve for Term policies renewed at age 70 and over is based on the 1941 CSO Table with 3.5 percent interest and the age 70 Term capped premium of $5.87 per month per $1,000 face amount.

Veterans Reopened Insurance (VRI) basic policy reserves are based on an interest rate of 3.5 percent and a mortality basis that varies by segment ("J", "JR" or "JS") and by rating code within the "JR" segment. For "J", the basis is 100 percent of the 1958 CSO Basic Table. For "JR", the basis is the same as the rating code (150, 175, 200, 250, 300, 400 or 500 percent) of the Basic Table. For "JS", the basis is the American Experience Table, and the reserve is a single premium. Reserves for paid-up additions are based on the 1980 CSO Basic Table and 5 percent interest for "J", the 1958 CSO Basic Table and 4.5 percent interest for "JR", and 150 percent of the 1958 CSO Basic Table and 4.5 percent interest for "JS".

The Veterans' Mortgage Life Insurance (VMLI) program is operated through the Veterans' Insurance & Indemnities (VI&I) fund. The reserve for VMLI policies is based on 500 percent of the 1958 CSO Basic Table at 2.5 percent interest.

A reserve for unearned premiums is held for premiums paid for coverage past the date of the statement. It is comprised of an estimate for premiums paid less than one month in advance that are unearned at the end of the reporting period, and a reserve for premiums paid one month or more in advance computed from in-force master records.

Insurance dividends that are left on credit or deposit with VA accrue interest at a rate that varies by fund relative to the fund's investment portfolio earnings. For 2011, the interest rates ranged from 4.25 percent to 5.5 percent. For 2010, the interest rates ranged from 5.00 percent to 6.00 percent.

The Secretary of VA determines annually the excess funds available for dividend payment. Policyholders can elect to: (1) receive a cash payment; (2) prepay premiums; (3) repay loans; (4) purchase paid-up insurance; or (5) deposit the amount in an interest-bearing account. Policies in four of the administered programs are eligible for dividends: NSLI, USGLI, VSLI and VRI. The dividend authorization is based on an actuarial analysis of each program's claims and investment experience, compared to the mortality and interest assumptions utilized in that program, at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. A provision for dividends is charged to operations and an insurance dividend is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs.

The reserve for Dividends Payable is an estimate of the present value of dividends accrued as of the valuation date. In accordance with GAAP requirements, VA records only that portion of the estimated policy dividend that applies to the current reporting period as a dividend liability. For 2011 and 2010, a discount rate of 5 percent (4.5 percent for USGLI), along with the appropriate accrual factor, were used. The methodology employed by VA to estimate the dividend liability reflects expected dividends to be paid by quarter using percentages that are based on the actual distribution of dividend anniversaries at the end of the prior year.

Annual Leave

Federal employees' annual leave is accrued as it is earned, and the accrual is reduced annually for actual leave taken. Each year, the accrued annual leave balance is adjusted to reflect the latest pay rates for leave that has been earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not used, funding will be obtained from future financing sources.

Workers' Compensation Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. Claims incurred for benefits for VA employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by VA.

Workers' compensation is comprised of two components: (1) the accrued liability which represents money owed by VA to DOL for claims paid by DOL on behalf of VA through the current fiscal year, and (2) the actuarial liability for compensation cases to be paid beyond the current year.

Future workers' compensation estimates are generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases and for potential cases related to injuries incurred but not reported. The liability is determined by utilizing historical benefit payment patterns related to a particular period to estimate the ultimate payments related to that period.

Pension, Other Retirement Benefits, and Other Post-Employment Benefits

Each employing federal agency is required to recognize its share of the cost and imputed financing of providing pension and post-retirement health benefits and life insurance to its employees. Factors used in the calculation of these pensions and post-retirement health and life insurance benefit expenses are provided by OPM to each agency.

VA's employees are covered under the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS); VA makes contributions according to both plan requirements. CSRS and FERS are multi-employer plans administered by OPM. VA does not maintain or report information about the assets of the plans, nor does it report actuarial data for the accumulated plan benefits. That reporting is the responsibility of OPM.

Veterans Benefits Liability

VA provides compensation benefits to Veterans who are disabled by military service-related causes. Benefits are also provided to deceased Veterans' beneficiaries. These benefits are provided in recognition of a Veteran's military service. The liability for future compensation and burial payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Various assumptions in the actuarial model, such as the number of Veterans and dependents receiving payments, discount rates, cost of living adjustments, presumptive service conditions resulting in benefits coverage and life expectancy, impact the amount of the liability.

Discount rates used to measure the actuarial liabilities are based on the 10-year average historical interest rate yield curve on marketable Treasury securities at September 30 of each year for the 10-year historical period with maturities consistent with the period of expected future payments. Estimated liabilities for Veterans compensation and burial obligations in the financial statements are measured as of the end of the fiscal year based on June 30 beneficiary data that is adjusted for material known changes in the number of participants covered (enrollment) during the 4th quarter. The method used to measure the liabilities provides for consistency in the underlying relationship between discount rate, COLA, and the other economic assumptions. For 2011, valuation techniques or their application used to measure the fair value of the actuarial liabilities were consistently applied compared to the previous year. From time to time, VA may determine it is preferable to make refinements to the valuation techniques or their application used to measure the fair value of the actuarial liabilities because VA management concludes that the resulting measurements are equally or more representative of fair value of the actuarial liabilities in the circumstances and were due to improved computer software modeling capability and/or improved information. The resulting changes in fair value of the actuarial liabilities from the changes in valuation techniques or their application are treated as a change in estimate and accounted for on a prospective basis.

Contingencies

VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations other than disclosed in Note 18, Contingencies.

Non-Federal Trusts

VA has entered into enhanced-use leases to maximize use of underutilized VA property. In these enhanced-use leases, the assets and liabilities were transferred to a non-federal trust. The assets, liabilities, and results of operations of these seven trusts are included in the accompanying consolidated financial statements.

Application of Critical Accounting Estimates

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

Comparative Data

Certain amounts in the 2010 Consolidated Balance Sheet were reclassified from Public Accounts Payable to Insurance Liabilities to conform to the 2011 presentation. The reclassifications had no other effect on the Consolidated Financial Statements.

Certain revenue accounts in the 2010 Consolidated Statement of Net Cost were misclassified as federal revenues and reclassified to non-federal revenues to conform to the 2011 presentation. The reclassification of the revenues had no impact on the Consolidated Statements of Net Cost for 2011 or 2010; however, the disclosure of federal and public revenues in Note 21 was affected.

See Note 24 on Reclassifications for further discussion of the above items.

2. Non-Entity Assets

Entity and Non-Entity assets have been combined on the balance sheet. Non-Entity assets relate primarily to state and local taxes and other employee payroll withholdings and personal funds of patients included in Fund Balance with Treasury; downward reestimates for the Veterans Housing Program included in Intragovernmental Accounts Receivable; and amounts due to Treasury for medical costs billed to Veterans included in Public Accounts Receivable.

Non-Entity Assets
as of September 30,

	2011	2010
Fund Balance with Treasury	$ 144	$ 15
Intragovernmental Accounts Receivable	1	1
Public Accounts Receivable	63	50
Total Non-Entity Assets	$ 208	$ 66

3. Fund Balance with Treasury

Fund Balance with Treasury
as of September 30,

		2011		2010
Entity Assets				
Trust Funds	$	79	$	80
Revolving Funds		4,309		3,135
Appropriated Funds		35,407		39,646
Special Funds		272		235
Other Fund Types		-		44
Total Entity Assets		40,067		43,140
Non-Entity Assets				
Other Fund Types		144		15
Total Non-Entity Assets		144		15
Total Entity and Non-Entity Assets	$	40,211	$	43,155
Reconciliation of VA General Ledger Balances with Treasury				
Balance per VA General Ledger	$	43,456	$	41,066
Reconciled Differences, Principally Timing		(3,334)		2,177
Unreconciled Differences		89		(88)
Fund Balance with Treasury	$	40,211	$	43,155
Status of Fund Balance with Treasury				
Unobligated Balance				
Available	$	20,257	$	21,105
Unavailable		4,429		3,172
Obligated Balance Not Yet Disbursed		15,149		18,584
Deposit /Clearing Account Balances		376		294
Fund Balance with Treasury	$	40,211	$	43,155

4. Cash

Cash
as of September 30,

		2011		2010
Canteen Service	$	1	$	3
Agent Cashier Advance		17		17
Total Cash	$	18	$	20

5. Investments

Investment Securities

as of September 30, 2011

		Cost	Amortization Method		Amortized (Premium)/ Discount	Interest Receivable	Investments, Net		Market Value
Intragovernmental Securities									
Non-Marketable: Special Bonds	$	9,821	N/A	$	-	127	9,948	$	9,948
Treasury Notes		85	Effective Interest		(2)	1	84		84
Total	$	9,906		$	(2)	128	10,032	$	10,032
Public Securities									
Trust Certificates (Loan Guaranty)	$	140	N/A	$	-	-	140	$	140
Mutual Funds (Non-Federal Trusts)		51	Straight-line		(5)	-	46		46
Total	$	191		$	(5)	-	186	$	186

as of September 30, 2010

		Cost	Amortization Method		Amortized (Premium)/ Discount	Interest Receivable	Investments, Net		Market Value
Intragovernmental Securities									
Non-Marketable: Special Bonds	$	10,487	N/A	$	-	141	10,628	$	10,628
Treasury Notes		83	Effective Interest		(1)	1	83		83
Total	$	10,570		$	(1)	142	10,711	$	10,711
Public Securities									
Trust Certificates (Loan Guaranty)	$	140	N/A	$	-	-	140	$	140
Mutual Funds (Non-Federal Trusts)		48	Straight-line		(4)	-	44		44
Total	$	188		$	(4)	-	184	$	184

6. Accounts Receivable, Net

Accounts Receivable, Net
as of September 30,

		2011		2010
Intragovernmental Accounts Receivable, Net	$	6	$	29
Public Accounts Receivable				
Medical Care	$	2,265	$	2,068
Contractual Adjustment and Allowance for Loss Provision		(997)		(907)
Net Medical Care		1,268		1,161
Compensation and Pension		1,225		1,117
Allowance for Loss Provision		(846)		(729)
Net Compensation and Pension		379		388
Education Benefits		336		380
Allowance for Loss Provision		(132)		(185)
Net Education Benefits		204		195
Other		96		74
Allowance for Loss Provision		(13)		(10)
Net Other		83		64
Total Public Accounts Receivable		3,922		3,639
Total Contractual Adjustment and Allowance for Loss Provision		(1,988)		(1,831)
Public Accounts Receivable, Net	$	1,934	$	1,808

The Total Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Public Accounts Receivable was approximately 51 percent and 50 percent at September 30, 2011, and 2010, respectively. The Medical Care Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Medical Care related accounts receivable was approximately 44 percent at September 30, 2011, and 2010.

Included in the Medical Care Contractual Adjustment and Allowance for Loss Provision is an Allowance for Contractual Adjustment of $561 million and $537 million or approximately 52 percent and 54 percent, respectively of Medical Care Collection Fund third party receivables of $1.08 billion and $991 million at September 30, 2011, and 2010, respectively.

The Compensation and Pension Allowance for Loss Provision as a percentage of Total Compensation, Pension and Readjustment Benefit Overpayment-related accounts receivable was approximately 69 percent and 65 percent at September 30, 2011 and 2010, respectively. The Education Benefits Allowance for Loss Provision as a percentage of Total Education Benefits and Readjustment Benefit Overpayment-related accounts receivable was approximately 39 percent and 49 percent at September 30, 2011 and 2010, respectively.

7. Direct Loans and Loan Guarantees

As more fully discussed in Note 1 under the Loans Receivable and Loan Guarantees sections, the accounting for direct loans receivable and loan guarantee liabilities made after 1991, is governed by the Credit Reform Act. Disclosure of direct loans receivable and loan guarantee liabilities is provided in accordance with SFFAS 2, *Accounting for Direct Loans and Guarantees*, as amended.

VA operates the following direct loan and loan guaranty programs:

- Vocational Rehabilitation and Employment
- Education
- Insurance
- Loan Guaranty

Direct Loans

The following tables summarize the carrying amount of loans receivable related to pre-1992 and post-1991 direct loans. The carrying amount of direct loans receivable includes the remaining balance of the amount dispersed, interest receivable, an allowance for loan losses using the allowance method (estimated uncollectible loans) for pre-1992 loans, the present value of an allowance for subsidy costs for post-1991 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property. An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the direct loans are provided in the tables that follow:

Loans Receivable and Related Foreclosed Property and Insurance Policy Loans From Direct Loans
as of September 30, 2011

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans, Net
Direct Loans Obligated Prior to 1992 (Allowance for Loss Method)	$ 13	10	(1)	-	$ 22
Insurance Policy Loans	464	11	-	-	475
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net					$ 497

	Loans Receivable Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property	Value of Assets Related to Direct Loans, Net
Direct Loans Obligated After 1991	$ 723	13	2	8	$ 746
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net					$ 1,243

Loans Receivable and Related Foreclosed Property and Insurance Policy Loans From Direct Loans
as of September 30, 2010

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans, Net
Direct Loans Obligated Prior to 1992 (Allowance for Loss Method)	$ 17	10	-	-	$ 27
Insurance Policy Loans	503	12	-	-	515
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net					$ 542

	Loans Receivable Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property	Value of Assets Related to Direct Loans, Net
Direct Loans Obligated After 1991	$ 686	9	713	22	$ 1,430
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net					$ 1,972

Direct Loans Disbursed
The total amount of new direct loans disbursed for the years ended September 30, 2011, and 2010, was $270.7 million and $251.5 million, respectively.

Subsidy Expense for Post-1991 Direct Loans
The subsidy expense for direct loans is as shown:

Direct Loan Subsidy Expense for the years ended September 30,	2011	2010
Interest Differential	$ (49)	$ (107)
Defaults	1	1
Fees*	(4)	(4)
Other**	45	94
Subtotal	(7)	(16)
Interest Rate Reestimates	(2)	25
Technical Reestimates	407	37
Total Direct Loan Subsidy Expense	$ 398	$ 46

* "Fees" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.
** "Other" expense for direct loans includes the estimated loss of scheduled principal and interest when vendee loans are sold.

Subsidy Rates for Direct Loans by Component
The subsidy rates disclosed below pertain only to the current year loans. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of both current year loans and prior year(s) loans. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Direct Loans by Component	
Interest Differential	(26.42%)
Defaults	7.26%
Fees	(1.41%)
Other	18.02%

Allowance for Subsidy for Direct Loans (Post-1991)
For these loans, the allowance for subsidy represents the difference between the balance of the direct loan and the present value of the estimated net cash flows to be paid by VA. The allowance for subsidy is the result of the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows. For 2011, the subsidy rate is (2.42) percent for Veterans Housing Direct – Vendee Loans, (0.13) percent for Veterans Housing

Direct – Acquired Loans, and (13.65) percent for Native American Direct. For 2010, the subsidy rate was (4.45) percent for Veterans Housing Direct – Vendee Loans, 10.15 percent for Veterans Housing Direct – Acquired Loans, and (32.78) percent for Native American Direct. The allowance for subsidy as of September 30, 2011, and 2010 is $(2) million and $(713) million, respectively.

Schedule for Reconciling Subsidy Cost Allowance Balances Beginning Balance, Changes and Ending Balance	2011	2010
Beginning balance of the allowance	$ (713)	$ (718)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(49)	(107)
Default costs (net of recoveries)	1	1
Fees and other collections	(4)	(4)
Other subsidy costs	45	94
Total of the above subsidy expense components	(7)	(16)
Adjustments:		
Fees received	4	3
Foreclosed property acquired	(5)	(29)
Loans written off	(3)	(1)
Subsidy allowance amortization	309	(31)
Change in reestimate approved by OMB	8	17
Total Adjustments	313	(41)
Ending balance of the allowance before reestimates	(407)	(775)
Subsidy reestimates by component		
Interest rate reestimate	(2)	25
Technical/default reestimate	407	37
Total of the above reestimate components	405	62
Ending balance of the allowance	$ (2)	$ (713)

Loan Guarantees

The following tables summarize the carrying amount of loans receivable related to pre-1992 and post-1991 defaulted guaranteed loans and non-defaulted guaranteed loans. The carrying amount of the guaranteed loans receivable includes the amount dispersed by VA for its guaranty under the defaulted loans, an allowance for loan losses using the allowance method (estimated uncollectible loans) for pre-1992 loans and the fair market value less cost to dispose of foreclosed property based on the present value of future cash flows from the property.

An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy costs associated with loan guarantees are provided in the tables that follow:

Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30, 2011

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	$ 15	-	(14)	4	$ 5
Defaulted Guaranteed Loans - Post-1991 Guarantees	5	-	-	852	857
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 862

Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30, 2010

	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees	$ 21	-	(18)	5	$ 8
Defaulted Guaranteed Loans - Post-1991 Guarantees	5	-	-	1,200	1,205
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 1,213

Guaranteed Loans as of September 30,				
		2011		2010
Guaranteed Loans Outstanding:				
Outstanding Principal of Guaranteed Loans, Face Value	$	247,658	$	214,726
Amount of Outstanding Principal Guaranteed	$	66,222	$	58,080
New Guaranteed Loans Disbursed:				
Outstanding Principal of Guaranteed Loans, Face Value	$	66,630	$	57,641
Amount of Outstanding Principal Guaranteed	$	17,190	$	14,837
Number of New Loans Disbursed		322,380		280,579
Liabilities for Pre-1992 and Post-1991 Loan Guarantees (Present Value Method)	$	5,062	$	4,885

Subsidy Expense for Post-1991 Loan Guarantees

Pursuant to the Credit Reform Act, subsidy costs for new loan guarantees, net of up front funding fees, must be obligated at the time the loan is disbursed. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

Guaranteed Loan Subsidy Expenses for the years ended September 30,				
		2011		2010
Defaults	$	1,011	$	951
Fees		(1,234)		(1,058)
Subtotal		(223)		(107)
Interest Rate Reestimates		(10)		204
Technical Reestimates		801		1,224
Total Guaranteed Loan Subsidy Expenses	$	568	$	1,321

Subsidy Rates for Loan Guarantees by Component

The subsidy rates disclosed below pertain only to the loans guaranteed in the current year. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loan guarantees reported in the current year could result from disbursements of loans from both current year loan guarantees issued and prior year(s) loan guarantees issued. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Loan Guarantees	
Defaults	1.41%
Fees	(1.72)%

Liability for Loan Guarantees (Post-1991)

VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to a legally specified maximum based on the value of individual loans. VA will pay the lender the guarantee and foreclosure expenses. If an agreement can be made with the Veteran, VA may acquire the loan by refunding the lender for the loan. The 2011 and 2010 subsidy rate was (0.31) percent and (0.20) percent, respectively. The liability for loan guarantees as of September 30, 2011, and 2010 is $4,973 million and $4,823 million, respectively.

Schedule for Reconciling Loan Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2011**	**2010**
Beginning balance of the liability	$ 4,823	$ 3,871
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	1,011	951
Fees and other collections	(1,234)	(1,058)
Total of the above subsidy expense components	(223)	(107)
Adjustments:		
Fees received	904	867
Foreclosed property and loans acquired	(468)	(351)
Claim payments to lenders	(908)	(995)
Interest accumulation on the liability balance	215	103
Change in reestimate approved by OMB	(161)	7
Total Adjustments	(418)	(369)
Ending balance of the liability before reestimates	4,182	3,395
Subsidy reestimates by component		
Interest rate reestimate	(10)	204
Technical/default reestimate	801	1,224
Total of the above reestimate components	791	1,428
Ending balance of the liability	$ 4,973	$ 4,823

Loan Sales

VA owns mortgages and real estate on certain defaulted loans that were guaranteed by VA and have gone through the foreclosure process with the lender. VA sells the real estate to a third party owner and makes the direct loan for the underlying mortgage loan receivable. To reduce the administrative burden of servicing these loans, VA will bundle these loans and sell them to a third party investor (Trust) pursuant to a sale agreement. It is at least reasonably possible that the proceeds from the sale of its loans will differ from the reported carrying value of the loans and the underlying value of their related assets resulting in a realized gain or loss on sale.

Under the sale agreement, the Trust owns the mortgage loans and other property acquired in the sale and makes elections to treat certain of its assets as one or more Real Estate Mortgage

Investment Conduits (REMIC) for U.S. Federal income tax purposes. In addition, the Trust will issue certificates backed by mortgage loans and installment contracts. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. On the closing date of the certificates, VA transfers its entire interest in the related loans receivable and collateral to the Trustee for the benefit of the related certificate holders pursuant to the sale agreement. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates backed by the full faith and credit of the Federal Government.

During the period 1992 through 2011, the total loans sold amounted to $14.7 billion. VA recognized loan sale proceeds of $187 million during 2011 resulting in no gain or loss. VA recognized loan sale proceeds of $229 million during 2010 resulting in a gain of $2 million. As a result of the sale of $187 million and $227 million of loans receivable in 2011 and 2010, respectively, the amount of guaranteed loans sold increased by the carrying amount of the loans receivable at the date of sale. The components of the loan sale are summarized in the tables below:

Loan Sales				
Years Ended September 30,				
		2011		**2010**
Loans Receivable Sold	$	187	$	227
Net Proceeds from Sale		(187)		(229)
Gain on Receivables Sold	$	-	$	(2)

Outstanding Balance of Loan Sale Guarantees

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

Guaranteed Loans Sold				
as of September 30,				
		2011		**2010**
Outstanding Balance Guaranteed Loans Sold, Start of Year	$	1,661	$	1,714
Sold to the Public		187		227
Payments, Repayments, and Terminations		(59)		(280)
Outstanding Balance Guaranteed Loans Sold, End of Year	$	1,789	$	1,661

Subsidy Expense for Loan Sale Guarantees

Pursuant to the Credit Reform Act, subsidy costs for new loan sale guarantees must be obligated at the time the loan sale is closed. The subsidy expense for loan sale guarantees is shown below:

Loan Sale-Guaranteed Loan Subsidy Expense
for the years ended September 30,

	2011	2010
Defaults	$ 5	$ 6
Other	(1)	(1)
Subtotal	4	5
Interest Rate Reestimates	-	16
Technical Reestimates	26	16
Total Loan Sale-Guaranteed Subsidy Expense	$ 30	$ 37

Liability for Loan Sale Guarantees (Post-1991)

For these programs, the guaranteed loan sale liability represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee. These sales contain two types of guarantees. VA guarantees that the principal and interest payment due on a loan sold will be paid by the 15th of each month. If not paid by the borrower, VA allows the loan servicer to take funds from cash reserve accounts for the deficient amount. VA also guarantees the loan against loss at foreclosure. VA will not buy back the loans but will pay off the loan loss and foreclosure expenses. The subsidy rate for 2011 and 2010 is 2.00 percent and 2.42 percent, respectively. The liability for loan sale guarantees as of September 30, 2011, and 2010, is $89 million and $62 million, respectively.

Schedule for Reconciling Loan Sale Guarantee Liability Balances

Beginning Balance, Changes and Ending Balance	**2011**	**2010**
Beginning balance of the liability	$ 62	$ 45
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	5	6
Other subsidy costs	(1)	(1)
Total of the above subsidy expense components	4	5
Adjustments:		
Claim payments to lenders	(28)	(23)
Interest accumulation on the liability balance	25	1
Change in reestimate approved by OMB	-	2
Total Adjustments	(3)	(20)
Ending balance of the liability before reestimates	63	30
Subsidy reestimates by component		
Interest rate reestimate	-	16
Technical/default reestimate	26	16
Total of the above reestimate components	26	32
Ending balance of the liability	$ 89	$ 62

Program Totals

Total Loans Receivable and Related Foreclosed Property, Net as of September 30,		2011		2010
Total Direct Loans	$	1,243	$	1,972
Total Guaranteed Loans		862		1,213
Total Loans Receivable and Related Foreclosed Property, Net	$	2,105	$	3,185

Total Subsidy Expense for the years ended September 30,		2011		2010
Total Direct Loans	$	398	$	46
Total Guaranteed Loans		568		1,321
Total Loan Sales		30		37
Total Subsidy Expense	$	996	$	1,404

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Total Liabilities for Loan Guarantees as of September 30,		2011		2010
Total Loan Guarantee Liability	$	4,973	$	4,823
Total Loan Sale Guarantee Liability		89		62
Total Liabilities for Loan Guarantees	$	5,062	$	4,885

Foreclosed Property

Prior to the foreclosure of property secured by a VA Loan Guarantee, VA obtains an independent appraisal of the property. This appraisal is reviewed by VA staff to make a determination of the fair market value. To determine the net value of the property, VA costs such as acquisition, management, and disposition of the property as well as estimated losses on property resale, are subtracted from the estimated fair market value. The amount recorded for foreclosed property is estimated based upon the present value of future cash flows to be received upon the disposition of the property. Future cash flows are estimated based on the estimated selling price less the amounts paid at foreclosure plus estimated costs to carry the property. Recent volatility in the United States housing market could change the estimates and assumptions used for these calculations in the future, which could impact the amounts reported and disclosed herein. There has been no change in the methodology for calculating the amount recorded for foreclosed property and there are no restrictions on the use or disposition of foreclosed property for the years ended September 30, 2011, and 2010.

As of September 30, 2011, and 2010, the estimated number of residential properties in VA's inventory was 7,322 and 10,835, respectively. For 2011 and 2010, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 7 months and 8 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 22,000 and 20,500 as of September 30, 2011, and 2010, respectively.

Administrative Expense

Administrative expense on direct and guaranteed loans for the fiscal years ended September 30, 2011, and 2010, was $142 million and $145 million, respectively.

8. Inventories and Related Property, Net

Inventories as of September 30,		2011		2010
Held for Current Sale	$	68	$	54
Other		3		2
Total Inventories	$	71	$	56

9. General Property, Plant and Equipment

General Property, Plant and Equipment as of September 30, 2011		Cost		Accumulated Depreciation		Net Book Value
Land and Improvements	$	896	$	(142)	$	754
Buildings		22,019		(11,647)		10,372
Equipment		3,815		(1,940)		1,875
Other Structures and Capital Leases		3,033		(1,708)		1,325
Internal Use Software		472		(322)		150
Construction Work in Progress		4,041		-		4,041
Internal Use Software in Development		169		-		169
Total Property, Plant, and Equipment	$	34,445	$	(15,759)	$	18,686

General Property, Plant and Equipment as of September 30, 2010		Cost		Accumulated Depreciation		Net Book Value
Land and Improvements	$	789	$	(101)	$	688
Buildings		20,142		(10,455)		9,687
Equipment		3,726		(1,865)		1,861
Other Structures and Capital Leases		2,720		(1,560)		1,160
Internal Use Software		477		(336)		141
Construction Work in Progress		2,997		-		2,997
Internal Use Software in Development		196		-		196
Total Property, Plant, and Equipment	$	31,047	$	(14,317)	$	16,730

Depreciation and amortization expense totaled $1.9 billion and $1.4 billion in 2011 and 2010, respectively.

10. Heritage Assets

Heritage assets are properties that possess one or more of the following characteristics: historical or natural significance; cultural; educational or aesthetic value; or significant architectural characteristics. VA has properties at medical centers and National Cemeteries that meet the criteria for heritage assets. Heritage assets allow VA to meet its responsibilities under the National Historic Preservation Act to administer federally owned, administered, or controlled prehistoric or historic resources in a spirit of stewardship for the inspiration and benefit of present and future generations.

Generally, additions to VA's heritage assets inventory result from field station surveys, which identify items such as new collections or newly designated assets. VA classifies its heritage assets as: Art Collections (including artwork, archives, historic medical equipment, medals and awards, furniture, archaeological materials, and photographs); Buildings and Structures (including historic hospitals, quarters, lodges, and chapels); Monuments/Historic Flag Poles, Other Non-Structure Items (including rostrums, gates and historic walls); Archaeological Sites; and Cemeteries. According to VA's policy for heritage assets, only developed sections of National Cemeteries are classified as heritage assets.

Heritage Assets in Units					
as of September 30,	2010 Balance	2011 Additions	2011 Withdrawals	2011 Balance	Condition
Art Collections	245	-	-	245	A
Buildings and Structures	1,510	25	-	1,535	*U
Monuments/Historic Flag Poles	1,006	-	-	1,006	A
Other Non-Structure Items	247	-	-	247	A
Archaeological Sites	35	-	-	35	A
Cemeteries	**164	-	-	**164	A
Total Heritage Assets in Units	3,207	25	-	3,232	

Explanation of Condition: A = Acceptable (No to slight deterioration); U=Unacceptable (Moderate to significant deterioration)
*Buildings and Structures: Approximately 50% of VA's historic buildings and structures are unoccupied and risk deterioration. Many are in the "U" range.
** This total accounts only for open, operational cemeteries, not those under development.

11. Debt

Intragovernmental Debt as of September 30,	2010 Beginning Balance	2010 Net Borrowing	2010 Ending Balance	2011 Net Borrowing	2011 Ending Balance
Loan Guaranty Debt					
Debt to the Treasury	$ 1,544	$ 105	$ 1,649	$ 25	$ 1,674
Debt to the Federal Financing Bank	5	-	5	-	5
Total Loan Guaranty Debt	1,549	105	1,654	25	1,679
Direct Loans Debt – Vocational Rehabilitation Program					
Debt to the Treasury	1	-	1	-	1
Debt to the Federal Financing Bank	-	-	-	-	-
Total Direct Loans Debt	1	-	1	-	1
Total Debt					
Debt to the Treasury	1,545	105	1,650	25	1,675
Debt to the Federal Financing Bank	5	-	5	-	5
Total Debt	$ 1,550	$ 105	$ 1,655	$ 25	$ 1,680

At September 30, 2011, and 2010, all debt is classified as intragovernmental debt. VA had no debt due to any other Federal agency and all debt is covered by budgetary resources.

Loan Guaranty debt has a 30-year term from the date of issuance and bears interest at the Treasury securities rate at the time of borrowing. The interest rates on debt issued ranged from 1.00 to 7.58 percent in 2011 and 2.00 to 7.58 percent in 2010. Interest expense was $142.2 million for 2011 and $154.7 million for 2010.

Vocational Rehabilitation Program Direct Loan debt has a 2-year term from the date of issuance and bears interest at the Treasury securities rate at the time of borrowing. The interest rate on debt issued was 1.00 to 1.49 percent in 2011 and 1.07 to 4.12 percent in 2010. Interest expense was $56 thousand for 2011 and $42.9 thousand for 2010.

Net borrowings related to the Loan Guaranty debt and Direct Loans debt does not include any amounts that result from refinancing debt.

No debt was held by the public during 2011 or 2010. There were no redemptions or calls of debts before maturity or write-offs of debt owed to the Treasury.

12. Liabilities Not Covered By Budgetary Resources

Liabilities Not Covered By Budgetary Resources as of September 30,		2011		2010
Workers' Compensation (FECA)*	$	2,327	$	2,289
Annual Leave		1,797		1,733
Judgment Fund		966		798
Environmental and Disposal		884		879
Veterans Compensation and Burial		1,533,700		1,474,800
Insurance		1,161		1,073
Amounts due to Non-Federal Trust		155		161
Total	$	1,540,990	$	1,481,733

* The actuarial estimate for workers' compensation provided by DOL was computed using an interest rate of 4.30 percent and 4.72 percent to discount the projected annual benefit payments as of 2011 and 2010, respectively.

Total Unfunded Liabilities include Workers' Compensation (FECA) which is comprised of the actuarial Workers' Compensation (FECA) Liability, Accrued FECA Liability for DOL funded costs not yet appropriated and Unfunded Employee Liability. The Accrued FECA Liability and Unfunded Employee Liability are Intragovernmental Liabilities totaling $436 million and $427 million at September 30, 2011, and 2010, respectively.

13. Federal Employee and Veterans Benefits Liabilities

Federal Employee Benefits: Imputed Expenses-Employee Benefits Years ended September 30,		2011		2010
Civil Service Retirement System	$	375	$	145
Federal Employees Health Benefits		1,518		1,348
Federal Employees Group Life Insurance		2		1
Total Imputed Expenses-Employee Benefits	$	1,895	$	1,494

Veterans Benefits

Certain Veterans, who die or are disabled from military service-related causes as well as their dependents, receive compensation benefits. Also, Veterans are provided with burial flags, headstones/markers, and grave liners for burial in a VA national cemetery or are provided a burial flag, headstone/marker and a plot allowance for burial in a private cemetery. These benefits are provided under Title 38, Part 2, Chapter 23 in recognition of a Veteran's military service and are recorded as a liability on the balance sheet in the period the requirements are met.

Federal Employee and Veterans Benefits Liabilities as of September 30,		2011		2010
Workers' Compensation (FECA)	$	1,891	$	1,862
Compensation		1,529,200		1,470,500
Burial		4,500		4,300
Total Federal Employee and Veterans Benefits Liabilities	$	1,535,591	$	1,476,662

VA provides certain Veterans and/or their dependents with pension benefits if the Veteran died or was disabled from nonservice-related causes, based on annual eligibility reviews. The actuarial present value of the future liability for pension benefits is a nonexchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2011, and 2010 was $89.2 billion and $80.8 billion, respectively.

Assumptions Used to Calculate the Veterans Benefits Liability

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for the projected benefit payments to: (1) those beneficiaries, including Veterans and survivors, currently receiving benefit payments; (2) current Veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become Veterans in the future. Future benefits payments to survivors of those Veterans in classes (1), (2), and (3) above are also incorporated into the projection. The projected liability does not include any administrative costs. Actual administrative costs incurred annually are included in the Veterans Benefits Administration's Net Program Costs shown in the accompanying Statements of Net Cost.

In 2010, VA made refinements to (1) the method of estimating future changes in the degree of disability connected with military service due to the elimination of computer software modeling limitations, (2) the estimate of future Cost of Living Adjustments (COLA) based on a linear regression model of the Consumer Price Index (CPI) and Treasury interest rates to account for low interest rate environments compared to a constant real rate of interest assumption, and (3) the use of attained age method for future benefit calculations compared to the use of the age at valuation date for future benefit calculations. The changes in fair value of the actuarial liabilities that resulted from the refinements in valuation techniques or their application are treated as a change in estimate and accounted for on a prospective basis beginning in 2010.

The liability for future compensation and burial payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Discount rates at September 30, 2011, and 2010 were based on the 10-year average historical interest rate yield curves on marketable Treasury securities at September 30 of each year for the period 2002 to 2011 and 2001 to 2010 for September 30, 2011, and 2010, respectively. The yield rates that generate the average range from 1.64 to 4.1 percent and from 1.86 to 4.64 percent for September 30, 2011, and 2010, respectively.

All calculations were performed separately by age for the Compensation, Pension and Burial programs.

Various assumptions in the actuarial model, such as the number of Veterans and dependents receiving payments, cost of living adjustments, presumptive service conditions resulting in benefits coverage, change in degree of disability connected with military service and life expectancy, impact the amount of the liability.

The total number of Veterans, estimated future military separations and total number of beneficiary participants are determined through actual and projected data. The amount of benefits by beneficiary category and age were based on current amounts being paid, future cost of living adjustments (COLA), change in degree of disability connected with military service and presumptive service conditions in existence at September 30, 2011, and 2010, respectively, resulting in benefits coverage to determine the average benefits per Veteran for each future time period, and changes in other factors that affect benefits. The average COLA rate used for all future years at September 30, 2011, and 2010, was 2.78 percent and 2.86 percent, respectively. COLA rates for future years are modeled to be consistent with the discount rate assumption described above.

Life expectancies of beneficiaries collecting benefits from the Compensation and Pension programs were based upon studies of mortality experience of those beneficiaries between 2002 and 2008. Life expectancies of Veterans not yet collecting these benefits used in the calculation of the liability for future beneficiaries are based on mortality derived from the 2006 U.S. Life Table. Applying mortality improvements at a rate that varies by age of between 0.85 and 1.00 percent per annum brought both sets of mortality rates forward. In addition, rates of benefit termination of beneficiaries due to reasons other than mortality are also reflected.

Expected benefit payments have been explicitly modeled for the next 100 years. The Compensation and Pension projections only reflect benefits associated with military service through September 30, 2011.

Veteran's Presumptive Disability Benefits
Congress established a process to guide the creation of new presumptive disability benefit payments through the Agent Orange Act of 1991, P.L. No. 102-4. The Secretary of VA announced on October 13, 2009, that relying on an independent study by the Institute of Medicine (IOM), he determined that presumptions of service connection are warranted for Vietnam Veterans who have any of three specific illnesses, based on the latest evidence of an association with herbicides used in Vietnam, including Agent Orange. The illnesses affected by the recent decision are B cell leukemia, such as hairy cell leukemia; Parkinson's disease; and ischemic heart disease. Effective August 31, 2010, subject to the 60-day waiting period, a final regulation was issued. In accordance with the Agent Orange Act, the adjudication of cases based on these three new presumptions began.

For accounting purposes, the three new presumptive disability benefits were recognized in the compensation actuarial liability at September 30, 2010, as previously discussed. This had the effect of increasing the calculated liability amounts by $105.9 billion as of September 30, 2010. Increased benefit expenses due to these new presumptive illnesses have been incorporated into the VA's actuarial estimations as of September 30, 2011.

Adoption of New Accounting Standard

Effective October 1, 2009, VA adopted SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuation Dates* (SFFAS 33). SFFAS 33 will apply to the actuarial liabilities recognized for Veterans compensation and burial obligations reported in VA's general purpose financial reports prepared pursuant to FASAB standards.

SFFAS 33 requires the display of gains and losses from changes in long-term assumptions used to measure liabilities for Veterans compensation and burial obligations, as separate line items on the Statements of Net Cost. The Standard also requires disclosure in notes to the financial statements of a reconciliation of beginning and ending Veterans compensation and burial obligations balances, including all material components of expense "from experience" and "from assumptions changes" by significant programs and in total. In addition, SFFAS 33 provides standards for selecting the discount rate assumption to measure the Veterans compensation and burial obligations as of the reporting date and selecting a valuation date for estimating the obligation which will establish a consistent method for such measurements.

The adoption of the new accounting standard, effective October 1, 2009, was accounted for as a change in accounting principle and resulted in a $66.5 billion reduction in the Veterans Compensation and Burial Actuarial Liabilities. The cumulative effect of the change in accounting principle on prior periods is reported as an adjustment to the beginning balance of Cumulative Results of Operations, in the Consolidated Statement of Changes in Net Position with an offsetting reduction in the Veterans Compensation and Burial Actuarial Liabilities in the 2010 Consolidated Balance Sheet.

Reconciliation of Veterans Compensation and Burial Actuarial Liabilities
For the Year Ended September 30,

	Compensation	Burial	TOTAL
Liability at September 30, 2009	$ 1,313,900	$ 3,600	$ $1,317,500
Cumulative Effect of Change in Accounting Principle:			
Changes in Assumptions:			
Changes in Discount Rate Assumption	(186,200)	(500)	(186,700)
Changes in COLA Rate Assumption	119,800	-	119,800
Other Assumption Changes	-	400	400
Net Actuarial (Gain)/Loss from Cumulative Effect of Change In Accounting Principle	**(66,400)**	**(100)**	**(66,500)**
Liability at October 1, 2009, as adjusted	1,247,500	3,500	1,251,000
Current year changes:			
Changes in Assumptions:			
Changes in Discount Rate Assumption	110,500	300	110,800
Changes in COLA Rate Assumption	(45,700)	(100)	(45,800)
Model Refinements (Net)	40,700	600	41,300
Other Assumption Changes	(4,900)	-	(4,900)
Net (Gain)/Loss from Changes in Assumptions	100,600	800	101,400
Changes in Experience:			
Changes in Veterans Counts and Status	16,500	-	16,500
Changes due to New Presumptive Conditions	105,900	-	105,900
Other Experience Changes	-	-	-
Net (Gain)/Loss from Changes in Experience	122,400	-	122,400
Net Actuarial (Gain)/Loss from Current Year Activity	**223,000**	**800**	**223,800**
Liability at September 30, 2010	**1,470,500**	**4,300**	**1,474,800**
Current year changes:			
Changes in Assumptions:			
Changes in Discount Rate Assumption	51,900	200	52,100
Changes in COLA Rate Assumption	4,000	100	4,100
Model Refinements (Net)	-	-	-
Other Assumption Changes	13,500	-	13,500
Net (Gain)/Loss from Changes in Assumptions	69,400	300	69,700
Changes in Experience:			
Changes in Veterans Counts and Status	(10,700)	(100)	(10,800)
Other Experience Changes	-	-	-
Net (Gain)/Loss from Changes in Experience	(10,700)	(100)	(10,800)
Net Actuarial (Gain)/Loss from Current Year Activity	**58,700**	**200**	**58,900**
Liability at September 30, 2011	**$ 1,529,200**	**$ 4,500**	**$ 1,533,700**

14. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $884 million and $879 million as of September 30, 2011, and 2010, respectively. The majority of the unfunded liabilities involve asbestos removal, lead abatement, replacement of underground oil and gasoline tanks, decommissioning of waste incinerators, and decontamination of equipment prior to disposal.

While some facilities have applied prevailing state regulations that are more stringent than Federal guidelines, the Occupational Safety and Health Administration and Environmental Protection Agency regulations are the legal base behind the majority of VA's environmental and disposal liabilities. Estimated liabilities for these projects are based on known contamination that exists today and have been computed by the facility engineering staff based on similar projects already completed, or by independent contractors providing work estimates.

Technical Bulletin (TB) 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, as amended by TB 2011-2, was issued on September 28, 2006, and is effective for periods beginning after September 30, 2012. TB 2006-1 requires all Federal entities that own tangible property, plant, and equipment (PP&E) that contain asbestos to disclose liabilities related to friable and nonfriable asbestos cleanup costs deemed probable, but not reasonably estimable consistent with SFFAS 5, SFFAS 6, and Technical Release No. 2. VA does not believe adoption of the TB requirements will have a material impact on the Net Position and Statements of Net Cost.

15. Other Liabilities

Other liabilities are liabilities not reported elsewhere. They consist of Funded and Unfunded Liabilities. Funded liabilities are generally considered to be current liabilities. Unfunded liabilities are generally considered to be non-current liabilities.

Other Intragovernmental Funded Liabilities
as of September 30,

	2011	2010
Deposit and Clearing Account Liabilities	$ (4)	$ 22
Accrued Expenses - Federal	300	828
Deferred Revenue	33	41
Resources Payable to Treasury	169	177
Custodial Liabilities	187	25
Credit Reform Act Subsidy Reestimates*	64	50
General Fund Receipts Liability	-	6
Accrued VA Contributions for Employee Benefits	111	283
Total Other Intragovernmental Funded Liabilities	$ 860	$ 1,432

* The subsidy amount for each guaranteed loan is reestimated annually to ensure amounts reflect the actual losses on guaranteed loans. Based on the reestimated amounts, additional subsidy funds are provided for or excess funds are returned to Treasury.

Other Intragovernmental Unfunded Liabilities
as of September 30,

		2011		2010
Accrued FECA Liability	$	425	$	415
Unfunded Employee Liability		11		12
Total Other Intragovernmental Unfunded Liabilities	$	436	$	427
Total Other Intragovernmental Liabilities	$	1,296	$	1,859

Other Public Funded Liabilities
as of September 30,

		2011		2010
Accrued Funded Annual Leave	$	19	$	16
Accrued Expenses		4,055		3,348
Accrued Salaries and Benefits		475		1,242
Capital Lease Liability		10		10
Other		96		86
Total Other Public Funded Liabilities	$	4,655	$	4,702

Other Public Unfunded Liabilities
as of September 30,

		2011		2010
Annual Leave*	$	1,797	$	1,733
Amounts due to non-Federal trust		155		161
Judgment Fund-Unfunded**		966		798
Total Other Public Unfunded Liabilities	$	2,918	$	2,692
Total Other Public Liabilities	$	7,573	$	7,394

* Annual leave is accrued when earned and is adjusted at the end of each reporting period to reflect current pay rates of cumulative leave earned but not taken. Sick and other types of leave are expensed as taken.

** The Judgment Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgment Fund on behalf of VA (see Note 18, Contingencies).

16. Leases

VA has both capital and operating leases. The capital lease liability was $10 million as of September 30, 2011, and 2010.

Future commitments for Real Property and Equipment operating leases are based on leases in effect as of September 30, 2011. Due to the number of equipment operating leases and the decentralization of records, the future commitment for equipment leases has been estimated using the amount from 2011 in lieu of actual amounts being available. VA's 2011 operating lease costs were $394 million for real property rentals and $118 million for equipment rentals.

The 2010 operating lease costs were $468 million for real property rentals and $119 million for equipment rentals. The following chart represents VA's projected operating lease commitments or costs for the next five years:

Leases:		
Year	**Real Property**	**Equipment**
2012	235	118
2013	208	118
2014	180	118
2015	157	118
2016	130	118

17. Insurance Programs

Through VA, the Government administers six life insurance programs: the United States Government Life Insurance (USGLI) program, the National Service Life Insurance (NSLI) program, the Veterans Special Life Insurance (VSLI) program, and the Veterans Reopened Insurance (VRI) program, which cover Veterans who served during World War I, World War II, and the Korean Conflict eras, and also the Service-Disabled Veterans Insurance (S-DVI) program and the Veterans Mortgage Life Insurance (VMLI) program, which cover severely disabled Veterans and are open to new issues. VMLI is part of the Veterans Insurance & Indemnities (VI&I) fund.

In addition, VA supervises the Servicemembers Group Life Insurance (SGLI) and the Veterans Group Life Insurance (VGLI) programs, which provide coverage to members of the uniformed armed services, reservists, and post-Vietnam Veterans and their families. All SGLI insureds are automatically covered under the Traumatic Injury Protection (TSGLI) program, which provides for insurance payments to members who suffer a serious traumatic injury in service. VA has entered into a group policy with the Prudential Insurance Company of America to administer these programs.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their spouses are deducted from the Servicemember's pay by the Armed Services components through the Department of Defense (DoD). DoD, through the Defense Finance and Accounting Service (DFAS), remits collected premiums to VA, which are then transmitted to Prudential. Prudential records the premiums and maintains investments in their accounting records separate and independent from the VA reporting entity. VA monitors Prudential's insurance reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. The reserves for the contingent liabilities are recorded in Prudential's accounting records and are not reflected in the VA reporting entity because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy. Prudential administers the TSGLI program under an Administrative Services Only agreement with VA. Under the law, DoD pays for any claim costs for this program in excess of premiums collected.

The Secretary of VA determines the claim costs that are traceable to the extra hazards of duty in the uniformed services, on the basis of the excess mortality incurred by members and former members of the uniformed armed services insured under SGLI, above what their mortality would have been under peacetime conditions. The costs so identified by the Secretary are paid by the uniformed services, not from the Servicemembers' premiums, as are all other programs costs.

The insurance reserves for the administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and VI&I reserves are reported as liabilities not covered by budgetary resources. Reserves for SGLI and VGLI are maintained in Prudential's financial records since the risk of loss is assumed by Prudential and its reinsurers. United States Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.

Actuarial reserve liabilities for the administered life insurance programs are based on the mortality and interest assumptions that vary by fund, type of policy, and type of benefit. The interest assumptions range from 2.25 to 5 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, the 1980 CSO Basic Table, and the 2001 CSO Table.

Insurance Liability (Reserve) Balances
as of September 30, 2011

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 6,187	$ 84	$ 47	$ 6,318
USGLI	8	2	-	10
VSLI	1,528	7	15	1,550
S-DVI	484	6	646	1,136
VRI	227	1	2	230
VI&I	114	-	-	114
Subtotal	$ 8,548	$ 100	$ 710	$ 9,358
Unearned Premiums				65
Insurance Dividends Left on Deposit and Related Interest Payable				1,587
Dividends Payable to Policyholders				101
Unpaid Policy Claims				2
Insurance Liabilities reported on the Consolidated Balance Sheet				11,113
Less Liability not Covered by Budgetary Resources				(1,161)
Liability Covered by Budgetary Resources				$ 9,952

as of September 30, 2010

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	$ 6,753	$ 95	$ 55	$ 6,903
USGLI	10	3	-	13
VSLI	1,550	8	16	1,574
S-DVI	462	5	565	1,032
VRI	251	1	2	254
VI&I	115	-	-	115
Subtotal	$ 9,141	$ 112	$ 638	$ 9,891
Unearned Premiums				70
Insurance Dividends Left on Deposit and Related Interest Payable				1,648
Dividends Payable to Policyholders				121
Unpaid Policy Claims				2
Insurance Liabilities reported on the Consolidated Balance Sheet				11,732
Less Liability not Covered by Budgetary Resources				(1,073)
Liability Covered by Budgetary Resources				$ 10,659

Insurance In-Force

The amount of insurance in-force is the total face amount of life insurance coverage provided by each administered and supervised program as of the end of the fiscal year. It includes any paid-up additional coverage provided under these policies. The supervised programs' policies and face value are not reflected in the VA reporting entity because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy. As a result, the information provided below under the Supervised Programs is for informational purposes only and is unaudited. Prudential and its reinsurers provided coverage to 6,103,250 and 6,132,150 insured for a face value of $1.3 trillion for each year ended September 30, 2011, and 2010, respectively. The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in-force as of September 30, 2011, and 2010. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2011 Policies	2010 Policies	2011 Face Value	2010 Face Value
Supervised Programs				
(UNAUDITED)				
SGLI Active Duty	1,560,000	1,562,000	$ 604,138	$ 602,853
SGLI Ready Reservists	774,500	783,500	271,826	277,400
SGLI Post Separation	88,000	88,000	33,097	33,093
SGLI Family - Spouse	1,128,000	1,149,000	111,320	113,466
SGLI Family - Children	2,126,000	2,123,000	21,260	21,230
TSGLI*	-	-	233,450	234,550
VGLI	426,750	426,650	60,694	58,946
Total Supervised	6,103,250	6,132,150	$ 1,335,785	$ 1,341,538
Administered Programs				
NSLI	665,394	748,895	$ 8,040	$ 8,924
VSLI	158,765	167,320	2,141	2,218
S-DVI	227,887	213,295	2,340	2,179
VRI	27,605	31,425	283	317
USGLI	2,958	3,765	8	11
VMLI	2,395	2,381	179	177
Total Administered	1,085,004	1,167,081	$ 12,991	$ 13,826
Total Supervised and Administered Programs	7,188,254	7,299,231	$ 1,348,776	$ 1,355,364

*TSGLI coverage is a rider attached to SGLI coverage, so policies under SGLI also have TSGLI.

Policy Dividends

The Secretary of VA determines annually the excess funds available for dividend payment. Policy dividends for 2011 and 2010 were $229 million and $273 million, respectively.

18. Commitments and Contingencies

VA is a party in various administrative proceedings, legal actions, and tort claims arising from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice. Certain legal matters to which VA may be a named party are administered and, in some instances, litigated by the Department of Justice. Generally, amounts (more than $2.5 thousand for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award are funded from the Judgment Fund, which is maintained by Treasury. Medical malpractice cases comprised 78 percent of the amounts funded on behalf of VA by the Judgment Fund in 2011 and 2010. Contract dispute payments for 2011 and 2010 were $8.8 million and $5.5 million, respectively. The discrimination case payments for 2011 and 2010 were $4.2 million and $1.1 million, respectively. VA uses accepted actuarial methods to estimate the liability resulting from medical malpractice and other tort claim exposure. VA discounted future estimated payments using U.S. Treasury spot rates as of September 30, 2011, and 2010.

VA has recorded a liability for pending legal claims that are estimated to be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is required or not. This liability was $966 million for 2011 and $798 million for 2010. The contract and personnel law cases where there was at least a reasonable possibility that a loss may occur were 12 cases totaling $69.2 million for 2011 and 14 cases totaling $75.8 million for 2010. VA received an Administrative Claim on January 20, 2011, regarding the alleged use of patented technology for healthcare treatment of Servicemembers and Veterans. The estimated amount or range of the possible liability cannot reasonably be made at this time. VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. Judgment Fund accounting is shown below:

Judgment Fund

For the Years Ended September 30,

		2011		2010
Fiscal Year Settlement Payments	$	96	$	114
Less Contract Dispute and “No Fear” Payments		(13)		(7)
Imputed Financing-Paid by Other Entities		83		107
Increase (Decrease) in Liability for Claims		168		135
Operating Expense	$	251	$	242

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2011, will not materially affect VA's operations or financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. The 2011 tort payments were $83 million and the 2010 tort payments were $107 million.

Any payments due that may arise relating to cancelled appropriations will be paid out of the current year’s appropriations in accordance with the provisions of the Expired Funds Control Act of 1990. The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2011, and 2010 was $96.6 million and $74.3 million, respectively.

VA provides medical care to Veterans on an “as available” basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA’s Secretary makes an annual enrollment decision that defines the Veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled Veterans, and changes in cost. While VA expects to continue to provide medical care to Veterans in future years, an estimate of this amount cannot be reasonably made. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For 2009-2011, the average medical care cost per year was $37 billion.

VA Data Theft Litigation

VA was the subject of a class action lawsuit alleging breach of the Privacy Act, 5 U.S.C 552a (e) (10), in connection with the theft of a laptop computer containing sensitive personal information for approximately 17.5 million Veterans in 2009 that was settled and the claim paid from the Judgment Fund in 2010 in the amount of $20 million.

19. Earmarked Funds

SFFAS 27, *Identifying and Reporting Earmarked Funds*, requires disclosure of all earmarked funds for which VA has program management responsibility. The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, and are required by statute to be used for designated activities or purposes. They are accounted for separately from the Government's general revenues. VA's earmarked funds consist of trusts, special and revolving funds and remain available over time. The "trust" funds do not involve a fiduciary relationship with an individual or group but are designated exclusively for a specific activity, benefit, or purpose. The investments (Treasury Securities) are assets of earmarked funds that are not assets of the Federal Government as a whole and are available for authorized expenditures and are thus assets of the earmarked fund. Treasury Securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund the authority to draw upon the Treasury for future expenditures. When the earmarked fund redeems its Treasury Securities to make expenditures, the Treasury will finance those expenditures in the same manner that it finances all other expenditures.

The VA's Earmarked Funds are as follows:

Earmarked Fund Name	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
Medical Care Collections Fund	36x5287	P.L. 105-33 111 Stat 665	Third-party and patient co-payments for medical services.	Public, primarily insurance carriers.
Cemetery Gift Fund	36x8129	38 U.S.C. 1007	Donations for Veterans cemeteries.	Public donors.
National Service Life Insurance Fund	36x8132	38 U.S.C. 720	Premiums insure WWII Veterans.	Public, Veterans.
Post-Vietnam Era Education Assistance Program	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to Veterans.	Veterans, DoD.
U.S. Government Life Insurance	36x8150	38 U.S.C. 755	Premiums insure WWI Veterans.	Public, Veterans.
Veterans Special Life Insurance Fund	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict Veterans.	Public, Veterans.
General Post Fund, National Homes	36x8180	38 U.S.C. 101-228	Donations for patient benefits.	Public, mostly Veterans.
Canteen Service Revolving Fund	36x4014	38 U.S.C. 78	Operates the canteen services at hospitals.	Revenue from sales.
National Cemetery Administration Facilities Operation Fund	36x5392	P.L. 108-454	Proceeds benefit land and buildings.	Proceeds from leases.
Service-Disabled Veterans Insurance Fund	36x4012	38 U.S.C. 1922	Provides insurance to Veterans with service-connected disabilities.	Public, Veterans.
Servicemen's Group Life Insurance	36x4009	38 U.S.C. 1965	Provides insurance to active duty, ready reservists, retired reservists and cadets attending service academies and ROTC.	Public, Veterans.
Veterans Reopened Insurance Fund	36x4010	38 U.S.C. 1925	Provides insurance to World War II and Korea Veterans.	Public, Veterans.
Enhanced-Use Lease Trusts	N/A	38 U.S.C 8162	Lease underutilized VA property.	Public.

The following tables provide condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances related to Cumulative Results of Operations – Earmarked Funds in the Consolidated Statements of Changes in Net Position:

Balance Sheet – Earmarked Funds as of September 30, 2011	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	$ 45	$ 239	$ 65	$ 1	$ 350
Investments with Treasury	9,948	84	-	-	10,032
Other Assets	478	1,433	-	2	1,913
Total Assets	$ 10,471	$ 1,756	$ 65	$ 3	$ 12,295
Liabilities and Net Position:					
Payables to Beneficiaries	$ 190	$ 33	$ 1	$ -	$ 224
Other Liabilities	11,001	171	-	-	11,172
Total Liabilities	11,191	204	1	-	11,396
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(720)	1,552	64	3	899
Total Liabilities and Net Position	$ 10,471	$ 1,756	$ 65	$ 3	$ 12,295

Statement of Net Cost – Earmarked Funds for the Year Ended September 30, 2011	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Gross Program Costs	$ 1,054	$ 548	$ 2	$ -	$ 1,604
Less Earned Revenues	965	3,371	1	-	4,337
Net Program Costs	89	(2,823)	1	-	(2,733)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost/(Benefit) of Operations	$ 89	$ (2,823)	$ 1	$ -	$ (2,733)

Statement of Changes in Net Position – Earmarked Funds for the Year Ended September 30, 2011	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Net Position Beginning of Period	$ (631)	$ 1,455	$ 65	$ 3	$ 892
Budgetary and Other Financing Sources	-	(2,726)	-	-	(2,726)
Net Cost/(Benefit) of Operations	89	(2,823)	1	-	(2,733)
Change in Net Position	(89)	97	(1)	-	7
Net Position End of Period	$ (720)	$ 1,552	$ 64	$ 3	$ 899

Balance Sheet – Earmarked Funds as of September 30, 2010	Insurance	Medical Care	Benefits	Burial	Total Earmarked Funds
Assets:					
Fund Balance with Treasury	$ 29	$ 249	$ 66	$ 1	$ 345
Investments with Treasury	10,629	82	-	-	10,711
Other Assets	517	1,330	-	2	1,849
Total Assets	$ 11,175	$ 1,661	$ 66	$ 3	$ 12,905
Liabilities and Net Position:					
Payables to Beneficiaries	$ 235	$ 29	$ 1	$ -	$ 265
Other Liabilities	11,571	177	-	-	11,748
Total Liabilities	11,806	206	1	-	12,013
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(631)	1,455	65	3	892
Total Liabilities and Net Position	$ 11,175	$ 1,661	$ 66	$ 3	$ 12,905

Statement of Net Cost – Earmarked Funds for the Year Ended September 30, 2010					
Gross Program Costs	$ 1,263	$ 521	$ 1	$ -	$ 1,785
Less Earned Revenues	988	3,431	1	-	4,420
Net Program Costs	275	(2,910)	-	-	(2,635)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost/(Benefit) of Operations	$ 275	$ (2,910)	$ -	$ -	$ (2,635)

Statement of Changes in Net Position – Earmarked Funds for the Year Ended September 30, 2010					
Net Position Beginning of Period	$ (403)	$ 1,333	$ 65	$ 3	$ 998
Budgetary and Other Financing Sources	47	(2,788)	-	-	(2,741)
Net Cost/(Benefit) of Operations	275	(2,910)	-	-	(2,635)
Change in Net Position	(228)	122	-	-	(106)
Net Position End of Period	$ (631)	$ 1,455	$ 65	$ 3	$ 892

20. Exchange Transactions

Exchange Revenues
Although VA recognizes full cost per SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, VHA has legislated exceptions to the requirement to recover the full cost to the Federal Government of providing services, resources, or goods for sale. Under "enhanced sharing authority," VHA facilities may enter into arrangements that are in the best interest of the Federal Government.

The Office of Financial Policy within VA's Office of Finance established policy requiring a four-part biennial self certification program to be implemented by VHA. The first part of the certification program requires each medical facility to certify whether charges established by VHA are sufficient to recover the full cost of providing services. The second part requires each medical facility to certify that its cost accounting procedures comply with SFFAS 4. Any medical facility with a fully functional Decision Support System (DSS) that produces timely (i.e. current year) data will be able to certify compliance with this requirement. The third part requires each medical facility to certify its compliance with Federal pricing policies and that it has fully disclosed situations where it does not comply with those policies as required by SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. The fourth part requires each medical facility to certify whether its enhanced health care sharing contracts recover full cost or market price as defined in OMB Circular A-25, *User Charges*.

The Management Quality Assurance Service (MQAS) within VA's Office of Business Oversight (OBO) is responsible for reviewing the implementation and execution of the self certification program. Each year MQAS reviews half of the Veterans Integrated Service Networks (VISNs); even VISNs one year and odd VISNs the second year. Generally, one station is selected for review per VISN. MQAS review efforts culminate in a summary report issued to the VHA Chief Financial Officer (CFO) and is distributed to VA senior management including the VA Chief Financial Officer.

Public Exchange Transactions
VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for 2011 and 2010 were $917 million and $877 million, respectively. The loan guarantee lender participation fees collected for 2011 and 2010 were $1.6 million and $1.7 million, respectively.

VA's Loan Guaranty Program collects rental fees on a small number of properties during the period when the property is titled to VA.

NCA leases lodges at nine cemeteries to not-for-profit groups for no fee. These not-for-profit groups are required to provide the upkeep on the lodges and pay the costs for utilities, insurance, minor repairs, maintenance and any other costs associated with the lodges. NCA has agricultural licenses at seven cemeteries to private sector entities, for which it receives rental payments. NCA also leases buildings at two cemeteries, one to a private sector entity for which it receives rental payments, and one to a not-for-profit group that is responsible for the historic preservation of the building at no cost to NCA.

VA's Medical Care Collections Fund, "Conforming Amendments," changed the language of specific sections of 38 USC Chapter 17 to substitute "reasonable charges" for "reasonable cost." The VHA Chief Business Office (CBO) is responsible for implementing and maintaining these reasonable charges for billing third-party payers for services provided to insured Veterans for treatment of nonservice-connected conditions.

Reasonable charges are used to bill for reimbursable health care services, non-federal workers' compensation, tort feasor and no-fault or uninsured motorists insurance cases.

Reasonable charges are based on provider charges in the market area of each VA facility. Under regulations issued pursuant to section 1729 and published at section 17.101, title 38, Code of Federal Regulations, third party payers may elect to pay VA's billed charges (less applicable deductible or co-payment amounts) for the care and services provided to Veterans. Alternatively, third party payers may elect to pay VA an amount, generally known as usual and customary, that it would pay to other providers for care and services in the same geographic area.

Cost-based per diems are calculated annually to produce rates used to bill for medical care or services provided by VA:

(a) in error or on tentative eligibility;
(b) in a medical workers' compensation (other than federal), humanitarian emergency;
(c) to pensioners of allied nations;
(d) for research purposes in circumstances under which VA medical care appropriation is to be reimbursed by VA research appropriation; and
(e) to beneficiaries of the Department of Defense or other federal agencies, when the care or service provided is not covered by an applicable sharing agreement.

These per diem costs are derived primarily from cost and workload data from a national cost allocation report.

Intragovernmental Exchange Transactions
Intragovernmental costs relate to the source of goods and services purchased by VA and not to the classification of related intragovernmental revenue. Classification of revenue and/or costs as "Intragovernmental" or "With the Public" is determined on a transaction by transaction basis for disclosure purposes. Classification of preceding transactions in a product's life cycle will not have an impact on classification of subsequent transactions. The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

VA and DoD have authority to enter into agreements and contracts for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA's General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements, but the total amount billed below full cost is not readily available. VHA is in the process of developing mechanisms to report this information in the future. VBA collects funding from DoD in order to administer certain education programs. DoD transferred $380.0 million and $406.8 million during 2011 and 2010, respectively, for the Post-Vietnam Era Education Assistance Program, Reinstated Entitlements Program for Survivors, and the New GI Bill for Veterans.

When VA furnishes medical care or services for beneficiaries of other federal agencies, and that care or service is not covered by an applicable local sharing agreement, the billing rates used are determined and published annually by the VHA CFO. Similar to the tort rates, interagency billing rates are determined from cost and workload data in the Cost Distribution Report.

21. Net Program Costs by Administration

Schedule of Net Program Costs by Administration

For the Period Ending September 30, 2011 (Dollars in Millions)	Veterans Health Administration	Veterans Benefits Administration	National Cemetery Administration	Indirect Administrative Program Costs	Total
Production Costs					
Intragovernmental Costs	$ 7,719	$ 1,033	$ 31	$ 893	$ 9,676
Less Earned Revenues	(68)	(1,181)	-	(514)	(1,763)
Net Intragovernmental Production Costs	7,651	(148)	31	379	7,913
Public Costs	48,521	66,362	248	3,601	118,732
Less Earned Revenues	(3,651)	(846)	-	(159)	(4,656)
Net Public Production Costs	44,870	65,516	248	3,442	114,076
Net Cost by Administration before changes in Veterans Benefits Actuarial Liabilities	52,521	65,368	279	3,821	121,989
Net (Gain)/Loss on Actuarial Liability Changes	-	58,700	200	-	58,900
Total Net Cost of Operations	$ 52,521	$ 124,068	$ 479	$ 3,821	$ 180,889

Schedule of Net Program Costs by Administration

For the Period Ending September 30, 2010 (Dollars in Millions)	Veterans Health Administration	Veterans Benefits Administration	National Cemetery Administration	Indirect Administrative Program Costs	Total
Production Costs					
Intragovernmental Costs	$ 8,039	$ 362	$ 36	$ 809	$ 9,246
Less Earned Revenues	(165)	(1,145)	-	(534)	(1,844)
Net Intragovernmental Production Costs	7,874	(783)	36	275	7,402
Public Costs	43,726	59,561	238	3,395	106,920
Less Earned Revenues	(3,516)	(913)	-	(138)	(4,567)
Net Public Production Costs	40,210	58,648	238	3,257	102,353
Net Cost by Administration before changes in Veterans Benefits Actuarial Liabilities	48,084	57,865	274	3,532	109,755
Net (Gain)/Loss on Actuarial Liability Changes	-	223,000	800	-	223,800
Total Net Cost of Operations	$ 48,084	$ 280,865	$ 1,074	$ 3,532	$ 333,555

22. Disclosures Related to the Statements of Budgetary Resources

Budgetary Accounting

Budgetary resources, which include new budget authority, unobligated balances, direct spending authority, and obligation limitations, are forms of authority given to VA allowing it to incur obligations. Budget authority is provided by Federal law to enter into financial obligations that will result in immediate or future outlays involving Federal Government funds. Budget authority may be classified by the period of availability (1-year, multiple-year, no-year or available until expended), by the timing of congressional action (current or permanent), or by the manner of determining the amount available (definite or indefinite).

Budget authority from appropriations is the most common form of providing for the specific amount of money authorized by Congress for approved work, programs, or individual projects. Appropriations do not represent cash actually set aside in the Treasury for purposes specified in the appropriation act; they represent amounts that VA may obligate during the period of time specified in the respective appropriation acts. An appropriation may make funds available from the general fund, special funds, or trust funds.

Borrowing authority is budget authority enacted to permit VA to borrow money and then to obligate against amounts borrowed. It may be definite or indefinite in nature. The funds are typically borrowed from the Treasury.

Spending authority from offsetting receipts and collections is budget authority that permits VA to obligate and expend funds from sources that are not appropriated. Offsetting collections are authorized by law to be credited to appropriation or fund expenditure accounts. They result from (1) business-like transactions or market-oriented activities with the public, (2) intragovernmental transfers, and (3) collections from the public that are governmental in nature but required by law to be classified as offsetting. Collections resulting from business-like transactions with the public and other government accounts are also known as reimbursements. Laws authorizing offsetting collections make them available for obligation to meet the account's purpose without further legislative action.

Offsetting collections include reimbursements, transfers between federal and trust fund accounts, offsetting governmental collections, and refunds. For accounting purposes, earned reimbursements are also known as revenues. These offsetting collections are netted against gross outlays in determining net outlays from such appropriations.

Offsetting receipts are collections that are offset against gross outlays but are not authorized to be credited to expenditure accounts. Offsetting receipts are deposited in receipt accounts. Like offsetting collections, they result from (1) businesslike transactions or market oriented activities with the public, (2) intragovernmental transfers, and (3) collections from the public that are governmental in nature but required by law to be classified as offsetting receipts.

The Status of Budgetary Resources reflects the obligations incurred, the unobligated balances at the end of the period that remain available, and unobligated balances at the end of the period that are unavailable except to adjust or liquidate prior year obligations. Unobligated balances currently unavailable may become available subject to apportionment by OMB and allotment by VA.

Apportionments are distributions made by OMB of amounts available for obligation in an appropriation or fund account.

Apportionments divide amounts available for obligation by specific time periods (usually quarters), activities, projects, objects, or a combination thereof. The amounts so apportioned limit the amount of obligations that may be incurred.

Upon apportionment and allotment, obligations can be incurred. Obligations represent a commitment that creates a legal liability for VA to pay for goods and services ordered or received, or a legal duty on the part of VA that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of VA. An obligation is the amount of orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payments during the same or future period. Obligational authority is an amount carried over from one year to the next if the budget authority is available for obligation in the next fiscal year. Not all obligational authority that becomes available in a fiscal year is obligated and paid out in that same year. Balances are described as (1) obligated, (2) unobligated, or (3) unexpended.

An obligated balance is the amount of obligations already incurred for which payment has not yet been made, including undelivered orders and other unliquidated obligations. Budget authority that is available for a fixed period expires at the end of its period of availability, but the obligated balance of the budget authority remains available to liquidate obligations for 5 additional fiscal years. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled.
An unobligated balance is the portion of obligational authority that has not yet been obligated. For an appropriation account that is available for a fixed period, the budget authority expires after the period of availability ends but its unobligated balance remains available for 5 additional fiscal years for recording and adjusting obligations properly chargeable to the appropriations period of availability such as to record previously unrecorded obligations or to make upward or downward adjustments in previously recorded obligations, such as contract modifications properly within scope of the original contract. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled.

Unexpended balance represents the sum of the obligated and unobligated balances.

Outlay is the amount of checks, disbursement of cash, or electronic transfer of funds to liquidate a Federal obligation. Outlays also occur when interest on the Treasury debt held by the public accrues and when the Government issues bonds, notes, debentures, monetary credits, or other cash equivalent instruments in order to liquidate obligations. Under the Credit Reform Act, the credit subsidy cost is recorded as an outlay when a direct or guaranteed loan is disbursed. Outlays during a fiscal year may be for payment of obligations incurred in prior years (prior-year obligations) or in the same year.

The caption, Budget Authority - Appropriations Received under Budgetary Resources in the Combined Statements of Budgetary Resources, does not agree to caption Budgetary Financing Sources – Appropriations Received in the Consolidated Statements of Changes in Net Position. The amount in the Combined Statement of Budgetary Resources includes appropriations from the General Fund and Special Receipt Funds, while the Consolidated Statements of Changes in Net Position includes appropriations from the General Fund only.

The caption, Spending Authority from Offsetting Collections – Earned under Budgetary Resources in the Combined Statement of Budgetary Resources, does not agree to caption Earned Revenue in the Consolidated Statements of Net Cost. The amount in the Combined Statement of Budgetary Resources includes Credit Reform subsidies for interest, fees and principal as required by Treasury reporting requirements, while the Consolidated Statements of Net Cost includes interest only.

Apportionment Categories of Obligations Incurred: Direct vs. Reimbursable Obligations
Years Ended September 30,

Category A, Direct consists of amounts requested to be apportioned by each calendar quarter in the fiscal year. Category B, Direct consists of amounts requested to be apportioned on a basis other than calendar quarters, such as activities, projects, objects, or a combination of these categories.

	2011	2010
Category A, Direct	$ 68,345	$ 62,594
Category B, Direct	61,707	56,540
Reimbursable	5,247	5,285
Total Obligations	$ 135,299	$ 124,419

Prior Year Recoveries

Prior year recoveries consist of cancellations or downward adjustments of obligations incurred in prior fiscal years and recoveries of prior year paid obligations (i.e., cash refunds). Anticipated resources are required to be apportioned by OMB before they can be used. Once apportioned by OMB, they have to be allotted back down to the appropriate facilities or specific program offices. This authority cannot be used until funds are deobligated or refunded and realized. These adjustments relate primarily to multi-year and no-year appropriations.

VA's systems require modification to properly account for the prior year recoveries as provided by Treasury and the guidance in the Treasury Financial Manual. VA has begun a technical assessment to determine specific requirements for systems modifications. When an automated systems solution is implemented, VA will be enabled to properly identify prior year recoveries, systematically monitor reapportioned budget authority and track both for internal and external financial reporting.

Borrowing Authority

Loan Guaranty had borrowing authority of $1.47 billion and $1.5 billion as of September 30, 2011, and 2010, respectively. The interest rates on the borrowing authority range from 1.00 to 7.58 percent for 2011 and range from 2.00 to 7.58 percent for 2010. Principal repayment is expected over a 30-year period from the date of issuance of debt. Direct Loans under the Vocational Rehabilitation Program had borrowing authority of $3.05 million and $2.7 million as of September 30, 2011, and 2010, respectively. The interest rates on the borrowing authority were 1.00 to 1.49 percent for 2011 and ranged from 1.07 to 4.12 percent for 2010. Principal repayment is expected over a 2-year period from the date of issuance of debt. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to housing trusts. The Vocational Rehabilitation loans generally had a duration of one year, and repayment was made from offsetting collections.

Adjustments to Budgetary Resources
During 2011, $8 million was recovered from prior year obligations. For 2011, VA appropriations were subjected to a rescission of $384.3 million under the provisions of P.L. 112-10, *The Department of Defense and Full-Year Continuing Appropriations Act, 2011*.

Permanent Indefinite Appropriations
VA has four housing benefit programs that have permanent and indefinite appropriations to cover unexpected losses.

Use of Unobligated Balances of Budget Authority
Available unobligated balances on the Statement of Budgetary Resources (SBR) are comprised of current fiscal year apportioned funds for annual, multi-year, and no-year appropriations from Congress as well as revolving and trust funds. Other balances not available are comprised of unobligated funds that were not apportioned by OMB for 2011 use and expired appropriation unobligated amounts, which generally are not available for new obligations, but can be used to increase existing obligations under certain circumstances.

Unobligated VA funds are available for uses defined in VA's 2011 Appropriation Law (P.L. 112-10). These purposes include: Veteran's medical care, research, education, construction and maintenance of VA buildings, Veterans and dependents benefits, Veterans life insurance, loan guaranty programs, Veterans burial benefits, and administrative functions. Various obligation limitations are imposed on individual VA appropriations.

Explanation of Differences between the Statement of Budgetary Resources and the Budget of the US Government
Obligations were increased by $20.3 million for 2011 on the Combined Statement of Budgetary Resources to reverse the adjustment recorded in 2010 which was also not reflected in the FACTS II data used to prepare the President's Budget. No other differences were identified as of the preparation date of the financial statements.

Undelivered Orders at the End of a Period
The amount of budgetary resources obligated for undelivered orders at the end of 2011 and 2010 was $10.5 billion and $9.3 billion, respectively.

Contributed Capital
The amount of contributed capital received during 2011 consisted of donations in the amount of $48.8 million to the General Post Fund and $0.2 million to the National Cemetery Gift Fund. For 2010 $59.8 million was donated to the General Post Fund and $0.3 million to the National Cemetery Gift Fund.

23. Reconciliation of Net Cost of Operations to Budget

The objective of the information shown below is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and non-budgetary resources available to VA with its net cost of operations.

DEPARTMENT OF VETERANS AFFAIRS RECONCILIATION OF NET COSTS OF OPERATIONS TO BUDGET for the Years Ended September 30,	2011	2010
Resources Used to Finance Activities		
Obligations Incurred	$ 135,299	$ 124,419
Less Spending Authority from Offsetting Collections and Adjustments	(9,643)	(8,858)
Obligations Net of Offsetting Collections and Adjustments	125,656	115,561
Less Offsetting Receipts	(3,320)	(3,689)
Net Obligations	122,336	111,872
Donations of Property	26	37
Transfers-out	-	-
Imputed Financing	1,978	1,601
Other Financing Sources	(409)	(309)
Total Resources Used to Finance Activities	**123,931**	**113,201**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(1,067)	(1,909)
Resources that Finance the Acquisition of Assets	(7,339)	(7,646)
Resources that Fund Expenses Recognized in Prior Periods	(2,190)	(1,178)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	4,708	4,535
Other	-	-
Total Resources that Do Not Fund Net Cost of Operations	(5,888)	(6,198)
Total Resources Used to Finance the Net Cost of Operations	**118,043**	**107,003**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	64	78
Increase (Decrease) in Environmental and Disposal Liability	5	(5)
Reestimates of Credit Subsidy Expense	1,242	1,129
Increase in Exchange Revenue Receivable from the Public	(342)	(528)
Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities	59,252	224,308
Depreciation and Amortization	1,880	1,378
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	590	676
Loss on Disposition of Assets	111	171
Other	44	(655)
Total Costs That Do Not Require Resources in the Current Period	**62,846**	**226,552**
Net Cost (Benefit) of Operations	**$ 180,889**	**$ 333,555**

24. Reclassifications

Intragovernmental Revenues

In 2011, as a result of a corrective action plan to resolve VA's intragovernmental reporting deficiencies, VA identified and corrected the misclassification of certain revenue accounts from Federal to Non-Federal Revenues. These revenue accounts relate to Supply Fund and Franchise Fund rebates, usage fees and funding fees earned and collected from non-Federal entities, refunds of MCCF collections to the original paying individual or organization and contractual adjustments and uncollectible amounts from Medicare or insurance companies related to Medicare equivalent adjustments. The reclassifications had no impact on the Consolidated Statements of Net Cost for 2011 or 2010. However, the net effect on 2010 of reclassifying revenues between Federal Revenues and Public Revenues disclosed in Note 21 was to increase Federal Revenues and decrease Public Revenues by $147 million as the reclassifications primarily affected contractual adjustments and uncollectible revenue accounts.

Insurance Liabilities

Accrued Interest Payable on Insurance Policies of $44 million for 2010 was reclassified from Public Accounts Payable to Insurance Liabilities to conform to the 2011 presentation of the Consolidated Balance Sheet. The reclassification had no other effect on the Consolidated Financial Statements.

VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS

Department of Veterans Affairs

Audit of VA's Consolidated Financial Statements for Fiscal Years 2011 and 2010

November 10, 2011
11-00343-26

Department of Veterans Affairs

Memorandum

Date: November 10, 2011

From: Assistant Inspector General for Audits and Evaluations (52)

Subj: Audit of VA's Consolidated Financial Statements for Fiscal Years 2011 and 2010

To: Secretary of Veterans Affairs (00)

1. We contracted with the independent public accounting firm, Clifton Gunderson LLP, to audit VA's consolidated financial statements as of September 30, 2011 and 2010, and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of Clifton Gunderson LLP's audit are presented in the attached reports.

2. Clifton Gunderson LLP provided an unqualified opinion on VA's fiscal year 2011 and 2010 consolidated financial statements. With respect to internal control, Clifton Gunderson LLP identified one material weakness, information technology security controls, which is a repeat condition. They also reported two significant deficiencies, accrued operating expenses, which is a repeat condition, and loan guaranty reporting. The department has taken corrective actions sufficient to eliminate four other significant deficiencies previously cited last year.

3. Clifton Gunderson LLP reported that VA did not substantially comply with the Federal financial management systems requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. They also noted instances of non-compliance with the Debt Collection Improvement Act of 1996.

4. Clifton Gunderson LLP is responsible for the attached auditor's reports dated November 10, 2011, and the conclusions expressed in the reports. We do not express opinions on VA's financial statements, internal control, or compliance with FFMIA. We also do not express conclusions on VA's 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 fiscal year 2012 audit of VA's consolidated financial statements.

Belinda J. Finn

BELINDA J. FINN

Attachments

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the accompanying consolidated balance sheets of the Department of Veterans Affairs (VA) as of September 30, 2011 and 2010, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources for the years then ended. 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 applicable provisions of Office of Management and Budget 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2011 and 2010, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the consolidated financial statements, management adopted Statement of Federal Financial Accounting Standards No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuation Dates* in 2010, which required a change in its policy for calculating the actuarial liability for Veterans benefits.

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In accordance with *Government Auditing Standards,* we have also issued our reports dated November 10, 2011, on our consideration of VA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, not to provide an opinion on internal control over financial reporting or compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

All other information exclusive of the consolidated financial statements, MD&A, RSSI and RSI listed in the table of contents is presented for additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2011

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control Over Financial Reporting

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2011, and have issued our report thereon dated November 10, 2011. 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 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered VA's internal control over financial reporting by obtaining an understanding of the design effectiveness of internal controls, determined whether these controls had been placed in operation, assessed control risk, and performed tests of controls 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 VA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of 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 deficiencies, significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described below in Section 1 to be material weaknesses in internal control over financial reporting.

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A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below in Section 2 to be significant deficiencies.

SECTION 1 – MATERIAL WEAKNESS

1. Information Technology (IT) Security Controls (Repeat Condition)

The VA relies on extensive Information Technology (IT) systems to administer benefits to Veterans. Internal controls over these operations are essential to ensure the integrity, confidentiality, and reliability of critical data while reducing the risk of errors, fraud and other illegal acts. Our review of IT controls covered general and selected business process application controls. As noted in prior years' audits, VA continues to have weaknesses in Security Management, Access Controls, Segregation of Duties, Configuration Management and Contingency Planning controls designed to protect mission-critical systems from unauthorized access, alteration, or destruction.

This year VA made some incremental improvement in control activities supporting the segregation of duties within the Integrated Funds Distribution, Control Point Activity, Accounting and Procurement (IFCAP) module of the Veterans Health Information Systems and Technology Architecture (VistA) and supporting its compliance with OMB Memorandum M-08-22, *Guidance on the Federal Desktop Core Configurations (FDCC).* However, more improvement is needed.

Our current year audit identified that while weaknesses were corrected in some locations, they still continue to exist in other areas. This is evidenced by the continued existence of previously identified IT weaknesses at VA facilities. Many of these weaknesses may be attributed to ineffective implementation and enforcement of an agency-wide information security program and ineffective communication from VA management to the individual field offices. VA needs to improve its monitoring process to ensure controls are operating as intended and communicate the results of the monitoring process to the appropriate personnel to implement corrective actions.

Our assessment of the general and application controls of VA's key IT infrastructure and financial systems identified the following conditions:

Conditions:

Security Management

- Security management documentation, including the risk assessments, system security plans, and memoranda of understanding/information security agreements, were outdated and did not accurately reflect the current system environment or federal standards.
- Background reinvestigations were not being performed timely and personnel were not receiving the proper level of investigation for their position sensitivity levels.

- Plans of Actions and Milestones (POA&M) were not updated in a timely manner, milestones were frequently missed, and supporting documentation was not adequate to support closure of POA&Ms.
- Definitive guidance on role-based training requirements was not provided by the Office of Information and Technology (OI&T), which resulted in specialized training for IT personnel not being consistently performed. In addition, security awareness and privacy training for employees was not consistently performed.

Access Controls

- Reviews of user accounts and proper completion of user access requests were not consistently performed to eliminate conflicting roles and enforce the principle of least privilege.
- Inconsistent reviews of financial application user access resulted in numerous generic, system, and inactive user accounts that were not removed from the system and users with access rights that were not appropriate.
- Password standards were not consistently implemented and enforced across multiple VA systems including the network domain, databases, and key financial applications. In addition, multi-factor authentication for remote access had not been implemented across the agency.
- Timely remediation of security and privacy incidents was not consistently performed.

Segregation of Duties

- Some users within key financial applications had excessive rights or conflicting roles assigned within the systems.

Configuration Management

- Change control policy and procedures for authorizing, testing and approval of system changes were not consistently implemented for the VistA, Insurance Payment System, Veterans Insurance Claims Tracking and Reporting System, VALERI and iSeries and CLASS applications.
- Systems were not patched or securely configured to mitigate known and unknown information security vulnerabilities.
- Baseline configurations, including implementation of the Federal Desktop Core Configuration, were not consistently implemented to mitigate significant system security risks and vulnerabilities across the facilities and data centers.

Contingency Planning

- VA contingency plan policy did not contain explicit and consistent guidance regarding the testing of contingency plans.
- Contingency Plan documentation was outdated and the testing of contingency plans at selected facilities and data centers was not routinely performed.

Criteria:

OMB Circular A-130, Appendix III, *Security of Federal Automated Information Resources*, states that “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.”

The Federal Information Security Management Act of 2002 (FISMA) requires that each agency develop an agency-wide information security program that includes:

- Periodic assessments of risk, including the magnitude of harm that could result from the unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems that support the operations and assets of the organization;
- Policies and procedures that are based on risk assessments, cost-effectively reduce information security risks to an acceptable level and address information security throughout the life cycle of each organizational information system;
- Plans for providing adequate information security for networks, facilities, information systems, or groups of information systems, as appropriate;
- Security awareness training to inform personnel of the information security risks associated with their activities and their responsibilities in complying with organizational policies and procedures designed to reduce these risks;
- Periodic testing and evaluation of the effectiveness of information security policies, procedures, practices, and security controls to be performed with a frequency depending on risk, but no less than annually;
- A process of planning, implementing, evaluating, and documenting remedial actions to address any deficiencies in the information security policies, procedures, and practices of the organization;
- Procedures for detecting, reporting, and responding to security incidents; and
- Plans and procedures for continuity of operations for information systems that support the operations and assets of the organization.

Cause:

The dispersed locations, the continued reorganization, and the diversity in applications have impacted facilities and management’s ability to effectively address and reduce the number of prior year IT deficiencies. For example, VA lacks a coherent financial system architecture, which has resulted in the lack of common controls and maintenance of IT systems. VA continues to be challenged with the consistent and proactive enforcement of the established policies and procedures throughout its geographically dispersed portfolio of legacy applications and newly implemented systems. The continued reorganization of components within the VA, such as the centralization of the data centers and the shift of control from the Medical Center level to the Veterans Integrated Service Network (VISN) level and from the Regional Office level to the Network Service Center level has caused delays in communication with personnel throughout the VA.

Effect:

By not effectively documenting, implementing and enforcing IT policies and procedures, there is an increased risk that financial and personally identifiable information may be inadvertently or deliberately misused and may result in improper disclosure or theft without detection. Additionally, inappropriate or unnecessary changes may be made to key financial information systems, which could result in misstated financial information. Finally, inadequate contingency plan testing increases the risk that VA would not be able to recover systems and data in a timely manner and could have an adverse effect on financial processes.

Recommendations:

The Assistant Secretary for Information and Technology should continue to analyze and prioritize remediation efforts to accomplish security and control objectives. Key tasks should include, but are not limited to:

- Review and update security documentation, including risk assessments, system security plans, and memoranda of understanding/information security agreements on at least an annual basis to ensure all required information is included and accurately reflects the current environment, new risks, and federal standards.
- Develop and implement a process to ensure that facilities or Human Resource personnel track reinvestigations for employees and contractors in high risk positions and the Security Investigation Center (SIC) initiates all reinvestigations. Additionally, develop and implement a process for the facilities or Human Resource personnel to accurately and timely report any change in position sensitivity level to the SIC.
- Segregate national POA&Ms from the facility-level POA&Ms and implement a process to review, update and remediate national POA&Ms in a timely manner.
- Implement a process to review, update and remediate facility-level POA&Ms in a timely manner and ensure that closed POA&Ms are adequately supported with appropriate documentation.
- Provide definitive guidance on specific role-based training requirements for personnel with specialized security responsibilities and ensure that appropriate IT personnel receive specialized security training and retain documentation of completed training.
- Develop and implement a process to ensure that all personnel complete the annual VA Privacy and Information Security Awareness Training and retain documentation of completed training.
- Ensure the proper completion and retention of the user access request forms to include proper authorizations prior to system access being granted.
- Implement a process for the periodic review of network and financial applications to identify and remove generic and inactive accounts on systems and networks and recertify that access remains appropriate and restricted to necessary personnel.
- Establish and implement a process to be in compliance with VA policy for password and security configuration baselines on the domain controls, operating systems, databases, applications and network devices.
- Complete the implementation of two-factor authentication for remote access throughout the agency.
- Implement a process to ensure the timely follow-up and resolution of security and privacy incidents. Implement controls to enforce appropriate segregation of duties

principles and eliminate conflicting user access roles and permissions for key financial applications.
- Establish and implement change control procedures to ensure the consistent approval and testing during development and implementation of changes to VA financial applications.
- Establish and implement a process to ensure that systems, including network devices, servers, and databases are patched, updated and maintained at vendor recommended version levels.
- Establish and implement a process to ensure that workstations are patched, updated and configured to minimize security risks and are in compliance with Federal Desktop Core Configuration requirements.
- Review and update existing contingency planning procedures to provide more explicit guidance, communication and coordination of contingency testing activities. In addition, enforce procedures for the annual review and update of contingency plans.
- Implement processes to ensure information security contingency plans are fully tested at the alternate processing facilities on an annual basis.

SECTION 2 – SIGNIFICANT DEFICIENCIES

1. Accrued Operating Expenses (Repeat Condition)

Conditions:

In order to calculate, record, and track estimates for accrued services payable on nearly 175,000 unpaid obligations each month, VA employs a system generated accrual code at the time of obligation. When this “accrual flag” code is applied, FMS calculates a straight-line estimate of costs incurred under the obligation based on the recorded end date of the obligation’s period of performance, and after subtracting payments made to date, records an automatic accrual entry at the end of each month. Although VA improved compliance with its policy over the use of the accrual flag in FY2011, VA does not perform any validation review to ensure the methodology provides a materially accurate liability estimate throughout the year.

During our statistically based sample testing of accrued expenses for intragovernmental obligations we found that the actual amount of services performed as of September 30 was different from the estimate accrued for 6 sample items. The projected value of the error to the balance of accrued expenses – Federal was an overstatement of approximately $174 million.

During our statistically based sample testing of accrued expenses for non-federal obligations we found numerous errors including: 1) the end date of the period of performance was not accurate or was not updated for three sample items; 2) the actual amount of services performed as of September 30 were less than the accrued amount for 11 sample items; 3) a large pharmaceutical contract was accrued as management expected the delivery by September 30, however the delivery was not made until October; and 4) six obligations were found to be under accrued. The projected value of the error to the balance of accrued expenses – public was an overstatement of approximately $576 million.

Criteria:

Statement of Federal Financial Accounting Standards (SSFAS) No. 1, *Accounting for Selected Assets and Liabilities*, states, "Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities." SFFAS No. 1 continues, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of goods. If invoices for these goods are not available when the financial statements are prepared, the amounts owed should be estimated."

OMB Circular A-123, *Management Responsibility for Internal Controls*, 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:

Although the methodology should provide an overall reasonable estimate of accrued expenses, the methodology accrues a full month of service cost in the month the obligation is recorded. VA records many new large obligations at the end of the last month of the fiscal year where the actual amount of services performed in September is minimal.

Program managers are not always properly recording or updating the end date of the obligations in FMS.

Effect:

Without an effective review and validation process, VA's estimates of its accrued expense liability may be significantly misstated. The accompanying financial statements have not been corrected for the effect of these errors. We were able to perform sufficient testing to ensure the net impact of these errors was not material to the financial statements as a whole.

Recommendation:

VA should reevaluate the accrual flag system methodology based on the actual cost patterns to ensure the resulting accruals are materially consistent with actual costs. VA should also develop procedures to periodically review the largest open obligations and ensure the reasonableness of the accrued liability to be recorded in FMS.

2. Loan Guaranty Reporting

Condition:

VBA's Home Loan Guaranty Program helps veterans by insuring Veteran's home mortgage loans. VBA uses the Veterans Housing Model (model) to produce budget formulation, reestimate, and Financing Account Interest Calculator (FAIC) cash flows for four of its Housing programs—the Loan Guaranty Program (GL), the Direct Vendee Loan Portfolio (VL), the Direct

Acquired/Refunded Loan Portfolio (AL), and the Guaranteed Loan Sale Securities Account (LS). The model is also used to support certain estimated balances reported in the financial statements, including the liability for loan guarantee, and the allowance for subsidy for direct and defaulted guaranteed loans.

VA does not adequately monitor and review the loan guarantee modeling process and resulting financial statement balances. During our audit, we noted:

- An error in the model's methodology for discounting future cash flows from direct loans and defaulted guaranteed loans, resulting in a misstatement in the allowance for subsidy of $654 million.
- VA did not properly consider current trends in sales proceeds related to foreclosed property from loan guarantees in determining the proper allowance for subsidy. We estimated a potential misstatement in the allowance of $216 million.
- The model was not effectively calibrated to reflect the impact of the current housing crisis, which increases the risk of understating the liability for loan guarantee.

Criteria:

OMB Circular A-123, *Management Responsibility for Internal Controls*, 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.

Federal Financial Accounting and Auditing Technical Release 6*: Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act-* Amendments to Technical Release No. 3 *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*, states in part:

> *Preparing reliable and timely direct loan and loan guarantee subsidy estimates must be a joint effort between the budget, CFO and program offices at each agency. These offices should work together to ensure that the procedures and internal control outlined in this section are implemented and operating as designed.*
>
> *Agencies must accumulate sufficient relevant and reliable data on which to base cash flow projections. It is important to note that agencies should prepare all estimates and reestimates based upon the best available data at the time the estimates are made.*

Cause:

VA's current financial monitoring and internal review procedures do not include a detailed review of the Home Loan Guaranty modeling processes and resulting financial balances due to the complexity of the modeling process and accounting requirements.

VA does not have a structured program to compare actual program performance against model forecasts which could identify material deficiencies in model design or performance.

VA's model uses a static long term house price appreciation assumption, and does not incorporate other loan specific variables (e.g. debt-to-income and loan-to-value ratios) which could result in a more predictive model.

Effect:

VA may not be accurately presenting the current condition and expected performance of the Loan Guaranty Program.

Except for the $654 million error in the allowance for subsidy for vendee and acquired loans, the accompanying financial statements have not been adjusted to reflect these errors. We were able to perform sufficient testing to ensure the net impact of these errors was not material to the financial statements as a whole.

VA's credit subsidy rates may not be accurate or fully reflect the differences in performance caused by the impact of the different economic environments during each cohort.

Recommendations:

We recommend the Under Secretary for Benefits:

- Develop policies regarding the review of financial balances and the underlying support in connection with the quarterly financial reporting process.
- Develop and implement control procedures to perform a detailed mid-year analytical review and validation of all Housing Model assumptions and outputs against actual results.
- Develop a management review process specific for the model to assess the model forecasts against historical results for reasonableness.
- Document management's review and approval of the assumptions and outputs developed in connection with the subsidy estimation.
- Consider the benefits of incorporating loan level variables into the model to reflect changes in portfolio attributes over time.
- Incorporate dynamic house price forecast data rather than the historical average as a variable to the model.

STATUS OF PRIOR YEAR'S CONTROL DEFICIENCIES

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have reviewed the status of VA's corrective actions with respect to the findings and recommendations included in the prior year Independent Auditor's Report on Internal Control over Financial Reporting dated November 10, 2010.

The prior year report identified a material weakness in the area of Information Technology Security Controls. While VA has made some incremental progress on this material weakness, it is repeated as a material weakness this year.

****

We also noted certain other nonreportable matters involving internal control over financial reporting that we will communicate in a separate letter to VA management.

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

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2011

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance and Other Matters

To the Secretary
and Inspector General
Department of Veterans Affairs

We have audited the financial statements of the Department of Veterans Affairs (VA) as of and for the year ended September 30, 2011, and have issued our report thereon dated November 10, 2011. 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 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of VA is responsible for complying with laws and regulations applicable to the VA. As part of obtaining reasonable assurance about whether VA's financial statements are free of material misstatements, we performed tests of VA's compliance with certain provisions of laws and regulations, 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 07-04, as amended. We limited our tests of compliance to those provisions and we did not test compliance with all laws and regulations applicable to VA. Providing an opinion on compliance with certain provisions of laws and regulations 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 of compliance with laws and regulations described in the preceding paragraph disclosed no instances of reportable noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin 07-04, as amended.

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether the financial management systems used by VA substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

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The objective of our audit was not to provide an opinion on compliance with FFMIA. Accordingly, we do not express such an opinion. However, except for matters described below, where VA did not substantially comply with applicable Federal financial management systems requirements, the results of our work disclosed no other instances in which VA's financial management systems did not substantially comply with Federal accounting standards and the United States SGL at the transaction level.

1. Non-compliance with FFMIA

Financial Management Systems

We have concluded that VA's financial management systems do not substantially comply with the Federal financial management systems requirements as required by FFMIA Section 803(a) for the following reasons:

- As reported in our report on internal control over financial reporting, VA has a material weakness over "Information Technology (IT) Security Controls". This is a repeat finding.

- Although VA has made significant progress in remediating significant deficiencies, VA continues to have two significant deficiencies in internal control over financial reporting, one of which is a repeat finding.

- VA's underlying financial systems are complex and disjointed legacy applications and operating platforms. VA lacks a coherent financial system architecture that controls financial transactions from their initiation to their summarization and presentation in the financial statements. As a result, certain financial statement line items may not be readily re-created and supported by audit trails of detailed financial transactions. Not all current interfaced systems can be readily accessed and used without extensive manipulation, and manual processing and reconciliation. Some examples of issues we found include:

  - VBA's subsidiary ledgers (VETSNET and BDN) have reconciliation issues with the general ledger (FMS). We noted an $83.7 million difference at year-end between the subsidiaries and general ledger related to receivables.

  - The VBA systems are not fully integrated and the coding of the transaction level activity is not always accurate. Due to a previous lack of an automated interface between VETSNET and FMS, we noted a manual adjustment amount of $41.1 billion to reclassify incorrect manual budget coding. This adjustment relates to activity that occurred prior to the VETSNET to FMS interface that began in June 2010. Although this reconciling item did not affect the financial statement amounts, additional effort was expended to rectify the budget coding error. Prior to the automatic interface between VETSNET and FMS, VBA (through the Hines Finance Center) used certain VETSNET accounting transactions to manually back out cash activity from VETSNET and then manually post that activity to FMS. This manual work around, coupled with ongoing FMS and VETSNET coding issues caused the reconciling items.

- The BDN system is not designed to keep a complete history of education benefit related transactions. Detail transaction data on Chapter 34 and 35 education benefit expense could not be retrieved.

- The fixed asset system (FAS) can not readily provide reports on additions, deletions or current depreciation to support effective and efficient reconciliation of account balances and the investigation of discrepancies.

2. Non-compliance with Debt Collection Improvement Act

Condition:

We tested various sample transactions for compliance with the Debt Collection Improvement Act of 1996 (DCIA), and noted the following exceptions:

- 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, for 86 sample items out of a total of 90 sample selections tested, VBA did not charge interest or administrative costs on delinquent payments from veterans related to certain receivables for Compensation, Pension, and Education.

Criteria:

Public Law 96-466 and Title 38 U.S.C § 501(a) and §5315, and 38 CFR 1.919 require VA to charge interest and administrative costs on any amount owed to the United States.

Cause:

This has been a long standing issue and is based on a former VA Deputy Secretary's instruction in July 1992, that VA not charge interest or administrative costs on veteran debts.

Effect:

VA is noncompliant with the Debt Collection Improvement Act of 1996.

Recommendation:

We recommend that VA:

- Implement policies and procedures to assess applicable interest and administrative costs or propose a legislative remedy to request a waiver of these requirements.

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

Clifton Gunderson LLP

Calverton, Maryland
November 10, 2011

Department of Veterans Affairs

Memorandum

Date: NOV 10 2011

From: Executive in Charge, Office of Management, and Chief Financial Officer (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2011 and 2010

To: Assistant Inspector General for Audits and Evaluations (52)

1. The Office of Management has reviewed the Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2011 and 2010, and we are pleased with the receipt of an unqualified opinion. We are also pleased that we met the 2011 reporting timeline established by the Office of Management and Budget. Please extend to your staff and the staff of Clifton Gunderson, LLP our appreciation for their detailed planning, hard work, and cooperation during this year's audit.

2. VA senior officials and applicable program managers are aware of the unqualified audit opinion. As a result of the dedicated efforts of staff throughout the Department, only one material weakness remains. We will continue to focus on completing corrective actions as detailed in the remediation plans for the one remaining material weakness, Information Technology (IT) Security Controls. For this repeat material weakness, the existing remediation plans will be revised and expanded, as needed, to address the findings and recommendations in your audit report.

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

W. Todd Grams

Required Supplementary Stewardship Information

These materials are not audited
(dollars in millions, unless otherwise noted)

1. Non-Federal Physical Property

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

Grant Program Costs Years Ended September 30,	2011	2010	2009	2008	2007
State Extended Care Facilities	$ 54	$ 242	$ 163	$ 162	$ 138
State Veterans Cemeteries	44	49	40	37	46
Total Grant Program Costs	$ 98	$ 291	$ 203	$ 199	$ 184

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day health care for Veterans, and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, hospital, and day health care for Veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last five fiscal years, the State Home Construction Grant Program has awarded grants in excess of $759 million. VA also provides per diem payment for the care of eligible Veterans in state homes.

Since, the cemetery program was established in 1980, VA has awarded grants totaling more than $482 million to 47 states and territories. The program provides up to 100 percent of the cost to establish, expand, or improve state or tribal Veterans cemeteries. State organizations provide the land and agree to operate the cemeteries.

2. Human Capital

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

Veterans and Dependents Education		
Years Ended September 30,		
	2011	**2010**
Program Expenses		
Education and Training-Dependents of Veterans	$ 567	$ 477
Vocational Rehabilitation and Education Assistance	11,259	9,031
Administrative Program Costs	370	348
Total Program Expenses	$ 12,196	$ 9,856
Program Outputs (Participants)		
Dependent Education	96,078	81,974
Veterans Rehabilitation	81,097	77,176
Veterans Education	822,808	634,038

Veterans and Dependents Education		
Years Ended September 30,		
	2009	**2008**
Program Expenses		
Education and Training-Dependents of Veterans	$ 464	$ 451
Vocational Rehabilitation and Education Assistance	4,393	3,102
Administrative Program Costs	304	251
Total Program Expenses	$ 5,161	$ 3,804
Program Outputs (Participants)		
Dependent Education	82,345	80,409
Veterans Rehabilitation	72,803	68,826
Veterans Education *	822,738	459,594

*Due to the implementation of the new Post 9/11 GI Bill during 2009, total participants in the Veterans Education Program for 2009 may include two records for a single participant who switches from the Montgomery GI Bill (MGIB) to the Post-9/11 GI Bill mid-year.

Veterans and Dependents Education	
Years Ended September 30,	
	2007
Program Expenses	
Education and Training-Dependents of Veterans	$ 450
Vocational Rehabilitation and Education Assistance	3,095
Administrative Program Costs	243
Total Program Expenses	$ 3,788
Program Outputs (Participants)	
Dependent Education	79,134
Veterans Rehabilitation	69,409
Veterans Education	490,826

Program Outcomes

VA's education and training programs are intended to provide higher education to dependents that might not be able to participate otherwise. Veterans' rehabilitation and employment programs are provided to service-disabled Veterans; they are designed to improve employability and promote independence for the disabled. Educational programs for active duty personnel, reservists, and Veterans provide higher education assistance to those who are eligible under the new Post-9/11 GI Bill, MGIB and the Veterans Educational Assistance Program. Education and training assistance is provided to dependents of Veterans who died of service-connected disability or whose service-connected disability was rated permanent and total. The Vocational Rehabilitation and Employment program provides evaluation services, counseling, and training necessary to assist Veterans in becoming employable and maintaining employment to the extent possible. The program is open to Veterans who have a 10 percent or greater service-connected disability rating and are found to have a serious employment handicap. The Veterans Education program provides educational assistance to eligible Servicemembers and Veterans, and eligible family members.

3. Health Professions Education

Health Professions Education					
Years Ended September 30,					
	2011	**2010**	**2009**	**2008**	**2007**
Program Expenses					
Physician Residents and Fellows	$ 637	$ 584	$ 547	$ 508	$ 469
Associated Health Residents and Students	114	113	99	88	81
Instructional and Administrative Support	819	794	707	623	606
Total Program Expenses	$ 1,570	$ 1,491	$ 1,353	$ 1,219	$ 1,156
Program Outputs					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	36,984	36,600	35,099	34,003	33,775
Medical Students	20,516	21,267	20,567	18,135	18,728
Nursing Students	25,931	33,580	31,380	28,320	27,515
Associated Health Residents and Students	31,869	23,416	22,916	20,946	20,875
Total Program Outcomes	115,300	114,863	109,962	101,404	100,893

Program Outcomes

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

The VHA conducts education and training programs to enhance the quality of care provided to Veterans within the VA health care system. Building on the long-standing, close relationships among VA and the Nation's academic institutions, VA plays a leadership role in defining the education of future health care professionals that helps meet the changing needs of the Nation's health care delivery system. Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. Through its partnerships with affiliated academic institutions, VA conducts the largest education and training effort for health professionals in the Nation. Each year, over 100,000 medical and other students receive some or all of their clinical training in VA. VA has affiliation agreements with 112 allopathic and 15 osteopathic medical schools for physician education, and in 40 other health professions represented by affiliation agreements with more than 1,200 colleges and universities. Many have their health profession degrees and contribute substantially to VA's ability to deliver cost-effective and high-quality patient care during their advanced clinical training at VA.

4. Research and Development (R&D)

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

Program Expense Year Ended September 30,				2011
	Basic	Applied	Development	Total
Medical Research Service	$ 166.1	$ 80.0	$ -	$ 246.1
Rehabilitative Research and Development	8.7	68.6	47.4	124.7
Health Services Research and Development	-	85.3	-	85.3
Cooperative Studies Research Service	43.2	80.3	-	123.5
Medical Research Support	-	579.8		579.8
Total Program Expenses	$ 218.0	$ 894.0	$ 47.4	$ 1,159.4

Program Expense Year Ended September 30,				2010
	Basic	Applied	Development	Total
Medical Research Service	$ 202.9	$ 97.5	$ -	$ 300.4
Rehabilitative Research and Development	6.4	50.6	35.0	92.0
Health Services Research and Development	-	91.0	-	91.0
Cooperative Studies Research Service	34.0	63.6	-	97.6
Medical Research Support	-	581.0		581.0
Total Program Expenses	$ 243.3	$ 883.7	$ 35.0	$ 1,162.0

Program Expense Year Ended September 30,				2009
	Basic	Applied	Development	Total
Medical Research Service	$ 164.4	$ 89.6	$ -	$ 254.0
Rehabilitative Research and Development	5.6	42.7	32.7	81.0
Health Services Research and Development	-	80.0	-	80.0
Cooperative Studies Research Service	33.3	61.7	-	95.0
Medical Research Support	-	510.0		510.0
Total Program Expenses	$ 203.3	$ 784.0	$ 32.7	$ 1,020.0

Program Expense Year Ended September 30,				2008
	Basic	Applied	Development	Total
Medical Research Service	$ 155.3	$ 84.7	$	$ 240.0
Rehabilitative Research and Development	4.8	36.6	28.0	69.4
Health Services Research and Development	-	76.7	-	76.7
Cooperative Studies Research Service	32.9	61.0	-	93.9
Medical Research Support	-	411.0		411.0
Total Program Expenses	$ 193.0	$ 670.0	$ 28.0	$ 891.0

Program Expense Year Ended September 30,				2007
	Basic	Applied	Development	Total
Medical Research Service	$ 171.3	$ 56.9	$ -	$ 228.2
Rehabilitative Research and Development	4.8	24.5	24.4	53.7
Health Services Research and Development	-	58.2	-	58.2
Cooperative Studies Research Service	32.9	41.0	-	73.9
Medical Research Support	-	408.6	-	408.6
Total Program Expenses	$ 209.0	$ 589.2	$ 24.4	$ 822.6

In addition, VHA researchers received grants from the National Institutes of Health in the amount of $474 million and $249 million in other grants during 2011. These grants went directly to researchers and are not considered part of the VA entity. They are being disclosed here but are not accounted for in the financial statements.

Program Outputs/Outcomes

For 2011, VA's R&D general goal related to stewardship was to ensure that VA's Pre-clinical Research and Clinical Research Program (excluding CSP) met the needs of the Veteran population and contributed to the Nation's knowledge about disease and disability. Target levels were established for the: (1) percent of funded research projects relevant to VA's health-care mission in designated research areas and (2) number of research and development projects. Strategies were developed in order to ensure that performance targets would be achieved.

Research and Development Measures-Actual Years Ended September 30,					
	2011	2010	2009	2008	2007
Percent of Funded Research Projects Relevant to VA's Health-Care Mission	100.0%	100.0%	100.0%	100.0%	100.0%
Number of Research and Development Projects	2,200	2,350	2,193	1,956	2,019

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

Required Supplementary Information

These materials are not audited
(dollars in millions, unless otherwise noted)

1. Deferred Maintenance

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

VA facilities reported their cost estimates for deferred maintenance by utilizing the Facility Condition Assessment Survey, where condition ratings are assigned. The costs assigned "D" (poor) and "F" (critical) ratings, qualify for reporting as deferred maintenance.

Deferred Maintenance		
As of September 30,	**2011**	**2010**
General PP&E	$ 5,719	$ 5,166
Heritage Assets	698	648
Total Deferred Maintenance	$ 6,417	$ 5,814

2. Schedule of Budgetary Activity Year Ended September 30, 2011

	Total Budgetary Resources	Obligations Incurred	Spending Authority from Offsetting Collections and Adjustments	Obligated Balance Net, Oct. 1	Obligated Balance Net, Sept. 30	Total Outlays
Veterans Health Administration						
Medical Admin 0152	$ 5,572	$ 5,268	$ 72	$ 1,041	$ 893	$ 5,344
Medical Care 0160	41,548	40,133	295	4,885	5,139	39,584
Medical Facilities 0162	5,898	5,803	35	2,432	3,128	5,072
Information Technology 0167	3,762	3,584	52	1,605	1,785	3,352
All Other	6,569	2,765	435	3,512	2,972	2,870
Total	$ 63,349	$ 57,553	$ 889	$ 13,475	$ 13,917	$ 56,222
Veterans Benefits Administration						
Compensation, Pension, & Burial Benefits 0102	$ 66,863	$ 53,932	$ -	$ 3,923	$ 278	$ 57,577
Readjustment Benefits 0137	11,990	10,769	380	417	101	10,705
Direct Loan Financing 4127	573	404	408	15	7	4
Guaranteed Loan Financing 4129	5,980	2,774	3,798	264	279	(1,039)
National Service Life Insurance Fund 8132	1,238	1,238	196	1,269	1,182	1,129
All Other	5,649	3,311	1,666	501	503	1,643
Total	$ 92,293	$ 72,428	$ 6,448	$ 6,389	$ 2,350	$ 70,019
National Cemetery Administration						
Total	$ 309	$ 287	$ -	$ 199	$ 178	$ 308
Indirect Administrative Program Costs						
General Operating Expenses 0151	$ 3,371	$ 3,269	$ 735	$ 648	$ 542	$ 2,640
Supply Fund 4537	1,834	1,180	1,081	(424)	(279)	(46)
All Other	691	582	490	60	99	53
Total	$ 5,896	$ 5,031	$ 2,306	$ 284	$ 362	$ 2,647
Total of all Administrations	$ 161,847	$ 135,299	$ 9,643	$ 20,347	$ 16,807	$ 129,196

VA Snapshot

vICU Helps Patient Heal

Demonstration of the Virtual Intensive Care Unit.

The Department of Veterans Affairs (VA) strives to serve Veterans and improve their lives, and the new virtual intensive care unit (vICU) helps us do that. The vICU provides access to critical care services to smaller facilities within a Veterans Integrated Service Network (VISN). There are several Tele ICU models across the country using a traditional model where a physician sits in a room and monitors patients remotely. However, in VISN 19, VA is testing an innovative vICU that is nurse-driven and nurse-managed and uses a rapid response multidisciplinary team approach taking patient care to a higher level. This higher level of care is illustrated by the following example of the vICU in action.

At 2:45 a.m. on February 11, an ICU nurse at the Fort Harrison VA Medical Center (VAMC) requested immediate virtual assistance from the vICU nurse in Denver for an unstable patient. The vICU nurse then connected with Ft. Harrison via the vICU telehealth equipment and assessed the patient remotely to provide positive assistance.

The patient, a 34-year-old OEF/OIF Veteran, had been admitted that day to the Ft. Harrison ICU for severe lung problems. Despite receiving care, the patient's condition had worsened. When the vICU nurse was contacted, she suggested several medications and immediately contacted specialists in Denver for further assistance in areas including cardiothoracic, medicine, and neurology. Based on the specialists' recommendations, facilitated by the vICU, the patient was stabilized.

The vICU nurse coordinated the patient's expedited transfer to Denver where the patient was admitted to the Denver VAMC on February 12. The cardiothoracic, pulmonary, and medicine teams coordinated his care. A few days later, the patient underwent several specialized operations that could not be done in many rural facilities. The patient recovered without further complications and was discharged in stable condition on February 18. Without the vICU, he may not have survived.

For more information on VA's efforts to improve the health of Veterans living in rural areas, visit the Web site at www.ruralhealth.va.gov.

VA Snapshot

VA Psychologist Kathleen Castles Wins Myrtle Beach Marathon

Dr. Kathleen Castles became the first woman in the history of the Myrtle Beach Marathon to finish as the overall winner by finishing in 2:40:11. This record time qualifies her for the 2012 U.S. Olympic Team Trials.

Dr. Kathleen Castles accomplished an amazing feat on Saturday, February 19, 2011—winning the Myrtle Beach Marathon in South Carolina. In doing so, she became the first woman in the history of the event to finish as the overall winner. Castles, a psychologist at the VA New Jersey Health Care System, finished the marathon in 2:40:11. This time qualifies her for the 2012 U.S. Olympic Team Trials. This marks the second time that Dr. Castles has qualified for the Olympic Marathon Trials. What is even more remarkable is that as a full-time professional, she is competing against athletes who devote most of their time to training. Castles is the coordinator of the Dual Diagnosis Program as well as the MOVE!® Coordinator at the medical center. She is also the captain/coach of the VA New Jersey Health Care System's Running Team, ROVE (Runners of Veterans Everywhere).