



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 YEARS 2003 AND 2002**

Report No. 03-02159-52

December 19, 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 2003**

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 Years (FY) 2003 and 2002. The Franchise Fund is one of the components included in VA's CFS. The Franchise Fund management defined the requirements of the audit and contracted with the independent public accounting firm, Brown & Company CPAs, PLLC, to perform the audit. The independent auditors' report provides an unqualified opinion on VA's Franchise Fund FYs 2003 and 2002 CFS.
2. The report on internal control over financial reporting identifies one material weakness concerning information technology security controls. This finding and the related recommendation were included in the VA's FY 2003 CFS audit reports. During FY 2003, management has taken corrective action to eliminate the reportable condition reported in the FY 2002 audit report relating to application program and operating system change controls that affect one enterprise center.
3. The report on compliance with laws and regulations concluded that VA, as a whole, is not in substantial compliance with the financial management system requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. The VA's CFS include the Franchise Fund. The VA's internal control issues concerning an integrated financial system and information technology security controls indicate noncompliance with the requirements of Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems," which incorporates by reference OMB Circulars A-123, "Management Accountability and Control," and A-130, "Management of Federal Information Resources."
4. The independent auditors will follow up on the internal control finding and evaluate any corrective actions during the audits of the VA's and the Franchise Fund's FY 2004 CFS.

For the Assistant Inspector General
for Auditing

A handwritten signature in cursive script that reads "Marie A. Maguire".

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

Attachment



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 sheets of the Department of Veterans Affairs (VA) Franchise Fund as of September 30, 2003 and 2002, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources for the years then ended (collectively referred to as the financial statements). 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; 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the VA Franchise Fund as of September 30, 2003 and 2002, and its net cost, changes in net position, budgetary resources, and financing for the years 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 November 12, 2003 on our consideration of the VA Franchise Fund's internal control over financial reporting and a report dated November 12, 2003 on its compliance with laws and regulations. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The "Management's Discussion and Analysis" (MD&A) is not a required part of the basic financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board and 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 MD&A. However, we did not audit the information and, accordingly, express no opinion on it.

A handwritten signature in black ink that reads "Brown & Company". The signature is written in a cursive, flowing style.

Arlington, Virginia
November 12, 2003

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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 financial statements of the Department of Veterans Affairs (VA) Franchise Fund as of and for the year ended September 30, 2003, and have issued our report thereon dated November 12, 2003. 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 (OIG) 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 noted relates to one of the Enterprise Centers within the Franchise Fund and is described in the following paragraphs.

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

During fiscal year (FY) 2003, VA's financial data continue to be at risk due to serious weaknesses related to the VA's implementation and enforcement of general controls and oversight over access to the data center and recovery of its information systems.

These weaknesses placed financial data at risk. Key controls were tested over security administration for the general computer systems at the data center, as well as the payroll system (Personnel and Accounting Integrate Data - PAID), and the Integrated Funds Distribution, Control Point Activity, Accounting and Procurement (IFCAP).

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In the PAID and IFCAP applications, security weaknesses were identified, which included improper design of system controls to support segregation of duties, inappropriate access privileges and inadequate management of access privileges, and inadequate segregation of duties.

Recommendation

We reaffirm the recommendation contained in the VA's FY 2003 consolidated financial statements audit that VA improve information systems security and segregation of duties controls over general systems and key financial applications, such as the PAID and IFCAP systems, and assign, communicate, and coordinate responsibility for monitoring and enforcing such controls.

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 November 12, 2003.

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 VA Franchise Fund, the VA OIG, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.



Arlington, Virginia
November 12, 2003

=====**BROWN & COMPANY CPAs, PLLC**=====>



BROWN & COMPANY CPAs, PLLC

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 financial statements of the Department of Veterans Affairs (VA) Franchise Fund as of and for the year ended September 30, 2003, and have issued our report thereon dated November 12, 2003. 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's 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, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. 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 disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraph exclusive of FFMIA that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the VA Franchise Fund's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the VA Franchise Fund financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph. However, the VA Office of Inspector General (OIG) 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 weaknesses in internal control over financial reporting indicate that the VA is not in full compliance with the requirements of OMB Circulars A-123, A-127, and A-130. The other auditors believe these material weaknesses, in the aggregate, result in departures from certain of the requirements of OMB Circulars A-123, A-127, and A-130, and are therefore, instances of substantial non-compliance with the Federal financial management systems requirements under FFMIA.

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 VA Franchise Fund, the VA OIG, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Arlington, Virginia
November 12, 2003

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