



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General

**REPORT OF THE AUDIT OF THE
DEPARTMENT OF VETERANS AFFAIRS'
FRANCHISE FUND
CONSOLIDATED FINANCIAL STATEMENTS
FOR FISCAL YEAR 2002**

Report No. 02-02245-64

February 28, 2003

**VA Office of Inspector General
Washington, DC 20420**



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Assistant Secretary for Management (004)

**Report of Audit of the Department of Veterans Affairs' Franchise Fund Consolidated
Financial Statements for Fiscal Year 2002**

1. Attached is the Office of Inspector General's (OIG) Report of Audit of the Department of Veterans Affairs (VA) Franchise Fund Consolidated Financial Statements (CFS) for Fiscal Year (FY) 2002. The Franchise Fund is one of the components included in VA's CFS. The Franchise Fund management contracted with the independent public accounting firm Brown & Company CPAs, PLLC to perform the audit. The Franchise Fund management defined the requirements of the audit; and the OIG reviewed the audit plans, monitored the audit, and reviewed the draft reports. The independent auditors' report provides an unqualified opinion on VA's Franchise Fund FY 2002 CFS.
2. The report on internal control over financial reporting identifies one material weakness concerning information technology security controls and one reportable condition on the application program and operating system change controls that affect one enterprise center. These findings and the related recommendations were included in the Department's FY 2002 and 2001 CFS audit reports. We discussed these findings with Franchise Fund management.
3. The report on compliance with laws and regulations disclosed no instances of noncompliance.
4. We will follow up on the findings during the audits of the Franchise Fund's FY 2003 CFS and VA's FY 2003 CFS.

For the Assistant Inspector General
for Auditing

A handwritten signature in blue ink that reads "Marie A. Maguire".

MARIE A. MAGUIRE
Director, Financial Audit Division (52CF)

Attachment

Auditors' Reports



BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

The Director
VA Enterprise Fund Office

We have audited the accompanying consolidated balance sheet of the Department of Veterans Affairs (VA) Franchise Fund as of September 30, 2002, and the related consolidated statements of net cost, changes in net position, financing, and the combined statement of budgetary resources for the year then ended. These financial statements are the responsibility of the VA Franchise Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the VA Franchise Fund as of and for the year ended September 30, 2001 were audited by other auditors whose report dated January 18, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the VA Franchise Fund as of and for the year ended September 30, 2002, its net cost, changes in net position, budgetary resources, and financing for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 12, 2002 on our consideration of the VA Franchise Fund's internal control over financial reporting and a report dated December 12, 2002 on its compliance with laws and regulations.

The information in "Management's Discussion and Analysis" is presented for the purpose of additional analysis and is required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.

Arlington, Virginia
December 12, 2002

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CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Director
VA Enterprise Fund Office

We have audited the consolidated financial statements of the Department of Veterans Affairs (VA) Franchise Fund as of and for the year ended September 30, 2002, and have issued our report thereon dated December 12, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the VA Franchise Fund's internal control over financial reporting by obtaining an understanding of the VA Franchise Fund's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect VA Franchise Fund's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, certain matters involving the internal control and its operation that are considered to be reportable conditions were noted.

The VA Office of Inspector General brought to our attention that other auditors performing the audit of VA's consolidated financial statements noted certain matters involving the internal control over financial reporting that could effect the VA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The VA's consolidated financial statements include the Franchise Fund. The material weakness and other reportable condition noted relate to one of the Enterprise Centers within the Franchise Fund. The material weakness and other reportable condition noted are described in the following paragraphs.

Material Weakness - Information Technology (IT) Security Controls (Repeat Condition)

It was noted that the VA's financial data continues to be at risk due to serious weaknesses related to the VA's control and oversight over access to its information systems, which places sensitive information, including financial data at risk. Key security administration controls were tested for the core Financial Management System (FMS) and the payroll system (Personnel and Accounting Integrate Data - PAID).

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Auditors' Reports

The following control weaknesses were identified:

- FMS – the numerous security weaknesses noted included inadequate segregation of duties over security administration, inappropriate access privileges, and inadequate segregation of duties permitting individuals to both obligate funds and make disbursements.
- PAID – the numerous security weaknesses noted included inadequate segregation of duties over security administration, inappropriate access privileges, inadequate management of access privileges, and inadequate segregation of duties permitting individuals to make changes to the payroll master file and process payroll transactions.

Recommendation – We reaffirm the recommendation contained in the FY 2002 consolidated financial statement audit that the VA improve security and segregation of duties controls over the FMS and PAID systems, and assign, communicate, and coordinate responsibility for monitoring and enforcing such controls.

Reportable Condition – Application Program and Operating System Change Controls (Repeat Condition)

Several continuing weaknesses were noted at a VA data center, which include inappropriate access capabilities by application programmers and system support staff to production data, lack of application change procedures, inadequate procedures for testing, approving, and migrating system software changes, inadequate segregation of duties for approving, performing, testing, and documenting operating system software changes, and inadequate application program change tracking procedures. These weaknesses may cause unauthorized or invalid program and operating system changes to be placed into production.

Recommendation – We reaffirm the recommendation contained in the FY 2002 consolidated financial statement audit that improved controls over application program and operating system changes be instituted, communicated and enforced throughout the data centers.

During the course of our audit we noted other matters involving internal control and its operation that we have reported to management of the VA Franchise Fund in a separate management letter dated December 12, 2002.

In addition, with respect to internal control related to performance measures reported in “Management’s Discussion and Analysis,” we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

This report is intended solely for the information and use of the management of the Department of Veterans Affairs Franchise Fund, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Arlington, Virginia
December 12, 2002



BROWN & COMPANY CPAs, PLLC



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CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The Director
VA Enterprise Fund Office

We have audited the consolidated financial statements of the Department of Veterans Affairs (VA) Franchise Fund as of and for the year ended September 30, 2002, and have issued our report thereon dated December 12, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the VA Franchise Fund is responsible for complying with laws and regulations applicable to the VA Franchise Fund. As part of obtaining reasonable assurance about whether the VA Franchise Fund financial statements are free of 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, and certain other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the VA Franchise Fund.

The results of our tests of compliance with the laws and regulations discussed in the preceding paragraph disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of the Department of Veterans Affairs Franchise Fund, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Arlington, Virginia
December 12, 2002

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