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# INDEPENDENT AUDITOR'S REPORT
AUD-FM-17-09

To the Secretary and the Inspector General of the U.S. Department of State

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Department of State (Department), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, the related consolidated statements of net cost and changes in net position, the combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as the "consolidated financial statements").

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, "Audit Requirements for Federal Financial Statements." Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate under the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion on the Consolidated Financial Statements***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2016 and 2015, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, condition assessment of Heritage Assets section, Combining Statement of Budgetary Resources, and Deferred Maintenance and Repairs section (hereinafter referred to as "required supplementary information") be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by OMB Circular A-136, "Financial Reporting Requirements," and the Federal Accounting Standards Advisory Board, which consider the information to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of making inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audits of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The information in the Message from the Secretary, the Message from the Comptroller, the Introduction, Appendices, and the Other Information Section, as listed in the Table of Contents of the Department's Agency Financial Report, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on the information.

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**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02, we have also issued reports, dated November 15, 2016, on our consideration of the Department's internal control over financial reporting and on our tests of the Department's compliance with provisions of applicable laws, regulations, contracts, and grant agreements for the year ended September 30, 2016. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 15-02 and should be considered in assessing the results of our audits.

Kearney & Company

Alexandria, Virginia
November 15, 2016

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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Secretary and the Inspector General of the U.S. Department of State

We have audited the consolidated financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2016, and have issued our report thereon dated November 15, 2016. 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. 15-02, "Audit Requirements for Federal Financial Statements."

## Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Department's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate under the circumstances for the purpose of expressing our opinion on the consolidated financial statements but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 15-02. 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Our audit was also not designed to identify deficiencies in internal control that might be significant. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Department's internal control to be significant deficiencies.

## Significant Deficiencies

### I. Financial Reporting

Weaknesses in controls over financial reporting have been reported as either a material weakness or a significant deficiency since the audit of the Department's FY 2009 financial statements. The Department has addressed certain control deficiencies reported in prior financial statement audit reports related to financial reporting and improved underlying data. However, financial reporting continues to be a significant deficiency because of issues with the preparation of the Statement of Budgetary Resources (SBR).

The SBR is derived predominantly from an entity's budgetary general ledger in accordance with budgetary accounting rules. Information on the SBR should reconcile to budget execution information reported to the Department of the Treasury on Standard Form (SF) 133, Report on Budget Execution and Budgetary Resources, and with information reported in the Budget of the United States Government to ensure the integrity of the information presented. Agencies must submit their financial information, including budgetary data, to the Department of the Treasury using the Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS).

We found that the Department had made numerous adjustments related to budgetary resources outside the financial system, most of which were needed to pass GTAS automated edit checks. Further, we identified manual adjustments that were not supported as well as manual adjustments that were misclassified. The Department recorded adjustments to the SBR and related footnotes as a result of the audit procedures performed on the Department's SBR reporting process.

The Department did not enable the full functionality of its accounting systems to capture all budgetary accounting events and to automate budgetary reporting procedures. Although the Department took steps to standardize and document the process to prepare and input data into GTAS, the Department did not formalize or implement sufficient controls to ensure all manual budgetary adjustments were supported or that adjustments were consistently recorded when preparing the SBR. Manual adjustments require an increased measure of internal control and review, reduce the Department's ability to produce statements timely, and increase the likelihood of errors in the statements.

### II. Property and Equipment

The Department reported over $21 billion in net property and equipment on its FY 2016 balance sheet. Real and leased property consisted primarily of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities. Personal property consisted of several asset categories, including aircraft, vehicles, security equipment, communication equipment, and software. Weaknesses in property and equipment were initially reported in the audit of the Department's FY 2005 consolidated financial statements and subsequent audits. In FY 2016, the Department's internal control structure continued to exhibit several deficiencies that negatively affected the Department's ability to account for real and personal property in a complete, accurate, and timely manner. We concluded that the combination of property-related control deficiencies was a significant deficiency. The individual deficiencies we identified are summarized as follows:

- Personal Property Acquisitions and Disposals – The Department uses several non-integrated systems to track, manage, and record personal property transactions, which are periodically merged or reconciled with the financial management system to centrally account for the acquisition, disposal, and transfer of personal property. We noted a significant number of personal property transactions from prior years that were not recorded until the current year. In addition, we noted that the acquisition value for a number of selected items could not be supported and that the gain or loss on personal property disposals was not recorded properly for numerous items. The Department's control structure did not ensure that personal property acquisitions, disposals, and transfers were recorded timely and accurately. In addition, the Department's monitoring activities were not always effective to ensure proper financial reporting for personal property. The errors resulted in misstatements to the Department's consolidated financial statements. The lack of effective control may result in the loss of accountability for asset custodianship, which could lead to undetected theft or waste.

- Real Property Acquisitions and Disposals – The Department operates at more than 270 posts in over 180 countries around the world and is primarily responsible for acquiring and managing real property in foreign countries on behalf of the U.S. Government. The Department's overseas real property inventory consists primarily of land and facilities overseas that are used for diplomatic missions and capital improvements to those facilities. We found several real property transactions that were not recorded by the Department in a timely manner. Each untimely transaction related to an event other than traditional purchases or sales, such as real property exchanges, transfers to a host government, and property demolitions. Although the Department has a process to identify real property transactions that need to be recorded in its accounting records, the process did not effectively identify transactions that occurred by means other than traditional sales and purchases of real property. The untimely processing of property transactions resulted in misstatements in the Department's property balances.

- Accounting for Leases – The Department manages over 16,700 real property leases throughout the world. The majority of the Department's leases are short-term operating leases. The Department must disclose the future minimum lease payments (FMLP) related to the Department's operating lease obligations in the footnotes to the consolidated financial statements. We found numerous recorded lease terms that did not agree with supporting documentation. We also found errors in the Department's FMLP calculations, despite using accurate lease data. In addition, we tested leases that were scheduled to expire and found multiple leases that had been renewed; however, the renewed lease terms were not included in the Department's FMLP calculations. Finally, we tested leases listed as being occupied by other agencies and found one misclassified lease that should have been included in the Department's FMLP calculation. The Department's processes to monitor lease information provided by posts and to ensure the accuracy of FMLP calculations were not always effective. The discrepancies identified in the Department's FMLP calculation methodology led to errors in the Department's financial statement footnote disclosure.

- Accounting for Prepaid Leases – For over 10,000 of the leases managed by the Department, the Department makes prepayments that cover multiple months of rent expenses (such as rent prepayments made on an annual, semi-annual, or quarterly basis). The Department reports certain prepaid expenses in the "Other Assets" line item on its annual financial statements, as required by Federal accounting standards. However, we found that the Department did not record the advance payments made for leases as an Other Asset. Although Department officials were generally aware of the accounting requirements relating to prepayments, the Department had not considered recording prepaid leases. Without a process to identify advance lease payments, the Department understated assets in its annual financial statements.

- Incomplete and Inaccurate Reporting of Software – Federal agencies use various types of software applications, called "internal use software" (IUS), to conduct business. Applications in the development phase are considered software in development (SID). Agencies are required to report software as general property in the financial statements. We identified numerous instances in which the data recorded for SID and IUS were inaccurate. We also identified several instances in which software projects were not reported as SID or IUS and other instances in which the Department did not provide evidence as to why some IT projects should not be reported as SID or IUS. Although the Department performs a quarterly data call to obtain software costs from bureau project managers, this process was not sufficient because it relied on the responsiveness and understanding of individual project managers. Additionally, the Department does not have an effective process to confirm that information provided during the quarterly data call is complete or accurate. Without an effective process to obtain information pertaining to software projects, the Department may continue to understate its property balances and overstate its expenses.

## III. Budgetary Accounting

The Department lacked sufficient reliable funds control over its accounting and business processes to ensure budgetary transactions were properly recorded, monitored, and reported. Beginning in our report on the Department's FY 2010 consolidated financial statements, we identified budgetary accounting as a significant deficiency. During FY 2016, the audit continued to identify control limitations, and we concluded that the combination of control deficiencies remained a significant deficiency. The individual deficiencies we identified are summarized as follows:

- Support of Obligations – Obligations are definite commitments that create a legal liability of the Government for payment. The Department should record only legitimate obligations, which would include a reasonable estimate of potential future outlays. We identified a large number of low-value obligations for which the Department could not provide evidence of a binding agreement. The Department's financial system was designed to reject payments for invoices without established obligations. Because allotment holders were not always recording valid and accurate obligations prior to the receipt of goods and services, the Department established low-value obligations, which allowed invoices to be paid in compliance with the Prompt Payment Act but effectively bypassed system controls. The continued use of this practice could lead to a violation of the Antideficiency Act and increases the risk of fraud, misuse, and waste.

- Timeliness of Obligations – The Department should record an obligation in its financial management system when it enters into an agreement, such as a contract or a purchase order, to purchase goods and services. During our testing, we identified numerous obligations that were not recorded within 15 days of execution of the obligating document and obligations that were posted subsequent to the receipt of goods and services. We also identified obligations that were recorded in the financial management system prior to the formal execution of a contract. The Department did not have processes to ensure the accurate and timely creation and recording of obligations. Without an effective obligation process, controls to monitor funds and make timely payments may be compromised, which may lead to violations of the Antideficiency Act and the Prompt Payment Act.

- Capital Lease Obligations – The Department must obligate funds to cover the net present value of the Government's total estimated legal obligation over the life of a capital lease contract. However, the Department annually obligates funds equal to 1 year of the capital lease cost rather than the entire amount of the lease agreement. The Department obligated leases on an annual basis rather than the entire lease agreement period because that is the manner in which funds are budgeted and appropriated. Because of the unrecorded obligation, the Department's consolidated financial statements were misstated.

- Effectiveness of Allotment Controls – Federal agencies use allotments to allocate funds in accordance with statutory authority. Allotments provide authority to agency officials to incur obligations as long as those obligations are within the scope and terms of the allotment authority. We identified systemic issues in the Department's use of allotment overrides that allowed officials to exceed allotments. Certain Department systems did not have an automated control to prevent users from recording obligations that exceeded allotment amounts. Department management stated that an automated control is not reasonable because there are instances in which an allotment may need to be exceeded; however, the Department has not formally identified, documented, and communicated the circumstances under which an allotment override is acceptable. The Department has a process to identify instances in which an obligation exceeded a domestic allotment; however, this process does not include overseas allotments. Additionally, the process does not adequately confirm whether the override was consistent with Department policy, including whether the allotment holder determined whether sufficient funds were available or obtained approval from authorized officials or whether the override was acceptable under the circumstances. Overriding allotment controls could lead to a violation of the Antideficiency Act and increase the risk of fraud, misuse, and waste.

## IV. Validity and Accuracy of Unliquidated Obligations

Unliquidated obligations (ULO) represent the cumulative amount of orders, contracts, and other binding agreements for which the goods and services that were ordered have not been received or the goods and services have been received but for which payment has not yet been made. The Department's policies and procedures provide guidance related to the periodic review, analysis, and validation of the ULO balances posted to the general ledger. We identified a significant number of invalid ULOs that had not been identified by the Department's review process. The internal control structure was not operating effectively to comply with existing policy or facilitate the accurate reporting of ULO balances in the financial statements. The Department's internal controls were not effective to ensure that ULOs were consistently and systematically evaluated for validity and deobligation. As a result of invalid ULOs identified by our audit, the Department adjusted its financial statements. In addition, funds that could have been used for other purposes may have remained in unneeded obligations. Weaknesses in controls over ULOs were initially reported in the audit of the Department's FY 1997 consolidated financial statements and subsequent audits.

## V. Information Technology

The Department's information systems and sensitive information rely on the confidentiality, integrity, and availability of the Department's comprehensive and interconnected information systems utilizing various technologies around the globe. Thus it is critical that the Department manage information security risk effectively throughout the organization. The Department uses several financial management systems to compile information for financial reporting purposes. The Department's general support system, a component of its information security program, is the gateway for all of the Department's systems, including its financial management systems. Generally, control deficiencies noted in the information security program are inherited by the systems that reside in it.

In accordance with the Federal Information Security Modernization Act of 2014 (FISMA), the Office of Inspector General (OIG) is responsible for the audit of the Department's information security program. In the FY 2016 FISMA report,[1] OIG reported security weaknesses that significantly impacted the Department's information security program. Specifically, OIG found weaknesses in all eight key FY 2016 Inspector General FISMA metric domains, which consist of risk management, contractor systems, configuration management, identity and access management, security and privacy training, information security continuous monitoring, incident response, and contingency planning. The Department did not have an effective information security program because the Department had not fully developed and implemented an organization-wide risk management strategy to identify, assess, respond to, and monitor information security risk at all levels of the organization.

Without an effective information security program, the Department is vulnerable to IT-centered attacks and threats. Information security program weaknesses can affect the integrity of financial applications, which increases the risk that sensitive financial information could be accessed by

[1] OIG, *Audit of the Department of State Information Security Program* (AUD-IT-17-17, November 2016).

unauthorized individuals or that financial transactions could be altered either accidentally or intentionally. Information security program weaknesses increase the risk that the Department will be unable to report financial data accurately.

The weaknesses reported by OIG as a result of the FISMA audit are considered to be a significant deficiency within the scope of our financial statement audit. We have reported weaknesses in IT security controls as a significant deficiency since our audit of the Department's FY 2009 financial statements.

During the audit, we noted certain additional matters involving internal control over financial reporting that we will report to Department management in a separate letter.

## Status of Prior Year Findings

In the Independent Auditor's Report on Internal Control Over Financial Reporting included in the audit report on the Department's FY 2015 financial statements,[2] we noted several issues that were related to internal control over financial reporting. The status of the FY 2015 internal control findings are summarized in Table 1.

**Table 1. Status of Prior Year Findings**

| Control Deficiency | FY 2015 Status | FY 2016 Status |
|---|---|---|
| **Financial Reporting** | Significant Deficiency | Significant Deficiency |
| **Property and Equipment** | Significant Deficiency | Significant Deficiency |
| **Budgetary Accounting** | Significant Deficiency | Significant Deficiency |
| **Validity and Accuracy of Unliquidated Obligations** | Significant Deficiency | Significant Deficiency |
| **Information Technology** | Significant Deficiency | Significant Deficiency |

### Department's Response to Findings

Department management provided its response to our findings in a separate memorandum included in this report as Appendix A. We did not audit management's response, and accordingly, we express no opinion on it.

### Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing and not to provide an opinion on the effectiveness of the Department's internal control. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of

[2] OIG, *Independent Auditor's Report on the U.S. Department of State 2015 and 2014 Financial Statements* (AUD-FM-16-09, November 2015).

America, *Government Auditing Standards*, and OMB Bulletin No. 15-02, in considering the entity's internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
November 15, 2016

KEARNEY& COMPANY

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# INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS

To the Secretary and the Inspector General of the U.S. Department of State

We have audited the consolidated financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2016, and have issued our report thereon dated November 15, 2016. 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. 15-02, "Audit Requirements for Federal Financial Statements."

## Compliance

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we performed tests of the Department's compliance with provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material impact on the financial statement amounts, including the provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA) that we determined were applicable. We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Department. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests, exclusive of those related to FFMIA, disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 15-02 and which are summarized as follows:

- *Antideficiency Act*. This act prohibits the Department from (1) making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law; (2) involving the Government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law; and (3) making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations. Our audit procedures identified Department of the Treasury account fund symbols with negative balances that were potentially in violation of the Antideficiency Act. We also identified systemic issues in the Department's use of allotment overrides to exceed available allotment authority. Establishing obligations that exceed available allotment authority increases the risk of noncompliance with the Antideficiency Act. Conditions impacting the Department's compliance with the Antideficiency Act have been reported annually since our FY 2009 audit.

- *Prompt Payment Act*. This act requires Federal agencies to make payments in a timely manner, pay interest penalties when payments are late, and take discounts only when payments are made within the discount period. We found that the Department did not pay interest penalties for overseas payments and did not always pay interest penalties for contributions to certain international organizations in accordance with the Prompt Payment Act. Conditions impacting the Department's compliance with the Prompt Payment Act have been reported annually since our FY 2009 audit.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (USSGL) at the transaction level. Although we did not identify any instances of substantial noncompliance with Federal accounting standards, we did identify instances, when combined, in which the Department's financial management systems and related controls did not comply substantially with certain Federal financial management system requirements and the USSGL at the transaction level.

Federal Financial Management Systems Requirements

- The Department has longstanding weaknesses in its financial management systems regarding its capacity to account for and record financial information. For instance, the Department has significant deficiencies relating to financial reporting, property and equipment, budgetary accounting, and unliquidated obligations.
- During the annual audit of the Department's information security program, as required by the Federal Information Security Modernization Act of 2014 (FISMA), the Department's Office of Inspector General (OIG) reported control weaknesses in all eight IG FISMA metric domains.[1]
- The Department did not maintain effective administrative control of funds. Specifically, obligations were not created in a timely manner or were recorded in advance of an executed obligating document. In addition, systemic issues were identified in the Department's use of allotment overrides.
- Although we did not identify any reportable instances of noncompliance with the Antideficiency Act, we found seven Treasury Account Fund Symbols with negative fund balances either in Department of the Treasury reports or in the Department's general ledger system. A negative balance could indicate an Antideficiency Act violation, which the Department is required to report in a timely manner.
- The Department did not always minimize waste, loss, unauthorized use, or misappropriation of Federal funds. For example, OIG reported more than $45 million in questioned costs and funds put to better use during FY 2016.
- Interest was not paid on overdue overseas payments.

[1] OIG, *Audit of the Department of State Information Security Program* (AUD-IT-17-17, November 2016).

Standard General Ledger at the Transaction Level

- The Department's financial management systems did not consistently post transactions to USSGL-compliant accounts or track proprietary and budgetary account attributes consistent with the USSGL.
- General ledger account balances could not always be traced to discrete transactions. Further, discrete transactions could not always be traced to source documents.

The Department had not implemented and enforced systematic financial management controls to ensure substantial compliance with FFMIA. The Department had not developed and executed remediation plans to address instances of noncompliance or validate compliance against criteria. The Department's ability to meet Federal financial management system requirements and fully process transaction-level data in accordance with the USSGL was hindered by limitations in systems and processes. We have reported that the Department did not substantially comply with FFMIA annually since our FY 2009 audit.

During the audit, we noted certain additional matters involving compliance that we will report to Department management in a separate letter.

**Department's Response to Findings**

Department management provided its response to our findings in a separate memorandum included in this report as Appendix A. We did not audit management's response, and accordingly, we express no opinion on it.

**Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing and not to provide an opinion on the effectiveness of the entity's compliance. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards,* and OMB Bulletin No. 15-02, in considering the entity's compliance. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
November 15, 2016

**United States Department of State**

*Washington, D.C. 20520*

November 15, 2016

UNCLASSIFIED

**MEMORANDUM**

TO: OIG – Steve A. Linick

FROM: CGFS – Christopher H. Flaggs

SUBJECT: Draft Report on the Department of State's Fiscal Year 2016 Financial Statements

This memo is in response to your request for comments on the Draft Report of the Independent Auditor's Report on Internal Control Over Financial Reporting, and Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements.

As the OIG is aware, the Department operates in over 270 locations and 180 countries in some of the most challenging environments. The scale and complexity of Department activities and corresponding financial management operations and requirements are immense. We understand and take this dynamic into account as we pursue an efficient, accountable, and transparent financial management platform that supports the Department's and broader U.S. Government's foreign affairs mission. Part of our accountability is the essential discipline of the annual external audit process and the issuance of the Department's annual audited financial statements. Few outside the financial community likely realize the time and effort that go into producing the audit and the Agency Financial Report, as we all work to demonstrate our commitment to strong financial management and to producing meaningful financial statements. It is a rigorous and exhaustive process. This year was no exception. It has been a concerted and dedicated effort by all stakeholders involved.

While we may not agree on every aspect of the process and findings, we certainly appreciate and extend our sincere thanks for the professionalism and commitment by all parties, including the Office of the Inspector General and Kearney & Company, to work together throughout the audit process. We know there will always be new challenges and concerns given our global operating environment and scope of compliance requirements. Nonetheless, we believe the overall results of the audit reflect the continuous improvement we strive to achieve in the Bureau of the Comptroller and Global Financial Services and across the Department's financial management community.

As expressed in the Independent Auditor's Report, we are pleased that the Department has received an unmodified ("clean") audit opinion on its FY 2016 and FY 2015 principal financial statements; with no material weaknesses reported by the Independent Auditor.

We remain committed to strong corporate governance and internal controls as demonstrated by our robust system of internal controls overseen by our Management Control Steering Committee (MCSC), Senior Assessment Team (SAT), and championed and validated by senior leadership. We appreciate the OIG participation in both the MCSC and SAT. For FY 2016, no material management control issues or material weaknesses in internal controls over financial reporting were identified by senior leadership. As a result, the Secretary was able to provide an unqualified Statement of Assurance for the Department's overall internal controls and internal controls over financial reporting in accordance with the Federal Managers' Financial Integrity Act. We fully recognize that there is more to be done and that the items identified in the Draft Report will require our continued attention, action, and improvement. We look forward to working with you, Kearney & Company, and other stakeholders on addressing these issues in the coming year.