Independent Auditor's Reports

Accountants and Management Consultants

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Report of Independent Certified Public Accountants

Steven D. Swanson
Director, VA Enterprise Fund Office

We have audited the accompanying Department of Veterans Affairs Franchise Fund's consolidated balance sheets, as of September 30, 2001 and 2000, and the related consolidated statements of net costs, changes in net position, budgetary resources and financing for the fiscal years 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 audits.

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

In our opinion, the Department of Veterans Affairs Franchise Fund's financial statements referred to above present fairly, in all material respects, its assets, liabilities and net position as of September 30, 2001 and 2000, and its net costs, changes in net position, budgetary resources and reconciliations of net costs to budgetary obligations for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have issued our report dated January 18, 2002, on our consideration of the Department of Veterans Affairs Franchise Fund internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report when considering the results of our audit.

The Management Discussion and Analysis (MD&A) is not a required part of the financial statements, but is required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the MD&A and express no opinion on it.

This report is intended for the information and use of management of the Department, VA Enterprise Centers, the Franchise Fund Board of Directors, Office of Inspector General of the Department of Veterans Affairs, the OMB, and Congress and is not intended to be and should not be used by anyone other than those specified parties. However, this report is a matter of public record, and its distribution is not limited.

Vienna, VA
January 18, 2002

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Independent Auditor's Reports

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Report of Independent Certified Public Accountants on Internal Control over Financial Reporting and Compliance Based Upon The Audit Performed in Accordance With *Government Auditing Standards*

Steven D. Swanson
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 fiscal years ended September 30, 2001 and 2000, and have issued our report thereon dated January 18, 2002. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the requirements of the U.S. Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the VA Franchise Fund's internal control over financial reporting and safeguarding assets in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We evaluated management's assertion about the effectiveness of its internal controls designed to safeguard assets against loss from unauthorized acquisition, use, or disposition; assure the execution of transactions in accordance with laws governing the use of budget authority and with other laws and regulations that have a direct and material effect on the financial statements; and properly record, process, and summarize transactions to permit the preparation of reliable financial statements and to maintain accountability for assets.

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 noncompliance may nevertheless occur and not be detected.

During the course of our audit it was brought to our attention by the VA Office of the Inspector General that other auditors noted certain matters involving the internal control over financial reporting that they considered to be deficiencies in the design or operations of the internal control over financial reporting that could affect the VA's (Department-wide Consolidated) ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The VA's financial statements include the component named Franchise Fund. The material weakness and reportable condition are directly related to one of the enterprise centers within the Franchise Fund. The material weakness and reportable condition are described in the following paragraphs.

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Material Weakness—Information Technology (IT)

Franchise Fund's financial data is at risk due to serious weaknesses related to control and oversight over access to its information system. These weaknesses placed financial data at risk of inadvertent or deliberate misuses, fraudulent use, or destruction, possibly occurring without detection. The VA Office of Inspector General first reported this condition in its fiscal year 1997 audit report and made recommendations for VA to implement a comprehensive security program that would improve these controls. VA first reported IT security controls as a material weakness in its Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 1998.

Recommendation

We concur with the recommendations in the VA's fiscal year 2001 consolidated financial audit report which recommends that appropriate resources and accountability mechanisms be applied in order that the planned actions will be accomplished within a acceptable timeframe and will remediate the deficiencies identified in the Government Information Security Reform Act Process.

Reportable Condition—Application Program and Operating System Change Controls

Weaknesses in application program change controls and operating system change controls existed at the data center. Weaknesses 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; and inadequate application program change tracking procedures.

Recommendation

We concur with the recommendations in the VA's fiscal year 2001 consolidated financial audit report which recommends that improved controls over application program and operating system changes be instituted, communicated and enforced throughout the data center.

Compliance with Laws and Regulations

The VA Franchise Fund's management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the VA Franchise Fund's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts which could have a direct and material effect on the determination of financial statement amounts. The results of our tests disclosed no instances of noncompliance that are required to be reported under OMB Bulletin No. 01-02. Providing an opinion on compliance with laws and regulations was not an objective of our audit and accordingly, we do not express such an opinion.

This report is intended for the information and use of management of the Department, VA Enterprise Centers, the Franchise Fund Board of Directors, Office of Inspector General of the Department of Veterans Affairs, the OMB, and Congress and is not intended to be and should not be used by anyone other than those specified parties.

Grant Thornton LLP

Vienna, VA
January 18, 2002

Department of Veterans Affairs Franchise Fund

Consolidated Balance Sheets

As of September 30, (Dollars in Thousands)	2001	2000 Restated
Assets		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$ 52,055	$ 44,996
Accounts Receivable	14,422	10,044
Other Assets	867	1,886
Total Intragovernmental	67,344	56,926
Accounts Receivable	57	3
Property, Plant and Equipment, Net (Note 3)	22,197	20,590
Other Assets	1	0
Total Assets	**$ 89,599**	**$ 77,519**
Liabilities		
Intragovernmental Liabilities		
Accounts Payable	$ 212	$ 162
Other Liabilities (Note 4)	1,670	9,161
Total Intragovernmental	1,882	9,323
Accounts Payable	3,861	2,094
Other Liabilities (Note 4)	22,265	18,946
Total Liabilities	**28,008**	**30,363**
Net Position		
Unexpended Apportionments (Note 5)	42,354	33,969
Cumulative Results of Operations	19,237	13,187
Total Net Position	**61,591**	**47,156**
Total Liabilities and Net Position	**$ 89,599**	**$ 77,519**

The accompanying notes are an integral part of these financial statements.

Department of Veterans Affairs Franchise Fund

Consolidated Statement of Net Costs & Consolidated Statement of Changes in Net Position

Consolidated Statement of Net Costs

For the Fiscal Years Ended September 30,	2001	2000
(Dollars in Thousands)		
Program Costs		
Intragovernmental	$ 24,673	$ 3,516
With the Public	106,280	122,532
Total Program Costs	130,953	126,048
Less Earned Revenues	(140,985)	(137,743)
Net Program Costs	**$ (10,032)**	**$ (11,695)**

Consolidated Statement of Changes in Net Position

For the Fiscal Years Ended September 30,	2001	2000 Restated
(Dollars in Thousands)		
Net Cost of Operations	$ (10,032)	$ (11,695)
Financing Sources (Other than Exchange Revenues)		
Imputed Financing	3,903	2,999
Transfers-Out	512	204
Subtotal	4,415	3,203
Net Results of Operations	14,447	14,898
Cumulative Effect of Change in Accounting Principle (Note 6)	(1)	0
(Decrease) Increase in Unexpended Appropriations and Non-Operating Changes	(11)	3,856
Change in Net Position	**14,435**	**18,754**
Net Position—Beginning of Fiscal Year	**47,156**	**28,402**
Net Position—End of Fiscal Year	**$ 61,591**	**$ 47,156**

The accompanying notes are an integral part of these financial statements.

Department of Veterans Affairs Franchise Fund

Consolidating Statement of Budgetary Resources

For the Fiscal Years Ended September 30, (Dollars in Thousands)	2001	2000
Budgetary Resources		
Unobligated Balance at Beginning of Fiscal Year (Note 5)	$ 5,926	$ 17,645
Spending Authority from Offsetting Collections	144,754	147,498
Total Budgetary Resources	**150,680**	**165,143**
Status of Budgetary Resources		
Obligations Incurred	112,664	159,217
Unobligated Balance Available (Note 5)	36,221	5,926
Unobligated Balance Not Yet Available (Note 5)	1,795	0
Total Status of Budgetary Resources	**150,680**	**165,143**
Outlays		
Obligations Incurred	112,664	159,217
Less: Spending Authority from Offsetting Collections and Adjustments	(144,754)	(147,498)
Subtotal	(32,090)	11,719
Obligated Balance, Net–Beginning of Fiscal Year	39,069	16,035
Less: Obligated Balance, Net–End of Fiscal Year	(14,039)	(39,069)
Total Outlays	**$ (7,060)**	**$ (11,315)**

The accompanying notes are an integral part of these financial statements.

Department of Veterans Affairs Franchise Fund

Consolidated Statement of Financing

For the Fiscal Years Ended September 30, (Dollars in Thousands)	2001	2000 Restated
Obligations and Non-budgetary Resources		
Obligations Incurred	$ 112,664	$ 159,217
Less: Spending Authority from Offsetting Collections and Adjustments	(144,754)	(147,498)
Financing Imputed for Cost Subsidies	3,904	2,999
Transfers-In (Out)	9,341	204
Total Obligations as Adjusted and Non-budgetary Resources	**(18,845)**	**14,922**
Resources That Do Not Fund Net Cost of Operations		
Change in Amount of Goods Services and Benefits Ordered but Not Yet Provided (Net Increases) Net Decreases	27,498	(25,645)
Change in Unfilled Customer Orders	(5,432)	2,496
Costs Capitalized on the Balance Sheet (Increases) Decreases		
General Property, Plant and Equipment	(13,768)	(15,362)
Adjustments to Costs Capitalized on the Balance Sheet	(54)	(3)
Other	0	2,860
Total Resources That Do Not Fund Net Costs of Operations	**8,244**	**(35,654)**
Components of Costs of Operations That Do Not Require or Generate Resources		
Depreciation and Amortization	4,987	2,893
(Loss) Gain on Disposition of Assets	742	153
Other	(5,160)	5,991
Total Costs That Do Not Require Resources	**569**	**9,037**
Net Cost of Operations	**$ (10,032)**	**$ (11,695)**

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

September 30, 2001 and 2000

(Dollars in Thousands)

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Created by Congress in 1996, as one of six Franchise Fund pilots operating within the Executive Branch of Government, VA's Franchise Fund (the Fund), supports VA's mission by supplying common administrative services at competitive prices. By law, the business lines within the Fund can only sell to Federal entities. The Fund accounted for its funds in six lines of business (VA Enterprise Centers) and in one administrative organization: Austin Automation Center, Debt Management Center, Financial Services Center, Law Enforcement Training Center, Security and Investigations Center, VA Records Center and Vault and the Enterprise Fund Office.

Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) standards and related concepts. The American Institute of Certified Public Accountants (AICPA) designated FASAB as the accounting standard-setting body for Federal governmental entities. As a result, accounting principles promulgated by FASAB are considered accounting principles generally accepted of the United States of America for Federal governmental entities.

Principles of Consolidation

The consolidated financial statements include the six individual activity centers of the Fund. All material intra-fund transactions have been eliminated.

Accounts Receivable

Intragovernmental accounts receivable are from other Federal entities and are considered fully collectible; therefore no allowance for uncollectible accounts is necessary.

Public accounts receivable are incurred when the Fund makes payments on behalf of their employees. Examples of this would be for Permanent Changes of Station (PCS) travel or advances for Federal Employees Health Benefits (FEHB) when employees are on leave without pay and their health benefits are paid to the health carriers. These receivables are considered fully collectible; therefore no allowance for uncollectible accounts is necessary.

Other Liabilities

Other liabilities are classified as either intragovernmental or public. Intragovernmental liabilities arise from transactions between the Fund and Federal entities, whereas public liabilities arise from transactions between the Fund and non-Federal entities. Budgetary resources cover all other liabilities, both intragovernmental and public.

Revenues and Financing Sources

The Fund receives an annual apportionment that allows it to incur obligations and to recognize revenue from its customers on a "fee-for-service" basis. Exchange revenues are recognized when earned. Expenses are recognized when incurred. All significant intra-entity balances and transactions have been eliminated in consolidation.

For financial reporting purposes under accrual accounting, operating expenses are recognized currently, while those for capital and other long-term assets are capitalized and not recognized as expenses until actually used. Financing sources for these expenses, which derive from both current and prior year appropriations and operations, are also recognized this way.

Annual, Sick and Other Types of Leave

Annual leave is accrued when earned and the accrual is reduced when leave is used. At least once a year, the balance in the accrued annual leave account is adjusted to reflect current pay rates of cumulative annual leave earned but not taken. Sick and other types of leave are expensed as taken.

Imputed Financing

The imputed financing of retirement benefit costs is borne by the Office of Personnel Management to support the retirement of our employees. This cost is not included within the billing rates charged to customers.

Department of Veterans Affairs Franchise Fund

Notes to Consolidated Financial Statements

September 30, 2001 and 2000

(Dollars in Thousands)

NOTE 2—FUND BALANCE WITH TREASURY

The undisbursed account balance for the Fund is a revolving fund comprised of only entity assets. The funds available as of September 30:

	2001	2000
Fund Balance with Treasury	$52,055	$44,996

NOTE 3—PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, including transfers from other Federal agencies, are recorded at cost. Expenditures for major additions, replacements, and alterations are capitalized. Routine maintenance is expensed when incurred. Items costing over $5,000 with a useful life of two years or more are capitalized. Equipment is depreciated using the straight-line method over the estimated useful life, usually three to five years.

The property, plant and equipment for the Franchise Fund as of September 30:

	Cost	Accumulated Depreciation	2001 Net Book Value	2000 Net Book Value
Furniture & Equipment	$ 2,410	$ (915)	$ 1,495	$ 1,564
ADP Equipment	12,826	(5,556)	7,270	7,799
Software	8,183	(4,110)	4,073	4,268
Leasehold Improvements	15,105	(5,746)	9,359	6,959
Total Property, Plant and Equipment	**$38,524**	**$(16,327)**	**$22,197**	**$20,590**

NOTE 4—OTHER LIABILITIES

Budgetary resources fund all other liabilities, both intragovernmental and public.

	2001	2000
Intragovernmental		
Accrued Payables–Federal	$ 1,480	$ 4,014
Advances–Federal	190	5,147
Total Intragovernmental Liabilities	**$ 1,670**	**$ 9,161**
Public		
Accrued Payables	$ 17,621	$ 13,798
Accrued Salaries & Wages	1,708	2,406
Accrued Funded Annual Leave	2,936	2,742
Total Public Liabilities	**$ 22,265**	**$ 18,946**

NOTE 5—UNEXPENDED APPORTIONMENT

The Fund does not receive an appropriation from Congress. The Fund receives an annual apportionment that allows it to incur obligations and to recognize revenue from its customers on a "fee-for-service" basis.

	2001	2000
Unobligated Apportionment		
Available	$ 36,221	$ 5,926
Unavailable	1,795	0
Undelivered Orders		
Unpaid	4,338	28,043
Total Unexpended Apportionment	**$ 42,354**	**$ 33,969**

NOTE 6—CHANGE IN ACCOUNTING POLICY

Prior to 2001, the VA Franchise Fund's capitalization threshold was $300 for property, plant and equipment. In January 2001, the threshold was raised to $5,000. This new threshold was applied to purchases made on or after October 1, 2000.

Notes to Consolidated Financial Statements

September 30, 2001 and 2000

(Dollars in Thousands)

NOTE 7—RESTATEMENT OF FISCAL YEAR 2000

The accompanying 2000 consolidated financial statements have been restated to reflect the recording and classification of leasehold improvements that were excluded from the previously issued 2000 financial statements. The effect of the restatement was to increase property, plant and equipment and increase cumulative results of operations by $4,455. The leasehold improvements had not been capitalized nor expensed in the previously issued financial statements.

	2000	2000 (Restated)	Variance
Balance Sheet			
Property, Plant & Equipment	$ 16,135	$ 20,590	$ 4,455
Total Assets	73,064	77,519	4,455
Total Net Position	42,701	47,156	4,455
Total Liabilities & Net Position	73,064	77,519	4,455
Net Costs			
No Change			
Changes in Net Position			
(Decrease) Increase in Unexpended Apportionment and Non-Operating Changes	(599)	3,856	4,455
Changes in Net Position	14,299	18,754	4,455
Net Position—End of Period	42,701	47,156	4,455
Budgetary Resources			
No Change			
Financing			
Costs Capitalized on the Balance Sheet (Increases) Decreases Property, Plant & Equipment	(10,907)	(15,362)	(4,455)
Total Resources That Do Not Fund Net Cost of Operations	(31,199)	(35,654)	(4,455)
Components of Costs of Operations That Do Not Require or Generate Resources Other	1,536	5,991	4,455
Total Costs That Do Not Require Resources	$ 4,582	$ 9,037	$ 4,455