Proudly Providing Federal Government Clients with Competitively Priced Comprehensive Business Solutions

Department of Veterans Affairs Franchise Fund

Annual Report 2004

Proudly Providing Federal Government Clients with Competitively Priced Comprehensive Business Solutions

Table of Contents

Message To Our Stakeholders

D. Mark Catlett, Principal Deputy
Assistant Secretary for Management

VA is committed to the continuous improvement and growth of its Franchise Fund operations, which have been a resounding success since the pilot program was launched in FY 1997. We have continued our tradition of financial excellence—having received an unqualified "clean" audit opinion for the seventh consecutive year on our financial statements.

On behalf of the Department of Veterans Affairs (VA), I am pleased to present the VA Franchise Fund Fiscal Year (FY) 2004 Annual Report. Our commitment to continuous improvement and customer service has proven to be a very successful business model. Since our initial operating year as a federal provider of common administrative support services in FY 1997, the VA Franchise Fund has increased its annual revenue in a dramatic fashion—from $59 million in FY 1997 to $208 million in FY 2004.

We have continued our tradition of sound financial stewardship—having received an unqualified "clean" audit opinion for the seventh consecutive year on our financial statements. Our strong financial stewardship and customer focus are attracting more business from other government agencies (OGA).

OGA revenue in FY 2004 ($65.6 million) increased by 31 percent over FY 2003 levels ($46.6 million). The addition of this OGA business accrues benefits to all of our customers because it allows us to spread our overhead costs to a wider customer base.

Our federal workforce and commercial partners work together to leverage technology and apply innovative solutions to meet a wide range of customer requirements.

Some of our most noteworthy FY 2004 accomplishments include:

- Received seventh consecutive unqualified “clean” audit opinion

- Increased OGA revenue—31 percent over FY 2003 levels (from $46.6 million to $65.6 million)

- Earned VA $30.3 million in credit card rebates—compared to $18.2 million during the same period in FY 2003

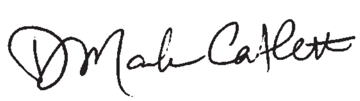
- Ranked in the top 6 percent in an information technology (IT) customer satisfaction survey among private and public sector organizations in Gartner Measurement’s database

- Received Site Accreditation from VA’s Office of Cyber and Information Security for IT infrastructure

- Established BuyIt.gov—a Federal Acquisition Center to assist customers in acquiring IT-related supplies and services

- Received the final shipment of retired veteran records from the National Archives and Records Administration (NARA), which completed a monumental project of relocating 940,000 cubic feet of Veterans Health Administration records from 14 NARA facilities located across the country into the Records Center & Vault

While we are proud of these accomplishments, we will continue to strive to be the “best-valued” source of competitive, high quality services for all of our federal government customers. We look forward to the coming year and are confident of our ability to meet the challenges that lie ahead.



On behalf of the Department of Veterans Affairs (VA), I offer my sincere appreciation to the VA Franchise Fund subject matter experts at the Financial Services Center and the Enterprise Fund Office for their significant contributions that led to our seventh consecutive unqualified “clean” audit opinion. The Franchise Fund exhibits the highest standards for financial stewardship.

I would also like to acknowledge the VA Office of Inspector General and Brown & Company CPAs, PLLC for the professional manner in which they conducted the audit of the VA Franchise Fund FY 2004 Consolidated Financial Statements.

In addition, I commend our primary editor, Loleisa Davis and the VA Franchise Fund (Austin Automation Center, Debt Management Center, Financial Services Center, Law Enforcement Training Center, Records Center and Vault, Security and Investigations Center and the Enterprise Fund Office) for their significant contributions to this report.

Management's Discussion and Analysis

Mission Statement

To be the provider of choice of common administrative support services for VA and other government agency (OGA) customers, enabling them to best meet their primary missions.

Vision

Comprehensive Business Solutions for Tomorrow's Government

Values

To guide us in fulfilling our mission as well as the Department's mission, our employees strive to uphold a set of core values, which are consistent and closely aligned with VA's core values. These values include: commitment, excellence, people, communication and stewardship.

Within the Department's headquarters in Washington, DC, the respective Enterprise Centers are managed by three VA component organizations (1) the Office of Management, (2) the Office of Policy, Planning and Preparedness, and (3) the Office of Information and Technology.

Commitment

Veterans have earned our respect and commitment, and their health care, benefits, and memorial service needs drive our actions. We will value our commitment to veterans through all contingencies and remain fully prepared to achieve our mission.

Excellence

We strive to exceed the service delivery expectations of veterans and their families. We perform at the highest level of competence with pride in our accomplishments.

People

We are committed to a highly skilled, diverse, and compassionate workforce. We foster a culture of respect, equal opportunity, innovation, and accountability.

Communication

We practice open, accurate, and timely communication with veterans, employees, and external stakeholders, and seek continuous improvement in our programs and services by carefully listening to their concerns.

Stewardship

We will ensure responsible stewardship of the human, financial, information, and natural resources entrusted to us. We will improve performance through the use of innovative technologies and sound business principles.

VA Franchise Fund At-A-Glance


Linda Voges, Director
Austin Automation Center and the Records Center and Vault


Daniel Osendorf, Director
Debt Management Center


Rodney Wood, Director
Financial Services Center


Ronald Angel, Director
Law Enforcement Training Center


Christopher Price
Business Manager
Security and Investigations Center


Steve Swanson, Director
Enterprise Fund Office

Who We Are

The VA Franchise Fund (Enterprise Centers) was established under the authority of the Government Management Reform Act of 1994 and the VA and Housing and Urban Development and Independent Agencies Appropriations Act of 1997. After careful screening, VA was selected by the Office of Management and Budget in 1996 as one of six franchise fund pilots. The VA Franchise Fund was established as a revolving fund and began providing common administrative support services to VA and OGA in 1997 on a fee-for-service basis.

The VA Franchise Fund is comprised of an administrative office (Enterprise Fund Office) and six self-supporting lines of business that are divided into three major segments: (1) the **financial management segment** is comprised of the Debt Management Center and the Financial Services Center, (2) the **security and law enforcement segment** is comprised of the Law Enforcement Training Center and the Security and Investigations Center, and (3) the **information technology segment** is comprised of the Austin Automation Center and the Records Center and Vault.

The directors of the individual Enterprise Centers and their staff are responsible for customer liaison and coordination, business planning and development, staffing and execution of day-to-day business activities consistent with their annual business plans.

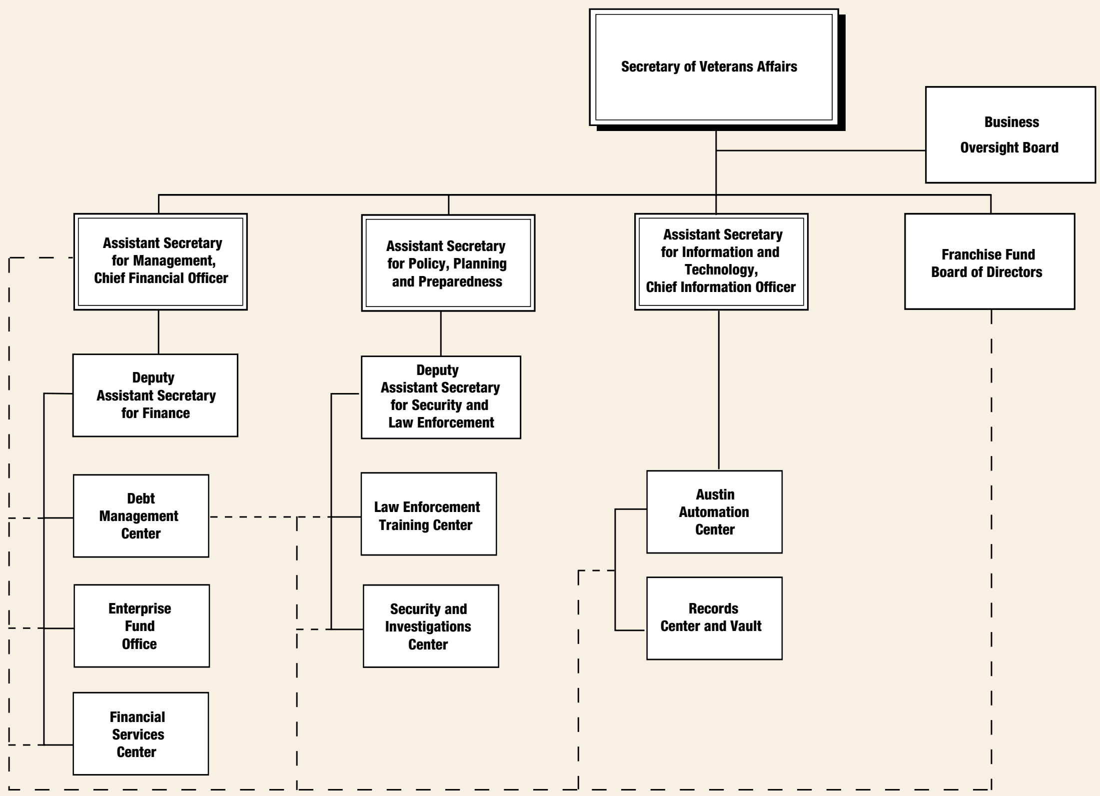
Within the Department's headquarters in Washington, DC, the respective Enterprise Centers are managed by three VA component organizations (1) the Office of Management, (2) the Office of Policy, Planning and Preparedness, and (3) the Office of Information and Technology.

In addition, the VA Franchise Fund Board of Directors (Board) and the VA Business Oversight Board (BOB) provide oversight to the VA Franchise Fund.

The Board represents the major organizations within VA, including the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and staff offices within VA Central Office. The Chairman of the Board is VA's Chief Financial Officer. Significant Board responsibilities include reviewing and approving the addition and/or deletion of Enterprise Centers, annual budgets and rates, capital projects, maintenance of financial integrity and accountability, and revisions to the charter.

The BOB serves as the Department's senior management forum on all business activities and is chaired by the Secretary of Veterans Affairs. Its mission is to review and oversee the performance, efficiency and effectiveness of the Department's business processes. Specific activities include identifying, monitoring and managing key business issues facing VA; reviewing and approving business activities planning, performance planning, and performance reporting documents; and monitoring business processes and goal attainment.

VA Franchise Fund Organization Structure



The charts show that the information technology segment continues to generate the majority of revenue for the Franchise Fund. However, as a result of new OGA business at the Financial Services Center, the financial management segment shows significant growth over FY 2003.

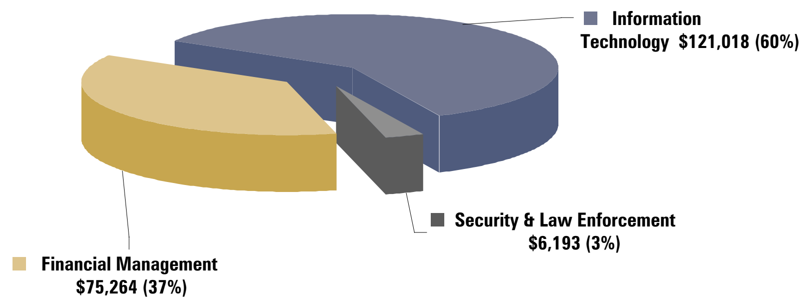
What We Do

We provide common administrative support services to VA and OGA customers, enabling them to best meet their primary missions. A brief description of the Centers and the wide range of services offered include:

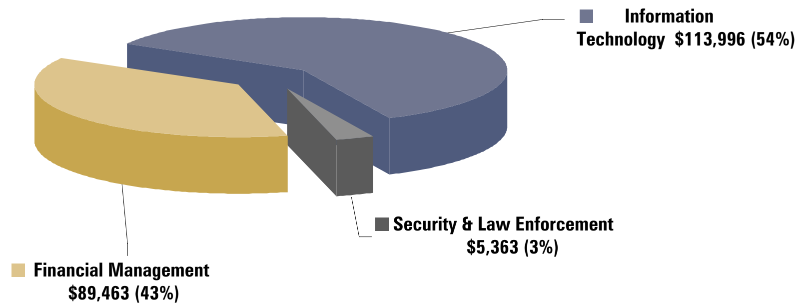
Austin Automation Center (AAC). Located in Austin, TX, the AAC provides comprehensive e-government solutions to match the critical needs of VA and other federal agency customers, from managing data to automating business processes. The AAC supports over 100 customer applications that provide mission-critical data for financial management, payroll, human resources, logistics, medical records, eligibility benefits and supply functions. In addition, the AAC offers a full complement of technical solutions (IT system hosting, application management, information assurance, customer business continuity, configuration management, data conversion and data interfacing, and acquisition services) to best meet customers' varied projects.

Debt Management Center (DMC). Located in St. Paul, MN, the DMC is a centralized facility that provides direct collection of delinquent consumer debt owed to VA. The DMC also provides administrative support for a local Cooperative Administrative Support Unit.

VA Franchise Fund
Revenue by Major Product Category
As of September 30, 2003
(Dollars in Thousands)



VA Franchise Fund
Revenue by Major Product Category
As of September 30, 2004
(Dollars in Thousands)



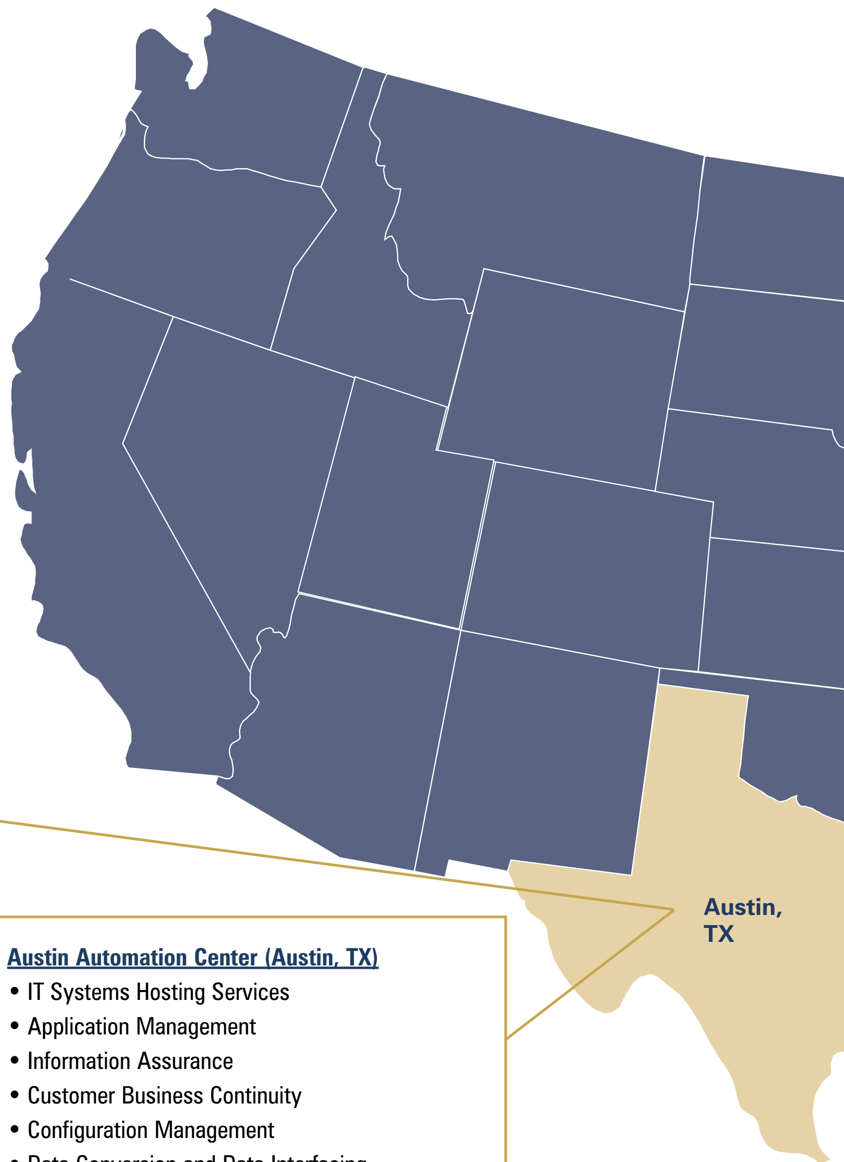
Note: The FY 2003 Financial Management segment revenue number was revised to reflect the change from $75,265 to $75,264 to correct a rounding error previously reported.

Financial Services Center (FSC). Located in Austin, TX, the FSC provides VA and OGAs with a full range of financial services including financial reports and accounting, invoice payments, credit card payments, medical claims payments, vendor file maintenance, discount subsistence purchases, payroll processing, travel payment processing, electronic commerce/electronic data interchange, automated document management, audit recovery, data matching and reconciliation, and consulting.

Law Enforcement Training Center (LETC). Located in Little Rock, AR, the LETC provides special training for police officers working in a health care or service-oriented environment. Emphasizing training in medical center patient situations, the LETC is available to approximately 2,400 law enforcement personnel working at VHA health care facilities and to law enforcement professionals at other federal agencies.

Records Center and Vault (RC&V). Located in a sub-terranean, climate-controlled facility in a remote Midwestern part of the country, the RC&V provides records storage, protection, and retrieval services for official federal records. The facility has been certified by NARA to operate as an agency records center. The RC&V can store records in any type of medium. This includes offsite storage of systems backups as well as general, vital, and classified records on paper, film, and electronic media.

Records Center and Vault (Midwest)
- Records Storage
- Retrieval Services



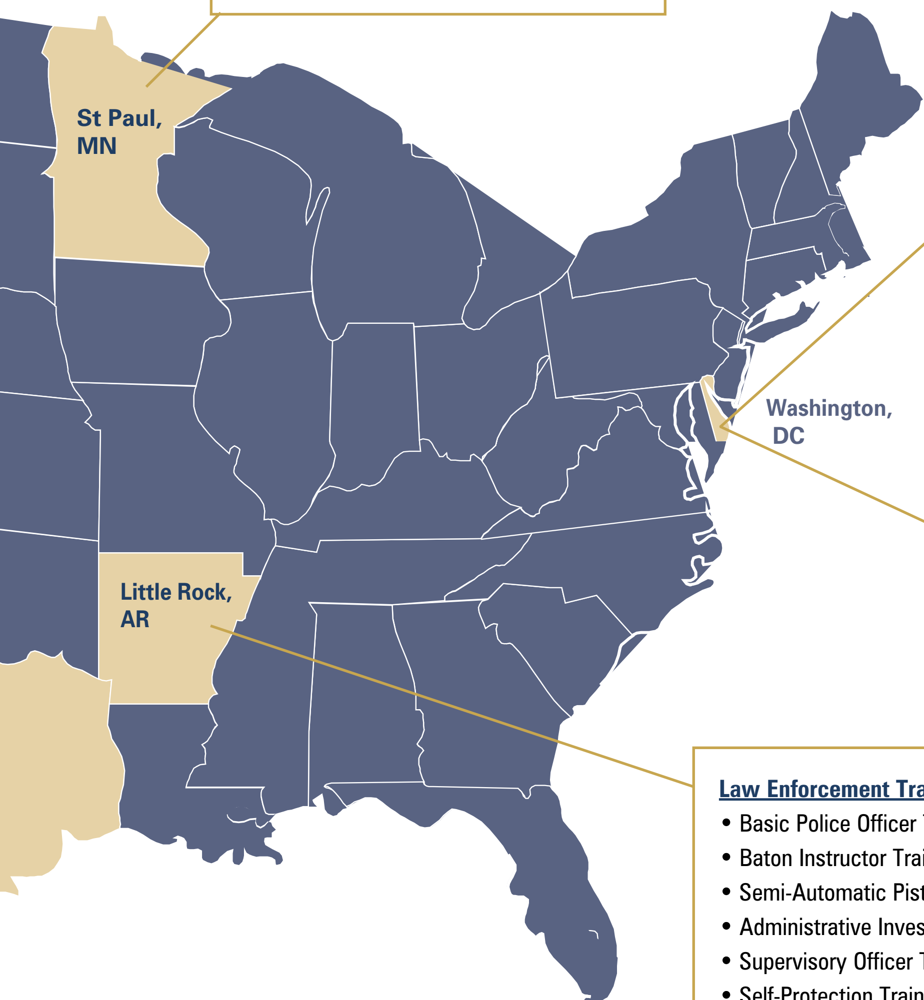
Financial Services Center (Austin, TX)
- Invoice and Payment Processing
- Payroll Services
- Financial Reports and Accounting
- Audit Recovery Services
- Financial Consulting Services
- Credit Card Processing
- Travel Services
- Document Management Services
- Electronic Commerce/Electronic Data Interchange
- Common Administrative Services
- Vendor File Maintenance
- Medical Claims Processing and Payments
- Data Matching and Reconciliation
- Discount Subsistence Purchases

Austin Automation Center (Austin, TX)
- IT Systems Hosting Services
- Application Management
- Information Assurance
- Customer Business Continuity
- Configuration Management
- Data Conversion and Data Interfacing
- Information Technology Laboratory
- Independent Verification and Validation Services
- IT Acquisition Services

Security and Investigations Center (SIC). Located in Washington, DC, the SIC provides quality and timely background investigations and adjudications for employees and contractors in sensitive positions for all VA entities nationwide. The SIC also issues and manages employee identification badges and provides fingerprint processing for VA employees and other federal customers in the Washington, DC area.

Enterprise Fund Office (EFO). The Enterprise Centers are supported by the EFO, which is responsible for the overall VA Franchise Fund operations including administering the financial resources, coordinating all business activities, and serving as the liaison between the VA Francise Fund, customers, and the VA Franchise Fund Board of Directors.

Debt Management Center (St. Paul, MN)
- Account Maintenance
- Administrative Offset
- Administrative Services
- Predictive Dialer (Telephone Solicitation)



Security and Investigations Center (Washington, DC)
- Investigations/Adjudications
- Fingerprint Processing
- Identification Badge & Access Card Design and Production

Enterprise Fund Office (Washington, DC)
- Provides administrative support to the Enterprise Centers
- Directs and analyzes Budget Formulation & Execution
- Oversees Financial and Business Planning
- Prepares Annual Report
- Coordinates Marketing Strategies
- Coordinates Audit of Consolidated Financial Statements

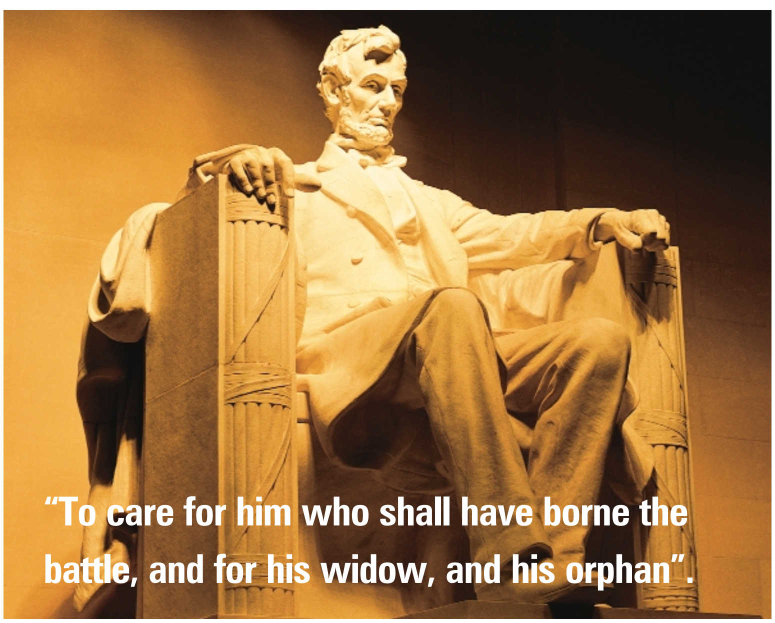
Law Enforcement Training Center (Little Rock, AR)
- Basic Police Officer Training
- Baton Instructor Training
- Semi-Automatic Pistol Training
- Administrative Investigations Training
- Supervisory Officer Training
- Self-Protection Training
- Violence in the Workplace Training
- Armorer Training

Who We Serve

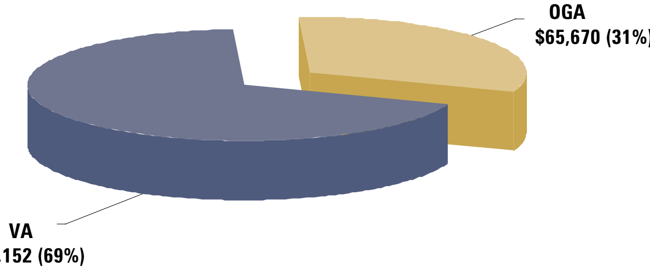
Our ultimate stakeholders are those who directly benefit from the services VA provides and those who carefully monitor the delivery of these services including the Office of Management and Budget, Congressional authorizations and appropriations committees and subcommittees, and veterans service organizations.

VA is the veterans' principal advocate for promoting the health, welfare, and dignity in recognition of their service to the Nation. As stated by President Abraham Lincoln, the Department's mission is *"To care for him who shall have borne the battle and for his widow and his orphan"*. The VA Franchise Fund takes great pride in supporting VA's mission.

We primarily serve VA–our parent agency, which accounted for 69 percent ($143 million) of our FY 2004 revenue. VHA is by far the largest customer of five of the six Enterprise Centers (Austin Automation Center (AAC), Financial Services Center (FSC), Law Enforcement Training Center (LETC), Security and Investigations Center (SIC), and the Records Center and Vault (RC&V). VBA is the Debt Management Center's (DMC) largest customer.



Revenue Sources - VA vs. OGA
As of September 30, 2004
(Dollars in Thousands)



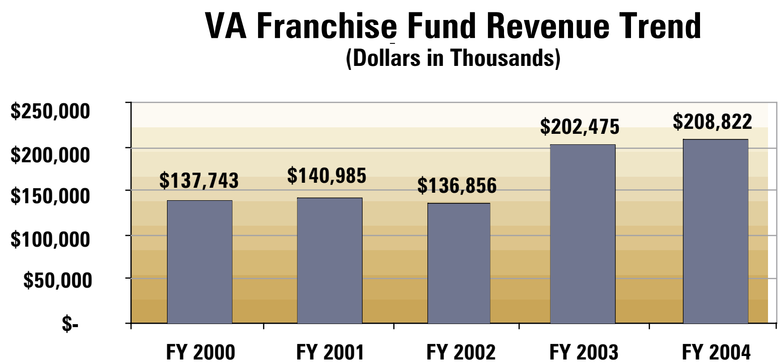
In the IT segment, the AAC provides VHA, VBA, and NCA with IT services that support many of the key systems (MyHealtheVet, Home TeleHealth, Scheduling Replacement Project (SRP), Veterans Service Network (VETSNET), Veterans Assistance Discharge System (VADS), and the Presidential Memorial Certificate) that directly support veterans. The RC&V indirectly supports the veteran population by providing a climate-controlled, highly secure facility for storage of their vital records, and prompt, courteous service in the retrieval of these records when requested by VA field facilities.

In the financial management segment, the DMC collects debts resulting from an individual's participation in VA programs in the most efficient and cost-effective manner, while maintaining compassion and high-quality service. The FSC ensures vendors who participate in VA's multi-billion dollar Prime Vendor Procurement Program are paid on time. These vendors provide VA medical centers with an efficient way to order supplies at low, negotiated contract prices and guarantee delivery within 24 hours, eliminating the need for warehousing large volumes of supplies.

In the security and law enforcement segment, the LETC provides well-trained police officers to ensure the safety of veterans, their families and visitors, and staff at VA medical centers. The SIC ensures that employees who provide patient protection, process claims, have access to veterans' information, and provide medical care receive the appropriate level of background investigations and timely adjudications.

We operate in a dynamic business environment where our operations are totally dependent upon revenues realized from customer purchases of our services. Accordingly, it is imperative that we maintain a high level of customer satisfaction by delivering high-quality services at competitive prices. Meeting customer expectations and delivering high-quality results begin with committed, principled leadership. The VA Franchise Fund's businesslike practices have enabled the Centers to become more efficient, responsive, and cost conscious. Together they have successfully combined best business practices and state-of-the-art technology to improve service delivery. As a result, we have become a part of the federal evolution of working better and costing less.

With the exception of the slight decrease in revenue in FY 2002, our total revenue has steadily increased each year. By the end of FY 2004, our total revenue grew to more than $208 million–a 3 percent increase over FY 2003 ($202 million) and a 34 percent increase over FY 2002 ($136 million).



VA Franchise Fund Customers

External Stakeholders

Veterans and their families

Office of Management and Budget

Congressional authorizations and appropriations committees and subcommittees

Veterans service organizations

Private sector vendors

Denali Commission

Department of Agriculture

Department of Defense

Department of Energy

Department of Health and Human Services

Department of Homeland Security

Department of Justice

Department of Labor

Department of State

Department of the Interior

Department of the Treasury

Federal Energy Regulatory Commission

General Services Administration

Government Accountability Office

Mid-Atlantic Cooperative Administrative Support Unit

Minnesota Cooperative Administrative Support Unit

National Aeronautics and Space Administration

National Archives and Records Administration

Office of Federal Housing Enterprise Oversight

Postal Rate Commission

Securities and Exchange Commission

United States Capitol Police

Other federal organizations

Internal Stakeholders

Veterans Benefits Administration

Veterans Health Administration

National Cemetery Administration

Staff offices within VA

Performance Measures Highlights

The performance information presented in this report accurately represents the performance during FYs 2001 – 2004. We are committed to ensuring that reported performance information is accurate and based on reliable information, and we constantly seek to improve our data collection and monitoring techniques.

Enabling Goal: Deliver world-class service to veterans and their families by applying sound business practices that result in effective management of people, communications, technology, and governance.

Objective: Improve the overall governance and performance of VA by applying sound business principles, ensuring accountability, and enhancing our management of resources through improved capital asset management; acquisition and competition sourcing; and linking strategic planning, budgeting, and performance planning.

- Ensuring all applications processing support and general support are of the highest quality
- Ensuring debt management collection services for delinquent consumer debt meet customer needs and requirements
- Ensuring payroll and financial services meet customer needs and requirements
- Ensuring VA's work environment is recognized by employees as conducive to productivity and achievement, and fosters respect among all

Each component that makes up the VA Franchise Fund is committed to achieving their performance goals to ensure we remain a performance-based organization.

- Ensuring high quality and timely investigations and adjudications for employees in national security and public trust positions and managing and issuing customer identification badges
- Ensuring accurate records management and secure archival storage, protection and retrieval services for veterans and other stored federal records
- Establishing and managing the business aspects of the Fund

Performance Summary Table

Performance Measure	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2004 Plan	Was the 2004 Performance Goal Met? Yes	No
Austin Automation Center							
Benchmarked Customer Satisfaction rating (ranking in the top percentage of Information Technology Customer Satisfaction (ITCS) peer database)	10%	12.5%	10%	6%	15%	✓	
Availability of on-line systems rate[1,2]	99%	99.9%	99.8%	99.8%	99.8%	✓	
Help Desk First-Contact Resolution (Tier 1) rate[3]	58%	67.4%	69.6%	73%	70%	✓	
Help Desk Abandoned Call Rate[4]	5.6%	4.1%	4%	3%	4%	✓	
Debt Management Center							
Rate of Return (Collections versus Expenses)	N/A	N/A	$63	$63	$61	✓	
Financial Services Center							
W-2 release dates met (All W-2s must be mailed by January 31st)	100%	100%	100%	100%	100%	✓	
FMS will be updated with credit card transactions daily, unless the FSC does not receive the transactions from Citibank	100%	100%	100%	100%	100%	✓	
Payment processing accuracy rate[5]	96%	97.9%	98.9%	98.4%	98.0%	✓	
Customer satisfaction rating (range 1-5)[6]	N/A	4.0	4.1	3.8	4.1		✓

[1] The industry standard is 99 percent and best practice is 99.5 percent.

[2] Goal will be 99.9 percent upon Corporate Data Center Infrastructure (CDCI) implementation for mission critical systems architected for high availability.

[3] The industry standard is 66 percent and best practice is 70 percent.

[4] The industry standard is 7 percent and best practice is 5 percent.

[5] Payment processing accuracy has been successfully maintained as a result of utilizing an automated solution, strong training, measuring and reporting accuracy on a daily basis, and continuous process improvements at the work center level.

[6] The FSC management responded to customer feedback by reducing rates and simplifying service level and franchise agreements. Process improvements, in addition to implementing a new survey structure include increased senior management oversight of survey results on a monthly basis. During FY 2004, the FSC made some minor adjustments in its survey methodology. The end result was a lower than expected customer satisfaction rating but better quality customer satisfaction data in FY 2004.

Performance Summary Table

Performance Measure	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2004 Plan	Was the 2004 Performance Goal Met? Yes	No
Law Enforcement Training Center							
Class graduation rate	98%	98%	95%	95.6%	95.0%	✓	
Security and Investigations Center							
Timeliness rate of investigations[7]	98%	95%	98%	98%	98%	✓	
Timeliness rate of arrest Records processed	100%	100%	100%	100%	100%	✓	
Records Center and Vault							
Timeliness rate of routine recall requests	98%	99%	99.8%	99.8%	97%	✓	
Timeliness rate of emergency recall requests	100%	98%	99.9%	99.5%	97%	✓	
Timeliness rate of rights and interests records that are available after a period of approximately 20 days in the event of a major national disaster[8]	N/A	N/A	N/A	N/A	97%		
Timeliness rate of accession number assignment[9]	N/A	N/A	N/A	99.7%	97%	✓	
Enterprise Fund Office							
Operating Reserves Target	70%	100%	100%	100%	100%	✓	
Number of audit qualifications for the VA Enterprise Centers	0	0	0	0	0	✓	

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[7] As a result of September 11th, the Office of Personnel Management alerted Federal agencies that they were experiencing a backlog on the completion of most background investigations. Due to this backlog, the SIC could not make its 98 percent goal of timeliness rate of investigations in FY 2002.

[8] National disaster record recalls will only occur in the event of a national disaster.

[9] This is a new measure. Results were tracked in FY 2004.

Limitation Statement

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Veterans Affairs Franchise Fund (VA Franchise Fund), pursuant to the requirements of 31 U.S.C. 3515 (b). Brown & Company CPAs, PLLC, performed the audit of the statements under the direction of the VA Office of Inspector General.

While the statements have been prepared from the books and records of the VA Franchise Fund, in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by 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 realization that they are for a component of the U.S. Government, a sovereign entity.

Auditors' Reports

Consolidated Financial Statements

Pressing Towards the Mark to Meet Franchise Fund Objectives

The franchising concept has added value to the government by empowering self-supporting federal government business entities to promote efficiencies in common administrative support services, reduce duplication of effort, foster competition, maintain customer satisfaction, and implement improved financial management and best practices.

Promoting Efficiencies in the Delivery of Common Administrative Support Services

We have a professional obligation to maintain excellence and to address the ever-changing challenges to provide the right services to our customers, at the right time, and in the right place. To guide those decisions, and to deliver quality common administrative support services, we are committed to actively listen to what customers say about their needs, and involve them in the development of future business activities. In many cases, the results benefit not only the immediate customer, but also the entire Department and ultimately the veterans we serve.

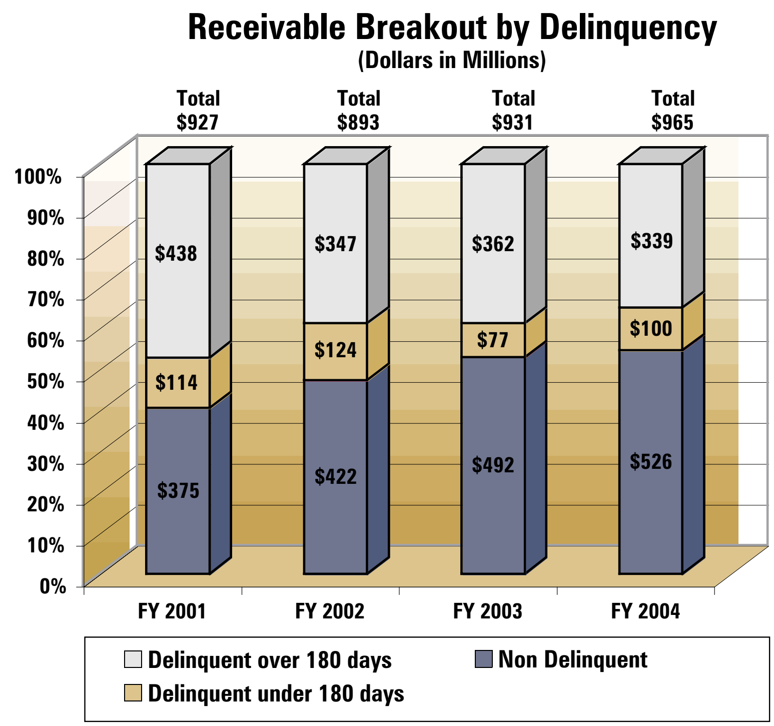
Online Credit Card Collections

In June 2004, the DMC implemented the use of credit cards using the Internet. Initial processes were developed and implemented to allow the entry of credit card information on a Web site and let that information flow through the banking system to the DMC for application. The system is being thoroughly tested with the DMC telephone operators performing all the key entry of the credit card information. Upon OMB's approval and the fine-tuning of the Web site to make it more user friendly, the Internet-based credit card collection system will be released to the general public in FY 2005. As a result of credit card collections, the DMC collected $3.3 million in FY 2004, compared to $2.1 million in FY 2003.

Receivable Breakout by Delinquency

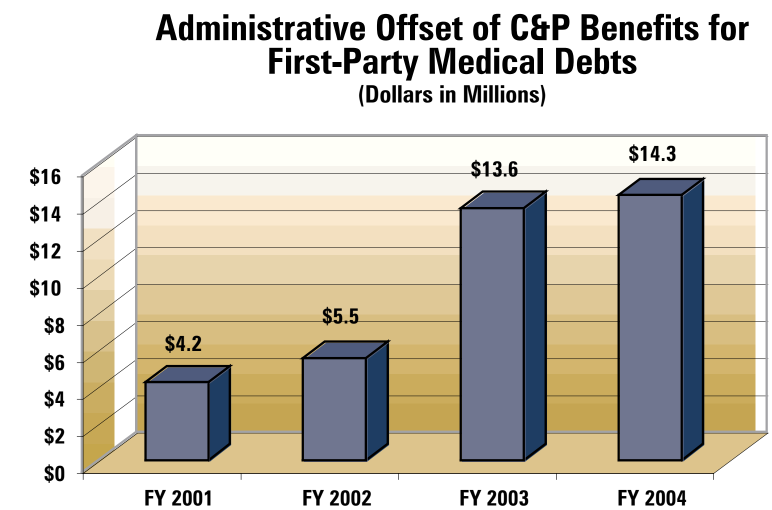
The chart on page 17 shows the total amount of benefit debt by VA's delinquency status (delinquent debt over 180 days, delinquent debt under 180 days and non-delinquent debt). A delinquent debt is defined as a debt not paid in full within 30 days from the date of notification or a debt not in a current payment plan or offset status. In FY 2004, there was a 9 percent increase in new debt (majority of the new debt resulted from compensation and pension (C&P) debts). These debts are more difficult to collect due to the nature of the benefit. As a result, the dollar value of debts delinquent under 180 days rose slightly from $77 million in FY 2003 to $100 million in FY 2004. However, the DMC was successful in getting many debtors into payment or offset status as evidenced by the $23 million increase in the non-delinquent category from $492 million in FY 2003 to $526 million in FY 2004.

Debts that are delinquent over 180 days have been referred to the Department of the Treasury (Treasury) for offset under the Treasury Offset Program (TOP) or for further collection under Treasury's cross-servicing program. Even though the debts have been referred to Treasury for further action, they remain on our books and are aged accordingly. Reductions in those balances are a result of offsets from TOP, collections through cross-servicing or from write-offs due to unsuccessful collection action. As a result of the reduction from $362 million in FY 2003 to $339 million in FY 2004, the combination of TOP and cross-servicing programs has had a positive affect on the delinquent balance over 180 days.

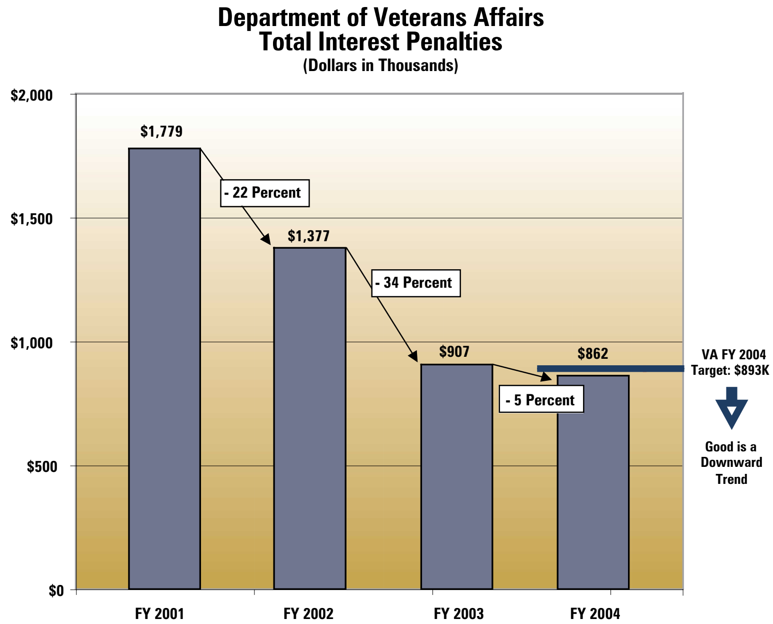


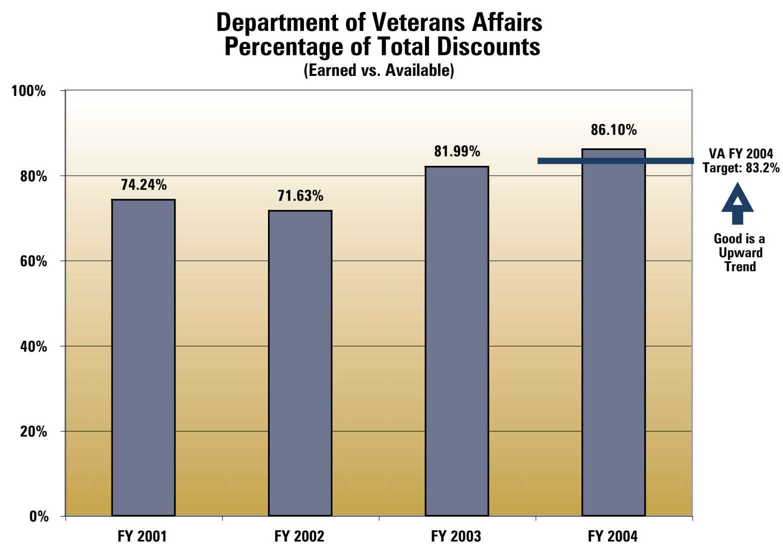
Administrative Offset by C&P for First-Party Medical Debts

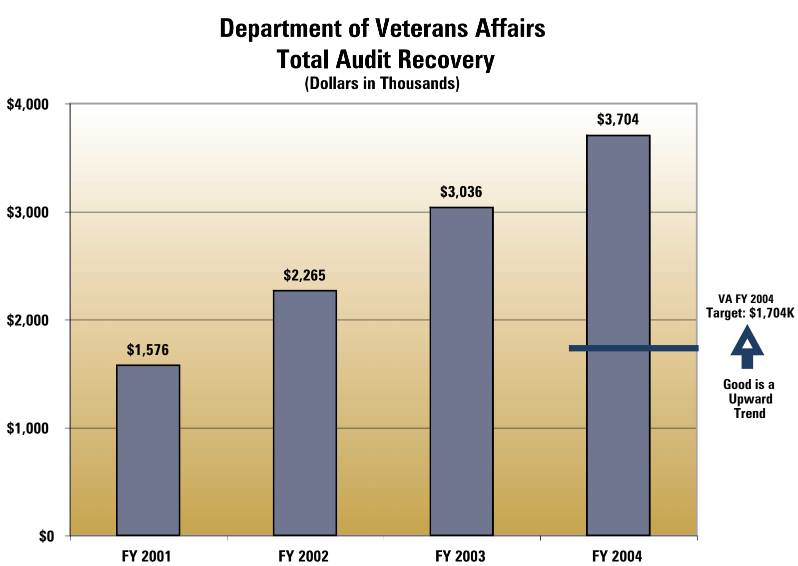
This chart displays the total dollar amount of C&P benefits that were offset to liquidate delinquent first-party medical debts. VHA's delinquent medical debt file is compared against VA's active benefit payment file on a monthly basis to determine if benefits are available for offset. The number of delinquent medical accounts referred for matching purposes increased 27 percent from an average of 345,118 during FY 2002 to 436,708 during FY 2003. This explains the significant increase in the dollar value of offsets from $5.5 million in FY 2002 to $13.6 million in FY 2003. The volume of referrals has continued in FY 2004, and as a result, offsets exceeded $14 million.



Each component that makes up the VA Franchise Fund makes a concentrated effort to press towards the mark to meet franchise fund objectives. We have a professional obligation to maintain excellence and to address the ever-changing challenges to provide the right services to our customers, at the right time, and in the right place.







Prompt Payment

VA continued to enhance its vendor payment processes throughout FY 2004. The Department processed over 5.3 million Prompt Payment Act (PPA) eligible invoices worth over $8.4 billion, with nearly 99 percent paid on time. In FY 2004, interest payments VA-wide declined by $45,000 (from $907,000 to $862,000)—a 5 percent improvement over FY 2003 levels and an annual reduction of $515,000, or 37 percent, over the past 2 years. At the same time, discounts earned surged by $469,000 to over $2.7 million, a 21 percent improvement over FY 2003 levels. VA's percentage of discounts earned also improved from 82 percent in FY 2003 to 86.1 percent in FY 2004.

Payment processing improvements saved VA $514,000 in FY 2004. The Department can use these savings to improve veterans' care. VA also continued to gain efficiencies and better results through an initiative completed in FY 2004 to centralize vendor payment activities at the FSC. By centralizing vendor payment activities, VA strengthened its focus on identifying and preventing vendor payment errors. The FSC also enhanced audit recovery efforts over improper/duplicate vendor payments. The FSC reviews VA vendor payments daily to systematically identify, prevent, and recover improper payments made to commercial vendors. Current payment files are matched to identify and, where possible, prevent duplicates prior to payment. Also, payments from prior fiscal years are matched to identify potential duplicate payments for further analysis, assessment and, as appropriate, collection. The FSC also reviews vendor payments to identify and collect improper payments resulting from payment processing such as erroneous interest penalties, service charges, and sales taxes. This initiative, started in FY 2004, recovered over $31,000 in erroneous interest penalties, service charges, and sales taxes for reuse by VA entities.

Overall, during FY 2004, collections of improper payments and the recovery of unapplied vendor statement credits totaled over $3.7 million—a 22 percent increase over FY 2003 collections ($3.0 million). Improved payment oversight also enabled VA to identify and cancel nearly $3.9 million in potential improper payments prior to disbursement during FY 2004. Since the inception of the FSC's audit recovery effort in FY 2001, VA has recovered over $10.5 million in improper payments and prevented the improper payment of another $9.7 million.

Purchase Card Program

The Department aggressively used the governmentwide commercial purchase card program. Over 3.6 million purchase card transactions were processed in FY 2004, representing over $1.9 billion in purchases compared to 3.2 million processed in FY 2003, resulting in $1.7 billion in purchases. In FY 2004, the electronic billing and payment process for centrally billed card accounts earned VA $30.3 million in credit card rebates—compared to $18.2 million during the same period in FY 2003. These rebates are returned to VA entities for use in veterans' programs. The increase in rebates can be mostly attributed to the increase in basis points VA receives as a result of the recompeted contract with the contract bank.

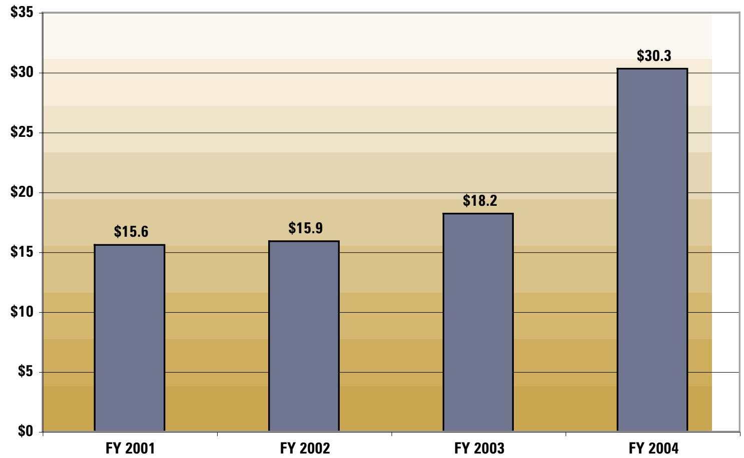
Fee Basis Credit Card Program

VA's fee basis credit card program went "live" in September 2003. This program electronically automates health care fee basis payments, eliminates processing of paper checks, and earns VA additional purchase card rebates. During FY 2003, the program generated 88 transactions and $8,000 in payments. In FY 2004, the number of fee basis purchase card transactions exceeded 21,000 and were valued at $5 million in payments, earning VA over $81,000 in additional rebates.

Prime Vendor Payment System

VA's Prime Vendor Payment System automates payments under a nationwide prime vendor centralized purchasing contract. During FY 2004, 126 VA medical centers used the Prime Vendor System to electronically process over 454,000 transactions worth over $3.5 billion compared to over $3.1 billion during FY 2003.

Purchase Card Rebates
(Dollars in Millions)



Electronic Commerce/Electronic Data Interchange System

Electronic commerce (EC)/electronic data interchange (EDI) uses commercially available, off-the-shelf software and national standards to move mission-critical information between VA and each of its trading partners which include vendors, mortgage service providers, and health care entities. EC/EDI also provides for internal exchange of information among VA application systems. Electronic data transfers enable program offices to restructure their work processes, take advantage of the accuracy and timeliness of electronic data, and concentrate on service objectives.

The FSC provides EDI services to process VHA Medical Care Cost Recovery (MCCR) health care billings. The FSC is also supporting VHA initiatives such as electronic Insurance Identification and Verification, electronic Pharmacy, electronic Medicare Remittance Advice, and the MCCR lockbox initiative for recording receipt of payments for billed items. Additionally, the FSC provides EDI services to assist the Veterans Canteen Service in receiving and processing invoices. The FSC will continue to support VA's efforts to increase cost savings and program efficiencies through the expansion of electronic data transfers in VA applications. The FSC will also continue to support VHA's efforts to comply with EC/EDI mandates identified in the Health Insurance Portability and Accountability Act (HIPAA) of 1996. The FSC recently procured software to electronically ensure the validity of data with regard to HIPAA compliance.

In addition to VHA, the FSC provides EC services to VA's Denver Distribution Center for invoices and payment vouchers, and to VA's subsistence prime vendor program. Furthermore, VBA benefits from FSC's EC services in the handling of loan processing, identifying the status of loan defaults, and processing loan guaranty certificates.

Fully Operational Corporate Data Center Infrastructure

The AAC serves as the lead project manager for VA's Corporate Data Center Infrastructure (CDCI), which became fully operational at the end of FY 2004. Over the past year, the AAC successfully demonstrated the concept of remote electronic vaulting, an electronic backup and recovery technology. In the event of a computer outage, this technology increases data security, reduces the time required for data recovery of mission-critical data, and provides for near-current data. As the Department moves to more enterprise-wide applications and transitions from batch-oriented to online transaction processing applications, the importance of a reliable and proven disaster recovery process cannot be overstated.

Business Continuity of Operations Planning Services

Having recently completed the CDCI project, the AAC is now able to offer highly sophisticated Continuity of Operations (COOP) planning services including enterprise fail-over capabilities, increased data availability for mission-critical applications, and hot-site backup solutions. A tiered service offering has been developed to allow mission-critical enterprise business functions and key enabling functions to be supported at a higher level of service, while keeping more cost-effective options available for routine activities such as historical repositories used for analysis.

Site Accreditation

Working with VA's Office of Cyber and Information Security (OCIS), the AAC received site accreditation for its IT infrastructure. These efforts ensure the security of the AAC's employees, customer data, and applications. The AAC also participates on several OCIS-led enterprise security working groups to discuss proposed enterprise-wide enhancements including smart cards, intrusion detection/prevention, and antivirus. Participation in these programs helps to ensure that the AAC's security program is on the leading edge and integrated with OCIS' plans for the VA enterprise.

New 80-Hour Refresher Training Course

The LETC plays a vital role in helping VA's law enforcement community meet its training needs. In an effort to bring VA police officers, who received training prior to FY 1996 up to the same training standard, and to maintain proficiency and address customer expectations for a fully trained officer corps, the LETC implemented an 80-hour refresher training course in FY 2004. As a result, 138 VA police officers completed the course and 300 per year are expected to be trained in FY 2005 and FY 2006.

The LETC plays a vital role in helping VA's law enforcement community meet its training needs. In addition, the LETC's training program is sought out by federal agencies that have the same customer-oriented vision of policing as VA.

Increase in the LETC's OGA Business

With the completion of VA's firearms initiative in FY 2003, which primarily catered to VHA, OGA business dramatically increased from $18,971 in FY 2003 to $84,570 in FY 2004. Our training program is sought out by federal agencies that have the same customer-oriented vision of policing as VA. We place a premium on training the federal law enforcement communities at health care facilities, parks, museums, and other federal special mission or limited jurisdiction settings nationwide and use an approach that focuses specifically on assaultive patient situations.

Reducing Duplication of Effort

Improved service and efficiency are not just slogans to us. Process improvements to avoid duplication of effort not only result in higher levels of customer satisfaction, but also yield savings across the Department which can be used to improve service in other areas.

DoD-VA Datasharing

The AAC hosts several important sharing projects between VA and the Department of Defense (DoD). VA's Consolidated Mail Out Pharmacy (CMOP) project allows DoD patients to receive prescription refills using VA CMOP facilities, which has resulted in substantial cost savings to DoD and enhanced revenue for VA. This project is expected to expand to include all DoD medical facilities. The Laboratory project is similar to CMOP and allows DoD hospitals to order lab results from VA medical centers and have results transferred to them securely using a virtual private network hosted at the AAC. If cost saving projections are correct, this program will also expand to include all DoD medical treatment facilities and VA medical centers. DoD is also investigating the benefits of using the DoD-VA gateway to transmit images, such as x-ray, CAT scan, and other digitized medical data to VA medical centers for analysis. Such telemedicine projects have been effective within VA.

Enterprise Architecture (EA) Team

The AAC is participating on several of the EA teams, defining infrastructure improvements and technical reference material included in the One VA EA. In addition, the AAC serves on customer design and architecture work groups to ensure customer needs are incorporated into systems design from the inception of a project.

One VA IT Investment Projects

The AAC provides services to several One VA IT investment projects including MyHealtheVet, Home Telehealth, Scheduling Replacement Project (SRP), Health Data Repository (HDR), Telecommunications Modernization Project (TMP), Veterans Services Network (VETSNET) and the Corporate Data Center Infrastructure (CDCI) project for continuity of operations.

The AAC works closely with VHA to provide hosting services for the MyHealtheVet, Home Telehealth and SRP technical infrastructures. HealtheVet is a collection of information systems, technologies and standards strategically designed to support patients, providers and administrators in VA's current and future health system. Home Telehealth is an innovative program that enables veterans to self report recurring health monitors, such as blood pressure, to VA medical centers and receive health assessments without having to physically go to clinics, which is often a hardship for elderly or chronically ill patients. SRP will provide VHA users with a reengineered and redesigned outpatient appointment scheduling system to better meet the needs of staff and patients. HDR is a centralized clinical database application in which the AAC provides such services as database and system administration, security and monitoring, optimization and volume testing, platform maintenance, service desk and change management support.

The TMP provides state-of-the-art wide area network technology to support the transportation of information across VA business lines. The AAC plays a pivotal position in VA networking, which is reflected in the TMP design that ensures all VA facilities can access the AAC with a minimal number of network "hops." The AAC employees participate in planning and implementing strategies and provide technical input and suggestions for implementing this One VA initiative.

The AAC works closely with VBA to provide platform hosting services for VETSNET, an integrated information system that enhances the claims processing process. The AAC works with VBA on capacity planning to ensure that adequate processing capacity is available to support the needs of the regional offices and monitors the performance of the system to ensure that response times meet expectations.

The AAC also provides an enhanced continuity of operations for mission-critical applications utilizing electronic vaulting of data. Mission-critical applications that are run at the AAC are now recovered at an alternate VA site within 12 hours of a declared disaster.

Information Technology Laboratory

The AAC is creating an Information Technology Laboratory (ITL) to evaluate technologies that may benefit significant portions of VA. Its effectiveness, benefits, and viability as a service offering will be evaluated after 18 to 24 months of implementation. The evaluation will focus on the contributions of the lab, customer feedback, Franchise Fund Board input, as well as the return on investment and cost benefit analysis. If successful, the AAC will offer ITL as a new product offering.

Independent Verification and Validation Services

VA does not have an independent verification and validation (IV&V) capability to validate whether major VA IT system implementations (i.e., projects requiring an OMB 300 exhibit) meet requirements and perform as specified. With increasing numbers of IT projects being delivered by third-party vendors, having a VA resource to independently evaluate adherence to design and performance requirements would greatly enhance VA project oversight capabilities. The AAC plans to create a new business line called IV&V services in FY 2006. Individual project IV&V efforts will be accomplished by establishing service agreements between the AAC and the VA project/program office responsible for a project. Since IV&V services will be set up under the AAC's current service center concept and billed to individual projects, there will be no negative impact on customer rates.

Virtual VA System

Virtual VA is a VBA electronic archiving system that provides desktop access to virtual claims folders. It can be accessed nationwide by all regional offices and is used extensively by VBA service representatives in processing pension claims and responding to veterans' inquires. The DMC worked extensively with VBA to begin electronically loading copies of the DMC's first collection notice and waiver grant letter in the Virtual VA system. This will assist VBA service representatives in responding to veterans' concerns about benefit overpayments without having to contact the DMC for information. The DMC personnel also have desktop access to the system to better explain what action caused benefits to be adjusted and possibly overpaid. This system improves customer service and shortens response time for both regional office and DMC personnel.

Online Certification System

The FSC continued to improve the online invoice certification process, which allows invoices to be certified electronically by VA facilities and schedule them for payment. The Online Certification System (OLCS) allows the FSC to notify certifying officials via e-mail of any invoice requiring payment certification. Through the Intranet, the certifying official can view, certify, and forward the invoice to the FSC for payment processing, reducing the processing time to hours rather than days. During 2004, system functionality was enhanced to add the Fund Control Point Clerk to the processing workflow as well as the capability to work rejected invoices at the station level. The FSC expanded the certified invoice service throughout VHA in FY 2004 and implemented OLCS at all facilities as part of the VHA's payment centralization initiative. This expansion increased the number of OLCS users to more than 9,000 VA employees. The OLCS also increased the efficiency of the payment process, which has led to significant savings in VA resources. At the same time, the OLCS and centralization have substantially reduced interest penalties and increased discounts earned. In keeping with this trend to increase efficiency, the FSC is currently working with VBA to centralize its payments at the FSC.

The FSC's certified payments process represents a full life cycle of services performed from the time the FSC receives an invoice until the Treasury renders proper payment. The services include processing cancelled checks, check tracers, vendor recertifications, rejects and adjustments, inquiries, vendor reclaims, bills of collection, Treasury offsets, tax levies, and faxhold follow-ups. The FSC provides these services in compliance with applicable VA regulations and directives and the PPA.

Document Management System

The FSC implemented an imaging system, referred to as the Document Management System (DMS), in May 1994. The DMS allows the FSC to provide a paperless work environment, reduce physical storage needs, and process high volumes of documents. The DMS stores documents on optical platters enabling users to retrieve these documents in seconds. In order to ensure a robust disaster recovery capability, the FSC stores a backup copy of all DMS records off-site. Initially, the DMS was used to process commercial payments and inquiries. Subsequently, the FSC's use of DMS has been expanded to include other functions such as vendorizing requests and federal accounts, preparing the Statement of Transactions Report (SF-224), and the OLCS. Additionally, the DMS has shown potential in storing and retrieving finance records, official personnel folder data, contract files, and legal documents.

Some current initiatives for the DMS include working with the VBA's Mortgage Loan Accounting Center (MLAC) to utilize the DMS in mortgage loan processing, and working with Central Office Human Resources Service, the Maryland Health Care System, the Washington, DC VA Medical Center, and the AAC Human Resources Office to develop a prototype application for an electronic official personnel file.

The FSC provides the Division of Immigration Health Services with an integrated, end-to-end medical claims payment-processing application in conjunction with document processing through an optical character reader. State-of-the-art technology is being applied to automate and Web-enable this application. This application truly represents a full life cycle—automated service from the time an invoice reaches the FSC through generation of payment—and is in full compliance with the PPA and HIPAA.

The FSC offers a one-stop response team to exclusively support VA with navigating FMS and to provide information to vendors about their payments. In addition, the e-Travel Help Desk provides timely and accurate responses to questions ranging from how to navigate in the e-Travel System, to assisting with reservation information and system administration or data integrity issues.

Vendor Inquiry System

The FSC staff continued to provide vendor payment history on the Internet. Currently, the Vendor Inquiry System (VIS) Internet application stores almost 2 years of information on invoices. Once vendors complete an authentication process, they can access a secure Web site to view payment information for their company. There were 6,270 registered vendors who made over 319,000 requests in FY 2004 and a total of over 619,000 requests were made since VIS's inception in April 2003. The VIS provides FSC vendors an easy-to-use tool for immediate access to their payment information 24 hours a day, without having to call and wait for a person to provide payment information. The VIS has also improved the FSC staff efficiency by handling many routine inquiries and freeing staff to work the more difficult issues for customers.

Centralized Accounts Receivable Online System Conversion

In May 2004, the DMC accepted the initial project plan for the Centralized Accounts Receivable Online System (CAROLS) database conversion to a Windows-based platform. CAROLS is the system used to access the DMC's collection database. The current system uses ADABAS and processes on the AAC's mainframe. The overall goal of the plan is to convert the online collection system from a mainframe environment to a Windows server-based platform, enhancing the user interface. This is also expected to significantly reduce the cost of licensing fees as well as mainframe processing costs. The project is scheduled for completion at the end of May 2005.

Customer Support Help Desk

At the request of the FSC's customers, a separate Customer Support Help Desk (CSHD) was established to offer a comprehensive, one-stop response team to exclusively support VA and vendor inquiries. It provides timely and accurate responses to questions ranging from how to navigate in the Financial Management System (FMS) to providing vendors with information about the status of their payments. The CSHD staff is comprised of seasoned professionals who are the most experienced processors within VA.

e-Travel Help Desk

The FSC offers a comprehensive, one-stop response team to support inquiries from VA stations. The e-Travel Help Desk is organized to provide timely and accurate responses to questions ranging from how to navigate in the e-Travel System, to assisting with reservation information and system administration or data integrity issues.

The e-Travel Help Desk staff provides the following services:

- Responds to telephone inquiries
- Responds to e-mail inquiries
- Responds to voice mail inquiries
- Reviews system issues and elevates issues to the proper point of contact
- Processes certain payment rejects
- Performs follow-up actions on reject issues
- Hosts the nationwide Super Users Conference Call
- Issues News Flash Messages to provide updates and instructions
- Performs global system administration functions
- Performs follow-up actions on reservation problems or questions from the online booking agent

The e-Travel Help Desk staff is comprised of trained professionals who have the most experience in working with VA's e-Travel system. The FSC recognizes the importance of the e-Travel Help Desk and is making necessary adjustments to ensure it is positioned to meet and exceed customer expectations.

Completion of Records Relocation Project

The RC&V received the final shipment of retired veteran records from the National Archives and Records Administration (NARA) in August 2004, which completed the monumental project of relocating over 940,000 cubic

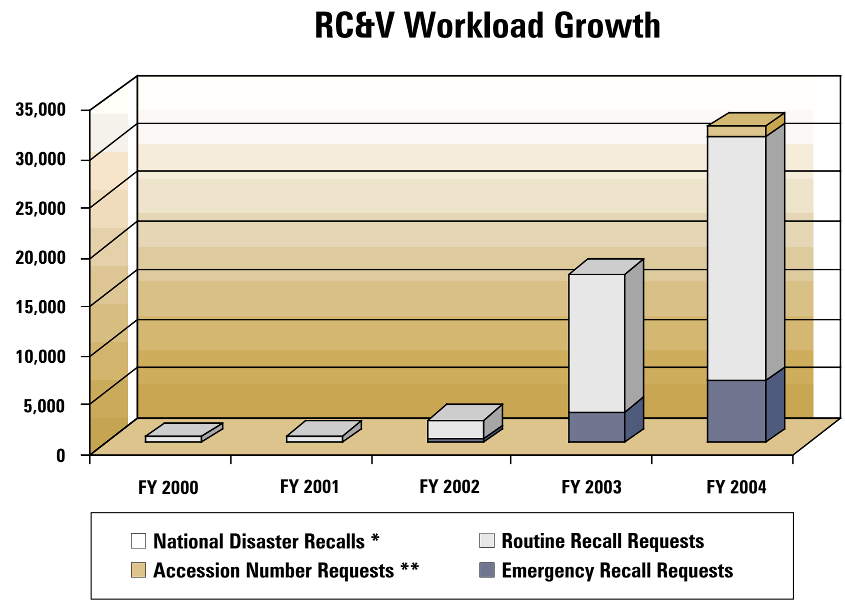
The RC&V has fire protection and prevention systems, which makes it ideally suitable for records storage of paper or electronic media.

feet of VHA records from 14 NARA facilities located across the country. The decision to move the VHA records from NARA facilities was based on long-term cost savings and benefits associated with records being stored in one location. Despite the complexity of the project itself and the challenges encountered, customer service remained a top priority and there was minimal disruption in service to our customers. Improved business processes allowed the RC&V to reach a breakeven status in FY 2004—one year ahead of schedule. As the RC&V gained experience, it is now managing and controlling costs more effectively. This is a win-win situation for customers as they will share in the economies of scale realized through our efforts with VHA.

The RC&V received the final shipment of retired veteran records from NARA in August 2004. This completed the monumental project of relocating over 940,000 cubic feet of VHA records, which began in May 2003.

RC&V Workload Growth

This chart depicts actual FY 2000 through FY 2004 annual volumes of the RC&V workload for accession number requests, routine recall requests, and emergency recall requests. The value of a records storage facility is defined by its ability to quickly retrieve and return records to customers when requested. The RC&V excels in this area. In spite of the substantial increase in workload due to the VHA Relocation Project and the increase in accession number and recall requests, the RC&V attained an overall performance rating of 99 percent in FY 2004.



	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual
National Disaster Record Recalls*	N/A	N/A	N/A	N/A	N/A
Accession Number Requests**	N/A	N/A	N/A	N/A	1,018
Routine Recall Requests	425	607	2,103	14,106	24,875
Emergency Recall Requests	96	59	257	3,128	6,124

*National disaster record recalls will only occur in the event of a national disaster
**This new measure was implemented in FY 2004.

Introduction of Web Functionality to the Records Management Process

The project to Web-enable the process of requesting accession numbers and routine/emergency recalls was made available to VA customers in FY 2004. This application allows customers to request and receive accession numbers electronically as well as request and track recalls. It not only results in faster and more accurate service to our customers, but also eliminates several of the RC&V's manual recordkeeping steps—resulting in labor savings.

Records Destruction

VHA expressed an interest in records destruction services. The RC&V has not previously offered this service due to smaller holdings and complexity of the destruction process for our customers who have classified holdings. With the completion of the VHA Records Relocation Project, the need for this new service became apparent. The RC&V will develop this product specific to VHA requirements in FY 2005 and expand the offering to all of its customers with non-classified holdings in FY 2006.

Future Expansion and Collocation Project

With the anticipated increase in future holdings from VHA (60,000 cubic feet per year) and Department of Energy (2,000 cubic feet per year), plans for a 60,000 square foot expansion are underway. This project will accommodate the long-term requirement for additional storage in FY 2005 as new holdings are acquired, while enhancing operational efficiencies and improving security. Plans include relocating equipment and security records inventory for OGA customers currently at the RC&V to this area. Direct benefits include collocation with the RC&V, additional capacity, better control of access to the area, better use of staffing, and additional non-classified shelf space for DOE records. This additional space will provide the capacity to house additional records through the third quarter of FY 2008.

Renovation Project to Construct a New Training Facility

During the latter part of FY 2004, the LETC obtained a building in need of renovation from the Little Rock Medical Center and began construction in November 2004. This facility is approximately 20,000 square feet and will be utilized as a dedicated physical fitness and defensive tactics training area. The LETC is also exploring options to expand its training capacity, including facility expansion and increased use of exportable training, to accommodate increased business.

Centralized Records Management System

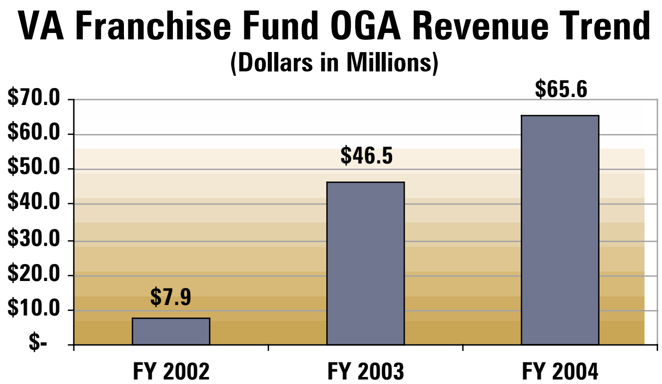
In an effort to better serve VA, the LETC is working with the AAC to develop a centralized Records Management System for the Office of Security and Law Enforcement and the individual police services at VA medical centers. This system will house all law enforcement-related information to include offense reports, daily police journals, physical security assessments, police training data, firearms and baton instructor lesson plans, and testing material and weapons qualification and inventory information. The system will improve the efficiency of the individual police officer, and provide senior management with an excellent tool for gathering law enforcement-related statistical information, and provide the ability to track trends in general criminal activity and physical security deficiencies. The system also has the potential to fit the automation needs of other federal law enforcement agencies, and after implementation throughout VA in FY 2005, it will be marketed as a product line to external customers.

Fostering Competition

We operate in a dynamic business environment, where our operations are totally dependent upon revenues realized from customer purchases of our services. Accordingly, it is imperative that we maintain a high level of customer satisfaction by delivering high-quality services at competitive prices.

An underlying tenet of entrepreneurial government is competition. Competition spurs efficiency and encourages market participants to provide the best-value products and services to meet customer needs. We are not a mandatory source offeror; therefore, we must compete in the federal marketplace in the best interest of our federal clients. Federal agencies are seeking the most economical and best-valued source to support their programs. This has placed competitive pressure on us to increase efficiency and improve performance to keep our existing customers and attract new ones.

As knowledgeable government professionals, we understand how to tailor services to provide federal clients with creative, cost-effective and practical solutions to fulfill their common administrative support services needs. Although federal agencies have unique missions, our collective experience enables us to give expert advice and counsel from an insider's point of view. The American public holds federal agencies accountable to high standards because they spend tax dollars to administer government programs. As a component of a federal agency, our organization also has unique requirements and financial constraints.



Acquiring a greater share of the federal marketplace continues to be challenge for us; however, we are progressively attaining more OGA business. Ending FY 2002 with just over $7.9 million in external sales, over the past two years we have dramatically increased our external sales to $46.5 million in FY 2003 and $65.6 million in FY 2004. We will continue to reach across Departmental boundaries for opportunities and innovative ways to increase our OGA business.

Addition of the IT Acquisition Services Product Line

The AAC, in partnership with VA's Office of Acquisition and Materiel Management, has created BuyIT.gov, a federal acquisition center, to assist OGA customers in acquiring IT-related supplies and services for their programs. BuyIT.gov became its own business line in FY 2004. There are ample opportunities in this market to help federal agencies with acquisition services and award contracts to private industry.

BuyIT.GOV℠

THE BETTER WAY TO **BUY IT**

Host to the Mid-Atlantic Cooperative Administrative Support Unit

The FSC is the host for the Mid-Atlantic Cooperative Administrative Support Unit (CASU). Based in New York, NY; Pittsburgh, PA; and Washington, DC, the CASU is a customer-driven organization that tailors its product lines to meet customer needs through high quality and low cost services, with quick turnaround response. It provides temporary help services for administrative assistance; cost-per-copy services for copier machines, bulk paper and laser cartridges; purchase service for copiers; and employee assistance program services to its present customer base of federal organizations. CASUs provide the federal community with discounted services through the economies of scale gained by the volume of business they provide to their vendors. This program remains a very stable and reliable source for support services within the federal marketplace and provides an effective means for federal agencies to support the Administration's focus on competitive sourcing.

Great Plains Accounting System

In response to the increased demand from small-to-medium-sized federal agencies for a low cost accounting system, and to more efficiently account for the CASU's revenue and expenses, the FSC purchased Great Plains Accounting Software in FY 2004. This accounting package will give the FSC the capability to provide small-to-medium-sized OGA customers with both accounting services and an end-to-end, full suite of financial management services that will integrate purchase cards, e-Travel, vendor payments, EC/EDI, and accounting through the same system. By acquiring Great Plains and marketing this software package, the FSC has an opportunity to increase its customer base for these services because VA's current core accounting system (FMS) will not allow the FSC to provide any of these services to OGA customers due to software and cost limitations.

Maintaining Customer Satisfaction

In addition to encouraging customer feedback throughout the year, AAC and FSC customer satisfaction is measured annually through a formal process. Surveys are tailored to the specific business lines and customer bases of each center.

The AAC scored in the top 6 percent of Gartner Measurement's Information Technology Customer Satisfaction database with an overall satisfaction rating of 4.17 out of 5.0, achieving a "best in class" rating and well surpassing the database average score of 3.63 for all 249 private and public sector organizations in Gartner's database.

Scores in Top 6 Percent of Gartner Satisfaction Survey

For the fifth consecutive year, the AAC contracted with Gartner Measurement, a division of Gartner, to conduct a satisfaction survey. Conducted in late FY 2004, AAC services were rated by over 600 VA and OGA customers. The AAC scored in the top 6 percent of Gartner Measurement's Information Technology Customer Satisfaction database with an overall satisfaction rating of 4.17 out of 5.0, achieving a "best in class" rating and well surpassing the database average score of 3.63 for all 249 private and public sector organizations in Gartner's database. The AAC showed an increase in satisfaction over its FY 2003 results.

The FSC achieved 3.8 out of 5.0 in its FY 2004 customer satisfaction rating as a result of making some minor adjustments in its survey methodology. The end result was a lower than expected customer satisfaction rating; however, the FSC received better quality customer satisfaction data. The FSC is confident that process improvements, in addition to implementing a new survey methodology and increasing senior management oversight, will help attain customer satisfaction goals in the future.

The remaining four smaller VA Enterprise Centers, the DMC, LETC, SIC, and RC&V, do not have formal standardized customer satisfaction survey instruments in place; however, they do solicit feedback from customers throughout the year. In the DMC's line of business, customer satisfaction can be clearly measured by the minimal number of negative comments received from customers. Corrective actions taken to improve performance depend on the complaints identified. The DMC continually reviews processes and procedures to ensure that the most cost-effective and efficient means are being used. The LETC receives immediate feedback through student critiques distributed at the completion of each course. In addition, feedback is sought from Chiefs of Police concerning the performance of their officers following the completion of the training program. The RC&V staff interacts daily with customers to obtain feedback on customer service regarding accession number and recall requests. The RC&V has a 90 percent success rate in meeting established timeframes.

No high-level survey has been done to measure the VA Franchise Fund and its effectiveness in meeting VA needs as well as the 12 operating principles on which the Fund was based. This is a short-term goal while each VA Enterprise Center explores its own customer survey instrument. However, the long-term goal is for all VA Enterprise Centers to measure customer satisfaction in a way that is meaningful to their customer mix and business needs.

Recovering Full Cost

By combining state-of-the-art technology and public/private sector synergy where applicable for cost efficiency, and by setting rates at levels to ensure that the costs of operations are recovered and operating and capital reserves are sufficient for business contingencies, capital investments, and new initiatives, we have been able to consistently price our services in a competitive manner. FY 2004 has been our most successful year.

Implementing Improved Financial Management and Best Practices

Sound financial management is more important than ever. It is the key to our success. Through the expertise of a quality workforce, attention to financial requirements and system capabilities, we, like other federal agencies, are focusing more intently on performance to ensure that every dollar is spent wisely and can be accounted for later.

Fiscal Management and Accountability

Our success as a fee-for-service organization depends on good stewardship and customer confidence in our ability to conduct business in a responsible way. Independent audits of our operations are conducted each year and are used to ensure management accountability and financial integrity. We continued our tradition of financial excellence—having received an unqualified “clean” audit opinion for the seventh consecutive year on our financial statements from an independent auditor engaged by the Office of Inspector General and the Enterprise Fund Office. We will continue to improve our fiscal management and accountability by completing the audit before the end of the calendar year, enhancing internal controls, and complying with financial management laws and regulations. These achievements cap our extensive efforts to produce timely, reliable, and auditable financial statements.

Through the expertise of a quality workforce, attention to financial requirements and system capabilities, we, like other federal agencies, are focusing more intently on performance to ensure that every dollar is spent wisely and can be accounted for later.

Revolutionizing File Matching and Reconciliations

The FSC utilizes FASMatch, a matching and reconciliation tool that can reconcile accounts receivable, accounts payable, fixed assets, inventories, patient records/accounts, management reporting, and automated data collection. FASMatch revolutionizes the matching and reconciliation needs across multiple files and complex systems. It automates manual matching of deposits and disbursements and produces, manages, and reconciles the Statement of Transactions Report (SF-224). The FSC used FASMatch heavily in the FY 2004 Annual Close process. It was a key contributor in leading VA and the Franchise Fund to unqualified "clean" audit opinions. It is also used in the vendor file update and maintenance process, and has been found to be a great success in identifying and controlling duplicate payments.

The FSC will implement business process reengineering (BPR) recommendations on service offerings (where applicable) to streamline operations.

Total Cost of Ownership Benchmark

The AAC completed a Total Cost of Ownership benchmark with Gartner Measurement in FY 2004. The scope of the benchmark was the AAC's mainframe computing environment. The benchmark effort included a structured cost model approach that compares data from other private and government data centers in the Gartner Benchmark database. A key output of the benchmark effort is an analysis of the Normalized Cost to Work Produced Index, a measure of cost-effectiveness that compares the cost of the service with the value of the workload produced. The AAC scored 30 percent better than the average score for data centers with comparable computing capacity. Additionally, the AAC mainframe business systems scored more effective than peers when the ratio of services delivered to business requirements was assessed. The AAC has begun data collection on two additional benchmark efforts focusing on open systems and storage management environments.

Business Process Reengineering

The FSC will implement business process reengineering (BPR) recommendations on service offerings (where applicable) to streamline operations; synchronize, integrate, and standardize data; apply technology to improve efficiency and reduce costs to customers; and provide greater visibility and access to data needed by VA customers. The FSC expects the BPR recommendations to be finalized in FY 2005.

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 **December 20, 2004**

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 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.

Brown & Company

Largo, Maryland
November 17, 2004

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BROWN & COMPANY CPAs, PLLC

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.

Brown & Company

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.

Brown & Company

Largo, Maryland
November 17, 2004

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Consolidated Financial Statements

DEPARTMENT OF VETERANS AFFAIRS FRANCHISE FUND
CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30,
(Dollars in Thousands)

	2004	2003
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$ 95,924	$ 90,392
Accounts Receivable	27,911	28,328
Other Assets (Note 3)	6,455	6,642
Total Intragovernmental	130,290	125,362
Accounts Receivable	18	41
Property, Plant and Equipment, Net (Note 4)	21,778	24,389
Other Assets (Note 3)	3	97
Total Assets	**$ 152,089**	**$ 149,889**
LIABILITIES		
Intragovernmental Liabilities		
Accounts Payable	$ 95	$ 243
Other Liabilities (Note 6)	28,536	9,722
Total Intragovernmental	28,631	9,965
Accounts Payable	3,944	7,495
Other Liabilities (Note 6)	28,821	24,533
Total Liabilities	**61,396**	**41,993**
NET POSITION	**$ 90,693**	**$ 107,896**
TOTAL LIABILITIES AND NET POSITION	**$ 152,089**	**$ 149,889**

All liabilities are current.

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

DEPARTMENT OF VETERANS AFFAIRS FRANCHISE FUND
CONSOLIDATED STATEMENT OF NET COST
FOR THE YEARS ENDED SEPTEMBER 30,
(Dollars in Thousands)

	2004	2003
PROGRAM COSTS		
Gross Costs Intragovernmental	$ 35,929	$ 36,634
Less: Intragovernmental Earned Revenue	(208,785)	(202,475)
Intragovernmental Net Costs	(172,856)	(165,841)
Gross Costs Public	194,692	147,757
Less: Public Earned Revenue (Note 7)	(37)	-
NET COST OF OPERATIONS	**$ 21,799**	**$ (18,084)**

DEPARTMENT OF VETERANS AFFAIRS FRANCHISE FUND
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30,
(Dollars in Thousands)

	2004	2003
NET POSITION		
Beginning Balance	**$ 107,896**	**$ 87,493**
OTHER FINANCING SOURCES		
Transfers-In	333	1,199
Imputed Financing	4,263	3,783
Total Financing Sources	**4,596**	**4,982**
NET COST OF OPERATIONS	(21,799)	18,084
Cumulative Effect of Change in Accounting Principle	-	(2,663)
TOTAL NET POSITION	**$ 90,693**	**$ 107,896**

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

DEPARTMENT OF VETERANS AFFAIRS FRANCHISE FUND
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30,
(Dollars in Thousands)

	2004	2003
BUDGETARY RESOURCES		
Unobligated Balance at the Beginning of the Period	$ 72,856	$ 52,682
Spending Authority from Offsetting Collections		
Earned		
Collected	222,579	200,055
Receivable from Federal sources	(417)	14,416
Change in unfilled customer orders		
Advance received	12,660	(118)
Total Budgetary Resources	**307,678**	**267,035**
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred	231,956	194,179
Unobligated Balance Available (Note 2)	48,055	54,414
Unobligated Balance Not Available (Note 2)	27,667	18,442
Total Status of Budgetary Resources	**307,678**	**267,035**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Obligated Balance, Net - Beginning of the Period	17,536	20,410
Less: Obligated Balance, Net - End of the Period (Note 2)		
Accounts Receivable	(27,911)	(28,328)
Undelivered Orders	375	4,865
Accounts Payable	47,738	40,999
Outlays:		
Disbursements	229,707	182,637
Collections	(235,239)	(199,937)
Net Outlays	**$ (5,532)**	**$ (17,300)**

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

DEPARTMENT OF VETERANS AFFAIRS FRANCHISE FUND
CONSOLIDATED STATEMENT OF FINANCING
FOR THE YEARS ENDED SEPTEMBER 30,
(Dollars in Thousands)

	2004	2003
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Obligations Incurred	$ 231,956	$ 194,179
Less: Spending Authority from Offsetting Collections and Adjustments	(234,822)	(214,353)
Net Obligations	**(2,866)**	**(20,174)**
Other Resources		
Transfers-In	333	1,199
Financing Imputed for Cost Subsidies	4,263	3,783
Net Other Resources Used to Finance Activities	**4,596**	**4,982**
Total Resources Used to Finance Activities	**1,730**	**(15,192)**
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	17,431	(4,674)
Resources that Finance the Acquisition of Assets Property, Plant and Equipment	(6,752)	(5,780)
Resources that Fund Expenses Recognized in Prior Periods	22	244
Total Resources Used to Finance Items Not Part of Net Cost of Operations	**10,701**	**(10,210)**
Total Resources Used to Finance the Net Cost of Operations	**12,431**	**(25,402)**
COMPONENTS NOT REQUIRING OR GENERATING RESOURCES		
Depreciation and Amortization	9,248	10,152
Gain/Loss on Disposition of Assets	115	(251)
Other	5	(2,583)
	9,368	**7,318**
NET COST OF OPERATIONS	**$ 21,799**	**$ (18,084)**

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

Notes to the Consolidated Financial Statements

Department of Veterans Affairs Franchise Fund

Notes to the Consolidated Financial Statements
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

Created by Congress in 1996, as one of six Franchise Fund pilots operating within the Executive Branch of Government, the Department of Veterans Affairs' (VA) Franchise 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. This organization accounted for its funds in six activity centers (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. The consolidated financial statements include the six individual activity centers of the Fund. All material intrafund transactions have been eliminated.

B. Basis of Presentation

The VA Franchise Fund consolidated financial statements report all activities of Franchise Fund components. The consolidated financial statements differ from the financial reports used to monitor and control budgetary resources, but are prepared from the same books and records. The statements should be read with the understanding that the VA Franchise Fund is a component unit of the U.S. Government. The Franchise Fund's fiscal year (FY) 2004 and 2003 financial statements are presented in conformity with the Office of Management and Budget's (OMB) Bulletin 01-09, "Form and Content of Agency Financial Statements," as amended.

C. 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 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 in the United States of America for Federal governmental entities.

D. Fund Balance with Treasury

The Department of the Treasury (Treasury) performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury represents the right of the VA Franchise Fund to draw on the Treasury for allowable expenditures.

E. 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 advances for Permanent Change of Station travel or advances for Federal Employees Health Benefits 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.

F. Property, Plant and Equipment

The majority of the general Property, Plant and Equipment (PP&E) is used to provide common administrative services to the VA and other federal entities and is valued at cost, including transfers from other federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Individual items are capitalized if the useful life is 2 years or more and the unit price is $100,000 or greater. Equipment is depreciated on a straight-line basis over its useful life, usually 3 to 5 years. There are no restrictions on the use or convertibility of general PP&E.

G. 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. All liabilities are current.

H. 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.

I. 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.

J. 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.

K. Litigation

VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA Franchise Fund management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims will not materially affect the financial position or results of VA Franchise Fund operations.

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,

	2004	2003
Fund Balance with Treasury	$ 95,924	$ 90,392

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.

	2004	2003
Unobligated Apportionment		
Available	$ 48,055	$ 54,414
Unavailable	27,667	18,442
Obligated balance not yet Disbursed	20,202	17,536
Total Unexpended Apportionment	**$ 95,924**	**$ 90,392**

Note 3. Other Assets

Other assets are generally made up of advances. There are two types of advances handled by the Franchise Fund. The first is when Treasury processes charges from other agencies to the Franchise Fund via the IPAC system. Charges are recorded as an advance until the applicable obligation is located and the charges can be transferred. These charges are for GSA rent, GPO printing services, FTS, and motor pool.

One of the product lines available to other government agencies is the handling of the purchase card activity. When the purchase credit card payments are scheduled, an advance is set up. Charges are then IPACed to the applicable agency to offset the advances.

Note 4. Property, Plant and Equipment

Property, Plant and Equipment (PP&E), 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 $100,000 with a useful life of 2 years or more are capitalized. All capitalized purchases are depreciated using the straight-line method over the estimated useful life, usually 3 to 5 years.

Leasehold Improvements and related depreciation are accounted for as Departmental assets. The Franchise Fund utilizes these assets in the production of revenue. Since the leasehold improvements are VA assets, they are recorded at the Departmental threshold of $100,000.

PP&E As of September 30, 2004:

	Acquisition Cost	Accumulated Depreciation	Net Book Value
Furniture & Equipment	$ 1,421	$ (837)	$ 584
Capital Leases	-	-	-
ADP Equipment	24,276	(15,186)	9,090
Software	9,026	(7,569)	1,457
Software - In Development	165	-	165
Leasehold Improvements	19,121	(8,639)	10,482
Total PP&E	**$ 54,009**	**$ (32,231)**	**$ 21,778**

PP&E As of September 30, 2003:

	Acquisition Cost	Accumulated Depreciation	Net Book Value
Furniture & Equipment	$ 1,503	$ (725)	$ 778
Capital Leases	7,921	(7,921)	-
ADP Equipment	20,296	(8,830)	11,466
Software	8,196	(6,088)	2,108
Software – In Development	-	-	-
Leasehold Improvements	17,540	(7,503)	10,037
Total PP&E	**$ 55,456**	**$ (31,067)**	**$ 24,389**

Note 5. Leases

The Franchise Fund has operating leases. Due to the number of operating leases, the future commitment for operating leases is not known. The Franchise Fund's FY 2004 operating lease costs were $1,293,809 for real property rentals and $83,308 for equipment rentals. The Franchise Fund's FY 2003 operating lease costs were $713,934 for real property rentals and $40,967 for equipment rentals. The following chart represents the Franchise Fund's estimate for operating lease costs for the next 5 years, assuming a range of 3.1 to 3.5 percent annual increase in cost.

OPERATING LEASES

Fiscal Year	Percentage Increase	Real Property	Equipment
2005	3.1	$ 1,334	$ 86
2006	3.5	1,381	89
2007	3.4	1,428	92
2008	3.4	1,476	95
2009	3.4	1,526	98

Note 6. Other Liabilities

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

	2004	2003
Intragovernmental		
Accrued Payables – Federal	$ 15,121	$ 8,972
Advances – Federal	13,415	750
Total Intragovernmental Liabilities	**$ 28,536**	**$ 9,722**
Public		
Accrued Payables	$ 23,476	$ 19,783
Accrued Salaries & Wages	1,932	1,400
Accrued Funded Annual Leave	3,413	3,350
Total Public Liabilities	**$ 28,821**	**$ 24,533**

Note 7. Public Earned Revenue

In 1987, the General Services Administration (GSA) issued regulations providing guidelines for the establishment and installation of physical fitness facilities in government-owned space. GSA coordinates the Cooperative Administrative Support Unit (CASU) program. This program establishes the legal and administrative framework for agencies in multi-tenant buildings to share common services, including health and fitness centers. The Financial Services Center is the sponsor agency for the Mid-Atlantic CASU. The Mid-Atlantic CASU manages a health and fitness center in a Federal building in New York City. Federal employees are members and the revenue for their fees is considered public revenue.

Glossary of Terms

AAC	Austin Automation Center
CAROLS	Centralized Accounts Receivable Online System
CASU	Cooperative Administrative Support Unit
CDCI	Corporate Data Center Infrastructure
CFS	Consolidated Financial Statement
CMOP	Consolidated Mail Outpatient Pharmacy
COOP	Continuity of Operations
C&P	Compensation and Pension
CPA	Certified Public Accountant
CSHD	Customer Support Help Desk
DMC	Debt Management Center
DMS	Document Management System
DoD	Department of Defense
EA	Enterprise Architecture
EC/EDI	Electronic Commerce/Electronic Data Interchange
EFO	Enterprise Fund Office
FASAB	Federal Accounting Standards Advisory Board
FFMIA	Federal Financial Management Improvement Act
FMS	Financial Management System
FSC	Financial Services Center
FY	Fiscal Year
GMRA	Government Management Reform Act
GSA	General Services Administration
HDR	Health Data Repository
HIPAA	Health Insurance Portability and Accountability Act
IFCAP	Integrated Funds Distribution, Control Point Activity, Accounting and Procurement
IT	Information Technology
ITL	Information Technology Laboratory
IV&V	Independent Verification and Validation
LETC	Law Enforcement Training Center
MCCR	Medical Care Cost Recovery
MD&A	Management's Discussion and Analysis
MLAC	Mortgage Loan Accounting Center
NARA	National Archives and Records Administration
NCA	National Cemetery Administration
OCIS	Office of Cyber and Information Security
OGA	Other Government Agencies
OIG	Office of Inspector General
OLCS	Online Certification System
OMB	Office of Management and Budget

PAID	Personnel and Accounting Integrated Data
PPA	Prompt Payment Act
PP&E	Property, Plant, and Equipment
RC&V	Records Center and Vault
SIC	Security and Investigations Center
SRP	Scheduling Replacement Project
TMP	Telecommunications Modernization Project
TOP	Treasury Offset Program
Treasury	Department of the Treasury
VA	Department of Veterans Affairs
VADS	Veterans Assistance Discharge System
VBA	Veterans Benefits Administration
VETSNET	Veterans Services Network
VHA	Veterans Health Administration
VIS	Vendor Inquiry System

Thank you for your interest in the VA Franchise Fund FY 2004 Annual Report. We welcome your comments on how we can make this report more informative. We are particularly interested in your comments on the usefulness of this information and the manner in which it is presented.

Please send your comments to vafund@mail.va.gov or write to:
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Annual Report 2004

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