

Auditors' Reports



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 2004 and 2003**

Report No. 04-01265-52

VA Office of Inspector General
Washington, DC 20420

December 20, 2004



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 2004**

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) 2004 and 2003. 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 2004 and 2003 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 2004 CFS audit reports.
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 includes the Franchise Fund. The VA's internal control issues concerning an integrated financial system and information technology security controls indicate the Franchise Fund's 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 2005 CFS.

For the Assistant Inspector General
 for Auditing

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, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources for the years ended September 30, 2004 and 2003. 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 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*, as amended. 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, 2004 and 2003, 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 our report dated November 17, 2004 on our consideration of the VA Franchise Fund's internal control over financial reporting and our report dated November 17, 2004 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 audit.

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.

Largo, Maryland
November 17, 2004

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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 years ended September 30, 2004, and have issued our report thereon dated November 17, 2004. 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*, as amended.

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, we noted certain matters discussed in the following paragraphs involving the internal control and its operation that are considered to be reportable conditions that are also considered to be material weaknesses.

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 affect 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 relate 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) 2004, VA's program and financial data continue to be at risk due to serious weaknesses related to: 1) inadequate implementation and enforcement of controls and oversight over access to information systems; 2) improper segregation of key duties and responsibilities of employees; and 3) underdeveloped contingency planning. These weaknesses placed financial data at risk.

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Recommendation

We reaffirm the recommendation contained in the VA's FY 2004 consolidated financial statements audit that the VA improve information systems security and segregation of duties controls over general systems, key financial applications, 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 17, 2004.

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



Largo, Maryland
November 17, 2004

 **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 consolidated financial statements of the Department of Veterans Affairs (VA) Franchise Fund as of and for the year ended September 30, 2004, and have issued our report thereon dated November 17, 2004. 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*, as amended.

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 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 Department of Veterans Affairs 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.

Largo, Maryland
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