Letter from the Chief Financial Officer

November 12, 2014

Entrusted to serve our Nation's 23 million living Veterans, as well as memorialize those who have died, the Department of Veterans Affairs (VA) must be transparent and accountable to Veterans and our broad community of stakeholders. To that end, I am pleased to report that VA received its 16th consecutive unqualified ("clean") audit opinion on the Department's consolidated financial statements. The enclosed audit provides an assessment of the Department's detailed financial information and our stewardship of taxpayer resources in support of our mission, fulfilling President Lincoln's charge to care for those "who shall have borne the battle" and their families.

VA staff worked diligently on remediation of its one remaining material weakness, "Information Technology (IT) Controls," however, this will remain a material weakness in 2015. VA received two significant deficiencies. One is for "Financial Reporting," driven in part by the age of VA's legacy financial management system; the other is for "Accrued Operating Expenses." Additionally, while there is no change in Total Net Position, the FY 2013 VA financial statements have been restated, with adjustments being made to Cumulative Results of Operations and Unexpended Appropriations as of September 30, 2012. Further information regarding the restatement can be found in Note 24 of the financial statements.

We also received other external validation of the Department's ongoing efforts to ensure sound financial management. VA's Franchise Fund is expected to receive its 17th successive unqualified audit opinion on its 2014 consolidated financial statements. In addition, the Supply Fund received an unqualified opinion in 2013 and anticipates another unqualified opinion in 2014.

The Department is committed to meeting financial management goals that include eliminating improper payments, strengthening internal controls, as well as enhancing data and analysis. In the improper payment area, we continued to build on the significant progress made last year, seeking to leverage every Veteran dollar and comply with the Improper Payments Elimination and Recovery Improvement Act (IPERIA). In 2014, the IPERIA governing board, comprised of senior accountable officials and program managers throughout VA, oversaw the remediation of all of the Inspector General's 2013 findings. VA staff continues to focus on identifying the root causes of improper payment and developing corrective actions to eliminate them in the future.

In 2014, VA launched a major initiative focused on the use of sophisticated data analytics to improve decision-making, reduce risk exposure, and discover valuable operational insights. The use of data analytics to identify VA financial activities with risk for fraud, improper payment, or noncompliance with VA policy, procedures and regulations was demonstrated in a proof-of-concept on VA-wide travel data. Our continued focus on data quality and governance is critical to support data-driven decision-making.

VA also made the successful transition to E-Gov Travel Service, the newest version of a government-wide, web-based, travel management service. We accelerated our implementation by 4 months, thereby avoiding a $1 million per month shared managed service fee. We are also pleased to announce that our E-Invoicing initiative was recognized in 2014 by the Tungsten Corporation with both the "Supplier Engagement Award" and the "Green Award." These awards recognize an organization that converted the highest number of suppliers from paper to electronic invoicing during the previous year.

Pursuant to guidance in the 2014 Omnibus Bill, VA successfully closed out the Recovery Act program. For USAspending.gov, VA continues to report all required contract, grant, loan, and other assistance program spending that totaled $142 billion in FY 2014. Additionally, VA bettered the travel spending reduction target established by the Office of Management and Budget, implementing memorandum M-12-12, "Promoting Efficient Spending to Support Agency Operations."

Recognizing the importance of continuous improvement, VA is proud of its financial management accomplishments during the past year and is committed to ensuring on-going stewardship of resources entrusted to it by Congress and the American people. While there is work to be done, financial management achievements in 2014 reflect the dedication and hard work of staff throughout the Department. Thank you to all who helped made the 2014 achievements in VA financial management possible. I invite you to read about our program and financial management achievements for FY 2014 in the attached report.

Helen Tierney

Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS				
CONSOLIDATED BALANCE SHEETS (dollars in millions)				
AS OF SEPTEMBER 30,		**2014**		**2013**
				Restated (Note 24)
ASSETS				
INTRAGOVERNMENTAL				
Fund Balance with Treasury (Note 3)	$	57,887	$	39,048
Investments (Notes 5 and 19)		7,827		8,564
Accounts Receivable, Net (Note 6)		40		41
Other Assets		352		540
TOTAL INTRAGOVERNMENTAL ASSETS		**66,106**		**48,193**
PUBLIC				
Cash (Note 4)		5		8
Investments (Note 5)		178		178
Accounts Receivable, Net (Note 6)		2,631		2,040
Direct Loans and Loan Guarantees, Net (Note 7)		1,838		2,147
Inventories and Related Property, Net (Note 8)		49		71
General Property, Plant and Equipment, Net (Note 9)		22,283		21,976
Other Assets		20		26
TOTAL PUBLIC ASSETS		**27,004**		**26,446**
TOTAL ASSETS	**$**	**93,110**	**$**	**74,639**
Heritage Assets (Note 10)				
LIABILITIES				
INTRAGOVERNMENTAL				
Accounts Payable	$	290	$	258
Debt (Note 11)		697		756
Other Liabilities (Note 15)		1,300		1,414
TOTAL INTRAGOVERNMENTAL LIABILITIES		**2,287**		**2,428**
PUBLIC				
Accounts Payable		11,740		10,807
Liabilities for Loan Guarantees (Note 7)		8,908		7,933
Federal Employee and Veterans Benefits Liabilities (Note 13)		2,009,364		1,977,020
Environmental and Disposal Liabilities (Note 14)		789		823
Insurance Liabilities (Note 17)		9,145		9,854
Other Liabilities (Note 15)		4,759		4,260
TOTAL PUBLIC LIABILITIES		**2,044,705**		**2,010,697**
TOTAL LIABILITIES		**2,046,992**		**2,013,125**
Commitments and Contingencies (Note 18)				
NET POSITION				
Unexpended Appropriations – All Other Funds (Note 24)		36,398		21,211
Cumulative Results of Operations – Funds from Dedicated Collections (Note 19)		1,008		843
Cumulative Results of Operations – All Other Funds (Note 24)		(1,991,288)		(1,960,540)
TOTAL NET POSITION		**(1,953,882)**		**(1,938,486)**
TOTAL LIABILITIES AND NET POSITION	**$**	**93,110**	**$**	**74,639**

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,	2014	2013
NET PROGRAM COSTS BY ADMINISTRATION (Note 21)		
Veterans Health Administration		
Gross Cost	$ 64,997	$ 60,317
Less Earned Revenue	(3,811)	(3,767)
Net Program Cost	61,186	56,550
Veterans Benefits Administration		
Gross Cost		
Program Costs	88,037	83,919
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	54,400	99,200
Less Earned Revenue	(1,237)	(1,549)
Net Program Cost	141,200	181,570
National Cemetery Administration		
Gross Cost		
Program Costs	310	305
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	-	(100)
Less Earned Revenue	-	-
Net Program Cost	310	205
Indirect Administrative Program Costs		
Gross Cost	1,831	2,087
Less Earned Revenue	(292)	(507)
Net Program Cost	1,539	1,580
NET PROGRAM COSTS BY ADMINISTRATION BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITY ASSUMPTIONS	**204,235**	**239,905**
CHANGES IN ACTUARIAL LIABILITY ASSUMPTIONS (Note 13)		
COMPENSATION:		
Changes in Discount Rate Assumption	(37,400)	39,600
Changes in COLA Rate Assumption	15,400	(11,800)
Changes in Disability Claims Rates	-	70,400
Changes in Other Assumptions	-	15,700
TOTAL COMPENSATION	(22,000)	113,900
BURIAL:		
Changes in Discount Rate Assumption	(100)	100
Changes in Other Assumptions	-	100
TOTAL BURIAL	(100)	200
NET (GAIN)/LOSS FROM ACTUARIAL LIABILITY ASSUMPTIONS	**(22,100)**	**114,100**
NET COST OF OPERATIONS (Note 21)	**$ 182,135**	**$ 354,005**

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, 2014

	Funds from Dedicated Collections (Note 19)	All Other Funds	Eliminations	2014 Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$ 843	$ (1,960,540)	$ -	$ (1,959,697)
Budgetary Financing Sources				
Appropriations Used	-	149,628	-	149,628
Nonexchange Revenue	-	9	-	9
Donations and Forfeitures of Cash and Cash Equivalents	27	-	-	27
Transfer In/Out Without Reimbursement	(3,038)	3,173	-	135
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	40	1	-	41
Transfers In/Out Without Reimbursement	-	14	-	14
Imputed Financing	-	2,169	-	2,169
Other	-	(471)	-	(471)
Total Financing Sources	(2,971)	154,523	-	151,552
Net Cost/(Benefit) of Operations	(3,136)	185,271	-	182,135
Net Change	**165**	**(30,748)**	**-**	**(30,583)**
Ending Balance – Cumulative Results	1,008	(1,991,288)	-	(1,990,280)
Unexpended Appropriations				
Beginning Balance	-	21,211	-	21,211
Budgetary Financing Sources				
Appropriations Received	-	166,963	-	166,963
Appropriations Transferred In/Out	-	138	-	138
Other Adjustments	-	(2,286)	-	(2,286)
Appropriations Used	-	(149,628)	-	(149,628)
Total Budgetary Financing Sources	-	15,187	-	15,187
Total Unexpended Appropriations	**-**	**36,398**	**-**	**36,398**
Total Net Position	**$ 1,008**	**$ (1,954,890)**	**$ -**	**$ (1,953,882)**

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, 2013, Restated (Note 24)

	Funds from Dedicated Collections (Note 19)	All Other Funds (Note 24)	Eliminations	2013 Consolidated Total (Note 24)
Cumulative Results of Operations				
Beginning Balances	$ 745	$ (1,725,997)	$ (200)	$ (1,725,452)
Adjustment: Correction of Error	-	(22,028)	-	(22,028)
Beginning Balances, as adjusted	745	(1,748,025)	(200)	(1,747,480)
Budgetary Financing Sources				
Appropriations Used (Note 24)	-	139,901	-	139,901
Nonexchange Revenue	-	8	-	8
Donations and Forfeitures of Cash and Cash Equivalents	29	-	-	29
Transfer In/Out Without Reimbursement	(2,824)	2,806	-	(18)
Other Financing Sources (Nonexchange)				
Donations and Forfeitures of Property	21	1	-	22
Transfers In/Out Without Reimbursement	(5)	5	-	-
Imputed Financing	-	1,971	-	1,971
Other	-	(325)	200	(125)
Total Financing Sources	(2,779)	144,367	200	141,788
Net Cost/(Benefit) of Operations	(2,877)	356,882	-	354,005
Net Change	**98**	**(212,515)**	**200**	**(212,217)**
Ending Balance – Cumulative Results	843	(1,960,540)	-	(1,959,697)
Unexpended Appropriations				
Beginning Balances	-	3,931	200	4,131
Adjustment: Correction of Error	-	22,028	-	22,028
Beginning Balances, as adjusted	-	25,959	200	26,159
Budgetary Financing Sources				
Appropriations Received	-	137,298	-	137,298
Appropriations Transferred In/Out	-	133	-	133
Other Adjustments	-	(2,278)	(200)	(2,478)
Appropriations Used (Note 24)	-	(139,901)	-	(139,901)
Total Budgetary Financing Sources	-	(4,748)	(200)	(4,948)
Total Unexpended Appropriations	**-**	**21,211**	**-**	**21,211**
Total Net Position	**$ 843**	**$ (1, 939,329)**	**$ -**	**$ (1,938,486)**

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

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2014

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources (Note 22)		
Unobligated Balance, brought forward, October 1	10,901	5,167
Recoveries of Prior Year Unpaid Obligations	2,510	-
Other Changes in Unobligated Balance	(297)	(96)
Unobligated Balance from Prior Year Budget Authority, net	13,114	5,071
Appropriations	169,136	-
Borrowing Authority	-	126
Spending Authority from Offsetting Collections	4,862	5,253
Total Budgetary Resources	**$ 187,112**	**$ 10,450**
Status of Budgetary Resources		
Obligations Incurred	$ 160,666	$ 2,921
Unobligated Balance, end of year:		
Apportioned	7,305	-
Unapportioned	19,141	7,529
Total Unobligated Balance, end of year	26,446	7,529
Total Status of Budgetary Resources	**$ 187,112**	**$ 10,450**
Change in Obligated Balance		
Unpaid Obligations:		
Unpaid Obligations, brought forward, October 1	27,644	346
Obligations Incurred	160,666	2,921
Outlays (gross)	(157,604)	(2,925)
Recoveries of Prior Year Unpaid Obligations	(2,510)	-
Other Adjustments	9	-
Unpaid Obligations, end of year	$ **28,205**	**$ 342**
Uncollected Payments:		
Uncollected Payments Fed Sources, brought forward, October 1	(2,094)	-
Change in Uncollected Pymts Fed Sources	189	-
Uncollected Payments, Fed Sources, end of year,	$ **(1,905)**	**$ -**
Memorandum entries:		
Obligated Balance, start of year	$ 25,550	$ 346
Obligated Balance, end of year	26,300	342

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DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions) (continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2014

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budget Authority and Outlays, net		
Budget Authority, gross	$ 173,998	$ 5,379
Actual Offsetting Collections	(5,066)	(5,342)
Change in Uncollected Customer Payments from Federal Sources	189	-
Budget Authority, net	**$ 169,121**	**$ 37**
Outlays, gross	$ 157,604	$ 2,925
Actual Offsetting Collections	(5,066)	(5,342)
Outlays, net	152,538	(2,417)
Distributed Offsetting Receipts	(3,418)	(46)
Agency Outlays, net	**$ 149,120**	**$ (2,463)**

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

DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions)
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources (Note 22)		
Unobligated Balance brought forward, October 1	$ 15,917	$ 4,006
Recoveries of Prior Year Unpaid Obligations	2,713	-
Other Changes in Unobligated Balance	(301)	(88)
Unobligated Balance from Prior Year Budget Authority, net	18,329	3,918
Appropriations	139,431	-
Borrowing Authority	-	114
Spending Authority from Offsetting Collections	5,584	4,282
Total Budgetary Resources	**$ 163,344**	**$ 8,314**
Status of Budgetary Resources		
Obligations Incurred	$ 152,443	$ 3,147
Unobligated Balance, end of year:		
Apportioned	6,984	-
Unapportioned	3,917	5,167
Total Unobligated Balance, end of year	10,901	5,167
Total Status of Budgetary Resources	**$ 163,344**	**$ 8,314**
Change in Obligated Balance		
Unpaid Obligations:		
Unpaid Obligations, brought forward, October 1	$ 24,906	$ 310
Obligations Incurred	152,443	3,147
Outlays (gross)	(146,992)	(3,111)
Recoveries of Prior Year Unpaid Obligations	(2,713)	-
Unpaid Obligations, end of year	**$ 27,644**	**$ 346**
Uncollected Payments:		
Uncollected Payments Fed Sources, brought forward, October 1	(1,591)	-
Change in Uncollected Pymts, Fed Sources	(503)	-
Uncollected Payments, Fed Sources, end of year	**$ (2,094)**	**$ -**
Memorandum entries:		
Obligated Balance, start of year	$ 23,315	$ 310
Obligated Balance, end of year	25,550	346

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DEPARTMENT OF VETERANS AFFAIRS

COMBINED STATEMENT OF BUDGETARY RESOURCES (dollars in millions) (continued)

FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Budgetary	Non-Budgetary Credit Reform Financing Account
Budget Authority and Outlays, net		
Budget Authority, gross	$ 145,015	$ 4,396
Actual Offsetting Collections	(5,097)	(4,397)
Change in Uncollected Customer Payments from Federal Sources	(503)	-
Budget Authority, net	**$ 139,415**	**$ (1)**
Outlays, gross	$ 146,992	$ 3,111
Actual Offsetting Collections	(5,097)	(4,397)
Outlays, net	141,895	(1,286)
Distributed Offsetting Receipts	(3,238)	(193)
Agency Outlays, net	**$ 138,657**	**$ (1,479)**

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

Notes to Consolidated Financial Statements

For the Years Ended September 30, 2014 and 2013, (dollars in millions, unless otherwise noted)

1. Summary of Significant Accounting Policies

Organization

The mission of the Department of Veterans Affairs (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 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 (CFO) Act 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 understanding that VA is a component of the U.S. Government, a sovereign entity. VA 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. VA's fiscal year end is September 30^{th}.

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 No. 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. In order to prepare reliable consolidated financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements. However, to remain consistent with the aggregate of the account-level information presented in budgetary reports, the statements of budgetary resources are not consolidated but combined; therefore elimination of intra-entity transactions is not permitted.

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

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

Revenues and Other Financing Sources

Exchange revenue, which is primarily medical revenue, is 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. Under chapter 17, title 38, United States Code, VHA is authorized to bill a Veteran's third-party health insurer for health care provided at VA and non-VA medical facilities. Generally, VA considers a Veteran's health care billable if the treatment is not for a service-connected disability.

Billable amounts are based on reasonable charges by locality for services provided as determined under the methodology prescribed by 38 CFR Regulation 17.101. Under this methodology, the billable amounts for services provided by VA represent the 80th percentile of nationwide average rates developed from commercial and Medicare statistical data by locality throughout the nation. The statistical data is adjusted by the Consumer Price Index (CPI) to account for the historical nature of the data being utilized. The billable amounts by service provided are developed based on the classification of services as inpatient, outpatient, professional and surgical or non-surgical. The nationwide average rates used to determine billable amounts for services provided for inpatient care are updated annually effective October 1st and nationwide average rates for billable amounts for outpatient and professional care are updated annually effective January 1st . The updated charges are published by a Notice in the Federal Register and the charges are available on the VHA Chief Business Office (CBO) website (http://www1.va.gov/CBO/apps/rates/). Revenue earned but unbilled is estimated using historical average data. An allowance for contractual adjustments from insurance companies and uncollectible amounts is determined using historical average data.

Exchange revenue consists of: benefits revenue from reimbursement of education benefit programs from service member contributions that are transferred to the general fund account with the Department of the Treasury (Treasury); insurance revenue from insurance policy premiums paid by policyholders; and housing revenue from interest earned on direct loans.

Nonexchange revenue (e.g., donations) is recognized when received, and the related receivables, refunds, and offsets are recognized when measurable and legally collectible. Nonexchange revenue consists of: benefits revenue from reimbursement of education benefit programs by the Department of Defense (DoD); insurance revenue from interest earned from Treasury on investments of insurance policy premiums; and housing revenue from interest earned from Treasury on uninvested balances in financing accounts and reestimates of subsidy.

Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by the Treasury Judgment Fund and post-retirement benefits for VA employees paid by the Office of Personnel Management (OPM).

Transferring Budget Authority to Other Agencies

VA, as the transferring (parent) entity, is a party to allocation transfers with 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 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 VA is less than the present value of cash outflows made by VA, a subsidy cost is incurred by 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 VA exceeds the present value of cash outflows made by 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, modifications, changes in reestimates of interest rates and application of loan technical/default provisions approved by OMB.

Direct loans obligated before October 1, 1992, are not subject to the Federal Credit Reform Act. Direct loans obligated before October 1, 1992, are recorded at net realizable value of the remaining balance of amounts disbursed plus accrued and unpaid interest receivable. The allowance for loan losses on direct loans obligated before October 1, 1992, is recognized when it is more likely than not that the direct loans will not be totally collected. The allowance of the uncollectible amounts is reestimated each year as of the date of the financial statements. Loan losses are reestimated by program.

Risk factors are evaluated for each program and separate loan year disbursed. Risk factors include historical loan experience, regional economic conditions, financial and relevant characteristics of borrowers, value of collateral to loan balance, changes in recoverable value of collateral and new events that would affect the loans' performance. A systematic methodology based on an econometric model is used to project default costs by risk category. Actual historical experience includes actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Fund Balance with Treasury

Treasury performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury (FBWT) 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 Program (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 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.

The section 'Status of Fund Balance with Treasury' in the Note 3 table represents the VA's unobligated balances, obligated balances and deposit and clearing accounts. The unobligated and obligated balances presented in that section may not equal related amounts reported on the Combined SBR. The unobligated and obligated balances reported on the SBR are supported by FBWT, as well as other budgetary resources that do not affect FBWT, primarily expired authority.

Cash

Cash consists of Canteen Service and Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Occasionally, cash includes cash held by non-federal trusts. 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 the 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 2029), 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. No securities have been reclassified as securities available for sale or early redemption. Additionally, no permanent impairments of securities have occurred. See Note 19 for additional disclosure of intragovernmental investments in Treasury securities from dedicated collections.

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 reported 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 estimated for Medical Care Collection Fund (MCCF) receivables due from patients and insurance companies using the allowance method. The allowance is determined based on the 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. The 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 defaulted 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 the liability for guaranteed loans and the allowance for subsidy for defaulted guaranteed loans included in the balance of loans receivable.

Vendee loans are direct loans issued to a third party 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 that 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.

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 disbursed, 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 disbursed 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 the VA's outstanding vendee or direct loans will default over a 12-year period. For 2014 and 2013, 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 reported at cost using the weighted-average cost method. Inventory that is excess, obsolete or unserviceable is reported at its estimated net realizable value. Upon disposal, any difference between the inventory's recorded amount and the value received for the inventory will be recognized as a gain or loss.

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 are used to provide medical care to Veterans. Property, plant, and equipment, including transfers from other federal agencies, leasehold improvements, other structures not classified as buildings and capital leases are valued at net carrying cost. Multi-use heritage assets are recognized and presented with general property, plant and equipment in the basic financial statements and additional information for the multi-use heritage assets with only incidental government use are classified as and included with the heritage assets information in Note 10. When the capitalization criteria are met, major additions, replacements, and alterations are capitalized, whereas routine maintenance and repairs are expensed when incurred.

VA has a significant construction program for medical facilities, national cemeteries, and other veteran related projects. VA submits its major construction project plans for medical facilities and national cemeteries to Congress for approval prior to receiving appropriated funds. VA maintains separate appropriated fund accounts for each type of project, as authorized, for major and minor construction and non-recurring maintenance projects.

Construction project costs incurred during the design and development phases are recorded in the appropriate Construction Work-in-Process (WIP) accounts including all materials, supplies, services, capital equipment, transportation costs, incremental overhead or support costs, and other construction-related costs directly attributable to the project. The assets are transferred to either capitalized or non-capitalized property, plant, and equipment, as appropriate, when placed in service. Construction projects completed in multiple phases are recorded as Construction WIP until the project phase is placed in service. Personal property and equipment not meeting the capitalization criteria is expensed upon being placed in service.

Individual items are capitalized if the useful life is two years or more and the unit price is $1 million or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is depreciated on a straight-line basis over its useful life, usually 5 to 20 years.

Internal use software is also subject to the $1 million threshold for capital assets. The costs subject to capitalization are incurred during the software development phase, and include the design of the chosen path, programming development, installation of hardware and testing, and are accumulated in Software in Development until a project is successfully tested and placed in service. The capitalized 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, which generally ranges from 2 to 4 years. Preliminary design phase costs and post implementation costs are expensed as incurred.

Property, plant and equipment, including construction WIP, internal use software and capitalized lease assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying value of the long-lived asset or asset group is not recoverable, an impairment loss is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including quoted market values and third party independent appraisals, as considered necessary.

VA follows Technical Release 14, Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment, which clarifies existing SFFAS 6, *Accounting for Property, Plant, and Equipment*, requirements to account for the disposal, retirement, or removal from service of general property, plant, and equipment (G-PP&E), as well as, the recognition and measurement of disposal related cleanup costs. The guidance differentiates between permanent and other than permanent removal from service of G-PP&E assets and delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

The removal from service is considered other than permanent; unless there is evidence of management's documented decision to permanently remove the asset from service and the asset's use is terminated. Permanent removal from service is evident from management's documented decision to dispose of an asset by selling, scrapping, recycling, donating or demolishing the asset. If only the termination of use or management's decision to permanently remove an asset from use occurs, but not both business events, then permanent removal from service has not occurred and there is no change in the G-PP&E reported value and depreciation continues. Likewise, in the case of G-PP&E cleanup costs, if only one of the two business events has occurred, permanent removal from service has not occurred and any cleanup costs associated with disposal, closure, and/or shutdown should continue to be expensed and accumulate as a liability.

When VA documents its decision to permanently remove an asset from service by selling, scrapping, recycling, donating or demolishing the asset and the asset's use is terminated, depreciation and amortization ceases in anticipation of disposal, retirement, or permanent removal from service; the G-PP&E accounts along with associated accumulated depreciation/amortization is removed from the G-PP&E accounts and recorded in an appropriate asset account at its expected net realizable value. Any difference in the book value of the G-PP&E and its expected net realizable value is recognized as a gain or a loss in the period of adjustment. The expected net realizable value is adjusted at the end of each accounting period and any further adjustments in value are recognized as a gain or a loss.

There are no restrictions on the use or convertibility of G-PP&E. For disclosure regarding Heritage Assets see Note 10.

SFFAS No. 40, *Definitional Changes to Deferred Maintenance; Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*, was adopted by VA for the year ended September 30, 2012. This standard clarifies that repair activities should be included to better reflect asset management practices and improve reporting on deferred maintenance and repairs activities not performed when they should have been, or were scheduled to be, therefore, are put off or delayed for a future period.

FASAB issued SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standard 6, 14, 29 and 32*, which is effective for periods beginning after September 30, 2014. This standard requires expanded qualitative and quantitative disclosure of the deferred maintenance and repairs, including (1) maintenance and repair policies and how they are applied, (2) ranking and prioritizing maintenance and repair activities among other activities, (3) determining acceptable condition standards, (4) whether deferred maintenance and repairs are related solely to capitalized G-PP&E and stewardship property, plant and equipment or to non-capitalized or fully depreciated G-PP&E, (5) G-PP&E excluded from measurement and/or reporting of deferred maintenance and repairs and the rationale for the exclusion of other than non-capitalized or fully depreciated G-PP&E, (6) beginning and ending deferred maintenance and repair balances by category of G-PP&E, and (7) explanation of significant changes from the prior year. Management is currently evaluating required changes to existing disclosures to be in compliance with the standard but does not believe that implementation will have a material effect on financial position, results of operations or disclosures. For additional disclosures on deferred maintenance and repairs of G-PP&E and heritage assets see RSI.

SFFAS No. 44, *Accounting for Impairment of General Property, Plant and Equipment Remaining in Use*, is effective for periods after September 30, 2014. This Statement establishes accounting and financial reporting standards for impairment of G-PP&E remaining in use, except for internal use software. G-PP&E is considered impaired when there is a significant and permanent decline in the service utility of

G-PP&E or expected service utility for construction WIP and management has no reasonable expectation that the lost service utility will be replaced or restored. Existing processes and internal controls are expected to reasonably assure identification and communication of potential material impairments, such as those related to deferred maintenance and repairs, and VA will not be required to conduct annual or other periodic surveys solely for the purpose of applying impairment standards.

The loss from impairment is recognized and reported in the statement of net cost in program costs or costs not assigned to programs. Reversals of impairment losses are not recognized. Where an impairment loss is not recognized, adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates may be appropriate. In the period the impairment loss is recognized, disclosure of the G-PP&E remaining in use for which an impairment loss is recognized, the nature and amount of the impairment, and the financial statement classification of the impairment loss will be provided in the notes to the financial statements. VA is currently evaluating the financial statement impact of implementing this standard and does not believe that implementation will have a material effect on financial position and results of operations.

Other Assets

Intragovernmental Other Assets are reported at cost and consist primarily of Intragovernmental Advances - Federal and are primarily advances to the Army Corps of Engineers (Corps) and the General Services Administration (GSA). Public Other Assets are reported at cost and 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

Accounts payable are amounts owed by VA for goods and services received from, progress in contract performance made by, and rents due to other entities and scheduled compensation, pension and education benefits payable to Veterans. Accounts payable do not include liabilities related to on-going continuous expenses such as employee's salaries, benefits, annuities for insurance programs, interest payable and loan guarantee losses and Veterans compensation, pension and education benefits payable, which are covered by other liabilities. When VA accepts title to goods, whether the goods are delivered or in transit, or incurs costs for services received, VA recognizes a liability for the unpaid amount of the goods and services. If invoices for those goods and services are not available when financial statements are prepared, the amounts owed are estimated.

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. Intragovernmental and public accounts payable are covered by budgetary resources.

Loan Guarantees

VA provides loan guarantees using two types of guaranty programs. Under one program, a loan may be made to an eligible Veteran borrower 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 a default by the Veteran borrower results in a loss by the loan holder. If the loan holder acquires the property which had secured the guaranteed loan at the liquidation sale, the loan holder can elect to convey the property to VA, which then attempts to resell the property at the best possible price and terms.

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 has the authority to 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.

Loan Guarantee Modifications
OMB Circular No. A-11, section 185, specifies that modifications to existing loan guarantee subsidy costs result from the government's decision to alter the percentage of the loan it will guarantee. The subsidy cost of a modification is the difference between the net present value of the remaining estimated cash flows before and after the modification (i.e., post-modification liability minus pre-modification liability) and the change in carrying amount is recognized as a gain or a loss. A reduction in the loan guarantee liability due to a modification reflects as savings to VA resulting in a modification gain being recognized. An increase in the loan guarantee liability due to a modification reflects increased costs to VA resulting in a modification loss being recognized. The carry amount of the loan guarantee liability reflects the post-modification liability balance.

VA and loan servicers perform loan modifications under current laws without the need to modify executed subsidy estimates for existing loan guarantees from 1992 to 2014.

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 2014 and 2013 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 4.0 percent. The mortality assumptions include the American Experience Table, the X-18 Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, the 1980 CSO Basic Table, and the 2001 Valuation Basic Male (VBM) 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 2001 VBM Table with 4 percent interest. The reserve for Term policies is based on the 2001 VBM Table with 4 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 2.5 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 2001 VBM Table with 4 percent interest. The reserve for Term policies is based on the 2001 VBM Table with 4 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 rate book premiums. The reserve for 5-Year Term policies is based on varying ratios of the 1941 CSO Table at 3.5 percent interest using rate book 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 2001 VBM Table and 4 percent interest for "J", the 1958 CSO Basic Table and 4 percent interest for "JR", and 150 percent of the 1958 CSO Basic Table and 4 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 2014 and 2013, the interest rates ranged from 3.5 percent to 5.0 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 2014, a discount rate of 4 percent (2.5 percent for USGLI), along with the appropriate accrual factor, was used. For 2013, a discount rate of 4 percent (5 percent VSLI), along with the appropriate accrual factor, was 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, and therefore, these liabilities are not covered by budgetary resources.

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. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds.

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's 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 total number of Veterans, estimated future military separations, the number of Veterans and dependents receiving payments, discount rates, cost of living adjustments, presumptive service conditions resulting in disability benefits coverage and life expectancy, impact the amount of the liability.

Discount rates used to measure the actuarial liabilities are based on spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities at September 30 of each year for the 10-year historical period with maturities consistent with the period of expected future payments. As a result, each year for which expected future payments are projected has a separate discount rate associated with it. However, a single weighted average discount rate is also disclosed that may be used for all projected future payments that results in a present value that is not materially different than the resulting present value using multiple-rates.

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 known material 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, Cost-of-Living Adjustment (COLA), and the other economic assumptions. For 2014, 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.

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 relying on independent studies by the Institute of Medicine (IOM) determines whether presumptions of service connection are warranted and presumptive disability benefit payments are due. Upon determination by the Secretary of VA that presumptive disability benefit payments are due, there is a waiting period and a final regulation is issued. In accordance with the Agent Orange Act, the adjudication of cases based on the new presumption has begun and a liability has been recognized.

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) applies to the actuarial liabilities recognized for Veterans compensation and burial obligations reported in VA's 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.

Commitments and 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 resolution of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations other than as disclosed in Note 18, Commitments and Contingencies.

Non-Federal Trusts
VA has entered into enhanced-use leases to maximize use of underutilized VA property. Certain enhanced-use leases were entered into with non-federal trusts. VA leased back the assets developed by the non-federal trusts under long-term leases. The assets developed by the non-federal trusts include cogeneration plants, office buildings, or parking garages and were financed with public bonds. The public bonds are repaid from the cogeneration fees and lease payments made by VA under the leases as long as VA utilizes these facilities. Under the lease arrangements, VA is the primary beneficiary of the trust assets with the obligation to absorb the majority of any expected losses and receive the majority of the residual returns that could be significant. As a result, VA has a controlling financial interest in the non-federal trust assets under the enhanced-use leases. Accordingly, the assets, liabilities, and results of operations of these six trusts under the enhanced-use leases are consolidated with VA operations 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.

Subsequent Events
Subsequent events have been evaluated through the auditors' report date which is the date the financial statements were available to be issued, and management determined that there are no other items to disclose.

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 FBWT; 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.

There are offsetting liabilities in the consolidated balance sheet for the non-entity assets reported below. Offsetting liabilities are included in Intragovernmental Other Liabilities and Accounts Payable and Public Other Liabilities, Insurance Liabilities and Accounts Payable. There is no balance in the consolidated net position from the non-entity assets.

Non-Entity Assets **as of September 30,**	**2014**	**2013**
Fund Balance with Treasury	$ 118	$ 116
Intragovernmental Accounts Receivable	1	1
Public Accounts Receivable	73	71
Total Non-Entity Assets	$ 192	$ 188

3. Fund Balance with Treasury

Fund Balance with Treasury as of September 30,		2014		2013
Entity Assets				
Trust Funds	$	91	$	87
Revolving Funds		8,360		6,060
Appropriated Funds		48,850		32,386
Special Funds		407		349
Other Fund Types		61		50
Total Entity Assets		57,769		38,932
Non-Entity Assets				
Other Fund Types		118		116
Total Non-Entity Assets		118		116
Total Entity and Non-Entity Assets	$	57,887	$	39,048
Reconciliation of VA General Ledger Balances with Treasury				
Balance per VA General Ledger	$	52,992	$	40,145
Reconciled Differences, Principally Timing		4,792		(1,167)
Unreconciled Differences		103		70
Fund Balance with Treasury	$	57,887	$	39,048
Status of Fund Balance with Treasury				
Unobligated Balance				
Available	$	7,267	$	6,898
Unavailable		25,071		7,405
Obligated Balance Not Yet Disbursed		25,085		24,333
Deposit /Clearing Account Balances		464		412
Fund Balance with Treasury	$	57,887	$	39,048

4. Cash

Cash as of September 30,		2014		2013
Canteen Service	$	2	$	2
Agent Cashier Advance		3		6
Total Cash	$	5	$	8

5. Investments

Investment Securities								
as of September 30, 2014								
		Cost	Amortization Method		Amortized (Premium)/ Discount	Interest Receivable	Investments, Net		Market Value
Intragovernmental Securities (Note 19)									
Non-Marketable: Special Bonds	$	7,700	N/A	$	-	60	7,760	$	7,760
Treasury Notes		67	Effective Interest		(1)	1	67		67
Total	$	7,767		$	(1)	61	7,827	$	7,827
Public Securities									
Trust Certificates (Loan Guaranty)	$	140	N/A	$	-	-	140	$	140
Mutual Funds (Non-Federal Trusts)		44	Straight-line		(6)	-	38		38
Total	$	184		$	(6)	-	178	$	178
as of September 30, 2013									
Intragovernmental Securities (Note 19)									
Non-Marketable: Special Bonds	$	8,406	N/A	$	-	70	8,476	$	8,476
Treasury Notes		90	Effective Interest		(3)	1	88		88
Total	$	8,496		$	(3)	71	8,564	$	8,564
Public Securities									
Trust Certificates (Loan Guaranty)	$	140	N/A	$	-	-	140	$	140
Mutual Funds (Non-Federal Trusts)		44	Straight-line		(6)	-	38		38
Total	$	184		$	(6)	-	178	$	178

6. Accounts Receivable, Net

Accounts Receivable, Net as of September 30,	2014	2013
Intragovernmental Accounts Receivable, Net	$ 40	$ 41
Public Accounts Receivable		
Medical Care	$ 2,655	$ 2,343
Contractual Adjustment and Allowance for Loss Provision	(1,113)	(1,023)
Net Medical Care	1,542	1,320
Compensation and Pension	1,281	1,071
Allowance for Loss Provision	(564)	(727)
Net Compensation and Pension	717	344
Education Benefits	419	380
Allowance for Loss Provision	(150)	(109)
Net Education Benefits	269	271
Other	124	127
Allowance for Loss Provision	(21)	(22)
Net Other	103	105
Total Public Accounts Receivable	4,479	3,921
Total Contractual Adjustment and Allowance for Loss Provision	(1,848)	(1,881)
Public Accounts Receivable, Net	$ 2,631	$ 2,040

The Total Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Public Accounts Receivable was approximately 41 percent and 48 percent at September 30, 2014 and 2013, respectively. The Medical Care Contractual Adjustment and Allowance for Loss Provision as a percentage of Total Medical Care related accounts receivable was approximately 42 percent and 44 percent at September 30, 2014 and 2013, respectively.

Included in the Medical Care Contractual Adjustment and Allowance for Loss Provision is an Allowance for Contractual Adjustment of $697 million and $611 million or approximately 55 percent and 56 percent, respectively of MCCF third party receivables of $1.27 billion and $1.09 billion at September 30, 2014 and 2013, 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 44 percent and 68 percent at September 30, 2014 and 2013, respectively. The Education Benefits Allowance for Loss Provision as a percentage of Total Education Benefits and Readjustment Benefit Overpayment-related accounts receivable was approximately 36 percent and 29 percent at September 30, 2014 and 2013, 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:

- Home Loans
- Vocational Rehabilitation and Employment
- Insurance

The VA Home Loan program is the largest of the VA loan programs. The Home Loan program provides loan guarantees and direct loans to Veterans, Servicemembers, qualifying dependents, and limited non-Veterans to purchase homes and retain homeownership with favorable market terms.

VA operates in the broader mortgage marketplace; as a result, the VA housing program is affected by overall housing market conditions. The current mortgage market has demonstrated steady improvements; and homeowner equity is recovering. VA and loan servicers will be better able to use foreclosure-resolution and avoidance tools to improve the outcomes of servicing efforts offered to borrowers with delinquent VA guaranteed home loans.

VA projects, funds, and reports the long-term direct costs for these loans, which includes estimates of loan lifetime costs incurred by the government from making VA loans. These estimates of long-term costs are updated annually and represent capital required to cover expected lifetime loan losses. Some drivers for the reestimated capital required are as follows:

1. Service-connected home loans are a larger proportion of new home loan guarantees in 2014. Purchase home loans, however, are a smaller proportion of new home loan guarantees in 2014. Service-connected home loans have lower funding fee rates compared to purchase home loans and generate less collection for the government.

2. A lower projected recovery rate in 2015 for existing home loans. The lower recovery rate generates less property sales proceeds, or recoveries on defaulted loans.

3. Interest expense on additional cash set aside to cover future mortgage losses. Additional cash is set aside because of more service-connected refinance home loans and the ower home loan recovery rate.

VA performs economic modeling and analysis using available loan portfolio data and economic assumptions correlated with some key loan data (foreclosures, outlays and collections, home prices, interest rates, and loan prepayments and terms). These estimates are based on current conditions that may change in the future. Actual results may differ materially from estimated amounts.

The Vocational Rehabilitation and Employment direct loans provide temporary financial assistance to eligible beneficiaries. Loans provided under this program are interest free and must be repaid within 10 months.

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.

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 disbursed, 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, 2014

	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)	$ 5	6	-	-	$ 11
Insurance Policy Loans	345	8	-	-	353
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net					$ 364

	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	$ 512	19	58	27	$ 616
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net					$ 980

Loans Receivable and Related Foreclosed Property and Insurance Policy Loans From Direct Loans as of September 30, 2013	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)	$ 8	6	-	-	$ 14
Insurance Policy Loans	384	9	-	-	393
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans, Excluding Direct Loans Obligated After 1991, Net					$ 407

	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	$ 584	16	56	17	$ 673
Total Loans Receivable and Related Foreclosed Property and Insurance Policy Loans from Direct Loans, Net					$ 1,080

Direct Loans Disbursed

The total amount of new direct loans disbursed for the years ended September 30, 2014 and 2013, was $4.8 million and $2.2 million, respectively.

Subsidy Expense for Post-1991 Direct Loans

Subsidy expense reflected no material change over the prior year and the methodology used to compute the subsidy expense was consistent with the prior year.

Input data and assumptions were changed based on analysis of loan performance and economic conditions in 2014. The changes in economic assumptions were marginal drivers in analysis of change in subsidy estimates for future potential bad loans. Actual home price appreciation, mortgage rate, and Treasury bond yield were better than their predicted values.

The subsidy expense for direct loans is as shown:

Direct Loan Subsidy Expense for the years ended September 30,	2014	2013
Interest Differential	$ (2)	$ (1)
Defaults	1	-
Subtotal	(1)	(1)
Interest Rate Reestimates	3	(11)
Technical Reestimates	(25)	(33)
Total Direct Loan Subsidy Expense	$ (23)	$ (45)

Budgetary 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.

Budgetary Subsidy Rates for Direct Loans by Component	
Interest Differential	(35.68%)
Defaults	6.76%
Fees	(1.26%)
Other	1.05%

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 2014, the subsidy rate is (24.13) percent for Veterans Housing Direct – Vendee Loans, (5.00) percent for Veterans Housing Direct – Acquired Loans, and (16.75) percent for Native American Direct. For 2013, the subsidy rate is (2.54) percent for Veterans Housing Direct – Vendee Loans, (2.29) percent for Veterans Housing Direct – Acquired Loans, and (17.83) percent for Native American Direct. The negative balances related to the allowance for subsidy shown below represent an increase in the post - 1991 direct loan balances reported in the direct loan table.

Schedule for Reconciling Subsidy Cost Allowance Balances Beginning Balance, Changes and Ending Balance	2014	2013
Beginning balance of the allowance	$ (56)	$ (24)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(2)	(1)
Default costs (net of recoveries)	1	-
Total of the above subsidy expense components	(1)	(1)
Adjustments:		
Foreclosed property acquired	(11)	(7)
New Loans	-	2
Loans written off	(3)	(5)
Subsidy allowance amortization	2	16
Change in reestimate approved by OMB	32	7
Total Adjustments	20	13
Ending balance of the allowance before reestimates	(37)	(12)
Subsidy reestimates by component		
Interest rate reestimate	3	(11)
Technical/default reestimate	(25)	(33)
Total of the above reestimate components	(22)	(44)
Ending balance of the allowance	$ (59)	$ (56)

Loan Guarantees

The following tables summarize the carrying amount of loans receivable related to pre-1992 and post-1991 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 the 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, 2014

	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees (Allowance for Loss Method)	$ 28	-	5	3	$ 36
Defaulted Guaranteed Loans - Post-1991 Guarantees	5	-	-	817	822
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 858

Loans Receivable and Related Foreclosed Property from Loan Guarantees
as of September 30, 2013

	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans - Pre-1992 Guarantees (Allowance for Loss Method)	$ 31	-	-	4	$ 35
Defaulted Guaranteed Loans - Post-1991 Guarantees	5	-	-	1,027	1,032
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					$ 1,067

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 or a delegated Staff Appraisal Reviewer to substantiate 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, 2014 and 2013.

Real Estate Owned				
as of September 30,				
		2014		**2013**
Opening Balance	$	1,048	$	1,016
Acquisitions Direct Loans	$	30	$	20
Acquisitions Guaranteed Loans	$	1,528	$	1,508
Gain/Loss on Sale	$	(368)	$	(436)
Proceeds from Sale	$	(1,649)	$	(1,260)
Property Management Expense	$	257	$	200
Ending Balance	$	846	$	1,048

As of September 30, 2014 and 2013, the number of residential properties in VA's inventory was approximately 8,180 and 11,100, respectively. For 2014 and 2013, the average holding period from the date properties were conveyed to VA until the date properties were sold was approximately 9 months for both years. The number of properties for which foreclosure proceedings are in process was approximately 29,900 and 18,800 as of September 30, 2014 and 2013, respectively.

Guaranteed Loans				
as of September 30,				
		2014		**2013**
Guaranteed Loans Outstanding:				
Outstanding Principal of Guaranteed Loans, Face Value	$	389,272	$	339,245
Amount of Outstanding Principal Guaranteed	$	101,506	$	89,227
Loan Principal Collections, New Guaranteed Loans	$	(756)	$	(1,452)
Termination of Outstanding Principal Guaranteed, Face Value	$	(36,793)	$	(74,123)
New Guaranteed Loans Disbursed:				
Outstanding Principal of Guaranteed Loans, Face Value	$	86,819	$	128,194
Amount of Outstanding Principal Guaranteed	$	22,043	$	32,359
Number of New Loans Disbursed		386,872		570,646
Liabilities for Pre-1992 and Post-1991 Loan Guarantees, Excluding Loan Sale Guarantees (Present Value Method)	$	8,753	$	7,559

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 current and prior year upward reestimate was principally caused by increasing claim payments following the housing crisis, increasing demand for new refinance loan guarantees resulting from lower mortgage rates, higher home sale prices and a recovering housing market. Specifically, the Loan Guarantee Financing Account (4129) operating income deteriorated on higher foreclosure claim payments that were inconsistent with rising home prices. The loan guarantee average funding fee rate deteriorated on higher demand for refinance loan guarantees. Deterioration in the average funding fee rate relative to budget contributed to upward reestimates. 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,		2014		2013
Defaults	$	1,384	$	1,897
Fees		(1,404)		(2,032)
Subtotal		(20)		(135)
Interest Rate Reestimates		58		167
Technical Reestimates		367		1,421
Total Guaranteed Loan Subsidy Expenses	$	405	$	1,453

Budgetary 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.

Budgetary Subsidy Rates for Loan Guarantees	
Defaults	1.41%
Fees	(1.43)%

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 subsidy rate for 2014 was (.02) percent. In the table below, the current year and prior year upward reestimate was principally caused by a higher proportion of new refinance loan guarantees and unanticipated increase claim payment rates for some older loan guarantees with steady improvements in housing market conditions.

Schedule for Reconciling Loan Guarantee Liability Balance				
Beginning Balance, Changes and Ending Balance				
		2014		2013
Beginning balance of the liability	$	7,559	$	5,445
Subsidy expense for guaranteed loans disbursed during the reporting years by component:				
Default costs (net of recoveries)		1,384		1,897
Fees and other collections		(1,404)		(2,032)
Total of the above subsidy expense components		(20)		(135)
Adjustments:				
Fees received		1,366		1,494
Foreclosed property		(352)		(243)
Claim payments to lenders		(940)		(1,123)
Interest accumulation on the liability balance		162		149
Change in reestimate approved by OMB		332		384
Total Adjustments		568		661
Ending balance of the liability before reestimates		8,107		5,971
Subsidy reestimates by component				
Interest rate reestimate		58		167
Technical/default reestimate		367		1,421
Total of the above reestimate components		425		1,588
Ending balance of the liability	$	8,532	$	7,559

Schedule for Reconciling Pre-1992 Loan Guarantee Liabilities				
Beginning Balance, Changes and Ending Balance				
		2014		2013
Beginning balance of the liability	$	208	$	189
Claims		(1)		(11)
Foreclosed Properties		(1)		(4)
Veteran Liability Debts		20		29
Amortization of Liability Balance		(4)		5
Total	$	222	$	208

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 has the authority to 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 2014, the total loans sold amounted to $14.2 billion. VA recognized no loan sale proceeds or gain or loss on sale of loans during 2014. The components of the outstanding balance for guaranteed loans sold are summarized in the table below:

Outstanding Balance of Loan Sale Guarantees - Guaranteed Loans Sold				
as of September 30,				
		2014		**2013**
Outstanding Balance Guaranteed Loans Sold, Start of Year	$	1,597	$	1,808
Payments, Repayments, and Terminations		(182)		(211)
Outstanding Balance Guaranteed Loans Sold, End of Year	$	1,415	$	1,597

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 below:

Loan Sale-Guaranteed Loan Subsidy Expense				
for the years ended September 30,				
		2014		**2013**
Defaults	$	-	$	-
Fees		-		-
Other		-		-
Subtotal		-		-
Interest Rate Reestimates		2		30
Technical Reestimates		(13)		23
Total Loan Sale-Guaranteed Subsidy Expense	$	(11)	$	53

Schedule for Reconciling Loan Sale Guarantee Liability Balances		
Beginning Balance, Changes and Ending Balance	**2014**	**2013**
Beginning balance of the liability	$ 166	$ 116
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Default costs (net of recoveries)	-	-
Fees	-	-
Total of the above subsidy expense components	-	-
Adjustments:		
Claim payments to lenders	(24)	(29)
Interest accumulation on the liability balance	9	46
Change in reestimate approved by OMB	14	(20)
Gain on Loan Sales	-	-
Total Adjustments	(1)	(3)
Ending balance of the liability before reestimates	165	113
Subsidy reestimates by component		
Interest rate reestimate	2	30
Technical/default reestimate	(13)	23
Total of the above reestimate components	(11)	53
Ending balance of the liability	$ 154	$ 166

Program Totals

Total Loans Receivable and Related Foreclosed Property, Net		
as of September 30,		
	2014	**2013**
Total Direct Loans	$ 980	$ 1,080
Total Guaranteed Loans	858	1,067
Total Loans Receivable and Related Foreclosed Property, Net	$ 1,838	$ 2,147

Total Subsidy Expense		
for the years ended September 30,		
	2014	**2013**
Total Direct Loans	$ (23)	$ (45)
Total Guaranteed Loans	405	1,453
Total Loan Sales	(11)	53
Total Subsidy Expense	$ 371	$ 1,461

Total Liabilities for Loan Guarantees		
as of September 30,		
	2014	**2013**
Total Loan Guarantee Liability	$ 8,532	$ 7,559
Total Pre-1992 Loan Guarantee Liability	222	208
Total Loan Sale Guarantee Liability	154	166
Total Liabilities for Loan Guarantees	$ 8,908	$ 7,933

Administrative Expense
Administrative expense for direct and guaranteed loans for the fiscal years ended September 30, 2014 and 2013, was $160 million and $151 million, respectively.

8. Inventories and Related Property, Net

Inventories as of September 30,	2014	2013
Held for Current Sale	$ 49	$ 71
Total Inventories	$ 49	$ 71

9. General Property, Plant and Equipment

General Property, Plant and Equipment as of September 30, 2014	Cost	Accumulated Depreciation /Amortization	Net Book Value
Land and Improvements	$ 1,345	$ (298)	$ 1,047
Buildings	27,253	(15,035)	12,218
Equipment	4,371	(2,568)	1,803
Other Structures and Capital Leases	3,941	(2,153)	1,788
Internal Use Software	1,033	(784)	249
Construction Work in Progress	4,855	-	4,855
Internal Use Software in Development	323	-	323
Total Property, Plant, and Equipment	$ 43,121	$ (20,838)	$ 22,283

General Property, Plant and Equipment as of September 30, 2013	Cost	Accumulated Depreciation /Amortization	Net Book Value
Land and Improvements	$ 1,158	$ (241)	$ 917
Buildings	25,834	(14,138)	11,696
Equipment	4,429	(2,393)	2,036
Other Structures and Capital Leases	3,612	(2,021)	1,591
Internal Use Software	912	(587)	325
Construction Work in Progress	5,102	-	5,102
Internal Use Software in Development	309	-	309
Total Property, Plant, and Equipment	$ 41,356	$ (19,380)	$ 21,976

Depreciation and amortization expense totaled $1.7 billion and $2.1 billion in 2014 and 2013, respectively. Loss on disposition of assets totaled $476 million and $100.2 million in 2014 and 2013, 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, Regional Offices and National Cemeteries that meet the criteria for heritage assets. Historic 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 and withdrawals of VA's heritage assets inventory result from field station condition assessment surveys, which identify items such as new collections or newly designated assets. There were no heritage assets transferred between Federal entities or acquired through donation or devise that were considered material to the consolidated financial statements for 2014 and 2013, therefore, fair value disclosure is not required for heritage assets acquired by donation or devise. 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, but excluding multi-use buildings); 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.

VA has 1,633 multi-use Heritage Assets that are included in General PP&E (and not a part of the count shown below). These multi-use Heritage Assets are being utilized as administration, operation, engineering and maintenance buildings.

VA expensed $7.9 million and $7.1 million of heritage asset costs associated with acquisition, construction, renovation and/or modification of VA-owned personal property and buildings and structures declared as heritage assets for the years ended September 30, 2014 and 2013, respectively.

Heritage Assets in Units					
as of September 30,	**2013 Balance**	**2014 Additions**	**2014 Withdrawals**	**2014 Balance**	**(Unaudited) Condition**
Art Collections	24	-	(11)	13	A
Buildings and Structures	604	-	(42)	562	A/U
Monuments/Historic Flag Poles	1,202	91	-	1,293	A
Other Non-Structure Items	390	125	-	515	A
Archaeological Sites	9	-	(5)	4	A
Cemeteries	*164	-	-	*164	A
Total Heritage Assets in Units	2,393	216	(58)	2,551	

Explanation of Condition: A = Acceptable (No to slight deterioration); U=Unacceptable (Moderate to significant deterioration).
* This total accounts only for open, operational cemeteries, not those under development.

11. Debt

Intragovernmental Debt as of September 30,	2013 Beginning Balance	2013 Net Borrowing	2013 Ending Balance	2014 Net Borrowing	2014 Ending Balance
Loan Guaranty Debt					
Debt to the Treasury	$ 837	$ (88)	$ 749	$ (58)	$ 691
Debt to the Federal Financing Bank	5	-	5	-	5
Total Loan Guaranty Debt	842	(88)	754	(58)	696
Direct Loans Debt – Vocational Rehabilitation Program					
Debt to the Treasury	1	1	2	(1)	1
Debt to the Federal Financing Bank	-	-	-	-	-
Total Direct Loans Debt	1	1	2	(1)	1
Total Debt					
Debt to the Treasury	838	(87)	751	(59)	692
Debt to the Federal Financing Bank	5	-	5	-	5
Total Debt	$ 843	$ (87)	$ 756	$ (59)	$ 697

At September 30, 2014 and 2013, all debt is classified as intragovernmental debt. Except as noted above, VA had no debt due to any other Federal agency and all debt is covered by budgetary resources.

Loan Guaranty Program 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 in 2014 ranged from 1.65 to 2.75 percent and 2.74 to 3.49 percent for debt issued in 2013. The interest rates on all outstanding debt issued ranged from 1.00 to 7.59 percent in 2014 and 2.01 to 7.59 percent in 2013. Interest expense was $27 million for 2014 and $40 million for 2013.

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 rates on debt issued was 1.00 percent in 2014 and 2013. The interest rate on all outstanding debt issued is 1.00 percent in 2014 and 1.00 percent in 2013. Interest expense was $37 million for 2014 and $41 million for 2013.

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

No debt was held by the public during 2014 or 2013. 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,	2014	2013
Workers' Compensation (FECA)*	$ 2,728	$ 2,680
Annual Leave	1,987	1,908
Judgment Fund	1,692	1,397
Environmental and Disposal Liabilities	789	823
Veterans Compensation and Burial	2,007,100	1,974,800
Insurance	1,442	1,352
Amounts due to Non-Federal Trust	134	141
Total	$ 2,015,872	$ 1,983,101

* The actuarial estimate for workers' compensation provided by DOL was computed using an interest rate of 3.46 percent for wage benefits and 2.86 percent for medical benefits to discount the projected annual benefit payments as of September 30, 2014 and 3.13 percent for wage benefits and 2.86 percent for medical benefits to discount the projected annual benefit payments as of September 30, 2013.

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided.

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 $464 million and $460 million at September 30, 2014 and 2013, respectively.

13. Federal Employee and Veterans Benefits Liabilities

Federal Employee Benefits

VA is the employer entity that generates employee costs to be funded, not the administrative entity responsible for managing and accounting for VA employees' retirement, health insurance and life insurance benefit plans. As a result, VA recognizes the benefit costs for the reporting period in its financial statements in an amount equal to the service cost for its employees based on the benefit plan's actuarial cost method and assumptions applied to VA and provided by the administrative entity, OPM. The offset to the expense is an increase to an intragovernmental imputed financing source entitled, Imputed Financing under Other Financing Sources (Nonexchange) in the Consolidated Statement of Changes in Net Position, representing the amount being financed directly through the benefit plan's administrative entity. The table below summarizes the imputed expenses reported by VA for its employees' benefit plans.

Federal Employee Benefits: Imputed Expenses-Employee Benefits
Years ended September 30,

		2014		2013
Civil Service Retirement System	$	714	$	527
Federal Employees Health Benefits		1,318		1,267
Federal Employees Group Life Insurance		4		4
Total Imputed Expenses-Employee Benefits*	$	2,036	$	1,798

*The total imputed expenses in the table above, when combined with the Imputed Financing – Paid by Other Entities reported in the table reconciliation of judgment fund operating expense in Note 18 reconciles to Imputed Financing Costs reported in the Consolidated Statement of Changes in Net Position.

Veterans Benefits

Eligible Veterans who die or are disabled during active military service-related causes, as well as their dependents, receive compensation benefits and are provided a burial flag, headstone/marker, and grave liner 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,

		2014		2013
Workers' Compensation (FECA)	$	2,264	$	2,220
Compensation		2,002,600		1,970,200
Burial		4,500		4,600
Total Federal Employee and Veterans Benefits Liabilities	$	2,009,364	$	1,977,020

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, 2014 and 2013, was $102.8 billion and $97.5 billion, respectively.

Assumptions Used to Calculate the Veterans Benefits Liability

Several significant actuarial assumptions were used in the valuation of compensation 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 program; 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.

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, 2014 and 2013, were based on spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities at September 30 of each year for the period 2005 to 2014 and 2004 to 2013 for September 30, 2014 and 2013, respectively. The spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities for each year of expected future payments range from 0.40 percent to 4.39 percent and from 1.81 percent to 4.35 percent as of September 30, 2014 and 2013, respectively. These spot rates produced a single weighted average discount rate of 4.29 percent and 4.20 percent as of September 30, 2014 and 2013, respectively, that could be applied to the expected future cash flows to produce a present value that is not materially different than the present value using multiple rates.

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

The Veterans benefit liability is impacted by interest on the liability balance, changes in experience, changes in actuarial assumptions, prior service costs and amounts paid for costs included in the liability balance. Interest on the liability balance is based on the prior year liability balance multiplied by the single weighted average discount rate used to compute the Veterans benefit liability balance for the prior year. Changes in experience include the number of Veterans and dependents receiving payments, changes in degree of disability connected with military service, changes in the number of presumptive conditions, the on-going incidence rate and the prevalence of the presumptive conditions in the Veteran population and the impact of those changes on future years. Changes in actuarial assumptions include changes in the spot rates derived from the 10-year average historical interest rate yield curve on Treasury securities, cost of living adjustments, presumptive service conditions resulting in benefits coverage, mortality and disability claims rates and backlog of Veterans claims to be processed. Prior service costs relate to new benefits due to administrative, judicial or legislative changes.

The total number of Veterans, estimated future military separations and total number of beneficiary participants are determined through actual record level data and projected American Community Survey 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 revised factors based on current year actual data related to the incidence and prevalence of presumptive service conditions in existence in the Veteran population at September 30, 2014 and 2013, 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, 2014 and 2013, was 2.61 percent and 2.57 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 program 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 projection only reflects benefits associated with military service through September 30, 2014.

VA has a unique program that is not a defined benefit plan and has no plan assets set aside to fund future costs. VA funds the current year costs of Veterans service related disability compensation and burial costs through its annual appropriations that are recognized in Program Costs under Veterans Benefits Administration in the Statements of Net Cost and in Amounts Paid in the Reconciliation of Veterans Compensation and Burial Actuarial Liabilities table that follows below.

The reconciliation table that follows the narrative below shows that the total cost for 2014 of $97.6 billion decreased $180.3 billion over 2013 expense of $277.9 billion. The decrease was primarily attributable to VBA's continued efforts to reduce the backlog of pending claims, including the large number of claims from eligible Veterans with preexisting conditions that were added to the list of presumptive conditions. The higher disability claims rates are based on emerging experience from initial and reopened claims for the new presumptive conditions related to Agent Orange. VA recognized these effects primarily in September 2013 and the liability balance has not changed significantly as of September 30, 2014. Also contributing to the reduction in costs year over year, was an increase in the single weighted average discount rate to 4.29 percent in 2014 from 4.20 percent in 2013. This change resulted in a decrease in costs associated with the reported liability compared to a decrease in the single weighted average discount rate to 4.20 percent in 2013 from 4.31 percent in 2012; which resulted in an increase in the 2013 liability.

Reconciliation of Veterans Compensation and Burial Actuarial Liabilities			
For the Year Ended September 30,			
	Compensation	Burial	TOTAL
Liability at October 1, 2012	**$ 1,757,100**	**$ 4,500**	**$ $1,761,600**
Expense:			
Interest on the Liability Balance*	75,700	200	75,900
Actuarial (Gain)/Loss from Current Year Activity			
Changes in Experience (Veterans Counts, Status)*	86,800	(100)	86,700
Changes in Assumptions:			
Changes in Discount Rate Assumption	39,600	100	39,700
Changes in COLA Rate Assumption	(11,800)	-	(11,800)
Changes in Disability Claims Rates	70,400	-	70,400
Changes in Other Assumptions	15,700	100	15,800
Net (Gain)/Loss from Changes in Assumptions	113,900	200	114,100
Prior Service Costs (Adjustment to Benefits)*	1,200	-	1,200
Total Expense	277,600	300	277,900
Less Amounts Paid*	(64,500)	(200)	(64,700)
Net Change in Actuarial Liability	213,100	100	213,200
Liability at September 30, 2013	**1,970,200**	**4,600**	**1,974,800**
Expense:			
Interest on the Liability Balance**	82,700	200	82,900
Actuarial (Gain)/Loss from Current Year Activity			
Changes in Experience (Veterans Counts, Status)**	36,800	-	36,800
Changes in Assumptions:			
Changes in Discount Rate Assumption	(37,400)	(100)	(37,500)
Changes in COLA Rate Assumption	15,400	-	15,400
Net (Gain)/Loss from Changes in Assumptions	(22,000)	(100)	(22,100)
Prior Service Costs (Adjustment to Benefits)**	-	-	-
Total Expense	97,500	100	97,600
Less Amounts Paid**	(65,100)	(200)	(65,300)
Net Change in Actuarial Liability	32,400	(100)	32,300
Liability at September 30, 2014	**$ 2,002,600**	**$ 4,500**	**$ 2,007,100**

* The sum of these changes represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2013.
** The sum of these changes represents Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions on the Statement of Net Cost for 2014.

14. Environmental and Disposal Liabilities

VA had unfunded environmental and disposal liabilities in the amount of $789 million and $823 million as of September 30, 2014 and 2013, 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. As of September 30, 2014, the liablities for friable and non-friable asbestos removal was $150 million and $461 million, respectively.

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.

It is at least reasonably possible that the estimated liabilities will change, possibly materially, as a result of changes in applicable laws and regulations, technology; future location requirements or plans; budgetary resources; and changes in future economic conditions, including inflation and deflation.

15. Other Liabilities

Other liabilities are liabilities not reported elsewhere in the Consolidated Balance Sheets. 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,

		2014		2013
Deposit and Clearing Account Liabilities	$	268	$	681
Accrued Expenses - Federal		13		16
Deferred Revenue		52		17
Custodial Liabilities		74		71
Credit Reform Act Subsidy Reestimates*		246		21
Accrued VA Contributions for Employee Benefits		183		148
Total Other Intragovernmental Funded Liabilities	$	836	$	954

* 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,

		2014		2013
Accrued FECA Liability	$	458	$	453
Unfunded Employee Liability		6		7
Total Other Intragovernmental Unfunded Liabilities	$	464	$	460
Total Other Intragovernmental Liabilities	$	1,300	$	1,414

Other Public Funded Liabilities

as of September 30,

	2014	2013
Accrued Funded Annual Leave	$ 21	$ 20
Accrued Expenses	168	68
Accrued Salaries and Benefits	747	609
Capital Lease Liability	11	8
Other	(5)	109
Total Other Public Funded Liabilities	$ 942	$ 814

Other Public Unfunded Liabilities

as of September 30,

	2014	2013
Accrued Unfunded Annual Leave*	$ 1,987	$ 1,908
Amounts due to non-Federal trust	134	141
Other	4	-
Judgment Fund-Unfunded**	1,692	1,397
Total Other Public Unfunded Liabilities	$ 3,817	$ 3,446
Total Other Public Liabilities	$ 4,759	$ 4,260

* 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 net capital lease liability was $11 million and $8 million as of September 30, 2014 and 2013, respectively. Capital leases consist primarily of information and computer technology, medical equipment, office equipment and real property. The capital lease liabilities are classified as Other Public Funded Liabilities in Note 15 since capital leases entered into after 1991 are required to be fully funded by budgetary resources in the first year of the lease.

The following is an analysis of the leased property under capital leases by major classes that is included in G-PP&E as disclosed in Note 9 (in millions of dollars):

Capital Lease Assets as of September 30, 2014	**Cost**	**Accumulated Amortization**	**Net Book Value**
Real Property	$ 17.7	$ (16.1)	$ 1.6
Equipment	39.4	(28.9)	10.5
Leased Property Under Capital Lease	$ 57.1	$ (45.0)	$ 12.1
Amortization Expense		$ 3.8	

Capital Lease Assets as of September 30, 2013	**Cost**	**Accumulated Amortization**	**Net Book Value**
Real Property	$ 17.7	$ (15.4)	$ 2.3
Equipment	40.2	(29.0)	11.2
Leased Property Under Capital Lease	$ 57.9	$ (44.4)	$ 13.5
Amortization Expense		$ 3.8	

Operating leases consist of equipment and real property leases that are funded annually and expensed as incurred. Operating equipment leases generally consist of medical and office equipment with terms of five years or less and level payments over the lease term. Operating real property leases generally consist of Veterans medical facilities and clinics, regional and district benefits offices and administrative facilities that enable VA to fulfill its mission to care for and provide benefits to Veterans.

For the year ended September 30, 2014, VA had 1,936 real property leases in effect consisting of approximately 23 million square feet and base annual minimum rental obligations of approximately $616 million. Of the operating real property leases, VHA accounts for 85.3 percent, VBA accounts for 10.4 percent, Indirect Administrative Program offices account for 4.1 percent and NCA accounts for the balance. These real property leases generally have lease terms ranging from one year to fifty years and all operating leases are funded annually by appropriation of funds by Congress. Approximately 69 percent of the real property leases have an initial lease term of five years or less; approximately 24 percent have initial lease terms of six to ten years; approximately 3 percent have initial lease terms of eleven to fifteen years; and approximately 3 percent have initial lease terms of sixteen years and more. Certain leases contain renewal, termination and cancellation options.

Approximately 85 percent of VA leases are executed directly with third party commercial property owners (third party direct leases) with the balance of the leases executed by GSA on behalf of VA. GSA charges rental rates for space that approximates commercial rental rates for similar properties. The terms of occupancy agreements (OAs) with GSA vary according to whether the underlying assets are owned directly by the Federal Government or rented by GSA from third party commercial property owners. VA executes cancellable and non-cancellable OAs with GSA. GSA OAs can be cancellable with varying periods of notice required (generally four to six months). For OAs executed after October 2011, periods of occupancy are generally one year. GSA OAs that are cancelled require a payment of all unamortized tenant improvements and rent concessions not yet earned. GSA OAs may also be non-cancellable, where VA would be financially responsible for rent payments on vacated space until the expiration of the OA, the termination of the OA permitted under the lease terms, or the occupancy by a replacement tenant covers the total rent obligation of VA. However, VA normally occupies the leased properties for an extended period of time without exercising cancellation or termination clauses in the leases.

Annual base rent for operating real property leases is generally flat over the lease term; however, certain GSA OAs and third party direct leases contain rent abatement and rent escalation clauses. For certain GSA OAs, the base rent is set for periods up to but not beyond 5 years. For certain GSA OAs with occupancy terms in excess of 5 years or that incur capitalized building improvement or replacement costs, the base rental rate will be reassessed every 5 years to reflect current market rental rates and additional real property investments. The GSA OAs and third party direct leases also require VA to reimburse increases in common area maintenance costs and operating costs over base year amounts annually based on increases in the Consumer Price Index (CPI), reimburse increases in real estate taxes over a base year amount at least annually and, in certain cases, VA may pay the common area maintenance costs, operating costs and real estate taxes directly.

Future commitments for real property and equipment operating leases are based on leases in effect as of September 30, 2014. VA normally occupies leased real property for the entire initial lease term without exercising cancellation and termination options. As a result, the operating lease commitment table that follows includes real property leases over the noncancellable initial lease term. Real property lease data is maintained in a centralized database and does not capture future fixed rent increases which are considered immaterial to the financial statements taken as a whole and are therefore excluded from the operating lease commitment table that follows.

Due to the number of equipment operating leases and the decentralization of equipment lease records, the future commitments for equipment leases have been estimated using the expense from 2014 in lieu of actual lease terms being reflected for the 5-year period in the disclosure table below. VA does not believe this disclosure method produces information that is materially different than using actual equipment lease terms.

VA's 2014 operating lease rental costs were $658 million for real property rentals and $148 million for equipment rentals. The 2013 operating lease costs were $634 million for real property rentals and $167 million for equipment rentals.

Excluded from the following table are leases of properties that have expired as of September 30, 2014, and prior, but are still occupied by VA. On occasion, VA will retain occupancy of properties once the full term of the lease has expired and continue to remit rent on a monthly basis in accordance with the holdover provisions of the expired lease agreement. These commitments are excluded from the 5-year lease commitment table pending a long-term lease renewal contract or the vacancy of the space by VA. The rent expense associated with holdover leases is reflected in the 2014 expense in the statements of net costs. The following table represents VA's projected future operating lease commitments (in millions of dollars):

Projected Future Operating Lease Commitments

Years Ending September 30,	GSA OAs	Third Party Direct Leases	Total Real Property	Equipment
2015	$ 208	$ 373	$ 581	$ 148
2016	171	351	522	148
2017	163	328	491	148
2018	151	306	457	148
2019	117	273	390	148
2020 and Thereafter (in total)	358	1,888	2,246	-
Total Future Lease Payments	$ 1,168	$ 3,519	$ 4,687	$ 740

VA is a lessor of certain underutilized real estate properties within the Department under its enhanced-use lease (EUL) program authorized by Congress. Title 38, U.S.C. 8161-8169, Enhanced-Use Leases of Real Property, authorizes VA to lease real property under VA’s control or jurisdiction to other public and private entities on a long-term basis (up to 75 years) only for the provision of supportive housing, in return for cash consideration or no consideration. VA’s previous EUL authority expired on Dec. 31, 2011 and was reauthorized under Public Law 112-154 Section 211, limited to supportive housing. The previous authority under which all of the current operational leases were executed allowed VA to enter into EULs for receipt of rental income or in-kind consideration (such as cost avoidance, cost savings, and enhanced services benefitting Veterans) as all or part of the consideration for the lease to further its mission to effectively serve Veterans and was not limited to supportive housing.

The leases related to the EUL and NCA’s leasing of excess land and buildings at cemeteries are more fully described in Note 20 under the caption, Public Exchange Transactions. The EUL program consists of 55 operational leases of land and/or buildings to the public and private sector, including the Non-Federal Trusts discussed in Note 1. The rental income recognized from the EUL program and the NCA leasing program for the years ended September 30, 2014 and 2013, respectively, are immaterial to the financial statements. VA believes that the future rental income to be recognized over the next 5 years from the EUL program and NCA leasing program described above will continue to be immaterial; therefore, the table of future minimum rental income commitments is not presented.

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; the Veterans Reopened Insurance (VRI) program, which covers Veterans who served during World Wars I, II, and the Korean Conflict eras; the Service-Disabled Veterans Insurance (S-DVI) program; and the Veterans Mortgage Life Insurance (VMLI) program, which covers severely disabled Veterans and are open to new issues. VMLI is part of the Veterans Insurance and Indemnities (VI&I) fund.

In addition, VA supervises the Servicemembers Group Life Insurance (SGLI) and the Veterans Group Life Insurance (VGLI) programs, which provides 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 Veterans 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 families are deducted from the Servicemember's pay by the Armed Services components through the 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 4 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, the 2001 CSO Table and the 2001 Valuation Basic Male (VBM) Table.

Insurance Liability (Reserve) Balances

as of September 30, 2014

Program	**Insurance Death Benefits**	**Death Benefit Annuities**	**Disability Income & Waiver**	**Reserve Totals**
NSLI	$ 4,448	$ 57	$ 27	$ 4,532
USGLI	2	2	-	4
VSLI	1,408	6	11	1,425
S-DVI	575	6	777	1,358
VRI	155	1	1	157
VI&I	213	-	-	213
Subtotal	$ 6,801	$ 72	$ 816	$ 7,689
Unearned Premiums				49
Insurance Dividends Left on Deposit and Related Interest Payable				1,346
Dividends Payable to Policyholders				59
Unpaid Policy Claims				2
Insurance Liabilities reported on the Consolidated Balance Sheet				9,145
Less Liability not Covered by Budgetary Resources				(1,442)
Liability Covered by Budgetary Resources				$ 7,703

as of September 30, 2013

Program	**Insurance Death Benefits**	**Death Benefit Annuities**	**Disability Income & Waiver**	**Reserve Totals**
NSLI	$ 5,050	$ 65	$ 34	$ 5,149
USGLI	3	2	-	5
VSLI	1,452	6	11	1,469
S-DVI	541	6	741	1,288
VRI	179	1	2	182
VI&I	200	-	-	200
Subtotal	$ 7,425	$ 80	$ 788	$ 8,293
Unearned Premiums				54
Insurance Dividends Left on Deposit and Related Interest Payable				1,438
Dividends Payable to Policyholders				68
Unpaid Policy Claims				1
Insurance Liabilities reported on the Consolidated Balance Sheet				9,854
Less Liability not Covered by Budgetary Resources				(1,352)
Liability Covered by Budgetary Resources				$ 8,502

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 5,739,444 and 5,894,490 policy holders with a face value of $1.3 trillion for both 2014 and 2013. The face value of the insurance provided by Prudential and its reinsurers represents 99 percent of the total insurance in-force for both 2014 and 2013. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2014 Policies	2013 Policies	2014 Face Value	2013 Face Value
Supervised Programs (UNAUDITED)				
SGLI Active Duty	1,461,000	1,504,000	$ 563,681	$ 582,115
SGLI Ready Reservists	753,500	761,500	253,499	261,262
SGLI Post Separation	91,000	100,000	33,798	37,431
SGLI Family - Spouse	1,037,000	1,055,000	102,200	104,071
SGLI Family - Children	1,972,000	2,048,000	19,720	20,480
TSGLI*	-	-	221,450	226,550
VGLI	424,944	425,990	66,002	64,418
Total Supervised	5,739,444	5,894,490	$ 1,260,350	$ 1,296,327
Administered Programs				
NSLI	438,252	509,337	$ 5,462	$ 6,297
VSLI	130,637	140,336	1,847	1,955
S-DVI	260,895	251,497	2,725	2,620
VRI	17,492	20,568	185	216
USGLI	1,071	1,572	2	4
VMLI	2,485	2,419	313	295
Total Administered	850,832	925,729	$ 10,534	$ 11,387
Total Supervised and Administered Programs	6,590,276	6,820,219	$ 1,270,884	$ 1,307,714

*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 2014 and 2013 were $129 million and $152 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 by 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 88 percent and 48 percent of the amounts funded on behalf of VA by the Judgment Fund in 2014 and 2013, respectively. Contract dispute payments for 2014 and 2013 were $5.8 million and $0.5 million, respectively. The discrimination case payments for 2014 and 2013 were $2.4 million and $1.4 million, respectively. The liability from existing medical malpractice claims is estimated using generally accepted actuarial standards and procedures. The estimated future payments related to these existing claims are discounted using Treasury spot rates as of September 30, 2014 and 2013.

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 $1.69 billion for 2014 and $1.40 billion for 2013.

There were 27 contract and personnel law cases, where there was at least a reasonable possibility that a loss may occur, with financial exposure ranging from $245 million to $1.3 billion in aggregate for 2014. Within that range, $93 million is considered probable and is recorded as a liability. In 2013, the range of exposure was $279 million to $2.8 billion, from 28 cases, of which $78 million was probable and recorded as a liability.

VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. The Judgment Fund accounting is shown below:

Judgment Fund				
For the Years Ended September 30,				
		2014		**2013**
Fiscal Year Settlement Payments	$	141	$	175
Less Contract Dispute and “No Fear” Payments		(8)		(2)
Imputed Financing-Paid by Other Entities*		133		173
Increase (Decrease) in Liability for Claims		299		217
Operating Expense	$	432	$	390

*The Imputed Financing-Paid by Other Entities in the table above, when combined with the Total Imputed Expenses – Employee Benefits reported in Note 13 reconciles to total Imputed Financing costs reported in the Consolidated Statement of Changes in Net Position.

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2014, 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 2014 tort payments were $133 million and 2013 tort payments were $173 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, 2014 and 2013 was $286.6 and $298.3 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 identifies which Veterans, by priority, 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 2010-2014, the average medical care cost per year was $41 billion.

19. Funds from Dedicated Collections

SFFAS 43, *Funds from Dedicated Collections: Amending SFFAS 27, Identifying and Reporting Earmarked Funds*, defines funds from dedicated collections as an individual fund with explicit authority to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the Federal Government's general revenues. The fund's sources of revenue and other financing sources are non-federal sources that are material to the VA and require disclosure of all funds from dedicated collections for which VA has program management responsibility. The Treasury does not set aside assets to pay future expenditures associated with funds from dedicated collections. VA's funds from dedicated collections consist of trusts, special and revolving funds that 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 discussed in Note 1 and presented in Note 5) are assets of funds from dedicated collections that are issued as evidence of specific dedicated receipts from fund activities by the fund and provide the fund the authority to draw upon the Treasury for future authorized expenditures related to the fund's specific purpose. The investments (Treasury Securities) are not general fund assets of the Federal Government, since their use is restricted to the funds' purpose, and are not non-entity assets. When the fund redeems its Treasury Securities to make expenditures, the Treasury will finance those expenditures in the same manner that it finances all other expenditures.

VA's Funds from Dedicated Collections are as follows and the classification of each fund into the grouping of Insurance, Medical Care, Benefits and Burial as shown in the condensed financial statements that follow is designated in the "Purpose of Fund" column below:

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

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

Balance Sheet – Funds from Dedicated Collections as of September 30, 2014	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Assets:					
Fund Balance with Treasury	$ 58	$ 388	$ 64	$ 2	$ 512
Investments with Treasury (Note 5)	7,760	67	-	-	7,827
Other Assets	382	1,680	-	4	2,066
Total Assets	$ 8,200	$ 2,135	$ 64	$ 6	$ 10,405
Liabilities and Net Position:					
Payables to Beneficiaries	$ 244	$ 63	$ 1	$ -	$ 308
Other Liabilities	8,933	156	-	-	9,089
Total Liabilities	9,177	219	1	-	9,397
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(976)	1,916	63	5	1,008
Total Liabilities and Net Position	$ 8,201	$ 2,135	$ 64	$ 5	$ 10,405

Statement of Net Cost – Funds from Dedicated Collections for the Year Ended September 30, 2014	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Gross Program Costs	$ 812	$ 321	$ -	$ -	$ 1,133
Less Earned Revenues	662	3,607	-	-	4,269
Net Program Costs	150	(3,286)	-	-	(3,136)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost/(Benefit) of Operations	$ 150	$ (3,286)	$ -	$ -	$ (3,136)

Statement of Changes in Net Position – Funds from Dedicated Collections for the Year Ended September 30, 2014	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Net Position Beginning of Period	$ (877)	$ 1,652	$ 63	$ 5	$ 843
Budgetary and Other Financing Sources	51	(3,022)	-	-	(2,971)
Net Cost/(Benefit) of Operations	150	(3,286)	-	-	(3,136)
Change in Net Position	(99)	264	-	-	165
Net Position End of Period	$ (976)	$ 1,916	$ 63	$ 5	$ 1,008

Balance Sheet – Funds from Dedicated Collections					
as of September 30, 2013					
	Insurance	Medical Care	Benefits	Burial	Funds from Dedicated Collections
Assets:					
Fund Balance with Treasury	$ 85	$ 298	$ 64	$ 1	$ 448
Investments with Treasury (Note 5)	8,476	88	-	-	8,564
Other Assets	425	1,486	-	4	1,915
Total Assets	$ 8,986	$ 1,872	$ 64	$ 5	$ 10,927
Liabilities and Net Position:					
Payables to Beneficiaries	$ 211	$ 63	$ 1	$ -	$ 275
Other Liabilities	9,652	157	-	-	9,809
Total Liabilities	9,863	220	1	-	10,084
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	(877)	1,652	63	5	843
Total Liabilities and Net Position	$ 8,986	$ 1,872	$ 64	$ 5	$ 10,927

Statement of Net Cost – Funds from Dedicated Collections					
for the Year Ended September 30, 2013					
Gross Program Costs	$ 862	$ 479	$ 1	$ -	$ 1,342
Less Earned Revenues	732	3,487	-	-	4,219
Net Program Costs	130	(3,008)	1	-	(2,877)
Costs Not Attributable to Program Costs	-	-	-	-	-
Net Cost/(Benefit) of Operations	$ 130	$ (3,008)	$ 1	$ -	$ (2,877)

Statement of Changes in Net Position – Funds from Dedicated Collections					
for the Year Ended September 30, 2013					
Net Position Beginning of Period	$ (826)	$ 1,502	$ 64	$ 5	$ 745
Budgetary and Other Financing Sources	79	(2,858)	-	-	(2,779)
Net Cost/(Benefit) of Operations	130	(3,008)	1	-	(2,877)
Change in Net Position	(51)	150	(1)	-	98
Net Position End of Period	$ (877)	$ 1,652	$ 63	$ 5	$ 843

20. Exchange Transactions

Exchange Revenues

Exchange revenue is an inflow of resources to VA that is recognized when earned from exchange transactions with other federal agencies or the public where each party to the transaction sacrifices value and receives value in return. Exchange revenue consists primarily of: medical revenue recognized when earned from other federal agencies or the public as a result of costs incurred or services performed on their behalf; benefits revenue from reimbursement of education benefit programs from service member contributions that are transferred to the general fund account with the Department of the Treasury (Treasury); insurance revenue from insurance policy premiums paid by policyholders; and housing revenue from interest earned on direct loans. Exchange revenues are discussed further in Note 1 under Revenues and Other Financing Sources.

Exchange revenue is usually based on the full cost associated with the goods exchanged or services performed. 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 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 No. 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 CFO.

Public Exchange Transactions

VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for 2014 and 2013 were $1.361 billion and $1.43 billion, respectively. The loan guarantee lender participation fees collected for 2014 and 2013 were $2.1 million and $2.1 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 seven cemeteries to not-for-profit groups at no cost. 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 ten cemeteries with private sector entities, for which it receives rental payments; one agricultural license to the state of Colorado at no cost, and one permit to the Federal Aviation Administration (FAA) at no cost. NCA also leases buildings at two cemeteries to not-for-profit groups that are responsible for the historic preservation of the building at no cost to NCA. Total rental revenues earned under the contracts above were $120 thousand and $93 thousand for 2014 and 2013, respectively.

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 DoD 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 $360 million and $369 million during 2014 and 2013, 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. Interagency billing rates are determined from cost and workload data in the Decision Support System.

21. Net Program Costs by Administration

Schedule of Net Program Costs by Administration					
For the Period Ending September 30, 2014 (Dollars in Millions)	**Veterans Health Administration**	**Veterans Benefits Administration**	**National Cemetery Administration**	**Indirect Administrative Program Costs**	**Total**
Program Costs					
Intragovernmental Costs	$ 8,938	$ 656	$ 40	$ 489	$ 10,123
Less Earned Revenues	(67)	(611)	-	(224)	(902)
Net Intragovernmental Program Costs	8,871	45	40	265	9,221
Public Costs	56,059	87,381	270	1,342	145,052
Veterans Benefits Actuarial Costs, Excluding Changes in Actuarial Assumptions (Note 13)	-	54,400	-	-	54,400
Less Earned Revenues	(3,744)	(626)	-	(68)	(4,438)
Net Public Program Costs	52,315	141,155	270	1,274	195,014
Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	61,186	141,200	310	1,539	204,235
Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13)	-	(22,000)	(100)	-	(22,100)
Net Cost of Operations	$ 61,186	$ 119,200	$ 210	$ 1,539	$ 182,135

Schedule of Net Program Costs by Administration					
For the Period Ending September 30, 2013 (Dollars in Millions)	**Veterans Health Administration**	**Veterans Benefits Administration**	**National Cemetery Administration**	**Indirect Administrative Program Costs**	**Total**
Program Costs					
Intragovernmental Costs	$ 8,589	$ 645	$ 40	$ 444	$ 9,718
Less Earned Revenues	(134)	(947)	-	(246)	(1,327)
Net Intragovernmental Program Costs	8,455	(302)	40	198	8,391
Public Costs	51,728	83,274	265	1,643	136,910
Veterans Benefits Actuarial Cost, Excluding Changes in Actuarial Assumptions (Note 13)	-	99,200	(100)	-	99,100
Less Earned Revenues	(3,633)	(602)	-	(261)	(4,496)
Net Public Program Costs	48,095	181,872	165	1,382	231,514
Net Program Cost by Administration Before Changes in Veterans Benefits Actuarial Liability Assumptions	56,550	181,570	205	1,580	239,905
Net (Gain)/Loss from Actuarial Liability Assumptions (Note 13)	-	113,900	200	-	114,100
Net Cost of Operations	$ 56,550	$ 295,470	$ 405	$ 1,580	$ 354,005

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 borrowed from the Treasury and Federal Financing Bank.

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) 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 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 cancelled.

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 cancelled.

The unexpended balance represents the sum of the obligated and unobligated balances.

An outlay is the amount of checks, disbursement of cash, or electronic transfer of funds to liquidate a Federal obligation. 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, Appropriations under Budgetary Resources, in the Combined Statements of Budgetary Resources, does not agree to the 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 under Budgetary Resources in the Combined Statement of Budgetary Resources, does not agree to the 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. The amounts by year and category reconcile to the SF 132, Apportionment and Reapportionment Schedule, SF 133, Report on Budget Execution and Budgetary Resources, and Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) as required by OMB Circular No. A-11, Section 120. The increase in Category A and decrease in Category B is primarily due to a change in the classification of the Compensation and Pensions fund to conform to the category definitions in A-11, Section 120.

	2014	**2013**
Category A, Direct	$ 148,452	$ 142,590
Category B, Direct	9,978	7,456
Reimbursable	5,157	5,544
Total Obligations	$ 163,587	$ 155,590

Adjustments to Budgetary Resources and Prior Year Recoveries
Recoveries of prior year unpaid obligations 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, required for all open phase funds, are required to be apportioned by OMB before they can be used. Once apportioned by OMB, these apportioned anticipated resources cannot be used until funds are deobligated or refunded and the recovered budget authority is realized. At that point, the budget authority is allotted back down to the appropriate facilities or specific program offices. These adjustments relate to the open phase only of multi-year and no-year appropriations beyond the first year of availability of budgetary authority and the expired phase of annual and multi-year appropriations. No-year appropriations have no expiration of budgetary authority unless cancelled by Congress.

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. During 2014, the coding was completed to implement the design document requirements. Meetings were held with representatives of all groups with prior year recoveries to explain how the core accounting system would be enabled to properly identify prior year recoveries, systematically monitor reapportioned budget authority and track both for internal and external financial reporting. Extensive testing was performed by the software developer, the system quality assurance service, and representatives of the user community. VA followed a detailed project plan with final end to end testing that resulted in a decision to install the automated systems solution at the start of 2015. Throughout 2014, VA continued a manual review process to identify prior year recoveries and quantify an estimate to be recorded at the VA combined level, not at the detailed fund account level. 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.

In the interim, VA has implemented a manual review process to identify prior year recoveries and quantify an estimated range of transactions that would be accounted for as and meet the definition of a prior year recovery. Based on the review process, estimated recoveries of prior year unpaid obligations were $2.5 billion and $2.7 billion for 2014 and 2013, respectively. The effect of recording the $2.5 billion estimate of recoveries of prior year unpaid obligations in 2014 was to increase "Recoveries of Prior Year Unpaid Obligations" and increase "Obligations Incurred" in the Combined Statement of Budgetary Resources.

For 2014 and 2013, VA appropriations were subjected to a rescission of $1.8 billion and $2.0 billion, respectively, under the provisions of P.L. 113-6, *Consolidated and Further Continuing Appropriations Act, 2014* and P.L. 113-6*, Consolidated and Further Continuing Appropriations Act, 2013*, respectively.

Borrowing Authority

The Loan Guaranty Program had borrowing authority of $356 million and $249 million as of September 30, 2014 and 2013, respectively. The interest rates on the borrowing authority range from 1.65 to 2.75 percent for 2014 and 2013. 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 $2.5 million and $2.8 million as of September 30, 2014 and 2013, respectively. The interest rate on the borrowing authority was 1.00 percent for 2014 and 2013. Principal repayment is expected over a 2-year period from the date of issuance of debt. The Loan Guaranty Program 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 Program loans generally had a duration of one year, and repayment was made from offsetting collections.

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 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 2014 use and appropriated unobligated amounts that have expired, 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 2014 Appropriation Law (P.L. 113-6). These purposes include: Veterans 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

Estimated recoveries of prior year unpaid obligations totaling $2.7 billion were recorded as an increase in “Recoveries of Prior Year Unpaid Obligations” and an increase in “Obligations Incurred” in the Combined Statement of Budgetary Resources for the year ended September 30, 2013. VA’s systems require extensive modification to properly account for the prior year recoveries in the base level of fund account and U.S. Standard General Ledger (USSGL) detail to conform to OMB and Treasury guidelines. During 2014, the coding was completed to implement the design document requirements. Meetings were held with representatives of all groups with prior year recoveries to explain how the core accounting system would be enabled to properly identify prior year recoveries, systematically monitor reapportioned budget authority and track both for internal and external financial reporting. Extensive testing was performed by the software developer, the system quality assurance service, and representatives of the user community. VA followed a detailed project plan with final end to end testing that resulted in a decision to install the automated systems solution at the start of 2015. Throughout 2014, VA continued a manual review process to identify prior year recoveries and quantify an estimate to be recorded at the VA combined level, not at the detailed fund account level. Therefore, the adjustments have not been reflected in the data used to prepare the President’s Budget.

Undelivered Orders at the End of a Period

The amount of budgetary resources obligated for undelivered orders for the years ended 2014 and 2013 was $16.4 billion and $16.8 billion, respectively.

Contributed Capital

The amount of contributed capital received during 2014 consisted of donations in the amount of $65.8 million to the General Post Fund, $0.5 million to the Supply Fund and $0.5 million to the National Cemetery Gift Fund The amount of contributed capital received during 2013 consisted of donations in the amount of $50.4 million to the General Post Fund, $1.1 million to the Supply Fund and $0.2 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,	**2014**	**2013**
Resources Used to Finance Activities		
Obligations Incurred	$ 163,587	$ 155,590
Less Offsetting Collections, Receipts and Adjustments	(16,193)	(16,141)
Net Obligations	147,394	139,449
Donations of Property	41	22
Transfers Out	14	-
Imputed Financing	2,169	1,971
Other Financing Sources	(471)	(125)
Total Resources Used to Finance Activities	**149,147**	**141,317**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	181	(725)
Resources that Finance the Acquisition of Assets	(5,378)	(6,684)
Resources that Fund Expenses Recognized in Prior Periods	(2,412)	(1,598)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	5,562	4,665
Total Resources that Do Not Fund Net Cost of Operations	(2,047)	(4,342)
Total Resources Used to Finance the Net Cost of Operations	**147,100**	**136,975**
Costs That Do Not Require Resources in the Current Period		
Increase in Annual Leave Liability	80	60
Increase (Decrease) in Environmental and Disposal Liability	(34)	(28)
Reestimates of Credit Subsidy Expense	346	1,406
Increase in Exchange Revenue Receivable from the Public	(501)	(318)
Increase (Decrease) in Veterans Benefits and Other Noncurrent Liabilities	32,722	213,666
Depreciation and Amortization	1,731	2,103
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	98	188
Loss on Disposition of Assets	476	100
Other	117	(147)
Total Costs That Do Not Require Resources in the Current Period	**35,035**	**217,030**
Net Cost (Benefit) of Operations	**$ 182,135**	**$ 354,005**

24. Restatement of components of Net Position Related to Expenditures of Medical Care Collection Fund (MCCF) Collections

The 2013 Consolidated Financial Statements have been restated to correct an error in the Medical Services Fund expenditures of Medical Care Collection (MCCF) receipts. In 2009, the accounting for the MCCF was changed to classify the transfer of funds from MCCF as appropriated receipts, while all expenditures made by the Medical Services Fund continued to be classified as expenditures of appropriations. The improper expenditure accounting (as if the expenditures were from appropriations) was in place prior to 2009 and continued until 2014 when the correction was made.

While the individual components of Net Position were misstatated, the adjustments were offsetting and the overall balance of Net Position was unchanged.

The following statement illustrates the impact of the above on the Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position for the year ended September 30, 2013:

Statement of Changes

Restated Balances as of September 30, 2013

	2013 As Previously Reported	Adjustments Increase (Decrease)	2013 As Restated
Consolidated Balance Sheet – Net Position			
Unexpended Appropriations – All Other Funds	$ 208	$ 21,003	$ 21,211
Cumulative Results of Operations – Funds from Dedicated Collections	843		843
Cumulative Results of Operations – All Other Funds	(1,939,537)	(21,003)	(1,960,540)
Total Change in Balance Sheet – Net Position	(1,938,486)	-	(1,938,486)
Consolidated Statement of Changes in Net Position			
Cumulative Results of Operations – All Other Funds			
Beginning Balances	(1,725,997)	(22,028)	(1,748,025)
Appropriations Used	138,876	1,025	139,901
Total Financing Sources	143,342	1,025	144,367
Net Change	(213,540)	1,025	(212,515)
Ending Balances	(1,939,537)	(21,003)	(1,960,540)
Unexpended Appropriations – All Other Funds			
Beginning Balances	3,931	22,028	25,959
Appropriations Used	(138,876)	(1,025)	(139,901)
Total Budgetary Financing Sources	(3,723)	(1,025)	(4,748)
Total Unexpended Appropriations	$ 208	$ 21,003	$ 21,211

tatements.

VA Office of Inspector General

OFFICE OF AUDITS & EVALUATIONS

Department of Veterans Affairs

Audit of VA's Financial Statements for Fiscal Years 2014 and 2013

November 12, 2014
14-01504-32

Department of Veterans Affairs

Memorandum

Date: November 12, 2014

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

Subj: Audit of VA's Financial Statements for Fiscal Years 2014 and 2013

To: Secretary of Veterans Affairs (00)

1. We contracted with the independent public accounting firm, CliftonLarsonAllen LLP, to audit VA's financial statements as of September 30, 2014 and 2013, and for the years then ended. This audit is an annual requirement of the Chief Financial Officers Act of 1990. The results of CliftonLarsonAllen LLP's audit are presented in the attached report.

2. CliftonLarsonAllen LLP provided an unqualified opinion on VA's fiscal year (FY) 2014 and 2013 financial statements. With respect to internal control, CliftonLarsonAllen LLP identified one material weakness, information technology security controls, which is a repeated condition. They also identified two significant deficiencies, financial reporting and accrued operating expenses, which are new conditions for this year.

3. CliftonLarsonAllen LLP reported that management restated amounts previously reported for Cumulative Results of Operations and Unexpended Appropriations as of September 30, 2013, due to the correction of a material error. Those amounts have been restated in the FY 2013 financial statements as presented in the FY 2014 comparative financial statements. The correction had no effect on Total Net Position. CliftonLarsonAllen LLP withdrew its previously issued auditor's report dated November 26, 2013, and replaced it with the Independent Auditor's Report on the restated financial statements.

4. CliftonLarsonAllen 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 cited instances of non-compliance with section 5315, title 38, United States Code, and section 3717, title 31, United States Code, pertaining to the charging of interest and recovery of administrative costs. They noted that VA is investigating two possible violations of the Antideficiency Act and is in the process of reporting two other violations. Three of these instances involve the combination of minor construction projects above the $10 million ceiling, beyond which Congressional approval for use of funds is required. They also referenced an Office of Inspector General report issued in FY 2014 that cited less than full compliance by VA in FY 2013 with the Improper Payments Elimination and Recovery Act.

5. CliftonLarsonAllen LLP is responsible for the attached audit report dated November 12, 2014, and the conclusions expressed in the report. 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 and compliance findings and evaluate the adequacy of corrective actions taken during the FY 2015 audit of VA's financial statements.

Linda A. Halliday

Linda A. Halliday

Attachment

CliftonLarsonAllen

CliftonLarsonAllen LLP
www.claconnect.com

INDEPENDENT AUDITORS' REPORT

To the Secretary
and Inspector General
Department of Veterans Affairs

Report on the Financial Statements

We have audited the accompanying financial statements of the Department of Veterans Affairs (VA), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources, for the years then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

VA management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.) and the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 U.S.; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 14-02). Those standards and OMB Bulletin 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

We are also responsible for applying certain limited procedures with respect to the Required Supplementary Information and all other accompanying information included with the financial statements.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Veterans Affairs as of September 30, 2014 and 2013, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the U.S.

Emphasis-of-Matter Regarding a Correction of an Error

As discussed in Note 24 to the financial statements, certain errors resulting in overstatement of amounts previously reported for Cumulative Results of Operations and understatement of amounts previously reported for Unexpended Appropriations as of September 30, 2013, were discovered by management of VA during the current year. Accordingly, amounts reported for Cumulative Results of Operations and Unexpended Appropriations have been restated in the fiscal year 2013 financial statements now presented, and an adjustment has been made to Cumulative Results of Operations and Unexpended Appropriations as of September 30, 2012, to correct the material misstatement. The correction had no effect on Total Net Position. Our previously issued auditor's report dated November 26, 2013, is withdrawn and replaced by this Independent Auditor's Report on the restated financial statements. A significant deficiency in financial reporting is included in the Report on Internal Control Over Financial Reporting.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the U.S. require that VA's Management Discussion and Analysis (MD&A) and other Required Supplementary Information (RSI), including stewardship information, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB), which considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and other RSI in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

All other sections exclusive of the financial statements, MD&A and other RSI as listed in the table of contents of the Performance and Accountability Report contain a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or RSI. The information has not been subjected to the auditing procedures applied in the audits of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Report on Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered VA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of VA's internal control or on management's assertion on internal control included in the MD&A.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore material weaknesses or significant deficiencies may exist that were not identified. However, we identified certain deficiencies in internal control, described below and in Exhibits A and B, respectively, that we consider to be material weaknesses and 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 VA's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described below and in Exhibit A to be material weaknesses.

<u>Information Technology Security Controls (Repeat Condition)</u>

> VA continues to have control weaknesses in Configuration Management, Access Controls, Security Management, and Contingency Planning.

A *significant deficiency* is a deficiency, or 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 and in Exhibit B to be significant deficiencies.

<u>Financial Reporting</u>

> Due to its age and limited functionality, VA's legacy Financial Management System (FMS) cannot be used without extensive manipulations, manual processes, and reconciliations.

Accrued Operating Expenses

VA does not have an adequate process to subsequently validate the reasonableness of its accrued operating expenses.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether VA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We also tested compliance with provisions of laws and regulations as required by OMB Bulletin 14-02. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests, exclusive of those required by the Federal Financial Management Improvement Act of 1996 (FFMIA), as discussed below, disclosed instances of noncompliance and other matters, described below and in Exhibit C, that are required to be reported in accordance with *Government Auditing Standards*.

Noncompliance with 38 USC 5315 and 31 USC 3717

VBA did not charge interest or recover administrative costs on delinquent payments from veterans related to certain receivables for Compensation, Pension, and Education.

Systems Compliance with FFMIA Requirements

Under FFMIA, we are required to report whether the financial management systems used by VA substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. Except for matters described in Exhibit C, where VA did not substantially comply with applicable Federal financial management systems requirements, the results of our tests of FFMIA disclosed no instances in which VA's financial management systems did not substantially comply with applicable Federal accounting standards, or the USSGL at the transaction level.

Management's Responsibility for Internal Control and Compliance

VA management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under the Federal Managers Financial Integrity Act (FMFIA), (2) providing a statement of assurance on the overall effectiveness of internal control over financial reporting, (3) ensuring VA's financial management systems are in substantial compliance with FFMIA requirements, and (4) ensuring compliance with other applicable laws and regulations.

Auditors' Responsibilities

We are responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, (2) testing whether VA's financial management systems substantially comply with the FFMIA requirements referred to above, (3) testing compliance with certain provisions of laws and regulations that have a direct and material effect on the financial statements and applicable laws for which OMB Bulletin 14-02 requires testing, and (4) applying certain limited procedures with respect to the MD&A and other RSI.

We did not evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws, regulations, contracts and grants applicable to VA. We limited our tests of compliance to certain provisions of laws, regulations, contracts and grants that have a direct and material effect on the determination of financial statements amounts and those required by OMB Bulletin 14-02. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. Also, our work on FFMIA would not necessarily disclose all instances of noncompliance with FFMIA requirements.

Management's Response to Findings

Management has presented a response to the findings identified in our report. We did not audit VA's response and, accordingly, we express no opinion on it.

Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of VA's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 26, 2013. The status of prior year findings is presented in Exhibit D.

Purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters sections of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of VA's internal control or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering VA's internal control and compliance. Accordingly, these reports are not suitable for any other purpose.

CLIFTONLARSONALLEN LLP

CliftonLarsonAllen LLP

Calverton, Maryland
November 12, 2014

EXHIBIT A
Material Weakness

Information Technology Security Controls (Repeat Condition)

The VA relies extensively on Information Technology (IT) system controls to initiate, authorize, record, process, summarize and report financial transactions in the preparation of its financial statements. 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 across 22 selected VA medical centers, regional offices and data centers. As noted in prior years' audits, VA continues to have weaknesses in Configuration Management, Access Controls, Security Management, and Contingency Planning controls designed to protect mission-critical systems from unauthorized access, alteration, or destruction.

Our current year audit identified security weaknesses that were corrected in some locations and for certain control activities. Examples of VA improvements in its IT control environment include continued implementation of a Continuous Readiness in Information Security Program to ensure continuous monitoring year-round. As part of the Continuous Readiness in Information Security Program initiative, we noted continued improvements related to role-based and security awareness training, contingency plan testing, reducing the number of individuals with outdated background investigations, improving data center web application security, and ensuring consistent compliance with *United States Government Configuration Baseline* standards. In addition, VA has continued predictive scanning of its networks allowing for the identification of vulnerabilities across field offices.

In August 2013, VA also implemented an IT Governance, Risk and Compliance (GRC) Tool to improve the process for assessing, authorizing, and monitoring the security posture of the Agency. However, the migration from the prior system to the GRC tool did not provide adequate time for the full implementation during the year or adequate user training on the use of the tool. While the GRC Tool has been helpful in providing a consistent mechanism in documenting and collecting Accreditation and Authorization artifacts, the information entered into the tool was inconsistent across VA and in some cases incomplete. The aforementioned controls require time to mature and show evidence of their effectiveness. Accordingly, we continue to see information system security deficiencies similar in type and risk level to our findings in prior years and an overall inconsistent implementation of the security program. Moving forward, VA needs to ensure a proven process is in place across the agency. VA also needs to continue to address control deficiencies that exist in other areas across all VA locations.

We continue to find control deficiencies in Configuration Management, Access Controls, Security Management, and Contingency Planning. Most importantly, we continue to identify significant technical weaknesses in databases, servers, and network devices that support transmitting financial and sensitive information between VA's Medical Centers, Regional Offices, and Data Centers. This is as a result of an inconsistent application of vendor patches and outdated system software that could jeopardize the data integrity and confidentiality of VA's financial and sensitive information. VA has made progress in deploying current patches; however, older patches and previously identified vulnerabilities related to configuration weaknesses and outdated system software persist on its networks. Even though VA has made some progress in these areas, more progress must be made to improve deployment of patches, system upgrades, and configuration management to mitigate security vulnerabilities and to implement a centralized process that is consistent across all field offices. In addition, VA continues to operate its financial system using outdated technology that hinders mitigation of certain vulnerabilities.

EXHIBIT A
Material Weakness

Many of these weaknesses can be attributed to an inconsistent enforcement of an agency-wide information security program across the enterprise and ineffective communication between VA management and the individual field offices. Therefore, VA needs to improve its performance monitoring to ensure controls are operating as intended at all facilities and communicate security deficiencies to the appropriate personnel, who take responsibility for implementing corrective actions. Our assessment of the general and application controls of VA's key IT infrastructure and financial systems identified the following conditions:

Conditions:

Configuration Management

- Systems including key databases supporting financial applications were not timely patched or securely configured to mitigate known and unknown information security vulnerabilities. The deployment of vendor patches and system upgrades to mitigate the vulnerabilities was decentralized, inconsistent, and not effective across all VA facilities. For example, we noted large variances in the number of critical and high vulnerabilities across all sites. Furthermore, VA does not have a comprehensive scanning process that scans all of the Agency's systems for known vulnerabilities.
- The financial management system uses outdated technology that hinders mitigation of certain vulnerabilities.
- VA needs to strengthen its methodologies for monitoring medical devices and ensuring they are properly segregated from other networks.
- Several VA organizations shared the same local network at some medical centers and data centers; however, the systems were not under the common control of the local site. These organizations or guest networks had significant critical or high known vulnerabilities that weaken the overall security posture of the local sites.
- Change management policies and procedures for authorizing, testing, and approving system changes were not consistently implemented for networks and mission-critical systems.
- No formal processes were in place for monitoring, preventing installation, and removing unauthorized application software on Agency systems.

Access Controls

- 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 fully implemented across the agency.
- Inconsistent reviews of networks and financial application user access resulted in numerous generic, system, terminated, and inactive user accounts that were not removed from the system. In addition, inconsistent exit clearance processes for separated employees contributed to the increase in the number of inactive user accounts.

- Proper completion of user access requests was not consistently performed to eliminate conflicting roles and enforce principles of least system privilege.
- Monitoring of access for individuals with elevated application privileges within a major application's production environment was lacking.
- Identification, notification, and remediation of security incidents were not consistently implemented to ensure incidents were resolved timely. In addition, network security event logs, which provide audit trails, were not consistently maintained or reviewed across all facilities.

Security Management

- Security management documentation including risk assessments, system security plans, and privacy impact assessments were not completed properly and did not reflect the current system environment. In addition, security controls were not effectively monitored and adequately documented, and system assessments and authorizations were not performed in accordance with Federal standards.
- VA Security Handbook 6500 had not been updated to reflect current information security controls in accordance with National Institute of Standards and Technology (NIST) Special Publication 800-53 "*Security and Privacy Controls for Federal Information Systems and Organizations,* Revision 4." This version of the NIST Special Publication was updated on February 19, 2014, with an April 1, 2014, implementation deadline for executive agencies.
- Background reinvestigations were not performed timely and tracked effectively. In addition, personnel were not receiving the proper levels of investigation for their position sensitivity levels.
- Plans of Action and Milestones (POA&Ms) were not completed by their milestone dates and were not updated to reflect changes to milestones. POA&M closures were not supported with adequate documentation. Additionally, POA&Ms did not contain sufficient detail to describe the control weaknesses or the corrective actions taken to close the findings.

Contingency Planning

- Backup tapes were not encrypted prior to being sent to offsite storage at selected facilities and data centers.

- Contingency plans did not reflect the current operating environment. Specifically, contingency plans had not been updated to reflect changes in system boundaries, roles and responsibilities, and lessons learned from testing contingency plans.

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 for 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:

Dispersed locations, continued reorganization, and diversity of applications have impacted facilities' and management's ability to consistently remediate IT security deficiencies across the enterprise. For example, VA's complex and disjointed financial system architecture has resulted in a lack of common system security controls and inconsistent maintenance of IT mission-critical systems. Consequently, VA continues to be challenged with consistent and proactive enforcement of established policies and procedures throughout its geographically dispersed portfolio of legacy applications and newly implemented systems. The continued reorganization of components within VA, such as the centralization of data centers and the shift of control from the Medical Centers to Regional levels, has caused delays in communicating established policies with personnel throughout VA. In addition, VA lacks an effective and consistent corrective action process for addressing and monitoring known internal security vulnerabilities on databases and network infrastructures.

Effect:

By not effectively 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. Further, the financial management system uses outdated technology that hinders mitigation of certain vulnerabilities.

Recommendations:

The Executive in Charge 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:

- Implement a process to ensure all VA organizations are included in the vulnerability management program and implement improved mechanisms to continuously identify and remediate security deficiencies on VA's network infrastructure, database platforms, and Web application servers.
- Strengthen patch and vulnerability management program to address security deficiencies identified during our assessments of VA's database platforms and network infrastructure.
- Develop and implement a strategic plan to address the outdated technology.
- Strengthen processes and controls to ensure medical devices are appropriately protected from other networks.
- Consolidate the security responsibilities for guest networks present under a common control for each site and ensure vulnerabilities are remediated in a timely manner.
- Strengthen change control procedures to ensure consistent approval and testing during development of system changes for VA financial applications and networks.
- Develop a comprehensive list of approved and unapproved software and implement a process for monitoring, preventing installation, and removing unauthorized application software on Agency devices.
- Strengthen processes to ensure compliance with VA policy for password and security configuration baselines on domain controls, operating systems, databases, applications, and network devices.
- Implement two-factor authentication for remote access throughout the agency.
- Strengthen processes for the periodic review of network and financial applications to identify and remove generic and inactive accounts on systems and networks. Recertify that access remains appropriate and is restricted to necessary personnel.
- Strengthen processes to ensure the proper completion and retention of user access request forms that enforce principles of least system privilege, prior to system access being granted.
- Implement access monitoring within production environments for individuals with elevated system privileges.
- Strengthen processes to ensure the proper completion of exit checklists for separated employees to verify that VA property, including access badges, is returned.
- Strengthen agency-wide incident response procedures to ensure timely notification and resolution of computer security incidents in accordance with VA standards. In addition, develop a system of metrics that can objectively measure organizational incident response capabilities, such as timeframes for remediation and closure of security events, with an emphasis on higher risk security-related incidents.

EXHIBIT A
Material Weakness

- Implement a process for monitoring network logs and ensuring audit logs are maintained in accordance with VA policy.
- Implement a continuous monitoring program in accordance with the NIST Risk Management Framework, specifically with regard to evaluating the effectiveness of security controls prior to authorizing systems to operate on a continuous basis.
- Strengthen processes for reviewing and updating key security documentation, including risk assessments, system security plans, and privacy impact assessments on an annual basis. Such updates will ensure all required information is included and accurately reflects the current environment, new security risks, and applicable federal standards.
- Implement a risk assessment process that allows for the evaluation of all relevant risks typically found in a complex risk environment.
- Implement enhancements to the GRC Tool to ensure all relevant system information is captured and reported accurately.
- Update relevant information security policies and procedures to address NIST Special Publication 800-53, Revision. 4, *Security and Privacy Controls for Federal Information Systems and Organizations,* requirements.
- Strengthen processes to ensure appropriate levels of background investigations are completed for all applicable VA employees and contractors in a timely manner.
- Strengthen processes to ensure local facilities track reinvestigations for employees and contractors in high-risk positions and the Security Investigation Center initiates all reinvestigations in a timely manner. Additionally, implement processes for local facilities to accurately and timely report any changes in position sensitivity levels. Furthermore, local facilities should ensure position descriptions are appropriately marked for position risk and sensitivity levels in accordance with the Office of Personnel Management (OPM) Position Designation Automation Tool.
- Strengthen processes to ensure that POA&Ms include sufficient detail to describe control weaknesses, corrective actions, target completion dates, and milestone progress. Additionally, implement improved processes to ensure closed POA&Ms are adequately supported with appropriate documentation.
- Implement processes to ensure the encryption of backup data prior to transferring storage media offsite.
- Strengthen processes for periodic reviews and updates of contingency plans to ensure all required information is included and plans accurately represent the current environment and critical components.

EXHIBIT B
Significant Deficiencies

1. Financial Reporting

Condition:

The Financial Management System (FMS) is VA's legacy core financial management and general ledger system. Due to FMS' limited functionality to meet current financial management and reporting needs, VA utilizes another application, the Management Information Exchange (MinX) system, to consolidate general ledger activities from FMS and create financial statements for external reporting. However, this process still requires significant manual intervention and workarounds to ensure accurate financial reporting. These limitations increase the risk of errors in the financial reporting process and become more apparent over time as additional reporting requirements accrue. Our testing of financial reporting identified the following conditions:

Prior Period Adjustment: As discussed in Note 24 to the financial statements, VA corrected certain errors that resulted in the overstatement and understatement of amounts previously reported for Cumulative Results of Operations and Unexpended Appropriations, respectively, as of September 30, 2013. The correction required a prior period adjustment of approximately $21 billion to the FY 2013 balances of these two accounts as presented in the FY 2014 comparative financial statements.

VA identified the error through its review process and determined that it was the result of an incorrect accounting method involving two accounts—the Medical Care Collections Fund (MCCF) and the Medical Services fund. VA did not apply the appropriate accounting methodology to MCCF funds transferred to the Medical Services fund. Had the accounting not been corrected, an inappropriate negative balance would have eventually occurred for Unexpended Appropriations, incorrectly indicating an anti-deficient position. This error occurred over several years, and a more thorough review, such as an unexpended appropriation roll-forward analysis, may have detected it sooner. However, the implementation of such procedures is hindered by system limitations and the manually-intensive process that underlies the preparation of accurate and auditable financial statements.

Over Reliance and Use of Journal Vouchers: VA makes a substantial number of adjustments, called journal vouchers, to its accounts in order to prepare VA's financial statements. Most of these adjustments are due to FMS limitations and are "top-side" entries into MinX. Top-side entries are those entries that VA makes directly into MinX when consolidating and preparing VA's financial statements. These entries do not flow through VA's general or subsidiary ledgers and are not subject to normal financial system controls. Although legitimate reasons exist for top-side entries, their overuse is indicative of system or control problems.

The substantial use of top-side entries in MinX creates a complicated and labor-intensive financial reporting environment. For example, each accounting period in MinX is independent, which requires that numerous journal vouchers, manual reconciliations, and analyses be reperformed and reentered to produce VA's quarterly financial statements and trial balances for the U.S. Department of the Treasury. Additionally, our testing at June 30, 2014, identified journal vouchers with limited descriptions and supporting documentation. We also noted that VA Administrations and business lines did not use journal voucher categories and entry descriptions consistently.

Use of manual adjustments such as top-side entries increases the risk of introducing errors into financial reporting and requires a high level of review and analysis to mitigate the risk of material errors in the financial statements. Further, strong internal controls must be in place and working as intended.

Periodic Review of Financial Data: The limitations of the legacy financial management system require a significant investment of time and resources to review financial data as a mitigating control procedure. We noted that management did not have adequate explanations or support for fluctuations in certain financial statement account balances at June 30, 2014. We also noted that management did not have a centralized process to perform a quality control review over the analysis of financial data performed by VA administrations and business lines.

Budgetary to Proprietary Relationship Analysis: VA does not have a formalized process to perform a routine and comprehensive reconciliation of budgetary and proprietary account relationships by Treasury Fund Symbol (TFS) as part of its financial reporting process. As part of our journal vouchers testing discussed above, we noted journal vouchers valued at over $45 billion that were recorded to adjust the budgetary cash and accounts payable to the respective proprietary account balances.

Intragovernmental Transactions: VA does not have a centralized repository for all current interagency agreements. As a result, intragovernmental transactions may not be completely and accurately reflected in the accounting records. Also, we noted that VA recorded significant top-side adjustments for trading partner transactions as of June 30, 2014, for submission to the U.S. Department of the Treasury.

Criteria:

OMB Circular A-123, *Management's Responsibility for Internal Control*, provides guidance to Federal managers on improving accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. Management is 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:

The FMS system limitations cause VA to record numerous manual journal vouchers and implement extensive manual processes and controls to prepare its financial statements for external reporting purposes.

Effect:

The extensive use of manual journal vouchers and lack of fully developed manual reconciliations and periodic analyses of financial data increase the risk of errors in the financial reporting process. During 2014, VA recorded a prior period adjustment in the amount of $21 billion to the components of Net Position.

Recommendations:

The Assistant Secretary for Management and the Executive in Charge for Information and Technology should implement actions to effect financial management system modernization, migration to shared services, or other options that will address current system limitations. Such actions are particularly important given the operational and security risks associated with maintaining, supporting, and updating outdated, legacy technology. In the meantime, the Assistant Secretary for Management should strengthen mitigating controls until the financial management system issues can be resolved. Key tasks should include, but are not limited to:

- *Journal vouchers*: Work with VA Administrations and business lines to limit the use of manual journal vouchers to transactions such as quarterly accruals and unusual one-time entries. Standardize journal entry categories throughout VA, establish policies on recording them, and monitor their use quarterly. Perform a pro forma analysis of the effects of adjusting entries prior to recording them and consult with budget officials for budgetary adjustments.
- *Financial data review*: Refine financial analysis techniques to ensure comparison of account balances from quarter to quarter and year to year, and consult program or budget officials.
- *Budgetary to proprietary relationships*: Perform account relationship tests at the Treasury Fund Symbol and trial balance levels on a quarterly basis to verify that proper relationships exist between budgetary and proprietary accounts and to identify abnormal account balances and anomalies.
- *Intragovernmental transactions:* Work with VA administrations and business lines to create a centralized repository of interagency agreements. Perform a review of them to determine whether balances are recorded in FMS accurately. Produce reports on transactions with other Federal agencies, called trading partners, with sufficient detail to link those transactions to relevant interagency agreements and facilitate management's reviews and reconciliations with the trading partners.

2. Accrued Operating Expenses

Condition:

Accrued operating expenses is comprised of two components—invoices received but not yet paid, and goods and services received but not yet invoiced. VA estimates the amount of goods and services received but not yet invoiced using either an automatic calculation by FMS or a manual process. VA does not have an adequate process to validate these estimates against actual payment data from FMS. VA only performs limited retrospective, or "look-back," analyses for its major construction and State Home Construction Grant (SHCG) programs. Our review of 11 transactions from the SHGC program identified a significant difference between estimated accrual amounts and actual disbursements within two months. During our statistically-based sample testing of accrued expenses, we found numerous errors.

We also noted the following additional limitations of the estimation process:

EXHIBIT B
Significant Deficiencies

- FMS ensures that the entire outstanding balance of an obligation is accrued when the end date for the contractual performance period has passed or is in the current month. However, without manual intervention, this accrual occurs even if performance is not complete or if the obligated funds are no longer needed. Although the automatic process helps mitigate the risk of accruing too little, it also increases the risk of accruing too much if VA does not monitor actual performance under contracts and adjust FMS accordingly. We noted that existing outstanding accruals expected to be liquidated were not sufficiently monitored.

- We noted instances where obligations were closed at year-end but the associated accruals were not reversed.

- Per VA policy, if an obligation is set up with a Budget Object Code above 2600, it is not set to auto accrue within FMS. If these obligations are not monitored, VA is at risk of understating accrued operating expenses. In our testing, we found instances where significant under-accruals occurred for this reason.

Lastly, obligations for non-VA medical care, also called purchased care, are set to auto-accrue based on a system formula. The accruals may not fairly represent the services provided to the veterans by the accrual date. A look-back analysis or validation, particularly for over-accruals recorded at year-end, should be initiated. Further, purchased care accruals that are recorded at year-end and not reversed should be periodically monitored for accuracy and relevancy.

Criteria:

Statement of Federal Financial Accounting Standards (SSFAS) No. 1, *Accounting for Selected Assets and Liabilities*, states, "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."

Cause:

An effective validation process for the accrued expenses balance, including a look-back analysis, is lacking.

Effect:

Without an effective process, VA's estimates of its accrued expense liability may be significantly misstated.

Recommendations:

We recommend that the Assistant Secretary for Management:

EXHIBIT B
Significant Deficiencies

- Develop procedures for validating the completeness and accuracy of underlying data used in preparing the accrual estimate, including contract performance periods, an analysis of subsequent payments, and acceptable levels of precision.

- Continue to reevaluate the automatic accrual methodology against actual cost patterns.

- Develop procedures for validating purchased care accruals.

EXHIBIT C
Compliance Findings

1. Noncompliance with FFMIA

Financial Management Systems

VA's complex, disjointed, and legacy financial management system architecture continues to deteriorate and has difficulty meeting increasingly demanding financial management and reporting requirements from the U.S. Department of the Treasury and the Office of Management and Budget (OMB). VA continues to be challenged in its efforts to apply consistent and proactive enforcement of established policies and procedures throughout its geographically dispersed portfolio of legacy applications and systems. We 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:

FMS and Financial Reporting: VA's core accounting system, FMS, was implemented in the 1990s. Since that time, Federal financial reporting requirements have become more complicated and the level of financial information needed by Congress and other oversight bodies has become increasingly demanding and complex. Some of the effects of FMS' limited functionality are described above in the significant deficiency, "Financial Reporting." Due to these limitations, VA utilizes MinX to consolidate general ledger activities from FMS to produce auditable financial statements and Governmentwide Treasury Account Symbol (GTAS) trial balances. Further, each accounting period in MinX is independent and thus numerous manual journal vouchers, reconciliations, and analyses must be reperformed and reentered in each period to produce VA's financial statements and GTAS trial balances. FMS' functionality limitations are further exacerbated by operational and security vulnerabilities due to the age of the system and its supporting technology.

Other deficiencies and limitations we noted as part of our audit include:

- FMS does not comply with the U.S. Government Standard General Ledger (USSGL) at the transaction level for budgetary accounts. During our review of journal vouchers, we noted that VA adjusted budgetary account balances based on proprietary account balances. We also noted that VA is unable record certain intragovernmental transactions in the USSGL at the individual transaction level. This situation also creates the need for VA to record significant journal vouchers.

- Certain subsidiary systems, including subsidiary systems within the Veterans Health Information Systems and Technology Architecture (VistA), are not interfaced with FMS, resulting in incomplete or unavailable audit trails at the transactional level. VA uses journal vouchers to enter amounts from certain VistA subsystems into FMS.

- VA's Integrated Funds Distribution Control Point Activity, Accounting and Procurement System (IFCAP), a major feeder system to FMS for obligations, is not fully interfaced with FMS. As a result, IFCAP is not updated when subsequent adjustments to obligating documents are made in FMS. Therefore, VA was unable to perform a complete reconciliation of obligations and fund status between FMS and IFCAP.

- FMS does not support commitment accounting, a feature that allows offices to reserve funds for specific projects prior to the award of a contract or purchase order. Without this feature, offices have an incentive to record funds as obligated when no contract has been awarded in order to reserve them for future use. We observed many obligations recorded in FMS that were not supported by valid contracts or purchase orders.

- FMS lacks the appropriate edit checks to ensure the proper posting of intragovernmental transactions. As a result, VA recorded over $1.5 trillion (absolute value) in trading partner-related adjustments as part of its GTAS submission to the U.S. Department of the Treasury.

- Recoveries of prior year unpaid obligations, also called downward adjustments, were not recorded in the proper USSGL accounts. In addition, FMS does not record the apportionment, allotment, and sub-allotment of recovered funds, as required by OMB guidance.

The Veterans Health Information Systems and Technology Architecture: According to a February 2014 GAO report, VistA "…was developed in-house by VA clinicians and IT personnel, the system consists of 104 separate computer applications, including 56 health provider applications; 19 management and financial applications; 8 registration, enrollment, and eligibility applications; 5 health data applications; and 3 information and education applications. Besides being numerous, these applications have been customized at all 128 VA sites. According to the department, this customization increases the cost of maintaining the system, as it requires that maintenance also be customized." For example, we noted during our testing that information technology maintenance patches to adjust third party and first party patient billing rates were not provided to medical centers in a timely manner, resulting in lost revenues. According to management, such delays are common to allow for sufficient testing of the patches. The timeframes used to test the patches depends on whether there are other software patches that may be required before the new rate table is updated in VistA. Another factor is whether enough medical centers have volunteered to test the patch. Since VistA is a decentralized system and each instance has to be updated individually, this process can take months before the new charge rates are updated.

In addition, VistA does not provide management with the ability to effectively and efficiently monitor Medical Care Collection Fund (MCCF) activities at the transaction level. Billing and collection functions have been centralized at the Consolidated Patient Accounting Centers (CPACs) to achieve better revenue management and improve VA's internal controls and quality assurance over its revenue processes. However, CPAC personnel still cannot generate combined reports for all the facilities under their purview. Reports are generated separately for individual MCs, which leads to inefficiencies in operations and revenue management. Further, a nationwide report at a sufficient level of detail cannot be generated. For financial reporting, MCCF revenues are recorded in FMS through a lump-sum journal entry based on station-by-station data. This complicates reconciliation of revenue transactions to collections and the supporting audit trail. In addition, as VistA is not able to produce a consolidated accounts receivable aging report at a sufficient level of detail, management does not have the tools to properly assess the reasonableness of its allowance for loss provision or perform a retrospective analysis to ascertain the reasonableness of its allowance methodology.

EXHIBIT C
Compliance Findings

Integrated Funds Distribution Control Point Activity, Accounting and Procurement System: VHA expends approximately $60 billion annually in procurements. IFCAP is a module within VistA that VHA and other VA employees, including contracting officers, use to initiate and authorize requests for goods and services, monitor status of funds, issue contracts or purchase orders , establish obligations, confirm the receipt of goods and services, and capture vendor payments. Transactions initiated and recorded in IFCAP cannot be reconciled to those in FMS or to the procurement source documentation maintained in the Electronic Contract Management System (eCMS).
Electronic Contract Management System: eCMS is an intranet-based contract management system mandated by VA policy. Source documentation of all actions pertaining to open-market procurements over $25 thousand must be maintained in eCMS. However, VA does not utilize eCMS to electronically process the approval and reviews performed for its acquisitions. Obligation of funds and assignment of purchase order numbers are still performed in IFCAP.

In addition, VA does not have a procurement file structure to maintain acquisition documentation in a consistent and efficient manner. It is often left to the preference of individual contracting officers, and as a result, it was difficult at times to find acquisition documentation to support the procurement process followed by VA. The information in this system is incomplete and can be unreliable.

2. Noncompliance with 38 USC 5315 and 31 USC 3717

Condition:

Our testing of a sample of receivables from debtors noted the following exceptions:

- In a sample of compensation and pension receivables, 17 of the 48 items tested were outstanding over 90 days. VBA did not charge interest on any of the delinquent receivables.
- In a sample of 45 education receivables, 27 of the 45 items tested were outstanding over 90 days. VBA did not charge interest or administrative costs on 25 of the 27 delinquent receivables.

Criteria:

The requirement to charge interest and administrative costs on receivables over 90 days is specified in 38 USC Sec 5315, *Interest and administrative cost charges on delinquent payments of certain amounts due the United States*. The requirement to use the U.S. Department of the Treasury interest rate is specified in 31 USC 3717, *Interest and penalty on claims*.

Cause:

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

Effect:

EXHIBIT C
Compliance Findings

VA is noncompliant with 38 USC 5315 and 31 USC 3717.

Recommendation:

We recommend that the Assistant Secretary for Management:

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

Other Matters

- VA is engaged in investigating two possible violations of the Antideficiency Act, 31 U.S.C. 1341(a), and is in the process of reporting two other violations. The two investigations involve the combination of minor construction projects. The combined total project values exceeded the $10 million ceiling, beyond which Congressional approval for use of funds is required. One of the violations in the process of being reported also involves the combination of minor construction projects. The other violation involves the obligation of funds from the Joint Department of Defense/VA Medical Facility Demonstration Fund in excess of an apportionment in FY 2012.

- On April 15, 2014, the VA Office of Inspector General reported that VA did not fully comply in FY 2013 with the Improper Payments Elimination and Recovery Act, 31 U.S.C. 3321.

Our assessment of the current status of the recommendations from the prior year audit is presented below.

Type of Finding	***FY 2013 Finding***	***Fiscal Year 2014 Status***
Material Weakness	Information Technology Security Controls	Repeat – See FY 2014 Material Weakness
Compliance Finding	Noncompliance with FFMIA	Repeat – See Compliance Finding 1
Compliance Finding	Noncompliance with the Debt Collection Improvement Act	Repeat – See Compliance Finding 2

Department of Veterans Affairs

Memorandum

Date: NOV 1 2 2014

From: Assistant Secretary for Management (004)

Subj: Report of the Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2014 and 2013

To: Assistant Inspector General for Auditing (52)

1. The Office of Management has reviewed the Report of the Audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements for Fiscal Years 2014 and 2013, and we are pleased with the receipt of an unqualified opinion. We are also pleased that we met the 2014 reporting timeline established by the Office of Management and Budget. Please extend to your staff and the staff of CliftonLarsonAllen, LLP our appreciation for their detailed planning, hard work, and cooperation during this year's audit.

2. VA senior officials, as well as program managers in the Administrations and affected Staff Offices, 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 Security Controls. For this repeat material weakness, the existing remediation plan 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.

Helen Tierney

Required Supplementary Stewardship Information (Unaudited)

(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,	**2014**	**2013**	**2012**	**2011**	**2010**
State Extended Care Facilities	$ 92	$ 180	$ 66	$ 54	$ 242
Veterans Cemeteries (NCA)	52	36	47	44	49
Total Grant Program Costs	$ 144	$ 216	$ 113	$ 98	$ 291

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, 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 $400 million. VA also provides per diem payment for the care of eligible Veterans in state homes.

Since, the cemetery program was established in 1980, it helped establish, expand, improve, operate and maintain 93 Veterans cemeteries in 45 states and territories including tribal trust lands, Northern Mariana Islands, and Guam, which provided more than 33,000 burials in 2014. VA awarded grants totaling more than $618 million. State or tribal 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,		
	2014	2013
Program Expenses		
Education and Training-Dependents of Veterans	$ 518	$ 487
Vocational Rehabilitation and Education Assistance	14,206	12,693
Administrative Program Costs	502	372
Total Program Expenses	$ 15,226	$ 13,552
Program Outputs (Participants)		
Dependent Education	90,641	89,618
Veterans Rehabilitation	93,363	89,708
Veterans Education	970,765	971,597

Veterans and Dependents Education		
Years Ended September 30,		
	2012	2011
Program Expenses		
Education and Training-Dependents of Veterans	$ 444	$ 567
Vocational Rehabilitation and Education Assistance	11,727	11,259
Administrative Program Costs	389	370
Total Program Expenses	$ 12,560	$ 12,196
Program Outputs (Participants)		
Dependent Education	94,618	96,078
Veterans Rehabilitation	85,436	81,097
Veterans Education	871,188	822,808

Veterans and Dependents Education	
Years Ended September 30,	
	2010
Program Expenses	
Education and Training-Dependents of Veterans	$ 477
Vocational Rehabilitation and Education Assistance	9,031
Administrative Program Costs	348
Total Program Expenses	$ 9,856
Program Outputs (Participants)	
Dependent Education	81,974
Veterans Rehabilitation	77,176
Veterans Education	634,038

Program Outcomes
VA's education and training programs are intended to provide higher education to dependents that might not be able to participate otherwise. The rehabilitation and employment programs are provided to service-disabled Veterans, and 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 a 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,	2014	2013	2012	2011	2010
Program Expenses					
Physician Residents and Fellows	$ 748	$ 692	$ 663	$ 637	$ 584
Associated Health Residents and Students	157	164	153	114	113
Instructional and Administrative Support	905	856	851	819	794
Total Program Expenses	$ 1,810	$ 1,712	$ 1,667	$ 1,570	$ 1,491
Program Outputs					
Health Professions Rotating Through VA:					
Physician Residents and Fellows	40,420	38,106	37,104	36,984	36,600
Medical Students	21,541	20,218	21,502	20,516	21,267
Nursing Students	29,067	25,948	32,349	25,931	33,580
Associated Health Residents and Students	27,771	33,228	25,839	31,869	23,416
Total Program Outcomes	118,799	117,500	116,794	115,300	114,863

Program Outcomes
Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. 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 partnerships between VA and the Nation's academic institutions, VA plays a leadership role in defining the education of future health care professionals to meet the changing needs of the Nation's health care delivery system.

VA's education mission contributes to high quality health care of Veterans by providing a climate of scientific inquiry and evidence-based practice; rapid application of medical advances; supervised trainees who provide clinical care; and the recruitment of highly qualified health care professionals.

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, 2014

	Basic	Applied	Development	Total
Medical Research Service	$ 218.6	$ 102.4	$ -	$ 321.0
Rehabilitative Research and Development	8.0	59.3	36.7	104.0
Health Services Research and Development	-	90.1	-	90.1
Cooperative Studies Research Service	18.8	66.3	-	85.1
Medical Research Support	-	586.0		586.0
Total Program Expenses	$ 245.4	$ 904.1	$ 36.7	$ 1,186.2

Program Expense
Year Ended September 30, 2013

	Basic	Applied	Development	Total
Medical Research Service	$ 192.0	$ 90.0	$ -	$ 282.0
Rehabilitative Research and Development	7.0	52.0	36.3	95.3
Health Services Research and Development	-	90.0	-	90.0
Cooperative Studies Research Service	40.6	75.0	-	115.6
Medical Research Support	-	581.9	-	581.9
Total Program Expenses	$ 239.6	$ 888.9	$ 36.3	$ 1,164.8

Program Expense
Year Ended September 30, 2012

	Basic	Applied	Development	Total
Medical Research Service	$ 191.0	$ 92.0	$ -	$ 283.0
Rehabilitative Research and Development	6.7	52.0	36.6	95.3
Health Services Research and Development	-	88.6	-	88.6
Cooperative Studies Research Service	40.4	75.2	-	115.6
Medical Research Support	-	581.0	-	581.0
Total Program Expenses	$ 238.1	$ 888.8	$ 36.6	$ 1,163.5

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

VHA researchers received grants from the National Institutes of Health in the amount of $414 million in 2014. During this same period, grants totaling $251 million came from other organizations. The grants received 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 2014, VA's R&D general goal related to stewardship was to ensure that Pre-clinical Research and Clinical Research Programs (excluding Cooperative Studies Program (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,

	2014	2013	2012	2011	2010
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	2,184	2,241	2,249	2,200	2,350

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 (Unaudited)

(dollars in millions, unless otherwise noted)

1. Deferred Maintenance and Repairs

FASAB issued SFFAS No. 40, *Definitional Changes to Deferred Maintenance; Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*, which was adopted by VA in 2012. This standard clarifies that repair activities should be included to better reflect asset management practices, and improve reporting on deferred maintenance and repairs. Deferred maintenance and repairs are maintenance and repair activities not performed when they should have been or were scheduled to be, therefore, are put off or delayed for a future period. Activities include preventive maintenance; replacement of parts, systems or components; and other activities needed to preserve or maintain an asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities that expand the capacity of an asset or otherwise upgrade it to serve needs different from, or significantly greater than, its current use.

FASAB issued SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standard 6, 14, 29 and 32,* which is effective for periods beginning after September 30, 2014. This standard requires expanded qualitative and quantitative disclosure of deferred maintenance and repairs. Management does not believe that implementation will have a material effect on financial statement disclosures.

Management determines the level of service and condition that is acceptable to carry out VA's mission, which may vary by VA components which include VHA, VBA, NCA, and Indirect Administrative Program Costs. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained, repaired and managed in a safe and effective manner; therefore, deferred maintenance and repairs are not applicable to them.

VA facilities reported their cost estimates for deferred maintenance and repairs by performing periodic Facility Condition Assessment Surveys, which are inspections of property, plant and equipment based on generally accepted methods and standards consistently applied, to assign condition ratings and estimate costs for each fixed asset to correct deficiencies. The costs assigned "D" (poor) and "F" (critical) ratings, qualify for reporting as deferred maintenance and repairs, except where deficiencies are to be replaced by capital expenditures. See Notes 1, 9 and 10 to the consolidated financial statements for additional information on general PP&E and heritage assets.

Deferred Maintenance and Repairs			
as of September 30,	**2014**	**2013**	**2012**
General PP&E	$ 8,477	$ 6,709	$ 5,911
Heritage Assets	672	622	740
Total Deferred Maintenance and Repairs	$ 9,149	$ 7,331	$ 6,651

2. Schedule of Budgetary Activity Year Ended September 30, 2014

	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	$ 6,186	$ 5,828	$ 12	$ 1,046	$ 1,135	$ 5,727
Medical Care 0160	52,869	46,132	155	8,633	8,582	46,028
Medical Facilities 0162	5,055	4,815	16	3,120	2,772	5,147
Information Technology 0167	4,012	3,653	40	1,713	1,894	3,432
All Other	15,930	2,935	484	3,409	3,409	2,451
Total	$ 84,052	$ 63,363	$ 707	$ 17,921	$ 17,792	$ 62,785
Veterans Benefits Administration						
Compensation, Pension, & Burial Benefits 0102	$ 72,698	$ 70,221	$ -	$ 5,136	$ 5,540	$ 69,817
Readjustment Benefits 0137	14,342	13,758	361	646	688	13,355
Direct Loan Financing 4127	154	61	49	-	1	(39)
Guaranteed Loan Financing 4129	10,088	2,823	5,123	339	340	(2,326)
National Service Life Insurance Fund 8132	1,039	1,039	141	1,107	1,053	952
General Operating Expenses 0151	3,003	2,833	414	343	403	2,359
All Other	5,791	3,546	1,230	501	492	2,305
Total	$ 107,115	$ 94,281	$ 7,318	$ 8,072	$ 8,517	$ 86,423
National Cemetery Administration						
Total	$ 328	$ 306	$ -	$ 167	$ 165	$ 308
Indirect Administrative Program Costs						
General Administration 0142	767	732	322	183	179	414
Supply Fund 4537	1,847	1,600	1,060	(562)	(153)	131
All Other	943	795	708	115	142	60
Total	$ 3,557	$ 3,127	$ 2,090	$ (264)	$ 168	$ 605
Reconciling Adjustments for Prior Year Recoveries	$ 2,510	$ 2,510	$ -	$ -	$ -	$ -
Total of all Administrations	$ 197,562	$ 163,587	$ 10,115	$ 25,896	$ 26,642	$ 150,121